Word to the Wise

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INSIDE THIS ISSUE

"It's never too early to start thinking about cutting next year's tax bill. In this month's newsletter, read about several ideas to help lower your 2023 tax obligation."

The Home Gain Exclusion: Make Sure You Qualify!

The home gain exclusion is one of the most generous tax breaks available to taxpayers, providing the ability to exclude up to $250,000 ($500,000 married) in capital gains on the sale of your personal residence. Here is what you need to know.

Background

As long as you own and live in your home for two of the five years before selling your home, you qualify for this capital gain tax exclusion. Here are the hurdles you must jump over to qualify for this tax break:

Main home

- This is a tax term with a specific definition. Your main home can be a traditional home, a condo, a houseboat, or mobile home. Main home also means the place of primary residence when you own two or more homes.

Ownership test

- You must own your home during two of the past five years.

Residence test

- You must live in the home for two of the past five years.

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Other nuances:

- You can pass the ownership test and the residence test at different times.
- You may only use the home gain exclusion once every two years.
- You and your spouse can be treated jointly OR separately depending on circumstances.

When to pay attention

- *You live in your home for a long time.* The longer you live in your home, the more likely you will have a large capital gain. Long-time homeowners should check to see if they have a capital gain prior to selling their home.
- *You have old home gain deferrals.* Prior to the current rules, home gains could be rolled into the next home purchased. These old deferred gains reduce the cost of your current home and can result in a capital gains tax.
- *Two homes into one.* Newly married couples with two homes have a potential tax liability as both individuals may pass the required tests on their own property but not on their new spouse's property. Prior to selling these individual homes, you may wish to create a plan of action that reduces your tax exposure.
- *Selling a home after divorce.* Property transferred as a result of a divorce is not deemed a sale of your home. However, if the ex-spouse that retains the home later sells the home, it may have an impact on the available amount of gain exemption.
- *You are helping an older family member.* Special rules apply to the elderly who move out of a home and into assisted living and nursing homes. Prior to selling property, it is best to review options and their related tax implications.
- *You do not meet the five-year rule.* In some cases, you may be eligible for a partial gain exclusion if you are required to move for work, disability, or unforeseen circumstances.
- *Other situations.* There are a number of other exceptions to the home gain exclusion rules. This includes foreclosure, debt forgiveness, inheritance, and partial ownership.

A final thought

The key to obtaining the full benefit of this tax exclusion is in retaining good records. You must be able to prove both the sales price of your home and the associated costs you are using to determine any gain on your property. Keep all sales records, purchase records, improvement costs, and other documents that support your home's capital gain calculation.

Calling All Taxpayers: Plan Now or Pay Later

Procrastination is easy, especially when it comes to summertime tax planning. But waiting to implement strategies to reduce your 2023 tax obligations could cost you money. Here are some suggestions to help jumpstart your midyear review:

- *Safeguard your deductions.* Ensure you can take deductions by keeping great records throughout the year. You'll need proof if you want tax breaks for things like childcare expenses, charitable contributions, gambling losses, vehicle costs and travel expenses. Create a system to keep track of these expenses.
- *Save more for retirement*. You can save more for retirement in 2023 thanks to inflation increasing annual contribution limits. You've even got time to increase the amount you set aside over the remainder of 2023. This year you can deposit up to $22,500 in your 401(k) and $6,500 into your IRA (additional catch-up contributions apply if you're 50 or older). You can also contribute to both a 401(k) and an IRA, though tax deductibility on IRA contributions may be limited depending on your income.
- *Be tax-savvy about school savings.* If you're setting aside money in a taxable account to pay for your child's school expenses, you could realize tax savings by opening a 529 education savings account. The sooner you do this, the sooner your earnings will start growing tax-deferred. Your earnings will also generally be tax-free when withdrawals are used for qualified education expenses.
- *Adjust your withholdings and estimated payments.* If you haven't already, update your withholdings and estimated tax payments to reflect any changes needed since last year. Updates may be in order if you experience a big life event, such as marriage, divorce or a new job. Overpaying your 2023 tax reduces the cash you have on hand throughout the year, and underpaying can lead to penalties and interest.

As always, if you have questions about tax planning for your 2023 tax return, please contact us at 215.675.8364.

"Mid-year tax planning is an excellent strategy to help reduce your annual tax obligations."

Graduation Season: A Great Time to Review Money Basics

With graduation season in full swing, now it a great time to review five key money basics for both students and the entire family.

Understand your net worth. Get used to making this calculation at least once per year. It equals everything you own minus everything you owe others. For young graduates, this number will probably be negative due to debts, which is ok. The key is to measure this number over time and set a goal to improve it each year. Positive net worth opens many doors, including the ability to start a business, get a first home, or even lower your car insurance bill.

Understand basic money mechanics. Review and understand a paycheck, along with learning about the basics of Social Security, Medicare, and common withholdings to pay for taxes. Then review and understand basic banking products. Actively managing your cash in today's high inflation environment can yield meaningful interest income, something long missing from banks. Learn how to review and catch banking errors or fraud, and understand how your debit and credit cards work, as well as overdraft protection.

Carefully manage debt. It is easy to burden yourself under a pile of debt. Credit card companies will fight each other over getting their credit card in your hands. And they love when you carry a balance on their card. If you do carry a balance, you are often paying 2 to 5 times the cost for every purchase you make. So ALWAYS pay the credit card bill in full each month. The next debt mountain built is from student loans. While unavoidable for many, try to minimize the size of the loans as much as possible.

Understand basic expenses. Food, transportation, utilities, insurance, taxes, rent, and medical expenses are just several examples of everyday expenses. The best way to understand these expenses is by creating a budget. Then, before every big decision, research the costs and talk to people that have been in your shoes so you see how it fits into your budget. In addition to recurring expenses, plan to save three-to-six months of expenses for unforeseen emergencies.

Invest in yourself. Remember, your most valuable asset is you. So invest in things that make you more employable and provide greater lifelong income earning potential. The best return is often one that is made to create a better future.

The world of money and finance can seem overly complicated. Be certain to continue asking questions and seek advice until you fully understand the mechanics of money and how it impacts your situation. You'll be amazed at how powerful that feeling can be.

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