



Newsletter

JULY 2022

Freddi Eberhart & Associates Inc. would like to thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time. Also, thank you for recommending us to your family, friends, and associates. We truly appreciate your referrals.

This Month:

Upcoming dates:

July 24

- Parent's Day

This recent run of inflation has caused many people to rethink how and where to store their cash. While many are understandably having second thoughts about having too much cash in accounts that have a lower or almost non-existent interest rate, there's been a renewed interest in making sure you've got enough cash immediately available in case of emergencies.

In this month's newsletter, please read how your bank accounts can work together as a team to provide the security and value you're looking for.

Also read about Toyota and Lexus Electric Vehicle Credits, tax surprises to be on the lookout for, and how your business mileage deduction just became more valuable.

Please feel free to forward the information to someone who may be interested in a topic and call with any questions you may have.

Toyota and Lexus Electric Vehicle Credits Will Start Phasing Out

Toyota recently announced that it has sold over 200,000 electric vehicles, the threshold that triggers a phaseout of the full \$7,500 IRC §30D New Qualified Plug-In Electric Drive Motor Vehicle Credit (EV Credit). This applies to their luxury Lexus brand, as well. The EV Credit will begin to phase out for its electric vehicles purchased after September 30, 2022, at which time the credit will be reduced to \$3,750, and then reduced again to \$1,875 starting April 1, 2023. The credit for Toyota and Lexus electric vehicles will phase out completely on October 1, 2023, absent further legislation.

Buyers hoping to claim the credit should note the above dates to optimize potential income tax credits.

Layering Your Bank Accounts

Time for the classic banking approach to make a comeback?

For years, savings and checking accounts provided very little in the way of interest income. In our current

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Layering Your Bank Accounts (Cont'd)

inflationary times, however, interest rates are on the rise. What is also on the rise is the comeback of traditional banking products. Here is a review of how your bank accounts traditionally work together as a team to provide you the best security and value for your money.

The checking account: 30 days of funds

- **Primary Purpose:** Checking accounts enable financial transactions. So store enough money here to pay immediate expenses. With checking accounts, you're allowed numerous withdrawals and unlimited deposits. The tradeoff for having an account where cash is available at a moment's notice is usually a much lower (or practically non-existent) interest rate.

***Action Item:** Determine what your 30-day cash needs are and limit the available cash in your checking account to this amount. Also consider setting up a link to another account. Most banks allow this so you do not have overdraft fees. Consider looking for a checking account that also allows an automatic sweep function of excess funds into a higher-interest savings account.*

Basic savings account: 2 to 6 months of funds

- **Primary Purpose:** To store your money in a secure location so you can use it to pay periodic expenses that are expected over the next 2 to 6 months. This is also where many store their emergency fund. While these accounts typically pay only a modest amount of interest, their safety and reliability make savings accounts a great choice for stashing cash you want available sometime within the next 12 months. This is often also your overdraft buffer in case your checking account gets overdrawn.

***Action Item:** Calculate your anticipated periodic expenses over the next 6 months, and limit the cash in your savings account to this amount. You don't want the balances too high, as you can typically get better interest in other bank products AND if a thief gets access to your debit card, you can limit the damage they do if this savings account is linked to your checking account.*

Higher-interest bank accounts: Lots of choices

- **Primary Purpose:** There are several types of bank accounts for storing your money beyond what you need for short-term expenses. High-yield savings accounts, money market accounts, and certificates of deposit (CD's) all provide at least 10x the interest return compared to a regular savings account. But in return for a higher interest rate, there are rules that govern how long you need to leave your money untouched in these accounts.

***Action Item:** Review your bank's alternatives for longer-term savings. Pay attention to interest rates and how often*

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Layering Your Bank Accounts (Cont'd)

they adjust with the market. If CD's are your bank's strength, consider building a ladder of expiration dates to make your money more available. On high-yield accounts, the interest rate often increases with higher balances, so know what products these are. It's also a good idea to talk to your banker to review your options.

