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Tax Newsletter

Five Financial Resolutions for 2025
Planning today for the future

What is your financial status as 2025 gets underway? This is a good time to make "New Year's resolutions" that may improve your outlook. Here are five common possibilities.

1. Cut down debt. This is often the first and most important financial resolution for people. A molehill of debt can turn into a mountain in a short period of time. Now you can start chipping away.

First, reduce unnecessary spending, like buying all the latest electronic devices or dining out nightly at trendy restaurants. Then use available resources to pay off the debts that have the highest interest rates. If possible, you might consolidate debts into a single loan at a reasonable rate.

2. Work out a monthly budget. It is difficult to accomplish the goal of reducing debt without having a firm grasp of your income and expenses. Spending more than what you earn is how you get in trouble in the first place.

Do not forget to account in the budget for increases in costs as well as fixed costs, like the rent or mortgage. Use a spreadsheet, ledger or other device to keep track of income and expenses —even a simple notepad may do.

3. Save more for retirement. Financial planning covers more than just one year. Figure out how much you will need to save to sustain a comfortable lifestyle through your golden years.

Typically, you may bulk up retirement savings by deferring part of your salary to a 401(k) plan or other company plan. For 2025, the limit on 401(k) deferrals is $23,500, plus another $7,500 if you are age 50 or older. Employers may also add matching contributions up to a stated percentage of compensation. **New for 2025:** Employees age 60-63 can kick in an extra $11,250 instead of $7,500.

To supplement these contributions, you may contribute up to $7,000 to an IRA in 2025 or $8,000 if you are age 50 or older. Have your professional advisors explain the key differences between traditional and Roth IRAs.

4. Adjust your portfolio. Although the stock market was booming throughout much of 2024, there are no guarantees that the trend will continue, given the inherent volatility of equities. You may hedge your bets by continuing to rely on basic principles of diversification and asset allocation.

- Diversification means spreading out investments among different asset classes to reduce your overall risk

- Asset allocation is the practice of investing in various categories—such as stocks, bonds, real estate and cash — based on a set percentage.

Of course, there are other factors to consider, including your personal tolerance for risk and the tax implications of transactions and holdings.

5. Create or update your will. If you do not have a will in place, make this a top priority. Without a legally-binding will, state law governs the disposition of assets and custody of young children, regardless of your intentions.

But do not assume you are "done" just because you have a will. It may need to be revised to reflect significant life events like births, deaths, divorces, marriages or remarriages; loss of a job or retirement; changes in the tax laws; and other events affecting the family.

Fortunately, this does not have to be a do-it-yourself proposition. Your professional advisors can help you meet your main objectives for 2025.

IRS Eases into Third-Party Reporting
New transitional rule affects payments

Recent tax legislation was intended to crack down on workers in the gig economy and others who may skirt the usual tax rules for reporting income. Under the American Rescue Plan Act (ARPA), entities known as third-party settlement organizations (TPSOs)—including apps like Venmo, Zelle and PayPal and online marketplaces—are required to report more transactions to the IRS.

But the new rules have been postponed twice. Now the IRS has announced a transitional rule that will affect reporting by TPSOs for 2024 and 2025 before the final requirements take full effect in 2026.

Background: The IRS requires certain entities to send annual tax forms to individuals receiving payments during the tax year. For example, if you have invested in mutual funds that pay capital gains and dividends, you receive Forms 1099-B before you file your annual tax return. The IRS also receives copies of these forms so its computers can cross-check tax return entries.

Similarly, a Form 1099-K is sent to recipients of payments made for goods or services during the year. Prior to ARPA, TPSOs were required to distribute Forms 1099-K to any business that had more than 200 transactions during the year AND the total amount of the transactions exceeded $20,000. Under ARPA, however, the requirement for the number of transactions was eliminated and the dollar threshold was knocked all the way down to $600. These changes were scheduled to go into effect in 2022.

But then the IRS jumped in. First, it postponed the new requirements for one year to enable TPSOs to establish reporting procedures. Subsequently, it granted a second reprieve for another year. Finally, the new transitional rule gradually eases TPSOs into the tax reporting requirements.

New limits: The IRS is phasing in the $600 threshold over three years, but there is still no exception based on the number of transactions. The schedule for TPSOs to send 1099-Ks to businesses is as follows:

- For 2024, reporting is required for transactions totaling more than $5,000.
- For 2025, reporting is required for transactions totaling more than $2,500.
- For 2026, reporting is required for transactions totaling more than $600.

Note that the changes do not affect casual transactions between friends like payments for settling a restaurant or bar bill or participating in a Fantasy football league. There is no reporting required for these types of personal payments.

The new rules are expected to increase compliance by taxpayers, like many gig economy workers who receive payments for goods and services through TPSOs and have previously treated their activities as a mere hobby. Of course, as self-employed individuals, gig economy workers may be entitled to claim offsetting deductions for qualified business expenses, subject to certain limits.

Practical approach: Gather all the required information before your 2024 tax return is prepared. Your professional tax advisors can help you maximize the tax benefits and minimize the tax damages.

Faster Deductions for Building Components
Cost segregation study for a business

Bad news: It takes almost four decades to fully recoup the cost of a business building through regular depreciation deductions. Good news: Your business may benefit from faster write-offs if it conducts a "cost segregation study." In effect, the study separates certain building components so that some costs can be deducted over a shorter time.

To sweeten the pot, the favorable tax treatment available with a cost segregation study may be complemented by recent tax law changes, although one benefit is being gradually written off the books.

