TAX PLANNING 2023

To Our valued Clients and Friends:

The less hectic summer/fall season is always a suitable time to consider steps to cut your 2023 tax bill. Here are some planning strategies to consider, assuming our current federal tax regime remains in place through 2024.

MANAGE THE GENEROUS STANDARD DEDUCTION ALLOWANCES

The 2023 standard deduction amounts are $13,850 for singles and those who use married filing separate status, $27,700 for married joint filing couples, and $20,800 for heads of household. If your total annual itemizable deductions for 2023 will be close to your standard deduction amount, consider making enough additional expenditures for itemized deduction items between now and year end to exceed your standard deduction. That will lower this year's tax bill. Next year, you can always claim the standard deduction, which will be increased to account for inflation. The easiest deductible expense to accelerate is included in the house payment due on January 1. Accelerating that payment into this year will give you 13 months' worth of interest in 2023.

Also, consider making bigger charitable donations this year and smaller one's next year to compensate. That could cause your itemized deductions to exceed your standard deduction this year. If you are age 70½ or older, consider a direct transfer from your IRA to a charity [known as a Qualified Charitable Distribution (QCD)]. While you will not be able to claim a charitable donation for the amount transferred to the charity, the QCD does count toward your Required Minimum Distribution (RMD). If you do not itemize, that is clearly better than taking a fully taxable RMD and then donating the amount to charity. Even if you do itemize, the QCD has the added value of not increasing your Adjusted Gross Income (AGI). Keeping your AGI low can decrease the amount of your Social Security benefits that is taxable, as well as avoid or minimize the phaseout of other favorable tax provisions based on AGI. Note: To get a QCD completed by year-end, you should initiate the transfer well before December 31. Talk to your IRA custodian but make the transfer no later than December.

CAREFULLY MANAGE INVESTMENT GAINS AND LOSSES IN TAXABLE ACCOUNTS

If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. The federal income tax rate on long-term capital gains recognized in 2023 is only 15% for most individuals, but it can reach the maximum 20% rate at higher income levels. The additional 3.8% Net Investment Income Tax (NIIT) can also apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2023 years, selling winners this year will not result in any tax hit. Sheltering net short-term capital gains with capital losses is beneficial because net short-term gains would otherwise be taxed at higher ordinary income rates. What if you have some loser investments that you would like to unload? Facing the situation and taking the resulting capital losses this year would shelter capital gains, including high-taxed short-term gains, from other sales this year. If selling a group of losers would cause your capital losses to exceed your capital gains, the result would be a net capital loss for the year. That net capital loss can be used to shelter up to $3,000 ($1,500 if you use married filing separate status) of 2023 ordinary income from salaries, bonuses, self-employment income, interest, royalties, etc. Any excess net capital loss from this year is carried forward to next year and beyond. In fact, having a capital loss carry over into next year and beyond could turn out to be quite favorable. The carryover can be used to shelter both short-term gains and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you will not have to hold appreciated securities for over a year to get a lower tax rate. And since the top two federal rates on net short-term capital gains recognized in 2024 are expected to remain at 35% and 37% (plus the 3.8% NIIT, if applicable), having a capital loss carry over into next year to shelter short-term gains recognized next year could be an exceptionally good thing.

EXPLORE GIFTING STRATEGIES

If you want to make gifts to some favorite relatives, other loved ones, and/or charities, they can be made in conjunction with an overall revamping of your taxable account stock and equity mutual fund portfolios. Gifts should be made according to the following tax-smart principles.

Do not give away loser shares (currently worth less than what you paid for them). Instead, you should sell the shares and book the resulting tax-saving capital loss. Then, give the cash sales proceeds to your loved one. On the other hand, you should give away appreciated shares. Your gift recipient will pay lower tax rates than you would pay if you sold the same shares.

The principles for tax-smart gifts to relatives and other loved ones also apply to donations to IRS-approved charities. You should sell loser shares and collect the resulting tax-saving capital losses. Then, you can give the cash sales proceeds to favored charities and claim the resulting tax-saving charitable deduction (assuming you itemize). Following this strategy delivers a double tax benefit: tax-saving capital losses plus a deductible charitable donation. Additionally, you could make charitable gifts of appreciated shares instead of giving away cash. Why? Because donations of publicly traded shares that you have owned over a year result in charitable deductions equal to the full current market value of the shares at the time of the gift (assuming you itemize). Plus, when you donate appreciated shares, you escape any capital gains taxes on those shares.

