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Tax Newsletter

Key Into Home Office Deductions
Tax write-offs for the self-employed

If you are self-employed and you normally work from the comfort of home, you may be entitled to home office deductions when you file your 2022 tax return next year. And you might also qualify if you started a home-based side gig. But deductions are not currently available if you are an employee working from home most of the time.

Background: You qualify for home office deductions only if you use part of the home regularly and exclusively as (1) your principal place of business or (2) a place where you meet or deal with customers, clients or patients in the normal course of trade or business. Similarly, you may be able to claim deductions for a separate structure—like a shed or detached garage—that is used to store business products or tools.

However, you cannot deduct home office expenses if the work area is used for other purposes. For example, you will not qualify simply by putting a work desk in a great room where your family watches TV.

Suppose you have no single fixed place of business and mainly provide services at a multitude of locations. You may still qualify for home office deductions if you handle administrative matters at home. In one landmark case, an anesthesiologist who worked for several hospitals was able to deduct home office expenses because of this rule.

Prior to 2018, some employees were able to claim home office deductions if they used a home office regularly and exclusively for their employer's convenience. They deducted the home office expenses as miscellaneous expenses, subject to an overall floor of 2% of adjusted gross income (AGI). But the Tax Cuts and Jobs Act (TCJA) suspends miscellaneous expense deductions through 2025. So, these employees get no deduction in 2022—regardless of their AGI.

Typically, your deductible expenses will include expenses directly related to your home office plus a portion of the home's overall expenses based on the percentage of business use of the home. Therefore, if you use 10% of your home for an office, you may deduct 100% of the cost of painting the office room as well as 10% of your mortgage interest, property taxes, utilities, repairs, etc. (If you itemize deductions, you may otherwise qualify for mortgage interest and property tax deductions.)

Finally, you may also claim a depreciation deduction for the home office, computed under IRS tables. Caveat: If you sell the home, you must "recapture" depreciation attributable to the home office at the 25% tax rate.

Note: Instead of deducting actual expenses, you may choose to claim a simplified deduction on your 2022 tax return. This deduction is equal to $5 per square foot of the area used as an office up to a maximum of $1,500. If you use this method, you do not have to worry about the recapture provision. However, the actual expense method generally produces a larger—sometimes significantly larger—annual deduction.

Bottom line: Do not make assumptions. Consult with your professional tax advisor regarding your situation.

When Do You Need A Prenup?
Key component in estate planning

Suppose that you're going to be married in the near future. Perhaps this is a second or even third marriage. Or maybe another family member—for example, your child or grandchild—will be the one walking down the aisle. In any event, it should be a blissful occasion.

But you cannot ignore the realities in this day and age. With close to half of the marriages in this country ending in divorce, it is worthwhile to consider using a prenuptial agreement ("prenup" for short) for protection, especially when one of your long-term objectives is to preserve assets for the descendants of a prior marriage. Prenups are becoming increasingly commonplace in estate planning. Despite what you may think, this is not just for the super-rich and famous.

Background: Essentially, a prenuptial agreement is a legally binding contract between the two parties intending to get married. The contract lists each individual's personal and real estate property and outlines a plan for distribution of that property in the event that the marriage does not work out.

It may seem unromantic or miserly for an engaged couple to take steps that will provide for an orderly divorce. Undoubtedly, you are looking forward to spending a long life together. Nevertheless, a prenuptial agreement may actually reduce pain and suffering over the long haul. It can also offer financial protection to children of a prior marriage. For these reasons, prenups no longer have the same stigma that was attached to them in the past.

Usually, a prenuptial agreement can be prepared in about the same time it takes to prepare a will. As with a will, the agreement assures that your property will be distributed in the manner you desire. In effect, this is a form of "marriage insurance."

Key point: The foundation of a successful prenuptial agreement is full disclosure of all assets. Both parties must be meticulous in listing everything of value that they own or in which they have an interest. Once that is done, the parties must agree on a fair distribution of these items after divorce. In many cases, particularly second and third marriages, the prevailing philosophy is "what's mine is mine and what's yours is yours."

If the respective wealth of the parties is substantially unequal—as is often the case in second marriages—some compromise may be necessary. Reason: In some states, the assets of both parties are put into the same pot upon divorce. The couple then splits the assets equally. Thus, one spouse could walk away with substantially more than they had when the marriage was entered into.

