



**Butterfield + Co.**  
CPAs, Inc.

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To our Clients and Friends,

As the end of the year is fast approaching, you should consider last-minute strategies that might help reduce your 2024 tax bill. This letter presents a few tax-saving ideas to get you started.

In January, the Tax Relief for American Families and Workers Act of 2024 passed the House with broad bipartisan support but failed to pass the Senate. For individuals, the bill would expand the child tax credit. For businesses, the bill would restore immediate expensing of research and development costs, extend 100% bonus depreciation through 2025, and increase the limits on expensing depreciable business assets. It is possible that the bill, or some version of it, could pass by the end of the year.

### **Tax Planning for Individuals**

**Filing Status.** Your tax return filing status can impact the amount of taxes you pay. For example, if you qualify for head-of-household (HOH) filing status, you are entitled to a higher standard deduction and more favorable tax rates. To qualify as HOH, you must be unmarried or considered unmarried (i.e., legally separated or living apart from a spouse) and provide a home for certain other people. If you are in such a situation, we need to review whether you qualify for HOH filing status.

If you are married, you'll either be filing your return using the married filing jointly or married filing separately filing status. Generally, married filing separately is not beneficial for tax purposes, but in some unique cases, such as when one party earns substantially less or when one party may be subject to IRS penalties for issues relating to their tax reporting, it may be advantageous to file as married filing separately. Additionally, if one spouse was not a full-year U.S. resident, an election is available to file a joint tax return where such joint filing status would otherwise not apply.

### ***Income, Deductions, and Credits***

**Standard Deduction versus Itemized Deductions.** The Tax Cuts and Jobs Act of 2017 (TCJA) substantially increased the standard deduction amounts, thus making itemized deductions less attractive for many individuals. For 2024, the standard deduction amounts are \$14,600 (single); \$21,900 (head of household); \$29,200 (married filing jointly); and \$14,600 (married filing separately). If the total of your itemized deductions in 2024 will be close to your standard deduction amount, you should evaluate whether alternating between bunching itemized deductions into 2024 and taking the standard deduction in 2025 (or vice versa) could provide a net-tax benefit over the two-year period. For example, you might consider doubling up this year on your charitable contributions rather than spreading the contributions over a two-year period. If these contributions, along with your mortgage interest, medical expenses (discussed below), and state income and property taxes (subject to the \$10,000 deduction limitation on such taxes that applies to both single individuals and married couples filing jointly; and the \$5,000 limitation on such expenses for married filing separately returns), exceed your standard deduction, then itemizing such expenses this year and taking the standard deduction next year may be appropriate.

**Medical Expenses, Health Savings Accounts, and Flexible Savings Accounts.** For 2024, your medical expenses are deductible as an itemized deduction to the extent they exceed 7.5% of your adjusted gross income. To be deductible, medical care expenses must be primarily to alleviate or prevent a physical or mental disability or illness. They don't include expenses that are merely beneficial to general health, such as vitamins or a vacation. Deductible expenses include the premiums you pay for insurance that covers the expenses of medical care, and the amounts you pay for transportation to get medical care. Medical expenses also include amounts paid for qualified long-term care services and limited amounts paid for any qualified long-term care insurance contract. Depending on what your taxable income is expected to be in 2024 and 2025, and whether itemizing deductions would be advantageous for you in either year, you may want to accelerate any optional medical expenses into 2024 or defer them until 2025. The right approach depends on your income for each year, expected medical expenses, as well as your other itemized deductions.

You may also want to consider health saving accounts (HSAs) if you don't already have one. These are tax-advantage accounts which help individuals who have high-deductible health plans (HDHPs). If you are eligible to set up such an account, you can deduct the amount you contribute to the account in computing adjusted gross income. These contributions are deductible whether you itemize deductions or not. Distributions from an HSA are tax free to the extent they are used to pay for qualified medical expenses (i.e., medical, dental, and vision expenses). For 2024, the annual contribution limits are \$4,150 for an individual with self-only coverage and \$8,300 for an individual with family coverage. Additional catch-up contributions of \$1,000 are available for 2024 for individuals who are 55 or older on or before December 31, 2024.

In addition, if you are not already doing so and your employer offers a Flexible Spending Account (FSA), consider setting aside some of your earnings tax free in such an account so you can pay medical and dental bills with pre-tax money. Since you don't pay taxes on this money, you'll save an amount equal to the taxes you would have paid on the money you set aside. FSA funds can be used to pay deductibles and copayments, but not for insurance premiums. You can also spend FSA funds on prescription medications, as well as over-the-counter medicines, generally with a doctor's prescription. Reimbursements for insulin are allowed without a prescription. FSAs may also be used to cover costs of medical equipment like crutches, supplies like bandages, and diagnostic devices like blood sugar test kits.

**Charitable Contributions.** The tax benefits of making charitable contributions and taking an itemized deduction for such contributions were tampered down because of the increase in the standard deduction in the TCJA. More people are forgoing itemized deductions as their standard deduction is more favorable.

