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Tax Newsletter

Seven Deductions for Self-Employeds
Key write-offs for common expenses

Naturally, corporations can claim large business expense deductions, but that does not mean that small business owners, including self-employed individuals, are left out in the cold. Following are seven common write-offs available to self-employeds.

1. Health and dental insurance: Yes, a self-employed individual can currently deduct the full cost of health and dental insurance, just like the corporate bigwigs. This includes premiums for you, your spouse and dependents under age 26. Icing on the cake: The deduction is claimed “above the line” on your personal tax return, so it reduces adjusted gross income (AGI) for other tax purposes.

2. Retirement plan contributions: Besides benefitting from tax-deferred growth, you can write off contributions to a qualified retirement plan within generous limits. There are numerous options ranging from Simplified Employee Pensions (SEPs) to Savings Incentive Match Plans for Employees (SIMPLEs) to solo 401(k)s and more. As with health insurance, retirement plan contributions are deductible above the line.

3. Vehicles: When you use a vehicle for both business and personal driving, you may deduct costs attributable to business travel. For example, if your car is used 75% for business driving in 2022, you can deduct 75% of your vehicle costs—oil and gas, repairs, insurance, etc.—plus depreciation subject to certain limits.

Caution: The IRS imposes strict substantiation requirements. In lieu of keeping all the required records, you may use a standard mileage rate of 58.5 cents per business mile for the first six months of 2022 and 62.5 cents per business mile for the last six months (plus related tolls and parking fees).

4. Business travel: Are you taking long-distance business trips again? If so, you might fly to another city for a face-to-face meeting with a top client. Accordingly, you can deduct your travel expenses, including the round-trip airfare, lodging and meals and other incidentals (e.g., Uber, Lyft, or cab fares).

The primary purpose of your trip must be business-related. Although you can spend some time on pleasurable activities like sightseeing, this cannot be a vacation in disguise.

5. Business meals: Despite a recent legislative crackdown on business entertainment, you may still claim a deduction for meals while you are away from home on business. Notably, the IRS has approved deductions for food and beverages incurred in connection with business-related entertainment—for example, at a sporting event—if charged separately from the entertainment.

Furthermore, the usual 50% deduction limit on business meals is doubled to 100% for 2021 and 2022 for restaurant-provided fare.

6. Home office expenses: Currently, you cannot deduct home office expenses if you are a corporate employee, but self-employed individuals are not affected by this restriction.

To qualify for deductions, you must use the home regularly and exclusively as your principal place of a business or a place to meet or deal with clients, customers, or patients in the normal course of business. If you have no fixed place of business, doing administrative work at home may suffice. Note: Other special rules may apply.

7. Self-employment tax: Finally, a self-employed individual must pay self-employment tax, the equivalent of payroll tax for employees. As with employees, the Social Security portion of self-employment tax is imposed on amounts up to an annual threshold ($147,000 for 2022).

Unfortunately, the usual 7.65% rate for employees is doubled to 15.3% for self-employment tax, but you can deduct half of this tax above the line.

These are just seven potential deductions for self-employed individuals. Contact your tax advisor concerning your situation.

When to Start Saving for Retirement
Planning for financial stability

Here is an age-old question: When is the best time to start saving for retirement? The short answer is simple—**now**. But this requires some more explanation.

For those who have recently entered the workforce, the sooner you begin a program of retirement saving, the better. If you are already in the midst of your career, you should not delay any longer. And, if you are nearing the traditional time for calling it quits, better late than never.

Just witness the power of tax-deferred compounding of funds set aside in a qualified retirement plan account such as a 401(k). For simplicity, assume that you can contribute $10,000 a year and earn an annual return of 8%. If you have only ten years until retirement, you will accumulate $151,069. If you figure you will be retiring in 20 years, you can pile up $477,215 in savings. And if your projected retirement is 30 years away, you will have accumulated $1,181,340!

Caution: The financial markets fluctuate, so the actual figures for your situation may vary significantly. Nevertheless, this should give you a rough idea of your earnings potential over time.

Of course, other issues might get in the way of retirement saving. For example, you may not be able to annually contribute as much as you would like due to a monthly mortgage “nut,” the need to help pay for your children’s college education or health issues or other unforeseen circumstances. Furthermore, if you are facing a mounting debt burden, it is generally recommended that you should address that first.

Once you have figured out the “when” of retirement saving, it is time to focus on the “how.” Typically, you may be eligible to participate in a 401(k) plan or other qualified employer plan where your contributions can grow without any current tax erosion. The maximum 401(k) deferral allowed for 2022 is $20,500 ($27,000 if you are age 50 or over). In addition, your employer may provide “matching contributions” up to a stated percentage of compensation.

