GROCO
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CERTIFIED PUBLIC ACCOUNTANTS

To Our Clients and Friends: January 2024

The year 2023 had no significant tax law changes. The worst of COVID seems to be behind us. The majority in the federal House of Representatives is only the majority by a few seats, and therefore no party has the legislative power to pass their agenda. Rather, both parties are constantly “kicking the can down the road” to keep the federal government from shutting down with “continuing resolutions,” without resolving major financial and social issues…all, sadly, in the shadow of several kinetic wars overseas. Sectors of the stock market did exceptionally well, while others stayed even. A banking crisis arose, but seems to be under control, perhaps…while the inflation rate and interest rates fluctuate.

The total federal budget for the year ending October, 2024 is estimated to have receipts of about $5.0 Trillion and outlays of $6.9T with a deficit of spending over incoming tax revenues of over $1.8T or greater. Such astonishing deficits are called “unsustainable” by the non-partisan U.S. Government Accountability Office (“GAO”).
What this means for our future daily reality is wildly in dispute.

Also, the I.R.S. is in the process of hiring 87,000 additional personnel (both administrative and telephone “assisters” as well as auditors) spread over 10 years. However, much of the first-year funding for the IRS was diverted to war funding, and the Commissioner of the Internal Revenue Service has commented that the overall manpower of the IRS into the future will be “stable,” far from the large increase previously promised. We have seen the IRS greatly improve various areas of processing. The impact on taxpayers will reveal itself as time passes and we plan to keep you informed. We hope you and your families are well.

In this letter, we provide some insight into the tax laws and procedures as they currently stand based on legislation enacted as of December 31, 2023, impacting 2023 tax returns and tax planning for 2024.

We deeply appreciate our relationship with you and continue to hope for peace and prosperity.

Individuals:

- **The federal individual tax rates remain unchanged** from 2023 (as applied to increasing levels of income) at **10, 12, 22, 24, 32, 35** and **37** percent. The tax brackets these rates apply to differ significantly based on your filing status (Single, Married Filing Jointly, Married Filing Separately, Head of Household.) The tax brackets (versus the rates) change each year to adjust for inflation. For example, for the 2024 tax year the top 37% tax bracket for a Joint filer now starts at $731,200 of taxable income, which is an inflation increase of $37,449 from $693,751 for the 2023 tax year. In other words, the top tax bracket starts at about 5.4% higher than in the prior year.

- **The federal Standard Deduction** amount increases for inflation each year. The Married Filing Jointly Standard Deduction is $29,200 for 2024 and $27,700 for the 2023 tax year; high enough for many taxpayers to avoid

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listing Itemized Deductions when the Standard Deduction (allowed for free) is higher. However, California has not conformed to various federal laws for itemized deductions, so taxpayers must still give us detailed information of their itemized deductions so we can attempt to claim them, subject to unique California limitations.

- There was no change to the federal tax treatment of **qualified dividends and long-term capital gains** taxed at 15% or 20% (based on your income level). The taxable income level at which the 15% rate increases to 20% is $583,750 for 2024 and $553,850 for 2023, for Married Filing Jointly taxpayers. Also, the Net Investment Income Tax ("NIIT") on such income with exceptions, of 3.8% used to fund the Affordable Care Act (health insurance), imposed on high-income taxpayers, continues. **Note** that an exemption exists reducing the tax rate on capital gains and qualified dividends to zero in many cases with lower income, so rather than estimating, taxpayers should call us or use software to compute the complex allowable exemption amounts.

- The special treatment for venture capital **"Carried Interests"** continues to require a three-year holding period. There are annual proposals to change this perceived tax benefit, however they were not enacted.

- The 2017 tax act repealed the federal **"individual mandate"** for health insurance. As a result, there is no longer a federal tax penalty assessed for failure to have health insurance. **However, California imposes a new penalty of up to $900 per adult and $450 per dependent under 18 years old, for a lack of health insurance, unless an exemption applies. A family of four that goes uninsured for the whole year would face a penalty of at least $2,700.**
  https://www.coveredca.com/learning-center/tax-penalty-details-and-exemptions/penalty/

- **<u>The federal deduction for State and Local income, sales taxes and property taxes, combined; continues to be limited to $10,000.</u>** The Build Back Better Act proposed to raise the allowed amount to $80,000, however the BBB Act has not become law. As you may have experienced on your tax returns, this may be a very significant limitation, compared to allowable deductions prior to 2018. This results, for many, in higher overall federal income tax liabilities for taxpayers in high-tax states like California and New York.

- **<u>State and Local Tax (aka: SALT) Limitation Workaround with mind-numbing complexity</u>**: Many states are now allowing pass-through entities (partnerships and S Corporations) the option of calculating and paying state tax at the entity level to allow the entity owners to deduct state taxes via a federal deduction within the pass-through entity…this is unprecedented tax policy logic. This can be a workaround of the $10,000 State and Local Tax (SALT) limitation for itemized deductions. Here is the procedure for California:
  https://www.ftb.ca.gov/file/business/credits/pass-through-entity-elective-tax/index.html

  The calculations are based on a good estimate of the entity's final accounting books for the year, and the proper timing of payments is critical to getting a benefit. A California limitation related to "tentative minimum tax" was later repealed. **Different states have substantially different approaches.** In the right circumstances, the additional state tax deduction can be significant. The above would be the start of a 30-minute discussion to sort this out. We have been calling clients about these laws in cases where they may apply. Please call us if you have any questions.

- **<u>Exemptions and Child Tax Credits</u>:** As a reminder, the Personal Exemption deduction of $4,050 per person, was repealed for 2018 and going forward. In contrast to an exemption, the federal tax system now provides for significant additional child tax credits.

  The maximum child tax credit is $2,000 per qualifying child and is not adjusted for inflation. The refundable portion of the child tax credit is adjusted for inflation and will increase from $1,600 to $1,700 for 2024.

  Congressional efforts to partially and retroactively restore an enhancement to the child tax credit (to higher levels from 2021) did **not** succeed. Politically, we clearly expect the enhancements to be reintroduced in the future.

