Coleman & Associates
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Common Tax Questions

Here are several of the most common tax questions and their answers. But like most things, there can be exceptions, so if in doubt always ask for help.

- **What happens to a loan if it's forgiven?** The IRS generally considers the canceled amount as taxable income, unless an exception applies. This means you may have to report the forgiven debt on your tax return and pay income taxes on it. Lenders typically issue a Form 1099-C for canceled debts, which you must include on your tax return.

- **Are my rewards earned on a credit card taxable?** Taxation of any extras you earn with a credit card – including miles, discounts, even cash back – are not taxable if you had to pay to get them. Other rewards that you receive, for example a reward for signing up for a card or for referring a new cardholder, are considered taxable income per the IRS.

- **Does my employer contribution count towards the 401(k) limit?** Your employer's matching contributions do not count toward your maximum contribution limit, which for this year is $23,500. If you're 50 or older, you can sock away an additional $7,500 (for a total of $31,000) this year.

- **What happens to loans from my retirement account if I change jobs?** When you switch jobs, you must pay back any loans borrowed from your employer-sponsored retirement account within a short amount of time. If the loan isn't paid back, the outstanding balance is considered a distribution that is subject to income taxes and an early withdrawal penalty.

- **Do I really need to report gifts given to people?** Yes, but only if you give more than $18,000 ($36,000 if married) in 2025 to any one person. It must be reported to the IRS on a gift tax return. That's because the IRS keeps track of gifts you're allowed to make over the course of your lifetime, which in 2025 is $13,990,000 ($27,980,000 if married). Only after reaching this lifetime dollar amount will you need to actually make a gift tax payment.

- **Do I have to report a loss?** You may think the IRS isn't interested in losses you incur, such as when you sell a stock at a loss or if your business loses money. The reality is that you should always report losses on your tax return because you can use them to offset income under certain conditions. In addition, most losses can be carried forward to future years to offset income.

Custodial Accounts for Kids: Understanding the Trade-offs of This Great Teaching Tool

Many parents rely on piggy banks and birthday cash to teach kids about money. But more are now turning to custodial accounts – a hands-on way for children to learn about saving and investing. While these accounts offer great learning opportunities, they also come with several trade-offs worth planning for.

What you gain by using custodial accounts

Custodial accounts are managed by a parent or grandparent until a child turns 18 or 21 (depending on the state). There are two primary types of accounts:

- UGMA (Uniform Gifts to Minors Act) - only basic assets are allowed, such as cash, stocks, bonds, mutual funds and ETFs
- UTMA (Uniform Transfers to Minors Act) - also allows other types of assets, such as real estate, art, and intellectual property

In addition to providing children a way to learn the basics of saving and investing, here are several other advantages of using custodial accounts:

- **Simple and accessible.** Easy to set up at most banks and brokerages.
- **Potential tax benefits.** A portion of your kids unearned income is taxed at the child's lower tax rate.
- **No contribution limits.** Custodial accounts don't cap how much you or your child can contribute to the account.
- **Flexibility.** The account's money can be used for anything that benefits your child, not just education.

While custodial accounts can be great for teaching kids about money, they do come with several trade-offs you'll need to consider.

The Kiddie Tax

Custodial accounts can trigger something called the kiddie tax. Here's how it works.
In 2025, the first $1,350 of your child's unearned income is tax-free. The next $1,350 is taxed at your child's tax rate (usually no more than 12%). Any unearned income above $2,700 ($1,350+ $1,350) is taxed at the parents' rate, which can be as high as 37%!

What to do instead: *If your child has earned income, a Roth IRA for minors offers tax-free growth and avoids the kiddie tax entirely.*

Impact on Financial Aid

Custodial accounts are counted as a child's asset on the Free Application for Federal Student Aid (FAFSA). Student assets are assessed at a much higher rate (20%) than parent assets (5.64%). This means that $10,000 in a custodial account can reduce financial aid eligibility by $2,000 or more.

What to do instead: *If you're saving for college, consider a 529 plan. The account owner retains control, the funds grow tax-free, and qualified withdrawals are tax-free as well. Plus, 529 plans are treated more favorably in financial aid calculations.*

Loss of Control
Once the child comes of age, they can spend the money however they want. If your goal was to fund education but your young adult wants to buy a motorcycle instead, you're out of luck.

What to do instead: *Spread your child's earned income around multiple types of accounts. Put some in a 529 plan or other education account. Contribute another amount to a traditional or Roth IRA in the child's name. And make a deposit into a custodial account that your child can (eventually) do whatever they want with.*

Bottom Line
Custodial accounts still have their place, especially for general-purpose savings or teaching financial responsibility. But it's important to understand the trade-offs and long-term implications.

