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Tax Newsletter

A Dozen Tax Eggs About to Crack
Key TCJA provisions set to expire

The massive Tax Cuts and Jobs Act (TCJA) passed during the first Trump administration includes numerous provisions scheduled to expire after 2025. When Congress returns in January, several or all changes may be extended or revised, including the following twelve key items.

1. Individual tax rates: The TCJA revamped the graduated tax rate structure for individuals. It established a top tax rate of 37% (down from 39.6%) and modified the income ranges for each bracket, with inflation indexing.

2. Standard deduction: In conjunction with the revised tax rate structure, the tax law hiked the standard deduction from $6,500 to $13,000 for single filers and $12,000 to $24,000 for joint filers, with inflation indexing. On 2024 returns, the standard deduction is $14,600 for single filers and $29,200 for joint filers.

3. Child Tax Credit: Among other changes for the Child Tax Credit (CTC), the maximum amount was doubled from $1,000 to $2,000. The TCJA also created a new $500 credit for non-child dependents. These tax breaks are supposed to vanish after 2025.

4. Alternative Minimum Tax: The complex calculation for the Alternative Minimum Tax (AMT) for individuals may result in extra tax liability. The exemption amounts, which were increased by the TCJA, are set to return to prior levels.

5. Personal exemptions: Previously, individual taxpayers could claim personal exemptions for themselves and their qualified dependents (e.g., young children). This tax break was suspended and is scheduled to be restored.

6. SALT payments: Prior to the TCJA, payments for state and local taxes (SALT) were generally deductible in full by itemizers. But the TCJA capped the annual SALT deduction at $10,000.

7. Moving expenses: An individual could previously deduct their job-related moving expenses if a two-part test was satisfied. The TCJA suspended this deduction (except for military personnel on active duty) as well as the tax exclusion for moving expense reimbursements.

8. Qualified business income: The TCJA created a new deduction of up to 20% of qualified business income (QBI) of owners of pass-through entities and self-employed individuals. The QBI deduction is subject to phase-outs with special rules applying to specified service trade or businesses (SSTBs).

9. Miscellaneous expenses: Under prior law, individuals could deduct various miscellaneous expenses (e.g., unreimbursed employee business expenses) above 2% of adjusted gross income (AGI). But the itemized deduction for miscellaneous expenses was suspended.

10. Mortgage interest: The TCJA reduced the deduction limit for interest paid on the first $1 million of qualified acquisition debt to $750,000. It also suspended the mortgage interest deduction for interest paid on up to $100,000 of home equity debt.

11. Casualty losses: Under prior law, deductions were allowed for unreimbursed casualty and theft losses above 10% of AGI (after subtracting $100 per event.) The TCJA allows deductions only for casualty losses sustained in a federal disaster area.

12. Estate tax exemption: Finally, the TCJA doubled the federal estate tax exemption for a decedent from $5 million to $10 million, with inflation indexing. The exemption for 2024 is $13.61 million ($13.99 million in 2025). This amount is set to revert to $5 million, with inflation indexing, after 2025.

Besides these provisions, other permanent TCJA changes, such as the flat 21% tax rate on corporate income, could be in Congress' crosshairs. We will update you on any significant developments.

Beware the Additional Medicare Tax
Hidden tax trap for high earners

Federal payroll taxes can take a big bite out of your paycheck. For starters, FICA tax is comprised of two portions: the Social Security tax portion and the Medicare tax portion. The Social Security tax is 6.2% on the first of $168,600 of wages in 2024. This "wage base" is increasing to $176,100 in 2025, up $7,500. The 1.45% Medicare tax applies to all wages.

Adding insult to injury, if you earn too much income during the year, you could be hit with the "Additional Medicare tax." This surtax, which often flies under the radar, only affects taxpayers with annual wages above a specified level.

How it works: Social Security and Medicare taxes are withheld from an employee's regular pay. The employer is required to deposit these taxes with the IRS. In addition, the employer must pay and deposit its corresponding share of the full FICA tax for each employee.

For example, say the owner of a small business earns $200,000 in 2024.The FICA computation is as follows:

Social Security Tax: 6.2% x $168,600 = $10,453.20
Medicare Tax: 1.45% x $200,000 = $2,900
Total Tax: $10,453.20 + $2,900 = $13,353.20

That can make a big dent in your take-home pay. But that is not the end of the story. For high wage-earners, the Additional Medicare tax may come into play. This surtax was introduced in 2013 by the Affordable Care Act (ACA). It is equal to 0.9% of the amount above one of these annual thresholds based on the employee's tax filing status.

- $250,000 if you are married and file a joint tax return
- $125,000 if you are married and file separate tax returns
- $200,000 if you are single and all other taxpayers

The Additional Medicare tax is only imposed on the excess above the threshold. Of course, the employee still must pay the regular FICA tax. Suppose that a joint filer earns $500,000 in 2024. In this case, the Additional Medicare tax comes to $2,250 (0.9% x $250,000 excess). That is on top of the FICA tax of $17,703.20 ($10,453.20 + $7,250) on $500,000 in wages.

The employer is responsible for withholding the Additional Medicare tax. But it does not have to cough up an equivalent amount like it does with FICA tax.