- **<u>Mortgage Interest Deductions</u>** continue to be limited to interest on acquisition indebtedness up to $750,000 (compared to; effectively $1.1m prior to 2018). Qualifying mortgage debt incurred before December 16, 2017, is "grandfathered" and remains deductible at higher levels. There are other requirements for second homes, and Home Equity Loans. For example, interest on Home Equity Loans is only deductible related to funds used for capital improvements in the home, subject to the $750,000 overall limit**. Potential Homebuyers and borrowers should seriously evaluate the impact of these limitations, along with the limits on deducting property taxes.** For those who have it, Private Mortgage Insurance is deductible.

- **<u>Alimony</u>** is not income to the recipient, nor deductible to the payer for divorce and separation agreements entered into after December 31, 2018. The tax treatment of prior agreements is grandfathered.

- **<u>Cryptocurrencies:</u>** As virtual currencies become more common, the IRS is continuing to try and find ways to tax users and holders of Bitcoin and other cryptocurrencies who are not self-reporting income. The IRS released a ruling back in 2014 that classified virtual currency as "property" rather than actual currency. This has a substantial impact on the tax treatment for taxpayers. When a taxpayer engages in a transaction using cryptocurrency or sells cryptocurrency, gain (or loss) is recognized **based on the sales price and the original cost basis**. For example, if a taxpayer purchases something as simple as a cup of coffee using cryptocurrency, it is treated as a sale of the virtual currency and will be subject to capital gain or loss reporting rules, transaction-by-transaction, comparing the original cost of the cryptocurrency to its value exchanged for the cup of espresso!

  The **Infrastructure Investment and Jobs Act** ("IIJA") (enacted in November 2021) added two cryptocurrency provisions, effective after January 1, 2023:

  1. The IIJA will now require brokers to report to the IRS the cost basis and other information regarding digital assets transferred by their clients to non-brokers, similar to how securities brokers report stock and bond trades.

  "The following information is now required to be reported to the IRS and to customers: (1) name, address, and phone number of each customer; (2) the gross proceeds from any sale of digital assets; and (3) capital gains or losses and whether such capital gains or losses were short-term (held for one year or less) or long-term (held for more than one year)."

In addition, the IIJA will modify existing tax law for reporting on IRS Form 8300. This means, individuals engaged in a trade or business will need to submit IRS Form 8300, ***Report of Cash Payments Over $10,000 Received in a Trade or Business***, when they receive over $10,000 in a single transaction or multiple related transactions. Not reporting transactions as required on Form 8300 is a serious tax crime. https://www.irs.gov/pub/irs-pdf/f8300.pdf

We expect further guidance from the IRS before the effective date in 2023, but some businesses may find accepting cryptocurrencies for payment won't be worth the reporting burden. See:https://www.voltequity.com/post/new-crypto-tax-reporting-requirements-in-the-2021-infrastructure-bill for a good summary of these new rules and be sure to look for any IRS updates.

- **Required Minimum Distributions & Retirement Plan Contributions:** Recent year legislation increased the age after which required minimum distributions from certain retirement accounts must begin, to 72 (from 70½) for taxpayers turning 70 ½ after December 31, 2019. RMDs for the 2020 year, only, were not mandatory as a result of COVID legislation, but WERE once again mandatory for the 2021 tax year and thereafter.

  However, on Friday, December 23, 2022, just before all the members of Congress went home, Congress passed the Secure 2.0 Act. Its significant provisions are:

  - Increases the age for **mandatory RMDs from age 72 to age 73 starting in 2023, and to age 75 starting in 2033.**
  - Increases the 401(k) and 403(b) plan catch-up contribution limits; **$7,500 for 2023 and $10,000 in 2025.**
  - Requires all catch-up contributions to qualified retirement plans by employees with compensation in excess of $145,000 (indexed) be subject to **mandatory** Roth tax treatment (after-tax), effective for post-2023 taxable years.
  - Increases the annual contribution for employee deferral and catch-up contributions to SIMPLE plans by 10% (employers with more than 25 employees would also have to increase their matching contributions) and allows employers to make additional nonelective contributions to SIMPLE plans, effective beginning with the 2024 taxable year.
  - **Allows for the creation of Roth SIMPLE IRAs and Roth SEP IRAs beginning with the 2023 taxable year.**
  - Removes the RMD requirement for employer-sponsored Roth accounts, such as Roth 401(k)s;
  - **Allows sole proprietors (and SMLLCs) who set up solo 401(k) plans after the end of the taxable year to make both deferral and matching contributions by the due date of the owner's income tax return.**
  - Replaces the IRC §25B Qualified Retirement Savings Contribution Credit with a federal government matching fund program for low and middle-income individuals that contribute to a qualified retirement program, effective beginning with the 2027 taxable year;
  - Makes it easier for an individual to purchase a qualifying longevity annuity contract (QLAC) with retirement savings by easing current limitations.
  - **Allows penalty-free rollovers from IRC §529 accounts that have been open for more than 15 years to Roth IRAs (subject to annual Roth contribution limits and a $35,000 lifetime cap), effective for distributions made after 2023.**
  - **Expands the list of exceptions from the 10% early withdrawal penalty for various types of retirement distributions.**
  - Expands the income exclusion for health insurance premiums of retired public safety officers.

For employers, the SECURE 2.0 Act also:

- **Mandates automatic enrollment** for new 401(k) and 403(b) plans offered by employers (with the option for employees to opt out) for plan years beginning after 2023.
- Expands the mandated 401(k) coverage for long-term, part-time workers enacted by the SECURE Act by shortening the three years of service eligibility rule to **two years**, effective for plan years beginning after 2024 and extends the mandate to 403(b) plans.
- Allows employers to replace SIMPLE retirement accounts with safe harbor 401(k) plans that require mandatory employer contributions, effective for post-2023 plan years.

Retirement plans are highly complex and subject to various reporting requirements. Please call us or your retirement plan advisor if you have questions.