Other plans have different sorts of annual limits. See your professional advisors for more details.

Another idea is to supplement an employer-based plan with contributions to a traditional IRA or Roth IRA, or both. The combined limit for IRA contributions in 2022 is $6,000 ($7,000 if you are age 50 or over). As with qualified plan contributions, these amounts can compound tax-deferred over time.

Finally, remember that you do not have to stop saving for retirement once you have retired. As evidenced by increases in life expectancies, your funds may have to carry you further than you initially envisioned. But there is no reason that you cannot continue to invest wisely throughout your retirement.

Bottom line: The need to save for retirement cannot be overemphasized. Do not be a procrastinator. Make this one of your top priorities before you head into next year.

Beware This "Generation-Skipping" Tax
Estate planning for well-to-do families

If you have accumulated significant wealth during your lifetime, you may hope to pass on the lion's share to your heirs. But estate taxes can take a big bite out of your assets if you are not careful. Do not forget about the **generation-skipping transfer tax** (GSTT) that applies to most inheritances that go directly to grandchildren.

Basic premise: Generally, assets that are inherited by beneficiaries other than a spouse are subject to federal estate tax. But estate tax liability is often eliminated or reduced through the unified estate and gift tax exemption.

Under the Tax Cuts and Jobs Act (TCJA), the exemption was doubled from $5 million to $10 million, with inflation indexing, beginning in 2018. It is $12.06 million in 2022. But the exemption is currently scheduled to revert to $5 million, with inflation indexing, in 2026. This could cause complications for wealthier individuals.

One idea in the past was to use transfers that skip a generation. But Congress had previously enacted a special tax, the GSTT, to discourage this practice.

How it works: Essentially, the GSTT applies to transfers to related individuals who are more than one generation away—such as your grandchildren—and unrelated individuals who are more than 37½ years younger. All these designated beneficiaries are referred to as "skip persons" in estate tax parlance. (A special exception may apply when the parents of grandchildren have predeceased them, although the transfers are still subject to estate tax.)

Furthermore, you cannot sidestep this potential tax pitfall simply by transferring assets to a trust and naming your descendants as the beneficiaries. For these purposes, all of the trust beneficiaries are treated as skip persons.

Saving grace: Your family may benefit from a GSTT exemption that moves in tandem with the exemption from federal estate tax. Thus, the GSTT exemption for 2022 is $12.06 million and is scheduled to revert to $5 million, plus inflation indexing, in 2026.

These figures are effectively doubled for joint filers. So, a married couple can shelter up to $24.12 million from the GSTT in 2022.

Also, be aware that you can benefit from another GSTT exemption reflecting the annual gift tax exclusion amount. Accordingly, in 2022 you can gift up to $16,000 per recipient, including grandchildren, without any GSTT liability. This exclusion is also indexed for inflation.

By maximizing the GSTT exemption and gift tax exclusion, you may be able to avoid any adverse tax consequences. Depending on your situation, a trust can still be a viable option for estate planning purposes.

Practical approach: Do not leave matters to chance. Meet with your professional estate planning advisors to devise a comprehensive plan that incorporates these aspects.

Donating a Car to Charity? Take It Slow

Maybe you've heard or seen advertisements from charities that accept car donations. Should you decide to go ahead with this, make sure you know the rules of the road.

Key limit: Even if you use a reputable buying guide to set the vehicle's fair market value (FMV), the deduction may be reduced if the charity then sells the vehicle. For example, if you have established a $5,000 FMV for a car when you donate it and the charity subsequently sells it for $3,000, your deduction is generally limited to $3,000.

On the plus side, your deduction may be based on the FMV if the charity makes material improvements to the car, such as adding a rear-view camera, for its own use. Consult with your tax advisor before you drop off the keys.

Facts and Figures
Timely points of particular interest

Book Marks—The IRS recently release its "Data Book" covering its 2021 fiscal year (October 1, 2020, through September 30, 2021). This report features a wealth of information, including 33 tables covering tax returns processed, tax revenue collected, tax refunds issued, audits conducted and a slew of other tax tidbits that may pique your interest. Want to know more? You can view the entire 2021 Data Book online at https://www.irs.gov/pub/irs-pdf/p55b.pdf.

Artificial Intelligence—AI is already working for the IRS. Case in point: The tax collection agency has expanded voice bot options to help you verify your identity to set up or modify a payment plan while avoiding long waits. Voice bots run on software powered by AI that allows you to navigate an interactive voice response. The IRS has been using voice bots on some toll-free lines since January so taxpayers with simple questions can get rapid-fire answers. Other enhancements are on the way.