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Tax Newsletter

IRS Delays New Rules for Inherited IRAs
New Notice extends prior waivers

The IRS has just extended tax relief to certain non-spouse beneficiaries of inherited IRAs in new Notice 2024-35. This ruling relates to the crackdown on so-called “stretch IRAs” included in the Setting Every Community Up for Retirement Enhancement (SECURE) Act, a precursor to the recent SECURE 2.0 law.

Under the new Notice, required minimum distributions (RMDs) from inherited IRAs may be postponed for another year.

Background: In the usual course of events, you must start taking RMDs from IRAs after you have reached the required beginning date (RBD) of April 1 of the year following the year you attain age 73 (increased from age 72 by SECURE 2.0 after the initial SECURE Act boosted it from 70½). The amount of the annual RMD is based on life expectancy tables and the value of the account on the last day of the previous year. For example, a 2024 RMD is based on your account balance as of December 31, 2023.

If you do not comply with these rules, the IRS may impose a penalty equal to 25% (decreased from 50% by SECURE 2.0) of the amount that should have been withdrawn (or the difference between the required amount and a lesser amount actually withdrawn). The penalty, which is reduced to 10% for errors fixed in a timely fashion, is added to the regular income tax due on the RMD.

Comparable rules apply when someone inherits an IRA from a person who has already reached their RBD. However, in the past, taxpayers who had inherited IRAs could stretch out RMD payments by basing the amounts on their own life expectancies. Thus, by using these stretch IRAs, tax deferral could continue for decades and result in more accumulated savings.

New rules: Under the SECURE Act, these IRA beneficiaries (other than surviving spouses and minor children) are generally required to empty out the account over a ten-year period, effectively eliminating stretch IRAs (except for beneficiaries inheriting before 2020). In 2022, the IRS issued proposed regulations that required beneficiaries to take RMDs in years one through nine if the original account owner died after reaching their own RBD.

But the latest rule changes led to considerable confusion among taxpayers and tax professionals alike. In particular, it was not clear if RMDs must be spread out over the applicable period of time. Recognizing the problems, the IRS subsequently waived the requirement for non-spouse beneficiaries who would normally be required to take RMDs from inherited IRAs for 2020 through 2023.

Now, in new Notice 2024-35, the IRS establishes that taxpayers in this situation will not be penalized for failing to take RMDs from inherited accounts for 2024. The IRS says it will soon issue final regulations clarifying the rules.

Practical advice: Take a deep breath. The latest delay gives non-spouse beneficiaries more time to plan for IRA distributions. Depending on your situation, you may decide to take 2024 RMDs anyway if it will lower your overall tax bill. Consult with your tax professional.

Is Bonus Depreciation Going Away?
Current rules for business tax break

The first-year bonus depreciation deduction is still around…for the time being. However, the Tax Cuts and Jobs Act (TCJA), which enhanced the bonus depreciation tax break, also phases it out over time. So your business only receives a partial deduction for qualified property placed in service in 2024.

Fortunately, there may be a way to help pick up most—if not all—of the slack. Let us take a closer look.

Background: Prior to the TCJA, a business could claim a first-year bonus depreciation deduction equal to 50% of the cost of new qualified property placed in service. The deduction may be added onto the amount expensed under Section 179 (more on this later).

Bonus depreciation was, and still is, available for property like computers, vehicles, off-the-shelf software, machinery and equipment, office furniture and other depreciable property with a cost recovery period of 20 years or less under the Modified Accelerated Cost Recovery System (MACRS). But only new property qualified for the deduction.

In addition, a business was able to claim 50% bonus depreciation for "qualified improvement property" (QIP) of a building. The definition of QIP excludes costs for the enlargement of a building, elevators and escalators and a building's internal structural framework.

On the plus side, the TCJA doubled first-year bonus depreciation to 100% for qualified property placed in service after September 27, 2017 and before January 1, 2023. It also expanded the definition of qualified property eligible for bonus depreciation to include used, not just new, property.

Initially, the deduction for QIP was inadvertently left out of the TCJA. However, subsequent legislation fixed this temporary glitch for QIP with a cost recovery period of 15 years. Under current law, QIP also qualifies for first-year bonus depreciation.

On the minus side, the TCJA phases out the first-year bonus depreciation deduction over the following years:

- 80% in 2023;
- 60% in 2024;
- 40% in 2025; and
- 20% in 2026.

After 2026, zero bonus depreciation is allowed, absent any further action by Congress.