If you are itemizing deductions, you can maximize the tax benefit of making a charitable contribution by donating appreciated assets, such as stock, instead of cash. Doing so generally allows you to deduct the fair market value of the asset while also avoiding the capital gains tax that would otherwise be due if you sold the asset. For example, if you own stock with a fair market value of \$1,000 that was purchased for \$250 and your capital gains tax rate is 15%, the capital gains tax you would owe is \$113 ( $\$750 \text{ gain} \times 15\%$ ). If you donate that stock instead of selling it, and are in the 24% tax bracket, your ordinary income deduction is worth \$240 ( $\$1,000 \text{ FMV} \times 24\% \text{ tax rate}$ ). You also save the \$113 in capital gains tax that you would otherwise pay if you sold the stock; that amount goes to the charity. Thus, the after-tax cost of the gift of appreciated stock is \$647 ( $\$1,000 - \$240 - \$113$ ) compared to the after-tax cost of a donation of \$1,000 cash which would be \$760 ( $\$1,000 - \$240$ ). However, it's important to also keep in mind that tax deductions for contributions of appreciated long-term capital gain property may be limited to a certain percentage of your adjusted gross income depending on the amount of the deduction.

In addition, if you have an individual retirement account and are 70 ½ years old and older, you are eligible to make a charitable contribution directly from your IRA. This is more advantageous than taking a distribution and making a donation to the charity that may or may not be deductible as an itemized deduction. If your itemized deductions, including the contribution, are less than your standard deduction, then you receive no tax benefit from making the donation in this manner. By making the donation directly from your IRA to a charity, you eliminate having the IRA distribution included in your income. This in turn reduces your adjusted gross income (AGI). And because various tax-related items, such as the medical expense deduction or the taxability of social security income or the 3.8% net investment income tax, are calculated based on your AGI, a reduced AGI can potentially increase your medical expense deduction, reduce the tax on social security income, and reduce any net investment income tax.

**Expenses Incurred While Working from Home.** If you are an employee, expenses related to working from home are not deductible for federal tax purposes. The TCJA eliminated the deductibility of such expenses when it suspended the deduction for miscellaneous itemized expenses that were available before 2018. However, if you are self-employed and work from home during the year, tax deductions are still available. Thus, if you have been working from home as an independent contractor, we should discuss what expenses you have incurred that might reduce your taxable income.

**Mortgage Interest Deduction.** If you sold your principal residence during the year and acquired a new principal residence, the deduction for any interest on your acquisition indebtedness (i.e., your mortgage) could be limited. The mortgage interest deduction on mortgages of more than \$750,000 obtained after December 14, 2017, is limited to the portion of the interest allocable to \$750,000 (\$375,000 in the case of married taxpayers filing separately). If you have a mortgage on a principal residence acquired before December 16, 2017, the limitation applies to mortgages of \$1,000,000 (\$500,000 in the case of married taxpayers filing separately) or less. However, if you operate a business from your home, an allocable portion of your mortgage interest is not subject to these limitations.

**Interest paid on Home Equity Indebtedness.** You can potentially deduct interest paid on home equity indebtedness, but only if you used the debt to buy, build, or substantially improve your home. Thus, for example, interest on a home equity loan used to build an addition to your existing home is typically deductible, while interest on the same loan used to pay personal expenses, such as credit card debt, is not.

**Sale of a Home.** If you sold your home this year, up to \$250,000 (\$500,000 for married filing jointly) of the gain on the sale is excludible from income. However, this amount is reduced if part of your home was rented out or used for business purposes. Generally, a loss on the sale of a home is not deductible. But again, if you rented part of your home or otherwise used it for business, the loss attributable to that portion of the home is deductible.

**Discharge of Qualified Principal Residence Indebtedness.** If you had any qualified principal residence indebtedness which was discharged in 2024, it is not includible in gross income.

**Deductions for Excess Business Losses.** Taxpayers other than corporations can deduct excess farm losses; however, such taxpayers cannot deduct excess business losses. An excess business loss for the tax year is the excess of aggregate deductions attributable to your trades or businesses over the sum of your aggregate gross income or gain plus a threshold amount. The threshold amount for 2024 is \$305,000 or \$610,000 for joint returns.

**Child Tax Credit.** For 2024, a child tax credit of as much as \$2,000 is available for each child under age 17, depending on your modified adjusted income. In addition, a \$500 nonrefundable credit is available

for qualifying dependents other than qualifying children. Where the credit exceeds the maximum amount of tax due, it may be refundable. The maximum amount refundable for 2024 is \$1,700 per qualifying child. The \$500 credit applies to two categories of dependents: (1) qualifying children for whom a child tax credit is not allowed, and (2) qualifying relatives. The amount of the credit is reduced for taxpayers with modified adjusted gross income over \$200,000 (\$400,000 for married filing jointly) and eliminated in full for taxpayers with modified adjusted gross income over \$240,000 (\$440,000 for married filing jointly).

**Earned Income Credit.** The earned income tax credit (EITC) is determined by multiplying your earned income for the year (but only up to a maximum amount of earned income) by a credit percentage that varies depending on whether you have any qualifying children and, if so, the number of qualifying children. The EITC is also subject to a limitation based on your adjusted gross income. For 2024, the maximum amount of the EITC is (1) \$632 for a taxpayer with no qualifying children, (2) \$4,213 for a taxpayer with one qualifying child, (3) \$6,960 for a taxpayer with two qualifying children, and (4) \$7,830 for a taxpayer with three or more qualifying children. In addition, the EITC cannot be claimed if your investment income (including interest, dividends, capital gain net income, and net rental income) exceeds \$11,600 for 2024.