A recent year law change requires beneficiaries of IRAs and qualified plans to withdraw all money from inherited accounts within 10 years for IRAs inherited in 2020 or later. This significantly differs from the prior rule in which distributions had to be taken as RMDs over the life expectancy (usually much longer than 10 years) of the beneficiary.

For the 2020 tax year and thereafter, a taxpayer with earned income, can now contribute to an IRA **after** age 70 ½, which was not allowed under prior law.

Note: The due date for making your 2023 tax year Individual Retirement Account contributions is April 18, 2024. Extending your individual income tax returns for 2022 does **NOT** extend the due date for making your IRA contributions! Late contributions are considered an IRA contribution for the 2024 tax year.

For tax years 2023 and 2024, the IRS published the following limits on IRAs:

2023

a) **Standard Contribution Limit:** $6,500 per taxpayer 49 and younger
b) **With the Catch-Up Contribution Limit:** $7,500 per taxpayer 50 and older

2024

a) **Standard Contribution Limit:** $7,000 per taxpayer 49 and younger
b) **With the Catch-Up Contribution Limit:** $8,000 per taxpayer 50 and older

Warning: IRA contribution limits (including Roth IRAs) are complex and take into account your Adjusted Gross Income and whether you are covered by a retirement plan at work. Here's a good article. Your IRA account administrator should review the limitations with you when making a contribution. Significant penalties (and mandatory withdrawals) can apply for over-contributions.
https://smartasset.com/retirement/ira-contribution-deadline

Taxpayers should also consider maximizing contributions to 401(k), 403(b), Simple IRA, 457 and Thrift Savings Account plans. Please check the limitations for the standard and Catch-Up contributions allowed with your plan administrator. Simplified Pension Plans (SEPs), Defined Benefit and Defined Contribution plans have different and very complex rules. Check with us or your Plan Administrator.

- **<u>Qualified Opportunity Zone investments:</u>** For those who have a capital gain, the reinvestment of part or all the proceeds of the prior sale into a Qualified Opportunity Fund (QOF) can result in a significant deferral or avoidance of federal tax. This tax planning is very complex with specific timing required to make a qualified investment. The Internet is full of QOF providers. Your financial advisor may have qualifying packaged investments available. QOFs do not defer or reduce California taxes, even if the QOF property investment is in California. This type of investment requires significant due diligence to understand, and a timely paperwork process to execute, far beyond what we can review here.

- **<u>Backdoor Roth IRA:</u>**
  The advantage of a Roth IRA is that future distributions are completely tax free if various requirements are met. However, high-income earners can't directly contribute after-tax money to a Roth IRA. Individuals can fund a Traditional IRA with nondeductible contributions, and then **convert** the account into a Roth IRA. This maneuver -- commonly called the ***Backdoor Roth IRA*** -- allows high-income earners to get the same Roth IRA benefits as taxpayers below the income limits, based on your filing status. There are issues if you have other IRAs, because the converted amount can be, in part, allocated to previous un-taxed amounts, triggering tax. In the case where prior traditional or Simplified Employee Pension Plan (SEP) or SIMPLE IRAs exist, a full computation must be done before deciding to execute a conversion on newly contributed funds.

- **<u>Big Taxable Conversions of Traditional IRAs:</u>** Various financial advisors are recommending converting Traditional IRA accounts (including rollovers from 401(k)s) into Roth accounts or to recognize the built-in tax liability on deferred income in those accounts and invest the remaining after-tax amounts into various types of insurance products. Such insurance products often provide protection against losses in various investments (via internal hedging operations). This move generally triggers tax immediately to achieve (hopefully) long-term tax savings and investment loss protection. One must be sure to do a "break-even" calculation (taking into account life expectancy and estimated market returns) before ever following advice to trigger tax upfront. There are many circumstances where this can be a tax-saving move, and others where it definitely will not be due to account fees charged by the transaction's promoters. GROCO is not a licensed financial advisor.

  Conversion is not an all-or-nothing proposition, as you can convert all or a portion of your eligible retirement accounts. Note that a Roth IRA conversion will trigger ordinary income in the year of conversion and potentially the Medicare surtax (3.8%) on other net investment income, as the conversion counts toward the calculation of Modified Adjusted Gross Income and may bump you into a higher tax bracket. Taxpayers often look to execute conversions in years they have lower income and are in a lower tax bracket. NOTE: The conversion must be executed before, not after, the tax year-end. There are no *retroactive* conversions.

- **<u>Health Savings Accounts ("HSAs") to Accumulate Tax Deferred Income:</u>** Many taxpayers fund an HSA to pay for health costs, thereby pre-funding medical expenses and making them tax deductible when funded (even when otherwise limited as an itemized medical deduction.) We'd like to point out some taxpayers have left unused annual funds in an HSA to accumulate in large amounts, (we've heard of a case of several $100,000s) to be used for medical expenses in future elderly years. Some plans allow mutual fund choices for the long-term investment of these funds. Consult with your HSA Administrator if you have any questions on this approach.

- **Qualified Charitable Distributions (QCDs):** QCDs are a unique tax strategy that allow individuals who are at least age 70½ and have Traditional and/or Inherited IRAs to distribute up to $100,000 indexed for inflation, per year directly from their IRA to a 501(c)(3) nonprofit with no federal income tax consequences. As part of your QCD, you may distribute a one-time $50,000, indexed for inflation, QCD paid directly from your IRA to certain split-interest entities that qualify under the new rule. Making a QCD will reduce the value of your IRA, thereby potentially reducing your RMDs. If you file a joint return, the $100,000 limit applies to each spouse. Deductible Traditional IRA contributions made beginning at age 70½ may reduce your QCD amount.

- **Donor Advised Fund:** A Donor Advised Fund ("DAF") is a charitable giving vehicle which may assist with "bunching" of charitable contributions into a given year. This can be useful when you are able to make a donation but have yet to determine the timing of the distributions out of the donor-advised fund or what charities will receive the gift. Most stock brokerage firms and other financial advisors can help you set up a DAF.