Comparable rules apply to self-employed individuals who pay self-employment tax in lieu of FICA. Although the usual tax rates are doubled for these businesspeople, they can deduct half of their self-employment tax on their personal tax returns. The thresholds for the Medicare surtax are the same for self-employed individuals as they are for employees with wages.

Note that the thresholds for the Additional Medicare tax are NOT adjusted for inflation. Therefore, if your income continues to rise each year, so does the resulting payroll tax liability. And the wage base for the Social Security tax portion keeps going up each year, too.

Best approach: Coordinate year-end planning strategies with your professional tax advisor to maximize the tax benefits and minimize the tax damages.

Passing the Tax Test on Student Loans
When loan interest is tax-deductible

The future of student loan forgiveness programs and other government initiatives is uncertain as we head into 2025. Silver tax lining: At least taxpayers who pay student loan interest in 2024 may be in line for some limited tax relief when they file their tax returns next year.

Background: As of July 2024, about 42.8 million borrowers were saddled with federal student loan debt in the U.S., totaling a staggering $1.753 trillion. If you borrow money to attend school, you can deduct part or all of the student loan interest above-the-line on your Form 1040. In other words, the write-off is available even if you do not itemize deductions (i.e., you claim the standard deduction).

However, the deduction is phased out for upper-income taxpayers. Thus, if the parents of a student take out the loan, the family may not derive any tax benefit from the interest payments. The IRS says that the deduction, if any, belongs to whomever is named on the loan.

If you qualify, the annual deduction is limited to the first $2,500 of interest paid for qualified expenses. The list of qualified expenses includes tuition and fees; room and board; books, supplies and equipment; and other necessary expenses, such as transportation.

Note: The lender must be an authorized source like a bank. You cannot deduct any interest paid on an intra-family loan like one you get from a rich aunt or uncle. And the proceeds must be paid to an accredited educational institution.

The loan proceeds can be for the education of yourself, your spouse or your dependent. Whoever is receiving the money must have been enrolled in school at least part-time.

Tax law test: Under longstanding IRS rules, student loan interest may be deductible only if ALL the following apply.

- You paid interest on a qualified student loan in the tax year of the tax return.
- You are legally obligated to pay interest on a qualified student loan.
- Your filing status is not married filing separately.
- Your modified adjusted gross income (MAGI) is less than the specified annual amount.
- You or your spouse, if filing jointly, cannot be claimed as dependents on someone else's tax return.

The MAGI limit is indexed annually for inflation (although recent increases have generally been relatively small). For the 2024 tax year, the deduction is phased out for a MAGI between $80,000 and $95,000 for single filers. The phase-out range is between $165,000 and $195,000 of MAGI for joint filers. Once you exceed the upper threshold, no deduction is allowed.

Thus, even taxpayers with relatively moderate incomes for the area in which they reside may be shut out on their tax returns.

Year-end tax planning: Should you accelerate student loan interest payments into 2024 or postpone them to 2025? Generally, it makes sense to take a current deduction, especially if you expect your income to rise next year, but it depends on your personal situation. Consult with your tax professional.

Retirement Plan COLAs on Tap

The IRS recently announced cost-of-living adjustments (COLAs) for qualified retirement plans. Here is a comparison of 2024 and 2025.

	Limit for 2024	**Limit for 2025**
Maximum annual dollar benefit for a defined benefit plan	$275,000	$280,000
Maximum dollar limit on additions to a defined contribution plan	$69,000	$70,000
Maximum amount of compensation taken into account for qualified retirement plans	$345,000	$350,000
Dollar limit for elective deferrals to a 401(k) plan	$23,000 ($30,500 if age 50 or over)	$23,500 ($31,000 if age 50 or over)*
Dollar limit for contributions to a SIMPLE plan	$16,000 ($19,500 if age 50 or over)	$16,500 ($20,000 if age 50 or over)*

*Beginning in 2025, a higher “catch-up contribution” limit applies to employees age 60-63. See your tax professional for details.

Note: The annual limit for contributions to **Traditional and Roth IRAs** remains at $7,000 for the 2025 tax year ($8,000 if age 50 or over). The phase-out levels for IRA and Roth contributions have also been adjusted upward.

Facts and Figures
Timely points of particular interest

Tax ID Protection—As tax return season rapidly approaches, the IRS is encouraging individual taxpayers to take an important step to safeguard their identities by signing up for an identity protection personal identification number (IP PIN). This simple yet critical step can provide an extra layer of security and help guard against tax-related identity theft. An IP PIN can be obtained online via the IRS website. Note: The IP PIN system is down for maintenance in December and will not be available again until January.

IRA Gifts to Charity—Do not forget that individuals age 70½ or older can avoid tax consequences by contributing IRA funds directly to charity. This qualified charitable distribution (QCD) is not taxable but cannot be deducted either. The IRS recently announced that the QCD limit for 2025 is increasing from $105,000 to $108,000. These amounts are doubled for a married couple if both spouses independently qualify. Extra benefit: A QCD counts as a required minimum distribution (RMD) for other tax purposes. RMDs from IRAs are generally required after age 73.

Happy Holidays—Our firm would like to wish you and your family a Happy Holiday Season and a Happy, Healthy and Prosperous New Year.