**Dependent Care Credit.** If you incur expenses to care for a child or another dependent so that you can work or look for work, you may be eligible for the child and dependent care credit. The credit is available to individuals who pay for childcare services for dependents under age 13 or for the care of a spouse or a dependent of any age who is physically or mentally incapable of self-care. The credit is not available for amounts paid to a dependent or a taxpayer under age 19. The amount of the credit is a specified percentage of your total employment-related expenses - generally, 35% reduced (but not below 20%) by one percentage point for each \$2,000 by which your adjusted gross income for the tax year exceeds \$15,000. Employment-related expenses incurred during any tax year which may be taken into account cannot exceed \$3,000 for one qualifying individual or \$6,000 for two or more qualifying individuals.

**Premium Tax Credit.** A health insurance subsidy is available in the form of a premium assistance tax credit for eligible individuals and families who purchase health insurance through the Health Insurance Marketplace, also known as the “Exchange.” The provision is the result of the Patient Protection and Affordable Care Act (PPACA). This credit is refundable and payable in advance directly to the insurer on the Exchange. In the past, individuals with incomes exceeding 400% of the poverty level were not eligible for these subsidies. However, the cap has been eliminated through 2025 and therefore, anyone can qualify for the subsidy. In addition, the percentage of your income paid for health insurance under a PPACA plan is limited to 8.5% of income. Thus, if you buy your own health insurance directly through an Exchange, you can receive increased tax credits to reduce your premiums.

**Education-Related Deductions and Credits.** Certain education-related tax deductions, credits, and exclusions from income may be available for 2024. For example, tax-free distributions from a qualified tuition program, also referred to as a Section 529 plan, of up to \$10,000 are allowed for qualified higher education expenses. Qualified higher education expenses for this purpose include tuition expenses in connection with a designated beneficiary’s enrollment or attendance at an elementary or secondary public, private, or religious school (i.e., kindergarten through grade 12). It also includes expenses for fees, books, supplies, and equipment required for the participation in certain apprenticeship programs and qualified education loan repayments in limited amounts. A special rule allows tax-free distributions to a sibling of a designated beneficiary (i.e., a brother, sister, stepbrother, or stepsister). As a result, a 529 account holder can make a student loan distribution to a sibling of the designated beneficiary without changing the designated beneficiary of the account.

Depending on your modified adjusted gross income for the year, you may also qualify for: (1) an American Opportunity Tax Credit of up to \$2,500 per year for each eligible student; (2) a Lifetime Learning credit up to \$2,000 for tuition and fees paid for the enrollment or attendance of yourself, your spouse, or your dependents for courses of instruction at an eligible educational institution; (3) an exclusion from income for education savings bond interest received; and (4) a deduction for student loan interest.

If you qualified for any student loan forgiveness in 2024, the forgiven amount will generally be excludible from your income for federal tax purposes. You may, however, be liable for state or local income taxes because of the discharge.

**Clean Energy Credits.** For 2024, the clean energy tax credits available include (1) residential energy property credits (the energy efficient home improvement credit and the residential clean energy credit) and (2) vehicle-related credits (the new clean vehicle credit, the previously owned clean vehicle credit, and the alternative fuel refueling property credit). These credits were significantly expanded by the Inflation Reduction Act of 2022.

The energy efficient home improvement credit is credit for 30% of the costs of all qualified energy efficiency improvements and residential energy property expenditures you make during the year. This credit is subject to an annual limit of \$1,200, and there are also limits for specific types of qualifying improvements. These limits are: (1) \$250 for any exterior door (\$500 total for all exterior doors), (2) \$600 for exterior windows and skylights, (3) \$600 for other qualified energy property (including central air conditioners; electric panels and certain related equipment; natural gas, propane, or oil water heaters; oil furnaces; water boilers), and (4) a higher \$2,000 annual limit for heat pumps and heat pump water heaters, biomass stoves, and boilers. The Inflation Reduction Act also added a credit of up to \$150 per year for home energy audits. Roofs do not qualify for the credit.

The residential clean energy credit equals 30% of the cost of certain qualified property installed on or used in connection with your home. Qualifying properties are: (1) solar electric property, (2) solar water heating property, (3) fuel cell property, (4) small wind energy property, (5) geothermal heat pump property, and (6) battery storage technology. There is no annual or lifetime limit on the residential clean energy credit except with respect to fuel cell property, which is limited to \$500 for each half kilowatt of capacity. In addition, if more than one person lives in your home, the combined credit for all residents can't exceed \$1,667 for each half kilowatt of fuel cell capacity.

A new clean vehicle credit of up to \$7,500 may be available if you acquired a qualified electric vehicle in 2024. To qualify, the vehicle must have been assembled in North America. The credit amount equals \$3,750 for vehicles meeting a critical minerals requirement plus \$3,750 for vehicles meeting a battery component requirement. Price limits (i.e., MSRP limitations) apply depending on the vehicle type (\$80,000 for vans, SUVs, and pickup trucks; \$55,000 for other vehicles). The Department of Energy provides a list at [FuelEconomy.gov](https://www.fueleconomy.gov) of eligible clean vehicles that meet the requirements to claim this credit, including the applicable MSRP limitation. The credit is not available if your adjusted gross income for the year is over \$300,000 (married filing jointly), \$225,000 (head of household), and \$150,000 (single).

