ClientLine®

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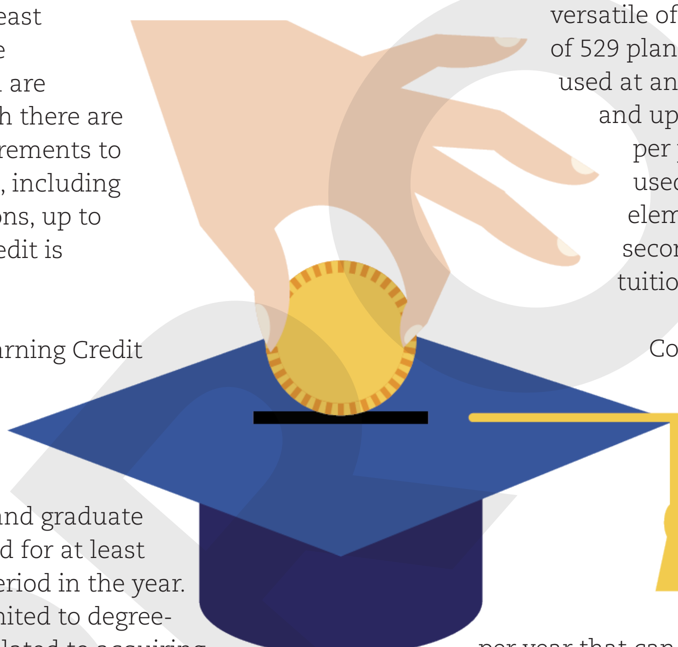
TAX BENEFITS FOR EDUCATION

The IRS provides numerous tax breaks for higher education expenses. Tax credits and tax-deferred savings plans take some of the sting out of paying for college.

TAX CREDITS

The American Opportunity Tax Credit is available to students in the first four years of higher education. Using this credit can offset up to $2,500 of qualified education expenses per year. Students pursuing a degree or other education credential who are enrolled at least half time for one academic period are eligible. Although there are additional requirements to claim this credit, including income limitations, up to $1,000 of this credit is refundable.

The Lifetime Learning Credit (LLC) is another educational tax credit. It's available to undergraduate and graduate students enrolled for at least one academic period in the year. The LLC isn't limited to degree-seekers. Costs related to acquiring or improving job skills qualify. While this credit isn't refundable, there is no limit to the number of years you can claim it.



TAX-DEFERRED SAVINGS PLANS

Qualified tuition plans, commonly known as 529 plans, come in two forms: prepaid tuition plans and education savings plans. Tuition plans allow savers to buy tuition credits at participating universities at current prices, while education savings plans use investment accounts to save cash for future education expenses.

Education savings plans are the more versatile of the two types of 529 plans. They can be used at any university and up to $10,000 per year can be used for elementary and secondary school tuition.

Coverdell Education Savings Accounts allow savers to put away up to $2,000 for each beneficiary per year that can be used for college, secondary, or elementary school expenses and qualified distributions are tax-free.

You can only claim one of the tax credits each year per student but the credit can be used together with savings plans, as long as there is no double-dipping.

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Reminder of Special Tax Breaks

The December 2020 stimulus package provided a few noteworthy tax breaks for companies.

A temporary tax break for 2021 and 2022 allows businesses to deduct 100% of business meals eaten at a restaurant, up from the usual 50%.