Business Income and Deductions

- **"C" Corporations have a flat tax rate of 21%** after 2017, and the corporate Alternative Minimum Tax has been repealed. This was a substantial decrease from the 35% top rate in 2017. President Joe Biden and congressional policymakers have proposed several changes to the corporate income tax, including raising the rate from 21 percent to 28 percent and imposing a 15 percent minimum tax on the accounting income of large corporations. The flat tax rate was not increased for 2022 and thereafter, however, the Inflation Reduction Act imposed a new, complex corporate alternative minimum tax for corporations with accounting (GAAP) income over $1 billion.

- **Sec. 199A Qualified Business Income Deduction:** To give S corporations, partnerships, sole proprietorships, and other entities a tax reduction, similar to the "C" corp. tax rate reduction to 21%; the 2017 tax act created a new business deduction, which may allow up to 20% of "qualified business income" to be deducted. Qualified business income is, in general, ordinary business income and does not include W-2 wages or guaranteed payments. This is calculated on an individual's personal income tax return, including utilizing extensive (and complex) flow-through data from entities owned. How much of a deduction can be taken depends in part on an individual's overall level of taxable income and the type of businesses involved. Significant regulations were released during the 2019 year that may impact how you can benefit from the Sec. 199A deduction.

- **Bonus Depreciation** rules allow a 100% deduction for property placed in service. There are various restrictions, including how Bonus Depreciation does not apply to property used outside the U.S. The deduction phases out over the following four years, dropping to 80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026.

  After 2026, the deduction will no longer be available and other normal tax depreciation rules will apply.

- **The Passenger Vehicle Depreciation limit** is $20,200 in the first year, and $19,500 for the second year when the vehicle was purchased in 2023.

- **The Sec. 179 Depreciation limit** is $1,160,000 (2023), $1,220,000 (2024), with a secondary overall investment limitation of $2.890 million (2023) and $3.050 million (2024). The Sport Utility Vehicle limit (vehicles between

6,001 to 14,000 pounds of Gross Vehicle Weight Rating (GVWR) for 2024 is $30,500. Alternatively, "Bonus" depreciation is also available in most cases and should be evaluated.

- **Research and development credits** continue, but the tax deduction for R&D expenses **must be amortized** over five years beginning with the 2023 tax year.

- **Interest deductions** are limited to 50% (increased from 30% by the CARES Act in 2020 and thereafter) of "adjusted taxable income" for large entities.

- **Net Operating Losses ("NOLs")** were severely restricted in the 2017 tax act. All that changed because of COVID, and the CARES Act in March of 2020. Under the prior rules, businesses couldn't carry back NOLs. Under the CARES Act, an NOL from a tax year beginning in 2018, 2019 or 2020 can be carried back five years to obtain a refund on taxes paid on income in those old tax years. Various filing deadline rules apply restricting those who have not already filed for these refunds, long ago.

  Please note that NOL carry forward losses in many circumstances are limited to 80% of the current year taxable income, leaving a remaining amount of taxable income potentially triggering current year tax due, and subject to estimated tax payment requirements.

  This is an important and complex area that can result in sizable refunds due to losses incurred. Please contact us if you have any questions.

- **Education planning, Sec. 529 plans**:

  a) Earnings, if any, accumulate tax-deferred; qualified withdrawals (such as tuition, fees, supplies, books, and required equipment) may be free of federal and state income taxes. See IRS publication 970 for more details.
  b) There are no federal income, state-residency, or age restrictions.
  c) Potential state-tax incentives are available in some states.

  Plans may be funded up to the annual exclusion amount, $17,000 (single) or $34,000 (married) per year per donation recipient. Donors can also elect to make five years' worth of annual exclusion amounts in a single year's contribution, up to $85,000 (single) and $170,000 (married). For example, a couple with twins could fund $170,000 for each child after birth and let those funds potentially grow tax-free until needed. Contributions in excess of annual exclusions should be filed on a gift tax return (Form 709) to report use of the donor's available lifetime exclusion or the election to superfund five years' worth of annual contributions. Most plans allow for contributions by people other than the original donors, such as aunts/uncles, grandparents, friends, etc. You should consult with us, your tax advisor, about filing a gift tax return to make this election.

  Elementary and secondary school tuition expenses of up to $10,000 per year are qualified education expenses for federal tax purposes. This flexibility may allow earlier access for private tuition prior to college. However, not all states conform to this definition of qualified expenses, so check with us, your tax advisor, and confirm your state rules before taking a distribution for this purpose.

- **International Business Structures:** Very often income earned offshore is immediately taxed in the U.S. unless certain complex exceptions apply. It does not matter whether the cash income earned has been distributed to the U.S. person/shareholder as a dividend, in many cases. This is a major change for multi-national entities after 2017.

  Any (and we mean ANY) taxpayer with an ownership interest in a non-U.S. business, directly, or via ownership indirectly through another entity, or in some cases, through relatives; should be greatly concerned and needs to understand these **multifaceted reporting provisions, even if an entity has no offshore income or has current year and accumulated losses.**

  After 2017, reversing a law that was in place since John Kennedy was president, a taxpayer can be deemed to own a non-U.S. entity through a domestic entity, even when that domestic entity owns no shares or interest in the foreign entity, and therefore, a taxpayer's entire world-wide ownership structure must be carefully reviewed under post-2017 rules. Consequently, **all legal entities owned in any percentage, where the entity legally exist under the laws of any U.S. state, territory, or other country during the year, must be considered, and that includes entities you may consider "inactive." Please be very careful and consult with us before becoming involved in any non-U.S. legal entity. The penalties for non-reporting of foreign ownership and bank accounts, even if no profits are earned and no tax is due, can be enormous.**

  Further, intentional or even unintentional non-reporting of foreign investments is considered a criminal violation.