If a partnership or an S corporation places a new clean vehicle in service, and the new clean vehicle credit is claimed by individuals who are partners of the partnership or shareholders of the S corporation, the AGI thresholds apply to those partners or shareholders. In addition, if a new clean vehicle is used both for personal and business use, and the business use of the vehicle is less than 50% of the total use of the vehicle, the credit must be apportioned and treated as a general business credit corresponding to the percentage of the business use.

A tax credit is also available for the purchase of a previously owned clean vehicle. The credit amount is the lesser of (1) \$4,000, or (2) 30% of the cost of the vehicle. To qualify for the previously owned clean vehicle credit, the vehicle must be sold by a dealer for a sale price not more than \$25,000, and the sale must be the first transfer of the vehicle since August 16, 2022. In addition, the buyer must be an individual taxpayer who cannot be claimed as a dependent by another taxpayer, who purchases the vehicle for use and not for resale, and who has not been allowed the previously owned clean vehicle credit in any of the 3 years preceding the sale of the vehicle. The credit is not available to taxpayers with adjusted gross income over \$150,000 (married filing jointly), \$112,500 (head of household), and \$75,000 (single). Like the new clean vehicle credit, this credit will be transferable to the dealer beginning in 2024.

Starting in 2024, the new clean vehicle credit and the previously owned clean vehicle credit can be transferred to the dealer in exchange for a reduction in the sale price of the vehicle, a cash payment, or both. A transfer election may be made only if the vehicle is predominantly for personal (rather than business) use. Note that even if the credit is transferred to the dealer, it still must be reported on the taxpayer's return.

The alternative fuel vehicle refueling property credit is allowed with respect to any single item of qualified alternative fuel vehicle refueling property placed in service during the tax year in a qualifying location (generally, a low-income community or non-urban area). The credit amount is limited to (1) \$100,000 in the case of depreciable property, and (2) \$1,000 in any other case. Qualifying property includes bidirectional charging equipment, and the credit can also be claimed for electric charging stations for two- and three-wheeled vehicles that are intended for use on public roads.

### ***Retirement Planning***

If you can afford to do so, investing the maximum amount allowable in a qualified retirement plan will yield a large tax benefit. If your employer has a 401(k) plan and you are under age 50, you can defer up to \$23,000 of income into that plan for 2024. Catch-up contributions of \$7,500 are allowed if you are 50 or over. If you have a SIMPLE 401(k), the maximum pre-tax contribution for 2024 is \$16,000. That amount increases to \$19,500 if you are 50 or older. The maximum IRA deductible contribution for 2024 is \$7,000 and that amount increases to \$8,000 if you are 50 or over.

There are several new retirement plan rules for 2024 because of the SECURE 2.0 Act, which was enacted in 2022. For example, if you are making student loan payments, your employer can now make matching contributions to your retirement account based on those payments. In addition, penalty-free retirement plan distributions of up to \$1,000 are permitted for certain emergency expenses and up to \$10,000 for certain victims of domestic abuse. Another new provision allows taxpayers who have money saved in a Section 529 plan to convert a portion of the funds to a Roth IRA. The Roth IRA is required to have the same beneficiary as the Section 529 plan. In addition, the taxpayer must have held the Section 529 account for at least 15 years, and a lifetime limit of \$35,000 applies (in addition to the annual Roth IRA rollover limits).

### ***Life Events***

Life events can have a significant impact on your tax liability. For example, if you are eligible to use head of household or surviving spouse filing status for 2024 but will change to a filing tax status of single for 2025, your tax rate will go up. If you married or divorced during the year and changed your name, you need to notify the Social Security Administration (SSA). Similarly, the SSA should be notified if you have a dependent whose name has been changed. A mismatch between the name shown on the tax return

and the SSA records can cause problems in the processing of tax returns and may even delay tax refunds. Let us know if you have been impacted by a life event, such as a birth or death in your family, the loss of a job or a change in jobs, or a retirement during the year. All of these can affect your tax situation.

## **Tax Planning for Businesses**

**Section 179 Expensing and Depreciation Deductions.** The two business tax deductions that present the best opportunities for reducing your business's taxable income are the Section 179 deduction, where your business can elect to deduct the entire cost of certain property acquired and placed in service during the year, and the bonus depreciation deduction, where 60% of the cost of business property may be expensed for 2024. Under the Section 179 expensing option, your business can immediately expense the cost of up to \$1,220,000 of "Section 179" property placed in service in 2024. This amount is reduced dollar for dollar (but not below zero) by the amount by which the cost of the Section 179 property placed in service during 2024 exceeds \$3,050,000.

The bonus depreciation rules apply to all businesses unless the business specifically elects out of these rules. An election out might be preferable where a business expects a tax loss for the year and the bonus depreciation would just increase that loss or where it might be advantageous to push depreciation deductions into future years. For example, if the owner of a pass-thru entity to whom these deductions would flow expects to be in a higher tax bracket in future years, such deductions might be of more use in those future years. When applying both the Section 179 deduction and the bonus depreciation deduction to an asset, the Section 179 deduction applies first.

