TaxUpdate

2024 TAX TIPS NEWSLETTER

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Five Big Tax Mistakes

Every year taxpayers are hit with tax surprises that could be avoided if they just knew the rules. Here are five big ones that are easy to avoid with some planning.

1 Mistake #1: Withholding too little

This results in a tax surprise when filing your income tax return. Don't be too hard on yourself if this happens. The key is to prepare and, at minimum, avoid the under withholding penalty.

The plan: *Check your withholdings after filing each year's tax return. Make adjustments as necessary by filing a new Form W-4 with your employer.*

2 Mistake #2: Inadvertently withdrawing funds from retirement plans

Amounts taken out of pre-tax retirement plans like 401(k)s and IRAs can create taxable income. The most common inadvertent withdrawal occurs when you roll over funds from one retirement plan to another. If done incorrectly, the entire rollover could be deemed taxable income.

The plan: *Do not touch your retirement accounts if at all possible. If you do withdraw funds, ensure you have the proper withholdings taken out at the time of withdrawal.*

3 Mistake #3: Not taking advantage of tax-deferred retirement programs

There are numerous opportunities to shelter income from tax through tax-deferred retirement programs.

The plan: *Review your retirement savings options and plan to contribute as much as possible to your plans. Pay special attention to plans that include an employee match component.*

4 Mistake #4: Direct deposit mix-ups

Tax refunds directly deposited in up to three bank accounts create a problem if one of the account numbers is entered incorrectly. Unfortunately, unlike replacing a lost check, the IRS does not have a good means of correcting this type of error.

The plan: *If you use direct deposit, avoid depositing your refund into more than one account. Ideally, have a second person double check the account number on your tax form prior to submitting the return.*

5 Mistake #5: Not keeping correct documentation

You know you drove the miles, donated the items to charity, had the medical expense, and paid the daycare. How can the IRS be disallowing your valid deductions? Remember that without correct documentation the IRS is quick to disallow them.

The plan: *Set up good record keeping habits at the beginning of each year. Create both a digital and paper folder sorted by income and expense type. Keep a contemporaneous mileage log and properly document your charitable contributions.*

Adult Student Tax Breaks: They're Out There!

Many adults are taking courses to pursue a new career or improve their current job skills. Fortunately, adult students may qualify for several great tax breaks. Here are four possible options:

American Opportunity Tax Credit (AOTC). This credit does not rule out your eligibility because of age. The maximum credit of $2,500 is phased out based on income. To qualify, you must be enrolled at least half-time and not have finished four years of higher education.

Lifetime Learning Credit. If you can't claim the AOTC, you may be able to use the Lifetime Learning Credit. The maximum Lifetime Learning Credit is $2,000. But you don't have to be enrolled half-time and the credit isn't restricted to four years of study. It's even available if you take just one class.

Student loan interest deduction. If you qualify, you can deduct up to $2,500 of your annual student loan interest on your tax return. Keep in mind that to claim this deduction, you need to be the one who is repaying the loan.

Educational assistance plans. Perhaps the best way to go back to school is to have your employer pay for it. With a written educational assistance plan that meets all the tax law requirements, the first $5,250 of education expenses paid by your employer is tax-free to employees and deductible by the employer. The coursework doesn't even have to be job-related.

Turning Your Hobby Into a Business

You've loved dogs all your life, so you decide to start a dog training business. Turning your hobby into a business can provide tax benefits if you do it right. But it can create a big tax headache if you do it wrong.

One of the main benefits of turning your hobby into a business is that you can deduct all your qualified business expenses, even if it results in a loss. However, if you don't properly transition your hobby into a business in the eyes of the IRS, you could be in line for an audit. The agency uses several criteria to distinguish whether an activity is a hobby or a business. Check the chart here to see how your activity measures up.

The business-versus-hobby test

If your dog training business (or any other activity) falls under any of the hobby categories on the right side of the chart, consider what you can do to meet the business-like criteria on the left side. The more your activity resembles the left side, the less likely you are to be challenged by the IRS.

BUSINESS	versus	HOBBY
You have a reasonable expectation of making a profit.	**Profit Motive**	You may sell occasionally, but making money is not your main goal.
You invest significant personal time and effort. You depend on the resulting income.	**Effort and Income**	It's something you do in your free time; you make the bulk of your money elsewhere.
Your expenses are ordinary and necessary to run your business.	**Reasonable Expenses**	Your expenses are driven by your personal preferences and not strictly necessary.
You have a track record in this industry, and/or a history of making profits.	**Background**	You don't have professional training in the field and have rarely or never turned a profit.
You have multiple customers or professional clients.	**Customers**	Your customers are mainly relatives and friends.
You keep professional records, including a separate checkbook and balance sheet; you have business cards, stationery and a branded business website.	**Professionalism**	You don't keep strict professional records of your activities; you don't have a formal business website or business cards.

Understanding Wash Sales Rules

You may be considering booking stock losses due to recent market drops. Selling losers can be a great strategy when the losses can offset other gains and up to $3,000 of your ordinary income. However, there is a little-known rule called the wash sale rule that could surprise the unwary taxpayer.

Wash sales explained

If the wash sale rule applies to your transaction, you cannot immediately report a loss you take when selling a security. Per the IRS, *A wash sale occurs when you sell or trade stock or securities at a loss and within 30 days before or after the sale you:*

- *Buy substantially identical stock or securities,*
- *acquire substantially identical stock or securities in a fully taxable trade,*
- *acquire a contract or option to buy substantially identical stock or securities,*
- *acquire substantially identical stock for your individual retirement account (IRA) or Roth IRA.*

Why the rule?

Many investors were selling stock they liked simply to book the loss for tax reasons. They then turned around and immediately re-purchased shares of the same company or mutual fund. If done repeatedly, shareholders could constantly be booking short-term losses on a desired company while still owning the shares in a chosen company's stock indefinitely. Clever shareholders would even purchase the replacement shares prior to selling other shares in the same company to book the loss.

Some ideas

How does one take action to ensure the wash sales rule works to your advantage?

- **Check dates.** If you decide to sell a stock to book a loss this year, make sure you haven't inadvertently acquired the same company's shares 30 days prior to or after the sale date.
- **Dividend investment.** If you automatically re-invest dividends, you will want to make sure this doesn't inadvertently trigger the wash sale rule.

This publication provides summary information regarding the subject matter at time of printing. Please call with any questions on how this information may impact your situation.

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