- **(New) Corporate Transparency Act**: There is a new rule for entities doing business within the United States which becomes effective on January 1, 2024, which will require persons/entities to file a Beneficial Ownership Information ("BOI") report. A BOI under "FinCEN" (the Department of the Treasury *Financial Crimes Enforcement Network*) will be defined as any individual (1) who directly or indirectly exercises "substantial control" over the reporting company, or (2) who directly or indirectly owns or controls 25 percent or more of the "ownership interests" of the reporting company. If a party meets the aforementioned definition a BOI report will need to be filed. The reports must be filed electronically. **The penalties for failing to file or filing inaccurately are large.**

  Reporting companies created or registered to do business before January 1, 2024, will have until January 1, 2025 to file its initial BOI report. A reporting company created or registered on or after January 1, 2024, will have only 90 days to file its initial BOI report. This 90-day deadline runs from the time the company receives actual notice that its creation or registration is effective, or after a secretary of state or similar office first provides public notice of its creation or registration, whichever is earlier.

  Assisting you with your compliance with the new Corporate Transparency Act ("CTA"), including beneficial ownership information ("BOI") reporting for legal entities "doing business" within the United States, is not within the scope of our engagement. You have sole responsibility for your compliance with the CTA, including its BOI reporting requirements and the collection of relevant ownership information, if they are required. We shall have no liability resulting from a failure to comply with the CTA. Extensive information regarding the BOI reporting requirements can be found at https://www.fincen.gov/boi. While we can answer casual questions, consider consulting with legal counsel if you have questions regarding the applicability of the CTA's reporting requirements and issues surrounding the collection of relevant ownership information. Please leave yourself plenty of time to do the filing and familiarize yourself with the FinCEN's website.

- **Multi-State Tax Issues:** The United States Supreme Court ruled in **South Dakota v. Wayfair**, (June 2018) that remote sellers can be subject to state sales tax (with all the collection and filing issues), even if the only connection to a state is the customers' location. This has a profound impact on out-of-state sellers, including internet businesses. The ruling overturned a 26-year old precedent exempting remote sellers from taxation when they had little activity or presence in a state (such as no employees, stores or offices.) This case is also considered to confirm the reach of states to impose income tax on remote sellers.

  If you sell to customers in more than one state, please discuss this issue with us and consider your multi-state sales tax and income tax obligations, including potentially numerous obligations to cities and counties.

  Various states, (Connecticut, Louisiana, Oklahoma and Rhode Island) are imposing a tax on income of previously untaxed partnerships and some S Corporation entities, in addition to taxing the income flowing to their owners. California has long had an entity level tax on S Corporations of 1.5% of taxable net income.

- **COVID-19 Related Payroll Tax Credits:** There are several payroll tax deferrals and credits that may be available to a business as a result of COVID-19 legislation. One such credit, The Employee Retention
  Credit, can be a very large $ amount per employee. **PLEASE** contact your payroll tax service provider for information on the various and complex credits and deferrals available. The payroll tax companies have entire teams dedicated to evaluating, computing and filing for these benefits. In a law change, the Employee Retention Credit is now available for individuals and entities that received Payroll Protection Plan (PPP) Loans.

- **COVID-19 Forgivable Loans and other loans available:** Repeating from last year, your bank, the Small Business Administration, the U.S. Federal Reserve Bank, as well as states and cities have various grants, repayable loans and forgivable loans available. The task of getting your bank's help, is often hard. The paperwork involved is difficult. Banks are sometimes slow to process the loans, and the U.S. Congress was slow to fund the forgiveness as promised. This issue is far beyond what we can cover in this letter. Here is the **GROCO COVID-19 Resource Center**: https://groco.com/company/covid-19-resource-center/

  Many Congress members' offices have a complete list of all the available benefits in your area**. Congress clarified (reversing prior U.S. Treasury Department negative guidance) that expenses paid with funds obtained from a loan that is/or will be forgiven, are tax deductible, resulting in a double tax benefit: the loan forgiven is not taxable income, and the expenses paid with such funds are tax deductible.** In tax history, that is truly unique.

  Also note, that as it is now 2024, many of the COVID programs have expired.

- **California Conformity & Other:** The State of California (via its tax authority, the Franchise Tax Board), has NOT conformed to many Federal law changes under the 2017 tax act. Therefore, we continue to have to analyze and report income and expenses differently under Federal and California tax rules.

  California has NOT fully conformed to the federal new rule to allow the deduction of expenses that are paid with funds from forgiven PPP loans. A significant limitation may apply greatly increasing a company's California taxable income compared to federal taxable income.

California voters passed **Proposition 19** effective February 16, 2021, which severely limits the ability to transfer ownership of property with a low property tax value (currently protected by Prop. 13) to heirs and children without increasing the value of the transferred property to the fair market value on the date of the transfer…**which will often greatly increase the post-transfer property tax.**

- **Proposal for California Wealth Tax:**

Have no fear…yet.

California currently has an estimated budget deficit for 2024 of $23 billion. That is without considering the unfunded liability in many state and local pension plans of approximately $1.6T. Therefore, the idea of a California Wealth and Exit tax is back!

Governor Gavin Newsom, in previous years, has stated publicly that he "does not support any tax increases during this legislative session." He stated that wealth is mobile (can leave the state), and therefore appears unwilling to impose an additional and novel tax. However, the proposal is once again, before the State Legislature. https://legiscan.com/CA/text/AB259/2023

Quoting, below:
https://news.bloombergtax.com/tax-insights-and-commentary/california-wealth-and-exit-tax-shows-a-window-into-the-future

"The recently introduced California wealth tax proposal essentially contains three components. The first, a wealth tax of 1% on household wealth over $50 million and 1.5% on wealth over $1 billion, would apply starting in 2024 and to those with over $50 million starting in 2026. It would be based on worldwide net worth, with some exceptions, and would apply to full-time, part-year, and temporary residents, subject to apportionment.

The second component is an exit-tax structure that allows the wealth tax to be applied for several years after a taxpayer leaves California. Also included are provisions that enable certain taxpayers to defer payment by contracting to pay the tax in the future, even if they leave. The third component is an enabling amendment to the California constitution.