If you need a vehicle for your business, purchasing a sport utility vehicle weighing more than 6,000 pounds can trigger a bigger deduction than if a smaller vehicle is purchased. This is because vehicles that weigh 6,000 pounds or less are considered listed property and the related first-year deduction is limited to \$20,400 for cars, trucks and vans acquired and placed in service in 2024. For vehicles weighing more than 6,000 pounds, however, up to \$30,500 of the cost of the vehicle can be immediately expensed.

It's worth noting that if you leased a passenger automobile in 2024 with a value of more than \$62,000, the deduction available for that lease expense is reduced. In such cases, you must include in gross income an amount determined by a formula the IRS issues each year.

**Qualified Business Income Deduction.** If you are conducting your business as a sole proprietorship, a partner in a partnership, a member in an LLC taxed as a partnership, or as a shareholder in an S corporation, the qualified business income (QBI) deduction can significantly help reduce taxable income. The QBI deduction allows eligible taxpayers to deduct up to 20% of their QBI, plus 20% of qualified real estate investment trust dividends and qualified publicly traded partnership income. A W-2 wage limitation amount may apply to limit the amount of the deduction. The W-2 wage limitation amount must be calculated for taxpayers with a taxable income that exceeds a statutorily defined amount (i.e., the threshold amount). For any tax year beginning in 2024, the threshold amount is \$383,900 for married filing joint returns and \$191,950 for all other returns.

Since the QBI deduction reduces taxable income, and is not used in computing adjusted gross income, it does not affect limitations based on adjusted gross income such as the medical expense deduction or the calculation of social security income that is includible in income. The QBI deduction may be limited or phased-out for "specified service trade or business," which is defined as any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts,

consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. Engineering and architecture services are specifically excluded from the definition of a specified service trade or business. The 2024 QBI deduction related to specified service trade or business begins phasing out when an owner's taxable income exceeds \$383,900 for married filing joint returns and \$191,950 for all other returns and is completely phased out when an owner's taxable income exceeds \$483,900 for married filing joint returns and \$241,950 for all other returns.

**Rental Real Estate.** If you have any rental real estate activities, it's important to determine if the activity will be considered a passive activity by the IRS. Generally, losses from passive activities are only deductible against passive activity income. However, a deduction of up to \$25,000 (\$12,500 if married filing separately) may be allowed against nonpassive income to the extent you actively participate in the rental real estate activities. This deduction is subject to a phaseout for individuals with modified adjusted gross income above \$100,000 (or \$50,000 if married filing separately). Additionally, you may be eligible for a qualified business income deduction if certain criteria are met, such as the rental activity qualifying as a Section 162 trade or business.

**Substantiation of Vehicle-Related Deductions.** In audits, the IRS tends to focus on deductions taken for vehicle expenses. If not properly substantiated, such deductions are disallowed. Thus, if vehicles are used in any part of your business or business-related activities, your tax records with respect to each vehicle should include the following:

- (1) the amount of each separate expense with respect to the vehicle (e.g., the cost of purchase or lease, the cost of repairs and maintenance, etc.); and
- (2) the amount of mileage for each business or investment use and the total miles for the tax period; and
- (3) the date of the expenditure; and
- (4) the business purpose for the expenditure.

The IRS will consider the following as adequate substantiation for such expenses: (1) records such as a notebook, diary, log, statement of expense, or trip sheets; and (2) documentary evidence such as receipts, canceled checks, bills, or similar evidence.

It's important to note that records are considered adequate to substantiate the element of a vehicle expense only if they are prepared or maintained in such a manner that each recording of an element of the expense is made at or near the time the expense is incurred.

**Employee Benefits.** There are several tax and other advantages your business could reap by offering a retirement plan and/or other fringe benefits to employees. By offering such benefits, your business has a better chance of attracting and retaining talented workers which, in turn, reduces the costs of searching for and training new employees. Contributions made to retirement plans on behalf of employees are deductible and your business may be eligible for tax credits for offering retirement and other benefits.

If you haven't already done so, you might consider the establishment of a flexible spending arrangement (FSA). An FSA allows employees to be reimbursed for medical expenses and is usually funded through voluntary salary reduction agreements with the employer. The employer has the option of making or not making contributions to the FSA. Some of the benefits of providing an FSA for employees include contributions made by the business being excluded from the employee's gross income, reimbursements to the

employee are tax free if used for qualified medical expenses, the FSA can be used to pay qualified medical expenses even if the employer or employee haven't yet placed the funds in the account, and up to \$640 of funds in the FSA can be carried over to subsequent years indefinitely.

Another popular employee benefit your business might consider is a high deductible health plan paired with a health savings account (HSA). The benefits to your business include savings on health insurance premiums that would otherwise be paid to traditional health insurance companies and having employee wage contributions to the plan not being counted as wages and thus neither the employer nor the employee is subject to FICA taxes on the payroll contributions. As for employees, they can reap a tax deduction for funds contributed to the HSA, and there is no use-it-or-lose-it limit like there is for most flexible spending arrangements (FSAs). Thus, the funds can grow tax free and be used in retirement.

Beginning in 2024, businesses that do not already sponsor a retirement plan can offer a "starter" 401(k) plan. A starter 401(k) plan generally requires that all employees be default enrolled in the plan at a 3%-15% of compensation deferral rate. Employer contributions are not permitted. The limit on annual deferrals is the same as the IRA contribution limit (for 2024, \$7,000 with an additional \$1,000 in catch-up contributions for employees aged 50 or older).