When you're trying to decide where to keep your money, there are also tax ramifications to consider. So keep this in mind as you review how your bank accounts work together as a team.

Watch for These Tax Surprises

Our tax code contains plenty of opportunities to cut your taxes. There are also plenty of places in the tax code that could create a surprising tax bill. Here are some of the more common traps.

- **Home office tax surprise.** If you deduct home office expenses on your tax return, you could end up with a tax bill when you sell your home in the future. When you sell a home you've been living in for at least 2 of the past 5 years, you may qualify to exclude from your taxable income up to \$250,000 of profit from the sale of your home if you're single or \$500,000 if you're married. But if you have a home office, you may be required to pay taxes on a proportionate share of the gain. For example, let's say you have a 100-square-foot home office in your house that is 2,000 square feet (your office is therefore 5% of your house's overall area). Since your home office occupies 5% of your house, you may have to pay taxes on 5% of the gain when you sell it. Even worse, if you claim depreciation on the business use of your home, this could add even more to your tax surprise. This added tax hit courtesy of depreciation surprises many unwary users of home offices.
- **Kids getting older tax surprise.** Your children are a wonderful tax deduction if they meet certain qualifications. But as they get older, many child-related deductions fall off and create an unexpected tax bill. And it does not happen all at once. As an example, one of the largest tax deductions your children can provide you is via the child tax credit. If they are under age 17 on December 31st and meet several other qualifications, you could get up to \$2,000 for that child on the following year's tax return. But you'll lose this deduction the year they turn 17. If their 17th birthday occurs in 2022, you can't claim them for the child tax credit when you file your 2022 tax return in 2023, resulting in \$2,000 more in taxes you'll need to pay.
- **Limited losses tax surprise.** If you sell stock, cryptocurrency or any other asset at a loss of \$5,000, for example, you can match this up with another asset you sell at a \$5,000 gain and - presto! You won't have to pay taxes on that \$5,000 gain because the \$5,000 loss cancels it out. But what if you

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Watch for These Tax Surprises (Cont'd)

don't have another asset that you sold at a gain? In this example, the most you can deduct on your tax return is \$3,000 (the remaining loss can be carried forward to subsequent years). Herein lies the tax trap. If you have more than \$3,000 in losses from selling assets, and you don't have a corresponding amount of gains from selling assets, you're limited to the \$3,000 loss. So if you have a big loss from selling an asset in 2022, and no large gains from selling other assets to use as an offset, you can only deduct \$3,000 of your loss on your 2022 tax return.

- **Planning next year's tax obligation tax surprise.** It's always smart to start your tax planning for next year by looking at your prior year tax return. But you should then take into consideration any changes that have occurred in the current. Solely relying on last year's tax return to plan next year's tax obligation could lead to a tax surprise.

Please call to schedule a tax planning session so you can be prepared to navigate around any potential tax surprises you may encounter on your 2022 tax return.

Your Business Mileage Deduction Just Became More Valuable

Your business mileage tax deduction just became more valuable for the rest of 2022 after a recent announcement by the IRS.

Starting July 1st, the IRS's business mileage rate is increasing by 4 cents, to 62.5 cents per mile, while the medical and moving mileage is also increasing by 4 cents, to 22 cents per mile. The previous mileage rates still apply through June 30th.

Here are some tips to make the most of your business's vehicle expense deduction.

- **Don't slack on recordkeeping.** You won't be able to take advantage of the increased mileage rates without proper documentation. The IRS mandates that you track your vehicle expenses as they happen (this is called contemporaneous recordkeeping). You're not allowed to wait until right before filing your tax return to compile all the necessary information needed to claim a vehicle deduction. Whether it's a physical notebook you stick in your glove compartment or a mobile phone app, pick a method to track your mileage and actual expenses that's most convenient for you.
- **Keep track of both mileage and actual expenses.** The IRS generally lets you use one of two different methods to track vehicle expenses – the standard mileage rate method or the actual expense method. But even if you use the standard mileage method you can still deduct other expenses like parking and toll fees. So keep good records.