While the California proposal is unlikely to pass, thanks in part to Gov. Gavin Newsom's opposition, ultrawealthy taxpayers should be wary of what it portends. The California proposal doesn't stand alone. Proposed legislation in Hawaii would impose a tax of 1% on state net worth exceeding $20 million, and proposed legislation in Washington would impose a tax of 1% on taxable worldwide wealth over $250 million.

Other states, including New York, have taken steps toward taxing the ultrawealthy, though primarily through higher taxes on capital gain and other income. Late last year, Massachusetts imposed a surtax of 4% on income over $1 million through a ballot initiative—and this example is perhaps telling. The "Massachusetts millionaires' tax" had been introduced and defeated multiple times before finally becoming law."

- **Federal Estate and Gift Tax**

The **Exemption Amount** under the 2017 tax act allows married couples to avoid estate tax on taxable net worth[s] up to $27,220,000 (for deaths or gifts in 2024) and $25,840,000 (for deaths or gifts in 2023). **The amounts are one-half for unmarried taxpayers**. These increased exemptions (from lower amounts prior to 2018) expire on January 1, 2026 unless renewed by Congress. The exemption increases each year, based on

inflation. California does not have an estate or inheritance tax, but 17 other states currently do. https://www.aarp.org/money/taxes/info-2020/states-with-estate-inheritance-taxes.html

Again, note, the high exemption amounts expire and are reduced by more than ½ at the end of 2025, so some estate planning for large estates may be in order. We cannot predict whether Congress and the President will decide to extend the current law and exemption amounts.

The federal Estate Tax Rates are from 18%, to a maximum of 40%. The maximum rate begins on taxable (after the exemption amount) estate net worth of $1,000,001. The estate tax rates are not adjusted for inflation since the exemption amount is. Note, the computation of taxable net worth and related exemptions, deductions and credits are complex. Please refer to Form 706 and its never-ending instructions.

The **Annual Gift Exclusion** before an IRS Form 709 is required to report gifts – filed by the giver, not the **recipient** - increases to $18,000 for 2024, from $17,000 in 2023. Please call us if you are making any substantial gifts to review the filing requirements and filing elections available. It is rare any tax is owed on a simple gift, but proper reporting is important. Establishing sophisticated trusts with gifts is an entirely different matter.

The "Portability Election," which allows a surviving spouse to use his or her deceased spouse's unused federal estate and gift tax exemption, is unchanged for 2023 & 2024. This means a married couple can use the full $27.220 million exemption before any federal estate tax would be owed. To make a portability election, a federal estate tax return (IRS Form 706; no simple task to file accurately.) must be timely filed by the executor of the deceased spouse's estate.

"Step Up in Basis" at Death:
There is no 2023 or 2024 change to the rules regarding step-up in basis at death. That means that when a taxpayer dies, their heirs' tax cost basis in the assets left to them is reset to the fair market value at the date of death, generally. In other words, the taxation of pre-death appreciation is permanently and legally avoided. A highly debated provision to eliminate the Step Up in basis was removed from the proposed BBB Act in November 2021, but it keeps coming up in early versions of proposed tax legislation submitted by both parties to significantly increase tax revenue. As of this writing, there is no serious proposal under consideration, but that could change at any time.

Estate tax planning is complex and challenging and requires a coordination between legal and tax advisors and family members to resolve Wills, avoid Probate, and provide for the creation and maintenance of trusts, as well as cover various personal issues. Rules also vary from state to state. Please be sure to contact us and an estate tax attorney (we work with many) if you have a significant net worth. In general, every adult should at least consider a written and signed Will. Also, it is a good idea to review Wills and Trusts every few years to make sure they are still in-line with your current goals and wishes.

- <u>**Foreign Assets/Foreign Income or losses (Businesses or Investments)**</u>
  There are extensive filings (federal and state) requirements for those who own foreign assets or earn foreign income or losses. There may be additional forms (often several) required for any foreign assets you own or foreign income or losses you incur. While a federal credit may be allowed for any foreign taxes you paid, offsetting some, or all, of the U.S. federal tax on such income, it is critical that foreign income, losses, and assets be reported, and on the correct forms. Certain exceptions apply for small amounts.

Note, California generally **allows no foreign tax credits** resulting in double taxation of foreign income in many circumstances. This issue is too complex to fully cover here.

Even if you don't **own** a foreign bank account or other financial account but have only signature authority on such account (this is very common) directly, or indirectly via a controlling ownership interest in a foreign corporation, partnership, trust, estate or other entity; a U.S. person must disclose that signature authority on a form filed with the U.S. Treasury Department each year including various details about the account. Again, certain exceptions apply for small amounts, but let us know about ALL accounts and amounts to evaluate the exceptions.

Failure to file such (sometimes multiple) forms and report any related offshore income can result in additional tax, plus various penalties, including a penalty of $10,000 per item (or much more, if negligence or willful underreporting occurs). In just one example, the 2017 tax act increased the penalty for Form 5472, related to reporting Non-U.S. ownership of a domestic corporation, from $10,000 to $25,000 for failure to furnish information or maintain records. This penalty applies even if all the companies involved are losing money.

Examples of foreign assets and foreign income or losses subject to these rules include: bank accounts, brokerage accounts, stocks of large or private corporations, (not those owned in a U.S. brokerage account), foreign mutual funds, partnership interests, bonds, private pensions, some foreign government pension arrangements, and insurance policies. This includes those held in non-U.S. banks or brokerage accounts, or for which documents are simply sitting in a safe deposit box. Even the receipt of a large gift or inheritance coming from outside the U.S. may require the U.S. taxpayer to file a disclosure form. This **is not a complete list** of items required to be disclosed on one or more of seven very complex forms that may be required depending on the circumstances, all with enormous penalties for non-filing, late filing or incorrect or incomplete filing.

For example, just one of many examples, failure to report a gift from non-U.S. relatives (or non-relatives) living outside the U.S. on the right form, at the right time, can trigger (and does in real life) a penalty of 25% of the gift received.