In addition, the following tax credits may be available for offering employee benefits such as paid leave, retirement benefits, and health insurance.

**Credit for Paid Family and Medical Leave.** Eligible employers may claim a general business credit equal to 12.5% of the wages paid to qualifying employees while such employees are on paid leave. The rate of payment must be at least 50% of the wages normally paid to the employee, and the employer is required to have a written policy that provides family and medical leave to all employees on a non-discriminatory basis.

**Credit for Small Employer Pension Plan Startup Costs.** Businesses with 50 or fewer employees that do not currently offer a retirement plan can claim a credit for 100% of the administrative costs of setting up a qualified employer plan. For employers with 51-100 employees, the credit applies for 50% of qualified startup costs. An additional credit of up to \$1,000 per employee is available for qualified employer contributions. This additional credit, which is calculated as a percentage of the amount contributed by the employer on behalf of employees, applies for the first tax year the eligible employer plan becomes effective and the succeeding 4 tax years.

**Small Employer Contributions Credit.** Businesses that employ 25 or fewer full-time employees can claim a credit for contributions made on employees' behalf for premiums for qualified health plans offered by the employer. The credit amount is 50% of the employer's premium payments made on behalf of its employees under a qualifying arrangement.

**Small Employer Auto-Enrollment Credit.** Employers with new or existing retirement plans can claim a credit for adding an auto-enrollment feature. The credit is \$300 per year for the three-year period beginning with the first year auto-enrollment is made available to employees.

**Military Spouse Participation Credit.** Employers with 1-100 employees can claim a credit for enrolling military spouse employees in their retirement plan. The amount of the credit is \$200 for employing a military spouse who participates in employer's defined contribution plan within 2 months of being hired, plus 100% of the contributions made, up to \$300. The maximum credit is \$500 and may be claimed for the first 3 years the military spouse participates in the plan.

**Pass-Thru Entity Considerations.** If you are operating a business through a pass-thru entity such as a partnership or S corporation, your basis in the entity must be high enough to allow for any loss deduction, if you have one for the year. In such a situation, we should consider the options available for increasing your basis in such entity.

If you are an S corporation shareholder, it's important to ensure that you and other shareholders involved in running the business are paid an amount that is commensurate with the work being done. The IRS scrutinizes S corporations which distribute profits instead of paying compensation subject to employment taxes. Failing to pay arm's length salaries can lead to tax deficiencies, interest, and penalties. The key to establishing reasonable compensation is to show that the compensation paid for the type of work an owner-employee does for the S corporation is similar to what other entities would pay for similar work. An S corporation needs to adequately document the factors that support the salary an S corporation owner is being paid.

Also, because there are stringent requirements for who may be an S corporation shareholder, if the number of shareholders have changed or increased during the year, we should review the residency or citizenship status of the S corporation's shareholders and S corporation stock beneficiaries (including contingent and residuary beneficiaries).

**Energy Efficient Commercial Buildings Deduction.** If your business owns a commercial building, a deduction is available for an amount equal to the cost of Energy Efficient Commercial Building Property (EECBP) placed in service during the tax year. EECBP includes property installed as part of the building's interior lighting systems; heating, cooling, ventilation, and hot water (HVAC) systems; or the building envelope that is certified as being installed as part of a plan to reduce the total energy and power costs for these systems. An alternative deduction is also available for energy efficient building retrofit property installed as part of a qualified retrofit plan that is expected to reduce the building's energy use intensity upon completion of the retrofit by 25% or more.

The amount of the deduction equals the lesser of (1) the cost of the energy efficient commercial building property or (2) the energy savings per square foot. The maximum deduction increases to 5 times the savings per square foot amount if local prevailing wages are paid and apprenticeship requirements are met.

**Qualified Commercial Clean Vehicles Credit.** A credit is available for qualified commercial electric vehicles placed into service and used in a trade or business by the taxpayer. The amount of credit is the lesser of (1) 15% of the taxpayer's basis in the vehicle (30% in the case of a vehicle not powered by a gasoline or diesel engine) or (2) the "incremental cost" of the vehicle. The credit is limited to \$7,500 in the case of a vehicle that weighs less than 14,000 pounds, and up to \$40,000 for all other vehicles.

A "qualified commercial clean vehicle" is defined as any vehicle that is (1) used in the taxpayer's trade or business or for the production of income, (2) acquired for use or lease by the taxpayer and not for resale, (3) treated as a motor vehicle under the Clean Air Act and is manufactured primarily for use on public roads or mobile machinery, and (4) propelled to a significant extent by an electric motor which draws electricity from a rechargeable battery. The "incremental cost" of the vehicle generally means the excess of the purchase price over the price of a comparable vehicle that is powered solely by a gasoline or diesel internal combustion engine. Under a safe harbor rule provided by the IRS, the incremental cost will not limit the available credit amount for street vehicles that weigh less than 14,000 pounds and are placed in service during calendar year 2024.

**Energy Investment Tax Credit.** The energy investment tax credit (ITC) could reduce your business’s federal tax liability by a percentage of the cost of a solar system installed during the tax year. Solar systems placed in service in 2022 or later, and that began construction before 2033, are eligible for a 30% ITC, or a production tax credit based on a kilowatt-hour formula, if they meet certain prevailing wage and apprenticeship requirements or are under 1 megawatt in size.