However, the same property that is eligible for bonus depreciation may also qualify for Section 179 expensing. For 2024, a business can expense—in other words, currently deduct—up to the lesser of $1.22 million or the amount of its taxable income (subject to a phase-out limit of $3.05 million). So bonus depreciation may never come into play for qualified property placed in service in 2024. If either limit for Section 179 applies, the remaining cost is eligible for 60% bonus depreciation and then MACRS deductions.

There are other special considerations for owners of pass-through entities like S corporations, partnerships and limited liability companies (LLCs). Notably, the bonus depreciation deduction reduces qualified business income (QBI). In turn, this lowers the QBI deduction. Therefore, if you are entitled to a QBI deduction, consider the potential tax impact of bonus depreciation.

Finally, bonus depreciation could be extended or modified, depending on the outcome of the elections in November.

Practical advice: Do not make any hasty decisions. Before you commit to acquiring qualified property for your business, discuss all the ramifications with your professional tax advisor.

Skirting Around the Wash Sale Rule
When to use "double up" strategy

Whether you have a taxable gain or loss on the sale of securities depends on your "basis" in the stock (usually, your cost) and the price at which you sell your shares. However, the tax rules for certain security sales can be tricky. In particular, you should pay close attention to the "wash sale rule."

How it works: Normally, you can use capital losses to offset your capital gains, plus up to $3,000 of ordinary income. However, under the wash sale rule, you are not permitted to deduct a loss from the sale of securities if you buy "substantially identical" securities within 30 days of the sale. So you get no tax benefit from the loss on your 2024 return. It does not matter if the purchase takes place before or after the date of the sale.

When are securities considered to be substantially identical? One example is shares of common stock in the same corporation. On the other hand, bonds that are issued by different obligors are not considered to be substantially identical. Whether the wash sale rule affects bonds from the same issuer depends on a number of factors, such as interest rates, face amounts, issue dates, maturity dates, etc.

Be aware that there is a way you can realize a current loss under the wash sale rule without waiting 31 days to repurchase the stock. This strategy commonly is referred to as "doubling up."

Example: You bought 100 shares of Gadget Corp. stock at $50 a share and now it is selling at $40 a share. But you believe the price of the stock is about to rebound. Instead of selling the original block of shares, which would produce a $1,000 loss, you double up by buying 100 more shares of Gadget Corp. stock at $40. Then you wait more than 30 days and sell the first 100 shares at $42.

Result: By doubling up, you have realized a deductible loss of $800. What's more, you are now holding shares in Gadget Corp. with a basis of $40. If you decide to sell the shares at $42, you will realize a capital gain of $200. Currently, long-term capital gains for securities owned longer than one year are taxed are taxed at a maximum rate of 15% (20% for high-income investors).

If you had simply sold the initial shares at $42 and reacquired the new shares without waiting more than 30 days, you would not be able to deduct your $800 loss.

At least there is a silver tax lining if you are forced to forfeit a tax loss due to the wash sale rule. The amount of the loss is added to your basis in the new stock. Thus, when you sell the new stock in the future, a smaller amount of gain will be subject to tax. If the stock is sold at a loss, you can deduct a larger amount as a loss.

Final points: Remember that the tax law is subject to change. Also, consider all the relevant economic ramifications—not just taxes—in your investment decisions.

Cleaning Up Nanny Tax Obligations
Liability for household workers

If you have someone who helps around the house while you (and your spouse, if you are married) work, you may be surprised to learn that the IRS effectively treats you as an "employer" for tax purposes. That means you must meet certain tax responsibilities relating to the worker under the "nanny tax."

Do not be fooled by the name. The nanny tax is not limited to the super-rich and famous who employ an around-the-clock au pair at their beck and call. It can also apply to families of all incomes who employ a part-time household worker or someone who simply helps out with the kids after school.

Details: The tax law requires you to pay employment taxes if the wages paid to a household employee exceed an annual threshold. This threshold, which is relatively low, is $2,700 for 2024 (up from $2,600 in 2023). The nanny tax collectively incorporates the following three taxes.

1. FICA Tax: FICA is comprised of the 6.2% Social Security tax and the 1.45% Medicare tax. Both the employer and the employee must pay the total 7.65% FICA tax. For 2024, the Social Security portion is owed on a wage base of $168,600 (up from $160,200 in 2023) while the Medicare portion applies to all wages.

Say you pay a housekeeper $200 a week with two weeks off for a total of $10,000 a year. The FICA tax that you and the worker each owe is $765 ($620 Social Security tax + $145 Medicare tax). You must withhold the worker's share.