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Your Business Mileage Deduction Just Became More Valuable (Cont'd)

- **Consider using standard mileage the first year a vehicle is in service.** If you use standard mileage the first year your car is placed in service, you can then choose which expense tracking method to use in subsequent years. If you initially use the actual expense method the first year your car is placed in service, you're locked in to using actual expenses for the duration of using that car in your business. For a car you lease, you must use the standard mileage rate method for the entire lease period (including renewals) if you choose the standard mileage rate the first year.
- **Don't forget about depreciation!** Depreciation can significantly increase your deduction if you use the actual expense method. For heavy SUVs, trucks, and vans with a manufacturer's gross vehicle weight rating above 6,000 pounds, 100% bonus depreciation is available through the end of the 2022 tax year if the vehicle is used more than 50% for business purposes. Regular depreciation is available for vehicles under 6,000 pounds with annual limits applied.

Please call if you have any questions about maximizing your business's vehicle expense deduction.

Understanding Tax Credits Versus Deductions

Tax credits are some of the most valuable tools around to help cut your tax bill. But figuring out how to use these credits on your tax return can get complicated very quickly. Here's what you need to know.

Understanding the difference

To help illustrate the difference between a credit and a deduction, here is an example of a single taxpayer making \$50,000 in 2022.

- **Tax Deduction Example:** Gee I. Johe earns \$50,000 and owes \$5,000 in taxes. If you add a \$1,000 tax deduction, he'll decrease his \$50,000 income to \$49,000, and owe about \$4,800 in taxes.

Result: A \$1,000 tax deduction decreases Gee's tax bill by \$200, from \$5,000 to \$4,800.

- **Tax Credit Example:** Now let's assume G.I. Johe has a \$1,000 tax credit versus a deduction. Mr. Johe's tax bill decreases from \$5,000 to \$4,000, while his \$50,000 income stays the same.

Result: A \$1,000 tax credit decreases your tax bill from \$5,000 to \$4,000.

In this example, your tax credit is five times as valuable as a tax deduction.

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Understanding Tax Credits Versus Deductions (Cont'd)

Too good to be true?

Credits are generally worth much more than deductions. However, there are several hurdles you have to clear before being able to take advantage of a credit.

To illustrate, consider the popular child tax credit.

Hurdle #1: Meet basic qualifications

You can claim a \$2,000 tax credit for each qualifying child you have on your 2022 tax return. The good news is that the IRS's definition of qualifying child is fairly broad, but there are enough nuances to the definition that Hurdle #1 could get complicated. And then to make matters more complicated...

Hurdle #2: Meet income qualifications

If you make too much money, you can't claim the credit. If you're single, head of household or married filing separately, the child tax credit completely goes away if you exceed \$240,000 of taxable income. If you're married filing jointly, the credit disappears above \$440,000 of income. And then to make matters more complicated...

Hurdle #3: Meet income tax qualifications

To claim the entire \$2,000 child tax credit, you must owe at least \$2,000 of income tax. For example, if you owe \$3,000 in taxes and have one child that qualifies for the credit, you can claim the entire \$2,000 credit. But if you only owe \$1,000 in taxes, the maximum amount of the child tax credit you could claim is \$1,400.

Take the tax credit...but get help!

The bottom line is that tax credits are usually more valuable than tax deductions. But tax credits also come with lots of rules that can be confusing. Please call to schedule a tax planning session to make sure you make the most of the available tax credits for your situation.

As always, should you have any questions or concerns regarding your tax situation please feel free to call.

This newsletter provides business, financial, and tax information to clients and friends of our firm. This general information should not be acted upon without first determining its application to your specific situation. For further details on any article, please contact us.