**Research and Development Deductions and Credits.** The provision allowing a deduction for research and development (R&D) expenses expired at the end of 2021. Such expenditures must now be amortized over five years. However, under the 2022 Inflation Reduction Act, businesses that engage in certain types of research may qualify for an income tax credit based on its qualified research expenses. The credit is calculated as the amount of qualified research expenditures above a base amount that is meant to represent the amount of research expenditures in the absence of the credit. Because some small businesses may not have a large enough income tax liability to take advantage of their research credit, the law allows that small business (i.e., a business with less than \$5 million in gross receipts and that is under five years old) to apply up to \$500,000 of the research credit toward its social security tax liability.

### California Taxes

**California Conformity and Nonconformity.** As California maintains a separate set of tax and compliance laws, any year-end tax moves should take into consideration California’s conformity or nonconformity to the federal income tax code.

**California Tax Rates.** California voters have passed several propositions over the years that have led to significant changes in California taxpayers’ overall tax burden. Proposition 30, a Sales and Income Tax Increase Initiative, was passed by California voters in 2012 increasing both income and sales taxes. The passage of Proposition 55 in 2016 extended the personal income tax increases enacted by Proposition 30 through 2030. The following table summarizes California individual income tax rate increases under Proposition 30/55 effective for 2024:

|                                   |                                                                                                           |
|-----------------------------------|-----------------------------------------------------------------------------------------------------------|
| 10.3% (1% increase) on income of: | \$349,138–\$418,961 for single/MFS;<br>\$474,825–\$569,790 for HOH; and<br>\$698,275–\$837,922 for MFJ.   |
| 11.3% (2% increase) on income of: | \$418,962–\$698,271 for single/MFS;<br>\$569,791–\$949,649 for HOH; and<br>\$837,923–\$1,396,542 for MFJ. |
| 12.3% (3% increase) on income of: | More than \$698,271 for single/MFS;<br>More than \$949,649 for HOH; and<br>More than \$1,396,542 for MFJ. |

Income more than \$1 million is also subject to the 1% mental health surcharge, in accordance with Proposition 63 passed by California voters in 2004.

**California Safe-Harbor Estimates for AGI over \$1 Million.** To avoid late payment penalties and interest, California taxpayers with current year adjusted gross income equal to or greater than \$1 million/\$500,000 MFS must figure and pay estimated tax based on at least 90% of their current year tax.

**California Passthrough Entity Elective Tax Payments.** California Assembly Bill 150 (AB 150) established the Small Business Relief Act which allows qualified passthrough entities to elect to pay and deduct a California passthrough entity tax (PTE) of 9.3% on qualified net income. This represents a “work around” to the federal income tax limitation on state and local income taxes (SALT) and pertains to taxable years beginning on or after January 1, 2021 and before January 1, 2026.

Passthrough entity tax payments are due by the original due date of the tax return (March 17, 2025 for calendar year 2024 tax returns) and are deductible on the passthrough entity’s federal tax return in the year paid. Thus, estimating the remaining amount of passthrough entity tax due for 2024 and making a payment relative to all remaining estimated passthrough entity tax due for 2024 on or before December 31, 2024, could yield significant federal tax savings for 2024. To qualify to make the 2024 California passthrough entity elective tax payments, a passthrough entity must have submitted at least 50% of its 2023 PTE or a \$1,000 minimum estimated tax payment on or before June 15, 2024.

**Franchise Tax Board Website Access.** The California Franchise Tax Board (FTB) allows tax preparers to view certain client information on their website (MyFTB) with authorization. This allows tax preparers the ability to access and verify California estimated tax, extension, and other payments, California wages and withholding, and 1099s issued by the State of California. It also allows the filing of California Power of Attorney forms. Please note that filing Power of Attorney forms with the California Franchise Tax Board may be initiated by our firm as a precautionary measure, primarily for those clients who have received or have the potential to receive substantial correspondence from the California Franchise Tax Board. Due to the FTB’s concerns over taxpayer privacy, a multi-step process has been implemented by the FTB for preparers to view **new client** information on MyFTB. First, the preparer will request limited access, at which point the FTB will send a letter to the client requesting that they contact the FTB if they do not want to provide limited access to the preparer. The preparer will then request full access, at which point the FTB will send a second letter to the client with an authorization code that must be used to grant full access within a specified period. Client account access typically expires 13 months from the date added or renewed and will be added or renewed by our firm unless you instruct us otherwise. If you receive correspondence from the FTB or our office regarding our access to MyFTB, we strongly advise that you act on it immediately.

### **Estate Planning and Annual Gifting**

Whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you can give each of them up to \$18,000 this year without utilizing any of your lifetime exclusion. So can your spouse. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. The sooner you start an annual gifting program, the better. In addition, you can pay for tuition, dental and medical expenses on behalf of anyone without utilizing any of the annual gift exclusion of \$18,000 so long as the payments are made directly to the providers of those services. If you simply reimburse the people who are benefiting, those reimbursements are subject to the \$18,000 annual gift exclusion - please note that most tuition deductions are available only to the taxpayer who claims the related student as a dependent. For 2025 the annual gift tax exclusion is \$19,000.

