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COUTO DEFRANCO, P.A.
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

ONLINE ADVISOR

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Tax season is now underway!

In this month's newsletter, we share the secret to getting a quick tax refund. Also read about tax saving tips for parents and grandparents, why you should consider reading the fine print, and several financial tips about how to navigate rising interest rates.

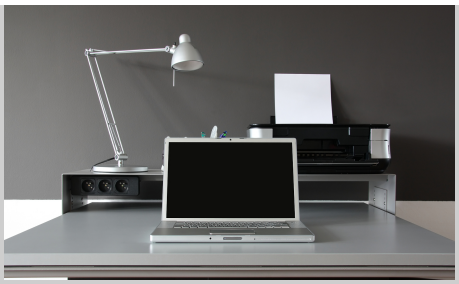
Please enjoy the information, and pass along articles of interest to all your family and friends. And as always, please call if you have questions or need help.

Debt: Gone But Not Forgotten by the IRS

With the ups and downs of our economy over the last 2 years, you may have had a loan or credit card balance forgiven or cancelled by a financial institution. You would think that the cancellation of debt by a credit card company or mortgage company would be a good thing for you and your family. And it can be, but it can also be considered taxable income by the IRS. Here is a quick review of various debt cancellation situations.

- **Consumer debt.** If you have gone through some type of credit workout program on consumer debt, it's likely that some of your debt has been cancelled. If that is the case, be prepared to receive IRS Form 1099-C representing the amount of debt cancelled. The IRS considers that amount taxable income to you, and they expect to see it reported on your tax return. The exception is if you file for bankruptcy. With bankruptcy, generally the debt cancelled is not taxable.

  Even if you are not legally bankrupt, you might be technically insolvent where your liabilities exceed your assets. If this is the case, you can exclude your debt cancellation income by reporting your financial condition and filing IRS Form 982 with your tax return.
- **Primary home.** If your home is short sold or foreclosed and the lender receives less than the total amount of the outstanding loan, expect that amount of debt cancellation to be reported to you and the IRS. But special rules allow you to exclude up to $2 million in cancellation income in many circumstances. You will again need to complete IRS Form 982, but the exclusion from taxable income brought about by the debt cancellation on your primary residence is incredibly liberal. So



Upcoming dates:

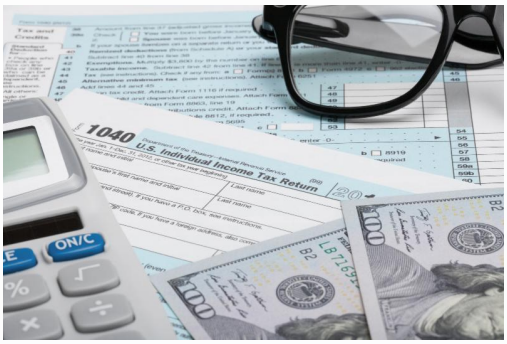
March 15
- Due date for partnership and S corporation tax returns (Forms 1065, 1120S)

Reminders
- Daylight saving time begins Sunday, March 13

make sure to take advantage of these rules should they apply to you.

- **Student loans.** If your school closes while enrolled or soon after you withdraw, you may be eligible to discharge your federal student loan and not include the forgiven amount as taxable income. You also may be eligible to exclude from taxable income any student loans discharged due to your school misleading you or engaging in other misconduct in violation of certain state laws.
- **Second home, rental property, investment property, business property.** The rules for debt cancellation on second homes, rental property, and investment or business property can be extremely complicated. Given your cost of these properties, your financial condition, and the amount of debt cancelled, it's still possible to have this debt cancellation income taxed at a preferred capital gains rate, or even considered not taxable at all.

Please call if you have questions about how a cancellation of debt situation applies to you.



The Secret to a Quick Tax Refund

Here's how to get your overpayment as soon as possible

Delayed tax refunds, penalties for not filing 2020 tax returns on time that *were* actually filed on time, and timely tax payments being flagged as late are just some of the headaches taxpayers are grappling with due to a massive backlog of several million unprocessed tax returns the IRS is trying to wade out from under.

Here's how to avoid getting your tax refund delayed and steer clear from late-filing and payment penalties resulting from the IRS backlog:

What you need to know

- **E-file your return!** The secret to getting a quick tax refund is to e-file your 2021 tax return! The IRS says approximately 90% of the more than 160 million individual tax returns expected for the 2021 tax year will be e-filed. The majority of these taxpayers will avoid any issues filing their return and getting their refund. If you do e-file, don't forget to sign Form 8879, which authorizes the e-filing of your return.
- **Stay calm if you receive a letter from the IRS.** You may receive an IRS notice indicating you have an unfiled tax return or that you have an unpaid balance on your account. If the notice was mailed because of the backlog and you indeed filed the tax return in question or paid the amount due listed, the IRS says there is no need to call or respond to the notice as it's continuing to process prior year tax returns as quickly as possible.
- **Certified mail is your friend.** If you receive an IRS notice for a situation not related to the backlog, you'll want to respond in a timely fashion via certified mail. This will provide proof of your timely correspondence. So even if your response gets lost or caught up in the backlog, you'll have evidence that you responded by the deadline listed on the notice. Remember that delays in responses could generate penalties and additional interest payments.
- **Be patient if you need to talk with the IRS.** The IRS received a record 282 million phone calls during its 2021 fiscal year, according to National Taxpayer Advocate Erin Collins. Only 32 million of these calls were answered. Collins said the best time to call the IRS are Wednesdays through Fridays, especially early mornings starting at 7 am Eastern time.