Background: Normally, the cost of a building is recovered through depreciation deductions over a period of 39 years, as required by the Modified Adjusted Cost Recovery System (MACRS). Conversely, personal property may be written off over shorter time periods based on a "useful life" of, say, five, seven or 15 years. The IRS regulations define "personal property" as tangible depreciable property (other than buildings and their structural components) used in transportation, communications and certain other industries.

A cost segregation study identifies those components that are eligible for faster write-offs. It then reclassifies those assets as personal property assets and enables business building owners to depreciate the components in less time than the 39-year recovery period for the overall building.

Caution: The IRS may challenge these deductions and has frequently done so in the past. In several cases, the courts have ruled that parts of a commercial building may be treated like personal property only if they relate to the equipment used in a business located in the building. This may include components such as HVAC systems, plumbing systems in restaurant kitchens and removable carpeting.

Typically, the cost segregation study will rely on engineering reports, mechanical and electrical plans and architectural drawings in compliance with IRS guidelines. Because the write-off periods for components often depend on the use of the building, taxpayers are generally advised to enlist the services of a qualified professional experienced in their particular industry. When it is handled properly, the cost segregation study should measure up to IRS standards.

Furthermore, tax legislation recently clarified that the cost of "qualified improvement property" (QIP) is eligible for a 15-year write-off. For these purposes, QIP includes qualified leasehold improvements, qualified retail improvements and qualified restaurant property. This change in the law has proven to be a boon for many business owners.

On the downside, 100% first-year bonus depreciation for qualified business property placed in service during the year is being gradually phased out. The deduction for 2025 is only 40% of the cost (down from 60% in 2024). This deduction will disappear completely after 2026 unless Congress modifies the rules.

Final words: In any event, a cost segregation study can provide valuable tax savings. Make sure you work with experts in the field to realize the optimal results for your business.

Stretching Flexible Spending Accounts
How to avoid loss of funds

An important deadline is coming up for participants in flexible spending accounts (FSAs). For healthcare FSAs that allow a grace period, you have until March 17, 2025, to withdraw any leftovers before you forfeit the money.

Background: An FSA is funded with pre-tax dollars, so there are significant income and employment tax savings for employees. Furthermore, the employer does not have to pay employment taxes on amounts contributed to FSAs, either. This benefit may offset some or all of the administrative costs of the plan. Thus, FSAs can be a "win-win situation" for employers and employees.

There are two types of FSAs. One is for healthcare expenses and the other is for dependent care expenses.

1. Healthcare FSAs: In brief, you arrange to have amounts deducted from your paycheck and deposited in your personal account. Then you use the money throughout the year to pay for qualified healthcare expenses as needs arise. The FSA covers expenses of an employee, spouse and dependents age 26 or younger. For instance, the money may be used to pay for LASIK surgery or braces for your kids.

The annual contribution limit for healthcare FSAs is $2,500, indexed for inflation. For 2025, the limit is $3,300 (up from $3,200 in 2024).

2. Dependent care FSAs: With a dependent care FSA, funds may cover expenses of caring for a child under age 13 or a dependent physically or mentally incapable of self-care (e.g., an elderly relative with Alzheimer's disease).

The annual limit for contributions is $5,000. (This figure is not indexed for inflation.) However, unlike healthcare expenses, which are usually not easy to predict, you will often have a good idea of your annual dependent care expenses, such as fees for day care or pre-school.

Timing is everything: At the start of the year, employees must decide how much of their wages to allocate to their FSAs. Usually, this decision requires some advance planning, especially when you factor in the "use-it-or-lose it" rule. How it works: If an employee does not withdraw the funds remaining in the FSA before the end of the year, this amount is forfeited. However, if the employer has authorized a grace period, employees have an extra 2½ months to use up their FSA funds. Therefore, the effective deadline for the 2024 plan year may be March 17, 2025. (March 15 falls on a Saturday.)

Alternatively, an employer may allow an employee to carry over up to $500 of unused healthcare FSA funds to the next year ($640 from 2024 to 2025). However, employers cannot allow employees to benefit from permit both the grace period and the carryover rule— it must be one or the other. Also, the carryover option is not available with a dependent care FSA.

Tax prescription: Check the balance in your healthcare FSA. If you have unused funds that will be forfeited after March 17, consider expenditures you might make at this time, such as contact lenses or first-aid kits. The money is yours, at least for now, so you may as well spend it. Finally, consider choices for the 2025 plan year.

Tax Breaks for Foster Parents

Are you thinking about becoming a foster parent of a young child? Your generosity may be rewarded with several tax breaks, including the following.

- You may be able to claim a Child Tax Credit (CTC) of up to $2,000 subject to a phase-out based on adjusted gross income (AGI).
- The cost of caring for a child under age 13 so you (and your spouse, if married) can work qualifies for a dependent care credit.
- Medical expenses paid on behalf of the child count toward the 7.5%-of-AGI threshold for medical expense deductions.
- You may be eligible for a charitable deduction for out-of-pocket costs for feeding, clothing and caring for a foster child if this benefits a tax-exempt charity.

Finally, tax breaks may also be available on the state income tax level.

Facts and Figures
Timely points of particular interest

New Mileage Rates—The IRS has just announced the new standard mileage rates for 2025. These rates can be used in lieu of deducting actual expenses. The rate for business driving is 70 cents per mile (up three cents from 2024), the rate for medical purpose trips is 21 cents per mile (the same as 2024) and the moving expense rate for active-duty military personnel is 21 cents per mile (the same as 2024). The charitable travel rate is statutorily set at 14 cents per mile. You can add fees to all the standard rates for related parking and tolls.

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