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CLIENTUPDATE
PRACTICAL TAX & FINANCIAL ADVICE

Help your high school student become money smart

Often lost in the race to get kids through high school and on to life in the real world are basic financial skills. Here are a dozen financial concepts to consider explaining to your kids before graduating high school.

1 How bank accounts work. While there are numerous online applications, consider using a good ol' check register when teaching the basics of how to track and reconcile bank account activity.

2 How credit cards work. Emphasize to your child that credit card spending actually creates a loan. Go through a monthly statement together and show how interest is calculated and stress the need to never carry a balance from month to month by showing how long it takes to pay off the debt with minimum payments.

3 Tax basics. When your child receives their first paycheck, walk through their paystub to explain Social Security and Medicare taxes, federal income tax withholdings, and state tax withholdings. If they receive a Form 1099 instead of a paycheck, consider opening a savings account and explain that they will need to set aside a certain percentage of their money to pay the IRS.

4 The power of a retirement account. Explain the advantages of long-term savings tools like an IRA. The wise saver can turn into a self-made millionaire by starting their retirement savings at a young age.

5 How credit scores work. Consider explaining how credit scores work and the importance of keeping their score at the highest level possible. If your child is like many young adults who currently doesn't have a credit score, consider downloading your own credit report and walk through it with them.

6 Spend within your means. Saving first before spending is a simple concept that is becoming a lost art. Help your child understand this by setting their sights on something they want, and then helping them save money to buy it.

7 The art of saving. Part of spending within your means implies that your child has healthy savings habits. Walk your child through the techniques that work for you. Perhaps it is setting up a separate savings account or automatic transfers from a paycheck.

8 The strength of investing. The most valuable investment a young person can make is in themselves. Whether it's a college degree or a trade school diploma, your child can build tremendous value with skills that will provide a positive financial return each year.

9 Understanding of stocks and mutual funds. Consider teaching your child the basics about investments available to them, including where to find current market values. In addition to stocks and mutual funds, also consider explaining bonds, certificates of deposits, and annuities.

10 Budgeting. Help your child create a basic budget, then help them track their savings and spending against this budget.

11 Cash flow. The hard way to learn the lesson of cash flow is when bill collectors are calling and there simply isn't money to pay them. When creating an initial budget, show your child the flow of funds each month.

12 Calculation of net worth. Assets (what you own) minus liabilities (what you owe others) equals net worth. Every person has a net worth...even a child. So help them understand theirs and periodically calculate it.♦

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SUMMER 2022

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Tips to grow your emergency fund amidst record inflation

While inflation may be making it more difficult to protect the purchasing power of your emergency fund, it's still possible to increase the rate of return on these funds with a little planning. Here are some ideas.

- **Actively monitor your savings account rate.** Earlier this year the Federal Reserve increased interest rates for the first time since 2018. In addition, the head of the Federal Reserve is suggesting there may be several of these rate increases in the next twelve months. This should increase the interest you can earn on the cash in your emergency account.

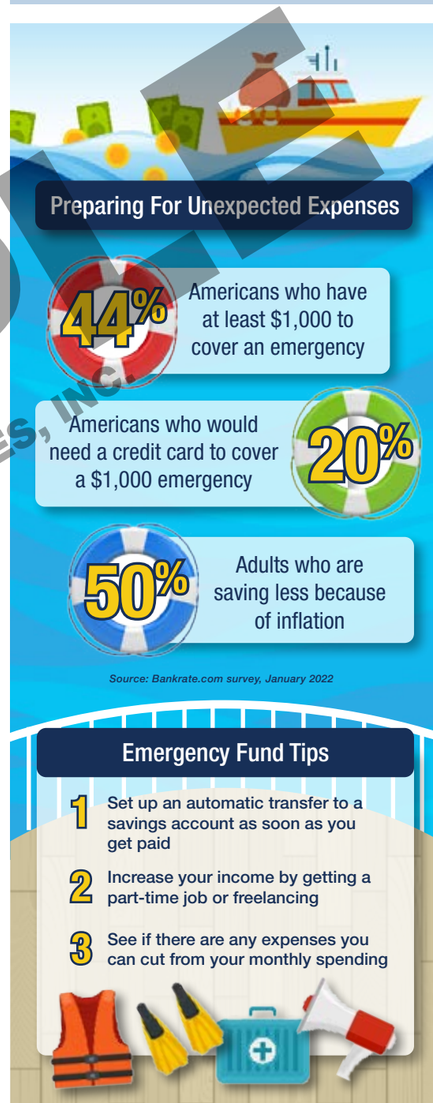
  What you need to know: *Not all savings accounts are created equal. When the Fed increases the interest rate, your savings account rate should also go higher...immediately. But this is not always the case. If your bank is slow to raise your savings rate, be willing to monitor and shift funds to a bank that does. Just make sure the funds are still FDIC insured and are kept at a reputable bank.*

- **Take a look at Series I Savings Bonds.** Series I Savings bonds are issued and backed by the U.S. government and feature two interest rate components: a fixed rate and an inflation rate. The fixed rate is set when the bond is issued and never changes during the life of the bond. The inflation rate resets semi-annually based on the Consumer Price Index.

