ClientLine®

December 2024

HOW BONUSES ARE TAXED

Many employers typically pay year-end bonuses in the first quarter of the year. If you received a bonus for the first time this year, you may be surprised at the net amount of your "windfall."

WHY THE SURPRISE?

Work bonuses are classified as supplemental wages, which are subject to federal income tax withholding. They are also subject to Social Security and Medicare taxes, and in some cases, state taxes may apply. The IRS provides employers with specific guidelines outlining the methods for calculating federal income tax on supplemental wages.

The default rate for federal income tax withholding on bonuses less than $1 million is currently 22%, so employers can withhold at a flat rate of 22% or combine regular and supplemental wages to calculate the tax amount. That means your bonus may be taxed at your highest individual income tax rate, which could be 37%, not to mention any state tax. You may receive some of the withheld amount back as a tax refund. Check with your tax professional.

HANDLING THE INFLUX OF CASH

So, now that you're over the tax sticker shock, what will you do with your windfall? First, reward yourself in some small way, such as a weekend away or an item you have wanted. Then, a good move is to contribute the rest to tax-advantaged accounts such as a 401(k), IRA or Health Savings Account (HSA). By contributing part of your bonus to these accounts, you save for your future and may offset some of your tax bill for the year.

Another way to minimize work bonuses' tax impact is to consider charitable contributions. Donating a portion of your bonus to qualified charitable organizations not only supports meaningful causes but also provides a deduction that could lower your taxable income.

While it won't reduce taxes, you may want to use some of your bonus to pay off a high-interest credit card or student loan. Be careful not to become reliant on annual bonuses. In tight economic times, bonuses can be reduced or even suspended.

The choice is yours, but being proactive and strategic with your bonus can lead to substantial tax savings and long-term financial benefits.

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PLAN FOR A CASH-ONLY HOLIDAY

Do you often find yourself still paying off credit card debt long after the holidays? Keeping spending under control can be difficult at this time of year, which is why using cash—not credit—is so important. Here are a few tips.

BE EFFICIENT

To help keep you focused, list people you're shopping for and the amount you intend to spend. Include ideas for gifts.

USE CASH OR A DEBIT CARD

This makes you accountable for staying on budget. You won't be able to spend more than you have in your wallet or in your bank account.

AVOID THE MALL

Colorful displays, new gift ideas and sales might tempt you to buy items that aren't on your list. Your favorite stores and online vendors have websites where you can order specific items without the distractions found in local stores, which tend to trigger impulse spending.

CLIENT PROFILE

Jenny owns a warehousing company and wants to give a holiday party, but she has heard that the cost is either 50% deductible or 100% deductible from business income. Which number is correct, and can she also give cash gifts to employees?

Jenny may have heard two similar IRS rules. The first allows companies to deduct 50% of employee meal costs during the course of normal business. She can deduct 100% of meals provided employees when offering company recreational or social activities, such as holiday parties or annual picnics.

To qualify, the holiday party should be primarily for the benefit of employees other than officers, shareholders or other owners who own a 10% or greater interest of the business.

Jenny can also give cash gifts to employees, but she and her employees should be aware that they are considered taxable income. She could include a gift to each employee that is typically worth no more than $25, which they don't have to report as income.

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

YEAR-END TAX-SAVING OPPORTUNITIES

As the year draws to a close, it's time to maximize your current year's tax deductions and other tax planning opportunities. Here's a brief checklist of moves you can make to help reduce current or future tax exposure.

BUSINESS EXPENSES

You may be able to reduce your 2024 tax bill by pre-paying certain business expenses before the year's end. For example, you can renew subscriptions, pay ahead for advertising, business insurance premiums, rent, business licenses, and other items that don't extend more than 12 months.

EQUIPMENT

Repair broken equipment and physical plant items by the end of the year. Buy business equipment and put it into service by year's end. Your business can deduct the entire cost of qualified equipment up to a purchase limit of $1,220,000 for tax year 2024.

MAXIMIZE QBI DEDUCTIONS

If you meet certain income limits, owners of S corporations, partnerships, and sole proprietorships may deduct up to 20% of qualified business income (QBI).

For tax year 2024, eligibility for the deduction begins to phase out at income levels of $191,950 for single filers and $383,900 for joint filers.

If you're over the income threshold, consider finding some more deductions.

DON'T BE YOUR OWN WORST INVESTING ENEMY

Many investors aim to have their gains match or beat a standard investment benchmark. According to Dalbar's annual Quantitative Analysis of Investor Behavior, 2024, the average investor falls short, earning 5.5% less than their targeted stock benchmark and 2.63% less than their chosen fixed income benchmark.

BEHIND THE STATISTICS

Often, investors weigh emotional behavior and personal recommendations too heavily against the knowledge and experience of investment professionals. Look at the checklist to see if this could be you.