Your Family's Financial Emergency Blueprint

Building and reviewing an emergency plan can help your family know what to do in a crisis – especially if the next one is financial. Here's how to create your own family financial emergency plan, stress-test your budget, and build a great financial foundation.

Step 1: Assess your current financial situation. Start by gathering the following information:

- ✓ Income sources. Document all incoming money, including salaries, wages, side gigs, and passive income.
- ✓ Fixed expenses. These are expense you pay at consistent intervals, such as your rent or mortgage, utilities, insurance, or internet access.
- ✓ Variable expense. This includes items like groceries, gas, and entertainment.
- ✓ Discretionary spending. These are the nice-to-have but not necessary expenses such as shopping, hobbies, and certain subscriptions.

Step 2: Simulate a job loss or income cut. Next, simulate a scenario where one or both income earners lose their jobs or face a significant pay cut. Ask the following questions:

- ✓ How long can you continue meeting essential expenses?
- ✓ What would be your first financial response? (cutting discretionary spending or using savings)
- ✓ What resources are available? (emergency fund, severance, unemployment benefits)

Now rebuild your budget assuming this new, lower income level. Prioritize essential categories such as housing, food, utilities, & healthcare. This exercise help you pinpoint which expenses can be eliminated or reduced.

Step 3: Build an emergency fund. Financial experts recommend saving 3 to 6 months' worth of living expenses. If this amount feels out of reach, aim for one month of essential expenses and build from there.

Step 4: Identify candidates for cutbacks. Pinpoint which expenses you could immediately pause or cancel in a crisis. Then develop a cutback plan in writing. This becomes your go-to response plan, allowing you to act quickly with no emotion or debate.

Step 5: Create an income recovery strategy. Increasing your income can speed up recovery. Brainstorm income replacement options in advance such as side hustles or freelance work; gig economy jobs like ride sharing, delivery, or tutoring; selling unused items online; accessing short-term assistance programs; tapping into a professional or industry network for job leads.

Step 6: Practice communication and assign roles. While creating your financial emergency plan, bring your family together and assign roles:

- Who handles bills and payments?
- Who checks into benefits and aid?
- How will you explain the situation to children in age-appropriate ways?

Step 7: Review and repeat. Your financial emergency plan isn't a one-time task. Schedule reviews every 6 to 12 months or after any major life event like a new job, having a baby, or moving.

Creating a family financial emergency plan doesn't guarantee immunity from hardship. But it does provide clarity, direction, and peace of mind. It also ensures that when the unexpected happens, you're not starting from scratch.

What Banks Don't Tell You About Credit Cards

Credit cards may offer convenience and opportunities to build credit, but they also come with terms and conditions that aren't always advertised. Here are several credit card secrets that banks may not tell you about.

- **Minimum payments are a trap.** Banks design minimum payments to look appealing (typically 2% to 3% of your balance). But paying only the minimum allows interest to grow on your remaining balance, which can result in you paying two or three times (or more!) of the original purchase price over time. If possible, pay your credit card balance in full each month.

- **Interest rates are negotiable.** If you've been a reliable customer and consistently make payment on time, there's a good chance your bank might lower your annual percentage rate if you ask. Simply call the customer service number on the back of your card and ask if you can lower your rate. Banks prefer to keep loyal customers rather than risk losing them to competitors.

- **The high cost of rewards programs.** Banks design these programs to encourage spending, which increases the likelihood that cardholders will carry a balance and pay interest. Some rewards cards also have high annual fees that can erode the value of the rewards you earn. To truly benefit from rewards programs, only use your card for planned purchases and pay off the balance in full each month.

- **Late fees are avoidable.** Many credit card issuers offer a grace period for late payments. If you miss your payment due date, call your bank immediately and explain the situation. This can often result in the bank waiving its late fee, especially if it's your first offense. Banks don't widely advertise this because they profit significantly from late fees.

- **Introductory offers have strings attached.** Offers like 0% interest or bonus rewards often come with terms and conditions that are easy to overlook. For example, some rewards programs require you to spend a certain amount within the first three months to qualify for the bonus. If you don't read the fine print, you might miss out on the offer or end up spending more than you intended. Always understand the requirements before applying for a new card.

- **Banks monitor your spending habits.** Banks track your spending patterns and use this data to their advantage. For example, if you consistently pay off your balance in full, you might not be as profitable to them, which could result in fewer promotional offers. On the other hand, customers who carry balances and pay interest may receive more marketing for additional financial products. Being mindful of your spending habits can help you avoid falling into costly traps that are pushed by banks.

Credit cards can be a valuable financial tool, but only if you understand how they work and how to avoid the hidden pitfalls. By paying off your balance in full, negotiating fees and rates, and leveraging rewards strategically, you can take control of your credit card rather than letting it control you.

As always, contact the office with questions by emailing us at info@colemancpas.com or calling 773-444-3100. We are here to help.