Review Financial Decisions When Interest Rates Change

Interest rates are expected to increase this year in response to inflation that is running at a 40-year high. How will you be affected?

Any interest rate revision can cause a ripple effect throughout the economy. Accordingly, the Federal Reserve's actions probably will exert at least a moderate influence over financial choices that you may

make at home and in your business in 2022 and beyond.

Savings and debt

As a consumer, you stand to gain from rising interest rates because you'll likely earn a better return on your deposits. Over the last ten years, placing your money in a certificate of deposit or passbook savings account has been hardly more profitable than stuffing it under a mattress. On the other hand, the cost of borrowing money will likely increase. As a result, mortgages, car loans, and credit cards will demand higher interest rates. That's not a big deal if you're already locked into low-interest fixed-rate loans. But if you have a variable rate loan or carry balances on your credit cards, you may find your monthly payments starting to increase.

Investments

On the investment front, market volatility may increase because rate increases are not completely predictable. Market sectors will likely exhibit varied responses to changes in interest rates. Those sectors that are less dependent on discretionary income may be less affected – after all, you need to buy gas, clothes, and groceries regardless of changes in interest rates.

As you adjust your financial plan, you might only need to make minor changes. Staying the course with a well-diversified retirement portfolio is still a prudent strategy. However, you may want to review your investment allocations.

Your Business

Rising interest rates can also affect your business. If your company's balance sheet has variable-rate debt, rising interest rates can affect your bottom line and possibly your plans for growth. As the cost of borrowing increases, taking out loans for new equipment or financing expansion with credit may become less desirable.

Please call if you have questions about deciding on the most beneficial response to potential future changes in interest rates.

Tax Saving Tips for Parents AND Grandparents

Leveraging the kiddie tax rules

With careful tax planning, you can use the kiddie tax rules to reduce your tax obligation. Here's what you need to know.

Background

The term kiddie tax was introduced by the Tax Reform Act of 1986. The rules are intended to keep parents from shifting their investment income to their children to have it taxed at their child's lower tax rate. In 2022 the law requires a child's unearned income (generally dividends, interest, and capital gains) above $2,300 be taxed at their parent's tax rate.

Who the Kiddie Tax Applies To

- Children under the age of 18
- Full-time students under the age of 24 and providing less than half of their own financial support
- Children with unearned incomes above $2,300

Who/What the Kiddie Tax Does *NOT* Apply To

- Earned income (wages and self-employed income from things like babysitting or paper routes)
- Children that are age 18 or older and have earnings providing more than half of their support
- Gifts received by your child during the year

How the Kiddie Tax Works

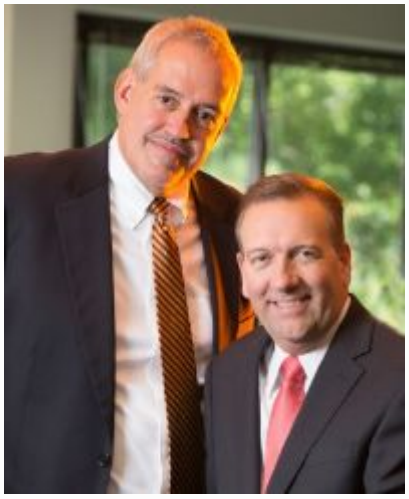
- The first $1,150 of unearned income is generally tax-free
- The next $1,150 of unearned income is taxed at the child's (usually lower) tax rate
- The excess over $2,300 is taxed at the parent's rate.

Tax Planning With the Kiddie Tax Rules

While your child's unearned income above $2,300 is a problem, you will still want to leverage the tax advantage up to this amount. Here are some ideas:

- **Maximize your lower tax investment options.** Look for gains in your child's investment accounts to maximize the use of your child's kiddie tax threshold each year. You could consider selling stocks to capture your child's investment gains and then buy the stock back later to establish a higher cost basis.
- **Be careful where you report a child's unearned income.** Don't automatically add your child's unearned income to your tax return. It might inadvertently raise your taxes in surprising ways by reducing your tax benefits in other programs like the American Opportunity Credit.
- **Leverage gift giving.** If your children are not maximizing tax-free investment income each year, consider gifting funds to allow for unearned income up to the kiddie tax thresholds. Just be careful, as these assets can have an impact on a child's financial aid when approaching college age years.

Properly managed, the kiddie tax rules can be used to your advantage. But be careful, this part of the tax code can create an unwelcome surprise if not handled properly.



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