  What you need to know: *You must hold an I bond for at least 12 months before redeeming it. And although you can redeem it after one year, you'll have to pay a penalty worth the interest of the previous three months if you redeem the bond within five years. And remember, you must be prepared to pay the penalty if you need the funds for an emergency.*

- **Creative use of Roth IRA funds in an emergency.** Roth IRAs are funded with after-tax dollars. Because of this, early removal of the contributions to a Roth IRA is tax and penalty free. If you dip into the earnings, however, you will not only be subject to income taxes, but also a potential 10% early withdrawal penalty.

  What you need to know: *Use of a Roth IRA is often a creative way to fund your emergency account while achieving higher returns with conservative investment choices, but it is not for the faint of heart. If you get this one wrong, it could cost you in taxes, penalties and lost fund value in a bear market. Prior to removing funds from any IRA, it makes sense to conduct a tax planning session.* ♦



Taxes & summer jobs

Now is the time to prepare for the not-so-pleasant part of having a summer job – paying taxes! Here's what you can expect depending on what type of job you have this summer.

Different jobs, different taxes

- **The employee.** A job at a retail store or restaurant generates earned income that is subject to payroll and income taxes. Paying taxes as an employee is super easy, as all necessary taxes will be withheld from your paycheck. You may need to file a tax return if wages and tips are more than $12,950, which is the standard deduction for single taxpayers in 2022.
- **The family business.** A job at a family business will also generate earned income that is subject to payroll and income taxes. If you are under age 18, receive reasonable compensation for a legitimate job, and the business is either a sole proprietorship or an LLC, you could qualify for an exemption from Social Security, Medicare, and federal unemployment taxes.
- **The entrepreneur.** A job such as mowing lawns, working on computers or dog walking will generate earned income that is subject to income taxes. You will also have to pay a 15.3% self-employment tax on all profits. Paying taxes as an entrepreneur or business owner also involves making payments to the IRS, either electronically or via check, throughout the year.
- **The domestic worker.** Performing chores such as babysitting and cleaning for neighbors may trigger the household employee rules, also known as the nanny tax. This can be good news, as these jobs are typically exempt from Social Security and Medicare taxes when paid to workers under age 18 who are considered household employees.

What you need to do

Here are some suggestions for understanding how taxes will affect your summer job:

- **Understand how taxes are withheld.** If you are an employee, take one of your paychecks and review how each dollar amount is calculated. This will also help you understand the different types of taxes, including federal and state income taxes, Social Security taxes and Medicare taxes.
- **Set up a savings account.** If you have your own business, you'll need to set aside a certain percentage of the money you earn to pay the IRS. An easy way to do this is by transferring a certain portion of the money into a savings account. Pay attention to the quarterly estimated due dates throughout the year – April 15th, June 15th, September 15th and January 15th. These are the deadlines for you to send tax payments to the IRS.
- **Lower your tax bill.** Consider opening an IRA that can help you start saving for the future while potentially lowering your taxes. This helps establish a healthy savings habit while understanding it is possible to pay less in taxes!

Please call if you have questions about taxes and how they apply to your summer job. ♦

IRS Update

IRS's Tax Withholding Estimator can help double check your paycheck withholding for 2022

If your 2021 tax refund was too big, too small, or maybe you received an unexpected tax bill, the IRS is encouraging you to visit www.irs.gov/individuals/tax-withholding-estimator to double check the amount of tax being withheld from your paychecks for 2022.

This online tool offers workers, self-employed individuals and retirees who have wage income a way to tailor the amount of income tax withheld from wages.

Before using this online tool, the IRS recommends gathering the following documents: Your most recent pay statements and if married, for your spouse; information for other sources of income; and your 2021 (or most recent) tax return.

Interest rates increase for second quarter of 2022

Interest rates for the second quarter in 2022 will increase compared to last quarter. These rates include: 4% for overpayments (3% for corporations); 1.5% for the portion of a corporate overpayment over $10,000; 4% for underpayments and 6% for large corporation underpayments.

Under the Internal Revenue Code, the rate of interest is determined on a quarterly basis. For taxpayers other than corporations, the overpayment and underpayment rate is the federal short-term rate plus 3 percentage points. ♦

Tax Calendar

June 15

☐ Second installment of 2022 individual estimated tax is due.

September 15

☐ Third installment of 2022 individual estimated tax is due.

Big tax savings for homeowners

How to make sure you qualify for the home gain exclusion

Housing prices might be slowly stabilizing in parts of the country, but many homeowners are still cashing out to multiples over list price, especially since one of the largest tax breaks available to most individuals is the ability to exclude up to $250,000 ($500,000 married) in capital gains on the sale of your personal residence. Making the assumption that this gain exclusion will always keep you safe from tax, however, can be a big mistake. Here is what you need to know.

When to pay attention

- **You have been in your home for a long time.** The longer you live in your home, the more likely it becomes that you will have a large capital gain. Long-time homeowners should check to see if they have a capital gains tax problem 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 exposure.
- **Two homes into one.** Newly married couples with two homes have potential tax liability issues 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 amount of gain exemption available.
- **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 all 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. ♦

The rule's basics

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. In tax-speak, you need to pass three hurdles:

- ✔ **Main home.** This tax term defines what a main home is. It 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.
- ✔ **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.