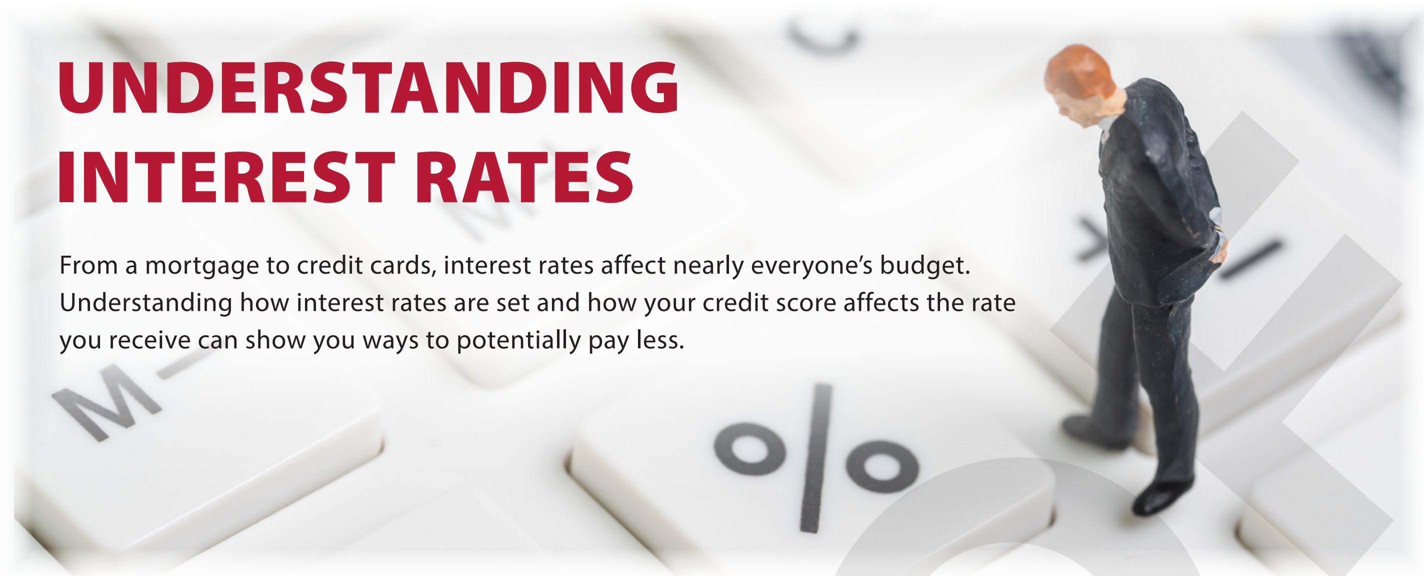
For businesses hard hit by the COVID-19 pandemic, the Employee Retention Tax Credit is available for the first half of 2021. Eligible businesses that were either shut down by the government or incurred at least a 20% reduction in gross receipts for one of the first two quarters of 2021 may qualify for this credit of up to $14,000 per employee. Claim this credit when you file quarterly form 941.

The Work Opportunity Tax Credit and the Family Medical Leave Tax Credit were extended to December 31, 2025.

Employers who pay qualified education expenses, including student loan payments, for employees can deduct up to $5,250 per employee through 2025.

UNDERSTANDING INTEREST RATES

From a mortgage to credit cards, interest rates affect nearly everyone's budget. Understanding how interest rates are set and how your credit score affects the rate you receive can show you ways to potentially pay less.



HOW RATES ARE SET

The twelve Fed members of the Federal Open Market Committee set the federal funds rate. The prime interest rate is actually set by individual banks. The federal funds rate is the amount banks charge each other for short-term loans and the starting point to set the prime rate for consumers. So, there is not just one prime interest rate. The prime rate you see published is usually an average of several large banks' prime rates for that day. However, the most used prime rate is the one that the Wall Street Journal publishes daily.

Alternatively, some international banks or large banks with many international customers use the London Interbank Offer Rate (LIBOR) instead of the federal funds rate as their starting point.

CREDITWORTHINESS COUNTS

Banks generally charge their most creditworthy customers the prime rate. If you have less than an excellent credit score, you will pay a higher rate.

Variable interest rate loans, like adjustable-rate mortgages and credit cards, are impacted by the prime rate. For example, when the prime rate rises, the rate on your credit card will likely rise. Personal and auto loans have a fixed rate, which will not fluctuate with interest rates.

YOUR CREDIT SCORE

Depending on which model is used, credit scores range from fair to excellent. The interest rate you receive is influenced by your credit score, which you can improve over time, if necessary. The following responsible credit behaviors impact your credit score:

- Consistently pay bills on time
- Keep credit card balances low—the ratio between balance and credit limit is important
- Apply for credit only when absolutely necessary
- Pay off debt—the ratio between debt and income is important
- Check your credit reports regularly.

Client PROFILE....

Barbara operates a floral shop and her CPA recently suggested she switch from the cash method of accounting to the accrual method and she doesn't understand the difference between the two methods.

The cash method of accounting is the most common way to maintain financial records for small businesses. Under this method, all transactions are recorded based upon when cash changes hand. Revenue is recorded when you get paid and expenses are recorded when you pay them.

As businesses get larger, switching to the accrual method provides a better long-term view of the company's financial situation. It shows how much money is earned and spent, regardless of when cash changes hands. If you complete work for a client in February but aren't paid until July, you'll record the revenue in February.

Although either method is generally acceptable, many banks will require financial statements using the accrual method when considering a loan application, as will most potential investors. And the IRS requires using the accrual method for certain businesses with inventory and most companies with revenue greater than $25 million per year.

Client Profile is based on a hypothetical situation.
The solutions we discuss may or may not be appropriate for you.