CONVERT TRADITIONAL IRAS INTO ROTH ACCOUNTS

A good profile for the Roth conversion strategy is when you expect to be in the same or higher tax bracket during your retirement years. If that turns out to be true, the current tax cost from a conversion done this year could be a small price to pay for completely avoiding potentially higher future tax rates on the account's earnings. In effect, a Roth IRA can insure part or all of your retirement savings against future tax rate increases.

DEFER INCOME INTO NEXT YEAR

Depending on your situation, you might be able to defer some taxable income from this year into next year and put off the related income tax hit. Because the thresholds for next year's federal income tax brackets will certainly be higher, thanks to inflation adjustments, the deferred income might be taxed at a lower rate. Contact us if you want to explore this possibility.

DO NOT OVERLOOK ESTATE PLANNING

The unified federal estate and gift tax exemption for 2023 is a historically huge $12.92 million, or effectively $25.84 million for married couples. Even though these exemptions mean most Americans are not currently close to being exposed to the federal estate tax, your estate plan may need updating to reflect the current tax regime. Also, you may need to make some changes for reasons that have nothing to do with taxes, such as various life changes.

Finally, be aware that in 2026, the unified federal estate and gift tax exemption is scheduled to fall back to what it was before 2017 tax reform with a cumulative inflation adjustment for 2018–2025. That might put it in the $7 million to $8 million range, depending on what inflation turns out to be through 2025. Depending on political developments, the exemption cutback could happen before 2026.

Estate planning can be a moving target. Personal and tax changes happen. Contact us if you would like to discuss conducting an estate planning update. The slower summer season would be a suitable time for that.

OTHER TAX-SAVING OPPORTUNITIES

There are tax breaks for Section 529 college savings accounts, Coverdell education savings accounts, and health savings accounts; tax-saving moves you can make at your job; tax credits for qualifying energy-efficient home improvements; tax credits for qualifying hybrid and electric vehicles; and more. Contact us for details and other ideas.

In addition to the tax planning strategies listed above for individuals, there are many to consider for small businesses. Please see below for additional information.

ESTABLISH A TAX-FAVORED RETIREMENT PLAN

If your business does not already have a retirement plan, now might be the time to take the plunge. Current rules allow for significant deductible contributions. For example, if you are self-employed and set up a SEP plan for yourself, you can contribute up to 20% of your net self-employment income, with a maximum contribution of $66,000 for 2023. If you are employed by your own corporation, up to 25% of your salary can be contributed, with a maximum contribution of $66,000 for 2023. Other small business retirement plan options include the 401(k) plan, which can be set up for just one person; the cash balance pension plan; and the SIMPLE-IRA, which can be a desirable choice if your business income is modest. Depending on your circumstances, non-SEP plans may allow bigger deductible contributions.

IT MIGHT NOT BE TOO LATE TO ESTABLISH A PLAN AND MAKE A DEDUCTIBLE CONTRIBUTION FOR LAST YEAR

The general deadline for setting up a tax-favored retirement plan, such as a SEP or 401(k) plan, is the extended due date of the tax return for the year you or the plan sponsor want to make the initial deductible contribution. For instance, if your business is a sole proprietorship or a single-member LLC that is treated as a sole proprietorship for federal income tax purposes (Schedule C), you have until 10/16/23 to establish a plan and make the initial deductible contribution if you extended your 2022 Form 1040.

However, to make a SIMPLE-IRA contribution for the 2022 tax year, you must have set up the plan by October 1 of last year. So, you might have to wait until this year if the SIMPLE-IRA option is appealing. If so, establish SIMPLE-IRA and make the initial contribution by October 1 of this year.

TAKE ADVANTAGE OF GENEROUS DEPRECIATION TAX BREAKS

Current federal income tax rules allow generous first-year depreciation write-offs for eligible assets that are placed in service in your business's current tax year. Section 179 Deductions. For qualifying property placed in service in tax years beginning in 2023, the maximum allowable Section 179 deduction is a whopping $1.16 million. Most types of personal property used for business are eligible for Section 179 deductions, and off-the-shelf software costs are eligible too. Section 179 deductions also can be claimed for certain real property expenditures called Qualified Improvement Property (QIP), up to the maximum annual Section 179 deduction allowance ($1.16 million for tax years beginning in 2023). There is no separate Section 179 deduction limit for QIP expenditures, so Section 179 deductions claimed for QIP reduce the maximum Section 179 deduction allowance dollar for dollar. QIP includes any improvement to an interior portion of a nonresidential building that is placed in service after the date the building is first placed in service, except for expenditures attributable to the enlargement of the building, any elevator or escalator, or the building's internal structural framework.