If you have any questions or concerns regarding foreign assets or income, please inform us so we can discuss these issues with you.

If similar items were not reported in prior years, please inform us so we can consider with you the IRS and state voluntary disclosure programs.

- **Social Security Earnings Record:**
  There is a building in Parkersburg, West Virginia that houses the U.S. Bureau of Public Debt. In file cabinets therein, they keep binders of physical paper U.S. Treasury Bonds (in the total amount of approximately $2.85 trillion and declining) purchased from the U.S. Treasury by the Social Security Administration during prior decades when more money was coming into Social Security than going out. In current years, Social Security is routinely cashing-in some of those bonds to make its payments to beneficiaries. You can check on your Social Security current or future benefits (in part, coming from those bonds) by reviewing your Social Security Record of Earnings at: https://www.ssa.gov/prepare/review-record-earnings

- **Social Security Earnings Test:** The earnings test indicates the level of earnings permissible for Social Security recipients without incurring a reduction of benefits. These limits are indexed to increases in national earnings.

  a) Worker younger than full retirement age: **$21,240**

  b) Year worker reaches full retirement age (applies only to earnings for months prior to attaining full retirement age): **$56,520**

  c) Worker at full retirement age: **No Limit**

  Find out your full retirement age, which is when you become eligible for unreduced Social Security retirement benefits. The year and month you reach full retirement age depends on the year you were born. https://www.ssa.gov/benefits/retirement/planner/ageincrease.html For, example, for a person born in 1959, their full retirement age is 66 years and 10 months.

- **California, more items:**
  The maximum California individual income tax rate is 12.3 percent for individual taxpayers with California taxable incomes over $677,276 ($1,000,000 for joint filers) for 2023. (Not available at this writing, the 2024 income amounts, indexed for inflation, will be a bit higher.) However, if California taxable income exceeds $1,000,000, the excess amount triggers an additional 1 percent Mental Health Services Tax, bringing the top marginal rate to 13.3 percent. Effective on January 1, 2024, (NOW) the *new* top rate is an eye-watering **14.4%.** There have been several proposals in Sacramento to increase the top rate as high as 16.8%, but a more modest 1.1% increase passed in 2023. The new 14.4% rate is the result of no limit on California's 1.1% employee payroll tax for State Disability Insurance. It translates to a top 14.4% rate for those earning over $1 million.

  Just for comparison, the individual income tax rate in Nevada, Texas, Florida, Wyoming, Alaska and Washington state is zero. Note though, in states with no income taxes other types of state, county, and local tax assessments can be very high.

- Rules on the **treatment of independent contractors** (in most cases, requiring the *reclassification* of them to employee status) were enacted by California for 2020 (Assembly Bill 5). Please be sure to review these rules if your business pays independent contractors. **Misclassifying an employee as an independent contractor can result in substantial payroll taxes, penalties, and interest.**

- **California Estimated Tax Payments:** Note that California taxpayers earning over $1,000,000 of taxable income for the tax year MUST make withholding and/or estimated tax payments equal to 90% of the **current** year tax liability (rather than a "safe harbor" amount based on the prior year tax) to avoid underpayment penalties. California estimated tax payments are also "front loaded" with accelerated percentages of full year tax due for the 1st (30%) and 2nd (40%) quarters. This issue is too complex to fully cover here. https://groco.com/article/tax-underpayment-penalties/

Please note that California **requires** electronic payment of taxes for any payment over $20,000, or for all payments if a taxpayer's total annual California tax liability for the year exceeds $80,000 or did in a prior year.
https://www.ftb.ca.gov/individuals/Mandatory-e-Pay/index.shtml
There are some exceptions where a waiver can be obtained.
https://www.ftb.ca.gov/forms/misc/4107.pdf

If you mistakenly pay by check, a significant penalty may be imposed, however the FTB normally sends only a "warning" letter for the first violation of these rules. We can't promise that result in the future. Estates and trusts are not required to make electronic payments.

A quick "Web pay" system is available for individuals and businesses with no registration.
https://www.ftb.ca.gov/pay/bank-account/index.asp

To avoid penalties, please check all the requirements well before any payment due date.

The Franchise Tax Board will consider your payment received on the payment date you select in Web Pay. They will consider your payment timely, even if the payment does not clear your bank for several days after the due date. However, given the size of potential penalties, just to be safe, **we don't recommend you wait and make electronic payments too close to the due date.** Be sure to print and KEEP a copy of the payment confirmation.

- **"Use" Tax:** **Remember to voluntarily pay California "use tax" on any internet (or other) purchases where the seller did not charge you sales tax, and the product is used in California.** The tax can be assessed and paid with your California Individual Income tax return in most small cases. Let us know the amount of such purchases in our Tax Organizer (or TaxCaddy).

- **Third-Party Authorization (FTB):** In the process of preparing your tax returns, on a limited basis, we may electronically request information via the California Franchise Tax Board's ("FTB") website to verify your California income tax payments, in an effort to accurately claim the proper amount of deductions and credits for those payments. When we do so, you will be notified by the FTB website system either via email or with a letter in the U.S. mail that there has been an inquiry regarding your FTB account. If you received such a letter, please provide us with a copy of the letter including the authorization code we need to obtain information from your account. Feel free to call us to confirm if a notification from the FTB is a result of an inquiry by GROCO.

- **IRS Payment and Account Information**

  The IRS has a webpage for the direct electronic payment of taxes (with no fees) for INDIVIDUAL taxpayers, debiting your bank account, without using the more complex **Electronic Federal Tax Payment System** ("EFTPS").