KIDS, MONEY AND TAXES

Unfortunately, personal finance is rarely taught in schools, so unless kids learn about money at home, they often learn hard lessons as adults. That's why it is so important for parents to put this task on the list of things to teach their children, starting at a very young age.

SHARE EXPERIENCES

As you deal with finances on a daily basis, involve your children, keeping in mind the child's age. For example, grocery shopping can become a lesson about budgets and decision making. Simply allow a younger child to choose only one item. Older children can learn about budgeting and sales tax while shopping for school clothes. A wellness check at the doctor's office presents the perfect opportunity to explain a bit about health insurance.

TEACH BY EXAMPLE

Let your kids see you working on planning finances. Tell them how you are saving up to buy something special for the family or putting money away for college and retirement. An older child could also learn the concept of time and money. At tax time, explain to them why you are paying income or property taxes.

LEARN BY DOING

Chores are a great way to teach kids to earn money. You can further help them learn about saving by putting their earnings into two clear jars. For every dollar earned put a quarter into one jar for savings and 75 cents into another, for spending. Encourage them to watch their money accumulate and add any birthday money they may receive. You could open a savings account for older children.

DISREGARDED ENTITIES

There are three types of disregarded entities, but the single-member limited liability company (SMLLC) is the most common.

TAXES

The IRS defines a disregarded entity as a business that is not taxed separately from the owner. All the company's income and expenses pass through to the owner and are reported on the individual's federal tax return—so no need for an additional company tax filing. This also avoids double taxation, unlike corporations. Owners of SMLLCs still have to pay self-employment taxes.

It's important to understand that disregarded entity status applies at the federal level only. State taxation of disregarded entities vary. While some may not impose an income tax on the business, they may charge other taxes like franchise or excise taxes.

LEGAL PROTECTION

A major benefit of a SMLLC is to provide legal protection to the owner. The company, not the individual, becomes the party to contracts and the borrower on loans. At the state level, the company retains all the liability benefits of an LLC so its assets are protected from creditor's claims.

Consult your tax advisor before taking on new partners/owners as this would change how your business is taxed.

Q&A

Q **I bought a fundraising ticket to support a non-profit and I won the main prize, a new car. Will I be taxed on winning the car?**

A Raffles are considered a form of lottery. Although cash winnings of more than $5,000 are subject to a 25% withholding tax, non-cash prizes are treated differently.

With no cash to withhold, the winner of a non-cash non-profit raffle must pay the organization 25% of the prize's fair market value, minus the amount of the wager. However, in some instances, the organization may pay the tax for the winner.

If the value of the car is at least 300 times the value of your wager, you'll receive a Form W2-G from the non-profit showing the car's value and the tax withheld. Since the IRS considers this prize to be income, you'll need to report the vehicle on Form 1040. Keep in mind you may also owe state taxes.

Q **My business was approached by a professional employer organization (PEO). What does a PEO do for businesses?**

A A PEO offers outsourced solutions for things like human resources, payroll, and benefits. Often it can decrease benefit costs due to its purchasing power and keep your company up-to-date with employment regulations. Using a PEO means that employees technically work for the PEO under a co-employment model. This means the PEO assumes some of the risks associated with being an employer.

ClientLine SHORT BITS....

> PRESIDENTIAL SALARIES

U.S. Presidents earn $400,000 per year as the commander in chief. On top of that, they receive a $50,000 expense account annually for things like dry cleaning and food. After leaving office, former Presidents receive an annual pension for life along with permanent Secret Service protection.

> 401(k) CONTRIBUTIONS

According to a recent study, for the 12-month period ending in September 2020, the average 401(k) participant saved $7,270 while earning another $4,010 in employer contributions. Based on participants' average income, this amounts to a 13.5% combined contribution, which is slightly less than the financial expert's recommended savings rate of 15%.

> DECLINE AND RECOVERY

Recovering from the economic impacts from the COVID-19 pandemic will take some time. According to the Brookings Institute, it will take until 2023 for the average American to spend the same amount as they did in 2019. While the off-premise food and beverage (i.e. grocery stores) sector saw an increase of $84 billion in consumer spending in 2020, health care spending dropped by $148 billion as many Americans delayed or skipped visits to health care professionals.

> IRS BACKLOG

Some taxpayers have waited six months or longer to have their 2019 federal tax returns processed. As of December 31, 2020, the IRS website indicated there were still 7.1 million unprocessed 2019 individual returns. Office closings due to COVID-19 and 20% fewer employees since 2010 levels are to blame. With approximately 26% of its employees eligible to retire in 2021, the IRS is asking for more funding to hire customer service representatives.