Note that Section 179 deductions can be claimed for qualified expenditures for roofs, HVAC equipment, fire protection and alarm systems, and security systems for nonresidential real property. To qualify, these items must be placed in service after the nonresidential building has been placed in service. In addition, Section 179 deductions can be claimed for personal property used predominately to furnish lodging or in connection with the furnishing of lodging. Examples of such property would include furniture, kitchen appliances, lawn mowers, and other equipment used in the living quarters of a lodging facility or in connection with a lodging facility such as a hotel, motel, apartment house, dormitory, or other facility where sleeping accommodations are provided and rented out.

Warning: Section 179 deductions cannot cause an overall business tax loss, and deductions are phased out if too much qualifying property is placed in service in the tax year. The Section 179 deduction limitation rules can get tricky if you own an interest in a pass-through business entity (partnership, LLC treated as a partnership for tax purposes, or S corporation). Contact us for details on how the limitations work and whether they will affect you or your business entity.

First-year Bonus Depreciation. 80% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service in calendar year 2023. That means your business might be able to write off 80% of the cost of some or all your 2023 asset additions on this year's return. However, you should write off as much as you can via Section 179 deductions before taking advantage of 80% first-year bonus depreciation.

Depreciation Deductions for Heavy SUVs, Pickups, and Vans. The federal income tax depreciation rules are super favorable for new and used heavy vehicles used over 50% for business. That is because such heavy SUVs, pickups, and vans are treated for tax purposes as transportation equipment. That means they qualify for Section 179 deductions and 80% first-year bonus depreciation. However, this favorable first-year depreciation treatment is only available when the SUV, pickup, or van has a manufacturer's Gross Vehicle Weight Rating (GVWR) above 6,000 pounds. The GVWR of a vehicle can be verified by looking at the manufacturer's label, which is usually found on the inside edge of the driver's side door where the door hinges meet the frame. If you are considering buying an eligible vehicle, doing so, and placing it in service before the end of this tax year could deliver a juicy write-off on this year's return.

Depreciation Deductions for Cars, Light SUVs, Light Trucks, and Light Vans. For so-called passenger autos (meaning cars and light SUVs, trucks, and vans) that are used over 50% for business, the so-called luxury auto depreciation limitations apply. Thankfully, the limitations are not that strict. For passenger autos that are acquired and placed in service in 2023, the luxury auto depreciation limits are as follows:

- $20,200 for Year 1 if first-year bonus depreciation is claimed or $12,200 if bonus depreciation is not claimed
- $19,500 for Year 2
- $11,700 for Year 3
- $6,960 for Year 4 and thereafter until the vehicle is fully depreciated.

Bottom Line: To take advantage of favorable federal income tax depreciation rules, consider making eligible asset acquisitions between now and year end.

Maximize the Qualified Business Income (QBI) Deduction

The deduction based on QBI from pass-through entities was a key element of 2017 tax reform. For tax years through 2025, the deduction can be up to 20% of a pass-through entity owner's QBI, subject to restrictions that can apply at higher income levels and another restriction based on the owner's taxable income.

For QBI deduction purposes, pass-through entities are defined as sole proprietorships, singlemember LLCs that are treated as sole proprietorships for tax purposes, partnerships, LLCs that are treated as partnerships for tax purposes, and S corporations.

Note: The QBI deduction is only available to individuals, trusts, and estates. The QBI deduction also can be claimed for up to 20% of income from qualified REIT dividends and 20% of qualified income from Publicly Traded Partnerships (PTPs). So, the deduction can potentially be a big tax saver.

Use the Pass-Through Entity (PTE) Deduction

Currently, individuals are limited to no more than $10,000 of state and local taxes (SALT) as an itemized deduction. Many states have now passed legislation to allow certain entities, particularly partnerships, LLCs, and S-Corporations, to pay their owner's state income tax at the entity level, deduct it from Federal taxable income, and pass the owners their share of the reduced net income and the state tax pre-payment. This technique effectively works around the $10,000 SALT limit with respect to the income from that entity. There are restrictions and limitations which can vary by state. Contact us if you would like to explore this strategy further.

Employing Family Members

Employing family members can be a useful strategy to reduce overall tax liability. If the family member is a bona fide employee, the taxpayer can deduct the wages and benefits, including medical benefits, paid to the employee on Schedule C or F as a business expense, thus reducing the proprietor's self-employment tax liability. In addition, wages paid to your child under the age of 18 are not subject to federal employment taxes, will be deductible at your marginal tax rate, are taxable at the child's marginal tax rate, and can be offset by up to $13,850 (your child's maximum standard deduction for 2023). However, your family member must be a bona fide employee, and basic business practices, such as keeping time reports, filing payroll returns, and basing pay on the actual work performed, should be followed.