- ❑ When deciding whether to sell a stock, you may be emotionally fixed on the price you paid for it and avoid selling so you won't regret having made a "bad" investment, resulting in a reportable loss.
- ❑ Are you hesitant to sell an investment that's had significant gains but its performance has fallen off? Remember, the past performance of any investment doesn't guarantee future results.
- ❑ Beware that paper losses are stressful and can trigger you to sell prematurely.
- ❑ Being too quick to jump on the latest trend or family or friends' recommendations without thorough research and talking with your financial professional first can be detrimental to achieving your goals.

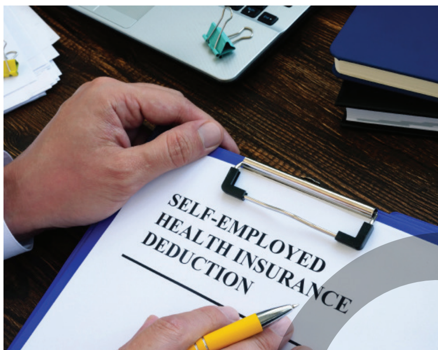
HEALTH INSURANCE DEDUCTION FOR SELF-EMPLOYED

There are many reasons why being self-employed isn't for everyone, not the least of which is that you're responsible for buying your own health insurance. However, most likely you can deduct health insurance premiums paid from your taxable income on your 2024 tax return.

NO COVERAGE ELSEWHERE

You need to meet two major requirements to qualify for this tax break.

First, you and your spouse cannot be eligible for an employer-sponsored health insurance benefit.



Second, you must have enough business income to qualify. You can take a partial deduction if you don't have enough. For example, you can only deduct $10,000 from a $15,000 health insurance policy if your income is $10,000. If your income is greater than the cost of insurance, deduct the entire premium.

ITEMIZE OR NOT

You don't have to itemize this on your tax return, meaning you may also want to take the standard deduction if you only have a few other deductions.

The health insurance deduction, unlike many others, is considered "above the line," meaning it is deducted from your gross income and lowers your eventual adjusted gross income.

The latter category often determines your availability for other tax breaks, including deductible IRAs.

Q

I received a CP-501 notice from the IRS claiming I have a balance due, but I disagree. What should I do?

A

Since the CP-501 notice is the first notice you will receive about a past due amount, you'll want to call the IRS immediately using the phone number provided.

But before you call, do your research and have all the information available to explain why you believe there is a mistake.

Although talking with the IRS may seem scary, don't ignore the notice. Interest and penalties may continue to be charged, and they have the right to place a lien on your property.

TRACK YOUR DOLLARS

Do you keep track of all the money you spend each month? Tracking your expenses will help you take control of your financial life.

SPENDING TRAPS

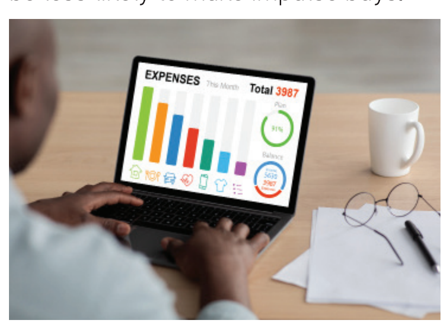
By tracking your monthly expenses, you can identify negative spending habits that you can change to make your money work better for you. You might find you're paying for services you don't use, like a streaming service or app you forgot to cancel before the free trial period expired.

FOCUS ON GOALS

If you're planning to buy a house someday or looking to increase your retirement savings, tracking your expenses will help you reach those goals. You'll be able to see if your expenses can be lowered or if your spending remains in line with your priorities.

ADDITIONAL BENEFITS

When you start tracking your expenses, you may worry less about money. Since you'll know where every dollar is going, you won't be anxious wondering if you'll have enough money at the end of the month. You'll feel more confident, and because you're keeping track of your spending, you'll be less likely to make impulse buys.



YEAR-END TAX PLANNING

Ideally, you have strived to minimize your taxes all year. Good news! Here are some year-end strategies that may help cut your tax bill even more. Before implementing these or any year-end strategies, talk with your tax advisor.

DEFER OR ACCELERATE INCOME

Project whether you'll have higher taxable income in 2024 or 2025. If it's 2025, consider receiving any potential bonus, investment and other supplemental income this year.

Do the opposite if, for example, you'll have fewer dependents to deduct next year, have a spouse taking leave, suffer business losses, etc., resulting in having less taxable income in 2025.

BUNCH DEDUCTIONS

For instance, if medical expenses for 2024 year exceed the deductible minimum threshold of 7.5% of adjusted gross income (AGI), squeeze in medical expenses planned for 2025 to maximize tax 2024 savings.

Before bunching any expenses into 2024, consider your overall tax bracket for this tax year and 2025. If you anticipate income increasing enough in 2025 to put you in a higher bracket, it may make sense to postpone a deduction.

TOP OFF YOUR CONTRIBUTIONS

You have until the April 15, 2025, tax filing deadline to make Health Savings Account (HSA) contributions for this year. If you have not already maximized your contribution, do so. Contributions and earnings are generally excluded from taxable income.