Final thoughts: This is not a do-it-yourself proposition. Consult with an experienced attorney to create a document that reflects your personal needs and desires.

Retirement Plans: Keep It SIMPLE
Easy qualified plan to operate

Are you looking for a retirement plan for your business that is easy to establish and maintain? Consider the aptly named SIMPLE. Short for Savings Incentive Match Plan for Employees, this type of qualified retirement plan can be a convenient alternative for small business owners.

Although it has been around for a couple of decades, the SIMPLE is not as well known as the 401(k) or Simplified Employee Pension (SEP). The most common variety of SIMPLE, the SIMPLE-IRA, closely resembles a SEP-IRA. As with SEPs, employers don't have to file annual returns for SIMPLEs—a major advantage.

Background: For starters, a SIMPLE is only available to employers with 100 or fewer employees. Any employee who has been paid at least $5,000 in compensation for any two previous years at the company and who expects to receive at least that amount in the current year is eligible to participate in the plan**. (**If the employer chooses, it can impose less restrictive eligibility requirements.) Note: A SIMPLE may also be used by self-employed individuals.

The contribution limit for SIMPLEs is adjusted annually for inflation. For 2022, the maximum allowable contribution is $14,000, plus another $3,000 if you are age 50 or older, for a current maximum of $17,000. Generally, the employer must provide matching elective contributions of up to 3% of compensation (but not less than 1% in no more than two out of five years) or non-elective contributions equal to 2% of each eligible employee's compensation (based on a maximum allowable compensation of $305,000 in 2022). These contributions are deductible by the employer.

Unlike some other qualified plans, contributions to SIMPLEs vest immediately. In other words, employees have the ability to withdraw funds from the plan anytime, without providing a reason. These distributions are taxable at ordinary income rates. Also, withdrawals made prior to age 59½ are hit with a 10% penalty tax, unless one of the special tax law exceptions applies (e.g., payments due to a disability).

Caution: The usual 10% penalty for an early withdrawal from a qualified plan is increased to 25% during the first two years of participation in a SIMPLE. After two years have elapsed, the normal 10% penalty will apply to early withdrawals.

Furthermore, the rules for required minimum distributions (RMDs) from qualified plans apply to SIMPLEs. Currently, RMDs are required after reaching age 72. To extend tax deferral, SIMPLE funds may be rolled over into a traditional IRA.

Finally, the tax law provides employers with more leeway than usual for setting up a SIMPLE. As long as the plan is established by October 1, it is effective for the current year (assuming the employer previously did not maintain a SIMPLE). So, your business still has until October 3, 2022 (October 1 is a Saturday) to get a plan going for this year.

The benefits of SIMPLEs are similar to SEPs, so compare the two types of plans. Your professional advisors can provide guidance.

Camp Out for a Tax Credit

If you send your under-age-13 kids to day camp this summer, the cost may qualify for the dependent care credit if this enables you (and your spouse, if married) to be gainfully employed. For 2022, the credit is generally equal to 20% of the first $3,000 of qualified expenses for one child or $6,000 for two or more children.

What's more, this tax break is also available for the cost of a specialty camp like one for a talented athlete or computer wiz. But the cost of an overnight camp does not qualify.

Note: Recent enhancements for the dependent care credit expired after 2021. We will continue to watch out for any new developments in this area.

Facts and Figures
Timely points of particular interest

Tax Talk—The IRS recently announced further expansion of its multilingual products as part of ongoing efforts to provides resources to all taxpayers. It now provides Braille, text, audio and large-print products in Spanish. Also, the IRS is converting Form 1040, its main schedules and six publications into Spanish Braille and large print. It already has a special webpage, featuring 20 different languages, that shows taxpayers how they can find basic tax information.

Vehicle Limits—In response to the latest bump in vehicle prices around the country, the IRS has announced sizeable increases in the vehicle depreciation allowances for vehicles placed in service in 2022. When additional first-year bonus depreciation is added in, the new limit is $19,200, up $1,000 from 2021. Also, the second-year jumps by $1,600 to $18,000; up $1,000 to $10,800 for the third year; and $6,460 for each year thereafter, an increase of $600. The vehicle can be placed in service as late as December 31, 2022.