Under the Tax Cuts and Jobs Act of 2017 (TCJA), beginning after December 31, 2017, the unified federal gift and estate tax exemption is doubled from \$5 million (adjusted for inflation after 2011) to \$10 million, which will also be indexed for inflation, and the federal estate tax rate will remain at 40%. As a result of the TCJA, the 2024 exclusion amount (lifetime exclusion) is \$13,610,000 and the 2025 exclusion amount is \$13,990,000. The unified federal gift and estate tax exemption is currently scheduled to revert to \$5 million (adjusted for inflation after 2011) after December 31, 2025. Taxpayers and taxpayers' estates that take advantage of the increased unified federal gift and estate tax exemption will not be adversely affected by the post-2025 decrease in the unified federal gift and estate tax exemption. For those with large estates, gifting or transferring a portion of their assets out of their estate prior to January 1, 2026, utilizing their lifetime exclusion, may save considerable estate taxes.

It is uncertain what future tax legislation will have on the lifetime exclusion amount or future exclusion amounts. Due to this uncertainty, consideration should be given to utilizing the entire 2025 exclusion amount of \$13.99 million prior to January 1, 2026.

**Using a Revocable Living Trust as part of an Estate Plan.** The establishment, funding and use of a revocable living trust should also be considered as part of your overall estate plan. Some of the advantages of utilizing a revocable trust as part of your estate plan are as follows:

- (1) Probate avoidance.
- (2) Planning for incapacity or incompetency.
- (3) Avoiding ancillary administration (in another state) when real property is in another state.
- (4) Ability to treat eligible revocable trusts as part of the estate (for income tax purposes) and, thus, the assets held are eligible for a step-up in basis.
- (5) Privacy.
- (6) Avoiding potential will contest.
- (7) Flexibility for amending terms or revoking the trust.

Please note that the use of a revocable living trust can be an effective tool in your estate plan, however, if you fail to fund the trust or fail to transfer assets to the trust sufficient to avoid probate, then the usefulness of the revocable living trust could be significantly diminished.

### **Form 1099-Misc and 1099-NEC Reporting Requirements**

The PATH Act, P.L. 114-113, Div. Q, sec. 201, accelerated the due date for filing Form 1099 that includes nonemployee compensation (NEC) from February 28 to January 31 and eliminated the automatic 30-day extension for forms that include NEC. You now must use Form 1099-NEC to report nonemployee compensation. You should review your records and ensure you have all the information necessary to file your Forms 1099-MISC and 1099-NEC properly and accurately for 2024. This includes obtaining the correct payee's name, address, and tax identification number by having a completed W-9, Request for Taxpayer Identification Number on file. Remember, if a sole proprietor provides you with their social security number, make sure to report their individual name, not the business name on the 1099. Some of the important reminders concerning Forms 1099-MISC and 1099-NEC are listed below:

- Form 1099-NEC reporting is due to the Department of Treasury on or before January 31, 2025 if you file on paper or if you e-file.

- Form 1099-MISC reporting is due to the Department of Treasury by January 31, 2025 if you file on paper or if you e-file.
- Payments made to attorneys, even if incorporated, must always be reported on a Form 1099-NEC.

If the total of the net W-2s and 1099s issued is greater than 10, then W-2s and 1099s are required to be e-filed. Keep in mind that reporting late or incorrect information can lead to additional IRS correspondence and penalties.

### **TIN Matching**

Avoiding IRS Forms W-2 and 1099 Taxpayer Identification Number (TIN) matching issues represents one of the easiest ways to reduce both tax return errors and preparation time needed to complete your tax returns. TINs, which include both social security and federal identification numbers, on W-2s and 1099s should be reviewed and corrected as soon as possible, if necessary. In addition, tax withholdings included on 1099s should be reviewed and adjusted, if necessary.

### **FinCEN Beneficial Ownership Reporting**

Beneficial ownership reporting with the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) is required for those entities that do not have a reporting exemption. The reporting due date for entities created or registered to do business in the United States before January 1, 2024 is January 1, 2025. If an entity is created on or after January 1, 2024 and before January 1, 2025, the due date is 90 calendar days after formation. If an entity is formed on or after January 1, 2025, the due date is 30 calendar days after formation. Please note that single member LLCs are also required to file.

The use of FinCEN identifiers (FinCEN ID) is one methodology for speeding up the compliance and reporting process and we encourage you to consider this in your reporting approach. In addition, if there's no expectation of beneficial ownership changes for an existing entity between now and January 1, 2025, we encourage you to file now.

### **Conclusion**

Through careful planning, it's possible your 2024 tax liability can still be significantly reduced, but don't delay. The longer you wait, the less likely it is that you'll be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they're no substitute for personalized professional assistance. Keep in mind that California has its own unique set of rules to consider and, as such, many of the strategies employed to reduce Federal taxes may not be applicable to California income taxes. With a new administration taking office in January, we will almost certainly see significant tax legislation enacted next year. Because we don't yet know what changes will pass or when they'll go into effect, we'll need to base our year-end planning on existing law.

Please don't hesitate to call us with questions or for additional strategies on reducing your tax bill. We'd be glad to set up a planning meeting or assist you in any other way that we can.

Very truly yours,

*Butterfield + Co. CPAs, Inc.*

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