2. FUTA Tax: An employer must also pay a 6% federal unemployment tax on the first $7,000 in wages, but this amount is generally reduced by a 5.4% credit if required amounts have been paid to the state. In this case, the effective tax rate is 0.6%.

3. State Unemployment and Disability Taxes: Typically, an employer is also responsible for its share of these state taxes and for withholding the proper amount on behalf of an employee. If the taxes are not withheld, the employer must pay them.

Be aware that the nanny tax may apply to a wide variety of household employees, including nannies, babysitters, private nurses, caretakers, cleaning people, yard workers and other domestic workers if you have requisite control over the work relationship. If you pay an agency directly, however, the agency is treated as the employer of the worker and is responsible for these taxes.

On the other hand, if the worker controls how and when the work is performed and works for several households, they may be considered to be a self-employed individual. This often occurs when the worker offers services to the general public and provides the tools and supplies needed for the job. Self-employed individuals are responsible for the own employment taxes.

Finally, the nanny tax is *not* imposed on amounts paid to a spouse; a child under age 21, a parent (unless certain special conditions apply) or an employee who is under age 18 at any time during the year unless providing household services is the employee's principal occupation.

What about you? Consult with your professional tax advisor concerning your personal situation.

Plug In New Electric Vehicle Credits
Changes taking effect over two years

The popularity of electric vehicles (EVs) continues to grow. According to the Energy Information Administration, it is estimated that EVs will have comprised 16.3% of all U.S. new car purchases in 2023 (up from 12.5% in 2022). Hybrid, plug-in hybrid and battery-electric vehicles reached 17.9% of all new light-duty vehicle sales in the second half of the year.

If you bought one of these vehicles last year, you may be in line for a big tax credit on your 2023 tax return, based on changes in the Inflation Reduction Act (IRA). However, be aware of new "stop" and "go" signals for EVs acquired in 2024.

Starting point: The tax law authorizes a tax credit for EVs, including plug-in hybrids, that meet certain energy consumption standards. The maximum credit is $7,500, regardless of cost. The credit is claimed on the tax return for the year in which you purchase the vehicle. Furthermore, you must meet other technical requirements, including a limit on the gross vehicle weight rating (GVWR).

In addition, be aware that the credit is nonrefundable. Finally, the credit is only available to vehicle owners. Lessees do not qualify for a tax break.

Notably, the IRA includes the following key provisions relating to tax credits for EVs.

- Single filers cannot claim the credit with modified adjusted gross income (MAGI) above $150,000 or above $300,000 for joint filers.

- The credit is not available for most passenger vehicles that cost more than $55,000. The limit is $80,000 for vans, sports utility vehicles (SUVs) and pickup trucks.

- For the full credit, the vehicle must be powered by batteries whose materials are sourced from the U.S. or its free trade partners and must be assembled in North America.

- Previously, the credit was eliminated for EVs of manufacturers with EV sales of 200,000 or more vehicles. But this ban no longer applies to vehicles purchased after 2022.

Note that the recent legislation also provides a credit of up to $4,000 to purchasers of *used vehicles* under a separate set of rules. For example, the credit is available to single filers with MAGI of no more than $75,000 or no more than $150,000 for joint filers. But the vehicle cannot cost more than $25,000, it must be at least two years old and you can only claim the credit once every three years.

What about new EVs purchased in 2024? Availability of the credit is being winnowed by the manufacturing rules. At this writing, only 18 EVs qualify for the credit in 2024, according to the U.S. Department of Energy.

That is the bad news. The good news: Instead of waiting until you file your 2024 return to claim the credit, you can obtain a rebate at the point of sale.

To participate in the program, dealers must register through an online system that allows them to verify the vehicle's eligibility. But you remain responsible for meeting the income requirements. If you surpass the threshold, you will have to "pay the IRS back" on your tax return.

Finish line: If you have any more questions, your professional tax advisors can steer you in the right direction.

Facts and Figures
Timely points of particular interest

Filing Deadlines—The April 15 filing deadline for 2023 returns has passed. However, U.S. citizens residing abroad have until **June 17, 2024**, to file their returns, including those with dual citizenship. Also, if you applied for an extension on your 2023 return, you have until **October 15, 2024**, to file (although a good faith estimate of your tax liability had to be paid by April 15).

Mail Call—The IRS is going after some tax-evasive heavy hitters. It recently announced that it has sent out warning notices to taxpayers with incomes above $400,000 who have not filed a federal income tax return since 2017. The IRS used W-2s, 1099s and other third-party reporting forms to compile the list of offenders. The agency has estimated that more than 125,000 taxpayers will receive these notices in the mail.

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