  Please investigate using this page before tax due dates. Same day payments can be made if all the verification goes well, but please try to pay sooner.
  See: https://www.irs.gov/payments

- **EFTPS**

  A corporation's taxes cannot be paid via the above webpage, nor can it be used by various other business and non-profit entities. EFTPS **must** be used in many cases, and those entities should investigate registering (the IRS must send you a password in the US mail to use EFTPS) well in advance of the estimated or tax return payment due dates. Payments using EFTPS must be scheduled by **"8 p.m. Eastern Time (not California time) *the day before the due date to be received timely by the IRS***." You can also use the voice response system at 1 (800) 555 3453, but still, your enrollment PIN is required. A significant penalty may be imposed for paying taxes with a check when EFTPS is required.
  See: https://www.eftps.gov/eftps/

  As a last resort to avoid late payment penalties, if EFTPS is required but not available, there is a "Same Day Wire" payment procedure requiring you to go to your bank with completed paperwork to process. https://www.irs.gov/payments/same-day-wire-federal-tax-payments

  Note, as always, **sales tax and payroll tax** return processing and payments **must** all be electronic, with very short deadlines. Federal and California payments of withholding taxes on payments to non-resident individuals or entities outside the U.S. and California, if required, have various electronic filing and payment requirements (Forms 1042 and CA Form 592).

In summary, both the IRS and state tax authorities want, or require, nearly everything to be filed and paid electronically. The tax authorities have adopted this approach to reduce the resources required to process tax returns and payments, and to better utilize Artificial Intelligence approaches to review electronic data for potential tax return audit issues.

When making electronic payments, be extremely careful in entering all information, including your tax identification number, the form number, tax year, and amount paid. Simple mistakes can result in very large penalties if the wrong information is entered. Mistakenly adding a "0" to a payment, may make the payment too large and your bank will reject the payment triggering various late payment and additional "dishonored payment" penalties.

- **IRS Website Link to View Your personal Tax Account: (This can be *very* helpful.)**

  The IRS has a webpage to quickly review the status of your personal "tax account." You can see all filing and audit adjustment activity plus balances due or refunds, plus review your tax payment history and order transcript information. Note, this system is normally at least two weeks behind in showing current information. This may help people avoid the long wait required when calling the I.R.S since contacting them by telephone has become near impossible during the COVID pandemic but is now improving. The IRS system asks many questions (and takes your picture) to authenticate your identity before allowing you access. Please follow the instructions, carefully. See: https://www.irs.gov/payments/view-your-tax-account

- **The old "Mailbox" Rule and the much slower U.S. Postal Service:** The U.S. Mail has slowed due to COVID staffing issues in addition to implementing intentional service cutbacks. We've seen **weeks** of delay between when an item is mailed and received, even for short distances, and even when we paid extra for Priority or Overnight mail. Taxpayers can no longer rely on when they put a letter in a mailbox to establish evidence of timely delivery or payment to the IRS. A document must be postmarked by the U.S. Postal Service on or before the last date prescribed for filing, and the mailed document must be delivered to the IRS (we've sent items that simply never arrived), or the taxpayer must send the document by registered or certified mail for proof of timely filing.

  Therefore, the **"best practice"** is to always electronically file, and electronically pay, as the filer obtains an official efiling postmark/receipt from the efiling system, and an acknowledgement of filing shortly thereafter from the tax authorities.

  The IRS and FTB strongly encourages both tax return preparers and taxpayers to not use the Post Office for most tax items, and if they do, mail items Certified (obtain a date-stamped receipt), with a Return Receipt Requested, with the required money postage. Further, those taxpayers mailing items should make sure the item's tracking number is electronically scanned-in by the postal worker and track them at https://www.usps.com/ **to confirm the item is in the USPS computer by the due date and the item is moving towards its destination and later delivered. You can have the USPS send you a text or email about various information on your item's movements and delivery. Keep all the receipts for at least 6 years from the date of filing. We know this is tedious information, but we have won many, many battles with the IRS and FTB based upon having good mailing receipts.**

  Private Courier delivery services (see below) are also acceptable proof of sending based on the date on the tracking documents.

  IRS Private Courier (FEDX, etc.) Address: If you need to FedX (or other company) items to the IRS, the normal IRS address **cannot** be used. It appears **ONLY FedEx, DHL and UPS** are acceptable Private Couriers for proof of sending.
  Here's the list of IRS addresses to use: **https://www.irs.gov/filing/submission-processing-center-street-addresses-for-private-delivery-service-pds**

  Overnight packages to the California Franchise Tax Board use the following address:
  Franchise Tax Board, Sacramento CA 95827-1500 (No P.O. Box, but it will get there.)

  https://www.ftb.ca.gov/help/contact/mailing-addresses.html?WT.mc_id=akAddresses

  Please double check the above information is current when used.

- **First Time Filing and Change of Address:**
  Finally, it is extremely important to make sure both the IRS and FTB (and any other tax authority you file with) have your current, correct address so that you receive any mail they send. Often, action is required, and appeal rights can be lost in 15 days, so it is important any mail from the tax authorities gets delivered to a mailbox you monitor.

Using a non-U.S. address for those living outside the U.S. is often a serious problem as non-U.S. postal systems are extremely unreliable in some countries; very slow, and privacy can be compromised.

IRS Form 8822 (Individuals) and Form 8822-B (Businesses), and FTB Form 3533 (Individuals), and Form 3533-B (Businesses), can be filed to provide notice of a **change of address**. All these forms are available on the internet. Even after filing those forms, the change may not get recorded, so you may want to call the tax authorities to confirm they have your correct address. For example, we've seen the IRS use different old addresses for different tax years even long after a tax return was filed with the new address. **Please call us if you need any assistance filing a change of address notice. Please do not rely solely on post office forwarding.**

If you have any doubt what address the IRS and FTB have on record – as taxpayers often move -- consider calling them to confirm it, as they will make a notation in their computer file about your call. It may take a long time on hold but could be very much worth the trouble to avoid missing their mail.

The tax laws - and filing and paying procedures - are incredibly complex, and this letter is only a short summary of a few highlights and procedural issues. Please call us with any questions or concerns.

Please do not take any action or enter into any transaction based solely upon the information herein. Our tax opinion can only be obtained via a review of all the relevant data specific to your situation.

Thank you for reading this long and detailed review. We hope you find this information helpful and have a healthy and prosperous 2024. We appreciate serving you.

Sincerely yours,

Greenstein, Rogoff, Olsen & Co., LLP