Adams Samartino CPAs

2023 Year-end Tax Planning Letter

To Our Clients and Friends:

The end of the tax year will be here before we know it, which means it's a good time to think about things you can do to reduce your 2023 federal taxes. We are heading into an election year, so it might be safe to say that a lot of Congressional attention is focused on things other than passing new tax legislation. We think it's unlikely that the individual income tax rates will increase in 2024. If any tax legislation occurs after next year's November election, any changes will most likely be prospective. Of course, this is up to Congress, so there are no guarantees. We will let you know if a tax rate change becomes more likely.

With that said, here are some things to think about doing before the end of 2023.

Check Your Tax Withholding and Estimated Payments

If your income is likely to be much higher in 2023 than it was in 2022, you should consider adjusting your Federal income tax withholding from any paychecks and your estimated tax payments to account for the difference. Otherwise, you might have a much larger tax bill than expected and may be exposed to an underpayment penalty.

Note: You will avoid an underpayment penalty for 2023 if your 2023 tax payments (estimated taxes and withholding) are at least equal to your 2022 tax liability [110% of that amount if your 2022 AGI is more than $150,000 ($75,000 if you file MFS)] or, if less than 90% of your 2023 tax.

Taxes that are withheld from wages are considered paid ratably over the year. So, if it turns out you had unexpected income or gains early this year, you can increase your withholding for the rest of the year to reduce or eliminate your underpayment from earlier quarters. Making an estimated tax payment reduces the underpayment from the time the payment is made. The IRS's "Tax Withholding Estimator," available at **www.irs.gov/individuals/tax-withholding-estimator** can be used to see if you need to adjust your withholding. Keep in mind that the calculator isn't perfect. If you want more precise results, please let us know. We can project your 2023 tax and make sure your withholding and estimated payments will be at least enough to eliminate (to the extent possible) an underpayment penalty. We can also let you know what your remaining 2023 tax bill next April will look like.

Consider Bunching Itemized Deductions

You can deduct the greater of your itemized deductions (mortgage interest, charitable contributions, medical expenses, and taxes) or the standard deduction. The 2023 standard deduction is $13,850 for singles and individuals who are Married Filing Separately (MFS), $27,700 for couples Married Filing Jointly (MFJ), and $20,800 for Heads of Household (HOH). If your total itemizable deductions for 2023 will be close to your standard deduction, consider timing your itemized deduction items between now and year-end. The idea is to "bunch" your itemized deductions, so they exceed your standard deduction every other year. Paying enough itemizable deductions in 2023 to exceed your standard will lower this year's tax bill. Next year, you can always claim the standard deduction, which will be increased to account for inflation.

For example, assume your filing status is MFJ and your itemized deductions are fairly steady at around $25,000 per year. In that case, you would end up claiming the standard deduction each year. But, if you can bunch expenditures so that you have itemized deductions of $30,000 in 2023 and $20,000 in 2024, you could itemize in 2023 and get a $30,000 deduction versus a $27,700 standard deduction. In 2024, your itemized deductions would be below the standard deduction (which adjusted for inflation will be at least $27,700), so for that year, you would claim the standard deduction. If you manage to exceed the standard deduction every other year, you'll be better off than if you just settle for the standard deduction each year.

If you have a home mortgage, you can bunch itemized deductions into 2023 by making your house payment due on January 1, 2024, in 2023. Accelerating that payment into this year will give you 13 months' worth of interest in 2023. There are limits on the amount of home mortgage interest you can deduct. Generally, in 2023, you can deduct interest expense on up to $375,000 [$750,000 if married filing jointly (MFJ)] of a mortgage loan used to acquire your home. More generous rules apply to mortgages (and home equity debt) incurred before December 15, 2017. Check with us if you are not sure how much home mortgage interest you can deduct.

Timing your charitable contributions is another simple way to get your itemized deductions into the year you want them. To a certain extent, you can also choose the year you pay state and local income and property taxes. Taxes that are due in early 2024 (such as fourth quarter state estimated tax payments in many states) can be paid in 2023. Likewise, property tax bills are often

sent out before year-end, but not due until the following year. Prepaying those taxes before year-end so that your itemized deductions exceed your standard deduction can decrease your 2023 federal income tax bill because your total itemized deductions will be that much higher. **However, note that the deduction for state and local taxes is limited to $10,000 ($5,000 if you are married filing separately).** So, if your state and local tax bill is close to or over that limit, prepaying taxes may not affect your total itemized deductions.

Warning: Prepaying state and local taxes can be a bad idea if you owe Alternative Minimum Tax (AMT) for 2023, since those taxes aren't deductible under the AMT rules. If you are subject to AMT in 2023 and think you won't be in 2024, it's better to pay the taxes in 2024, when you have a chance of deducting them. Contact us if you are unsure about your exposure to the AMT.

Finally, consider accelerating elective medical procedures, dental work, and vision care in 2023. For 2023, medical expenses can be claimed as an itemized deduction to the extent they exceed 7.5% of your Adjusted Gross Income (AGI).

Note: If your itemized deductions exceed your standard deduction every year, the conventional wisdom of paying them before year-end, to get your deduction in 2023 rather than 2024 applies, especially if you think that interest rates will increase. The higher the interest rate, the more interest you can earn on the taxes you manage to defer.

Manage Investment Gains and Losses

It's a good idea to look at your investment portfolio with an eye to selling before year-end to save taxes. But remember that selling investments to generate a tax gain or loss doesn't apply to investments held in a retirement account or IRA where the gains and losses are not currently taxed.

Sometimes, it makes tax sense to sell appreciated securities that have been held for over 12 months. The federal income tax rate on the 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 3.8% Net Investment Income Tax (NIIT) can apply at higher income levels. Even so, the highest tax rate on long-term capital gains (23.8%) is still far less than the 37% maximum tax rate on ordinary income. And, to the extent you have capital losses that were recognized earlier this year or capital loss carryovers from earlier years, those losses may absorb any additional tax if you decide sell stocks at a gain this year.

You should also consider selling stocks that are worth less than your tax basis in them (typically, the amount you paid for them). Taking the resulting capital losses this year would shelter capital gains, including short-term capital gains, which are taxed at ordinary income tax rates, resulting from other sales this year. But consider the wash sale rules. If you sell a stock at a loss and within the 30 day period before or the 30 day period after the sale date, you acquire substantially identical securities, the loss is suspended until you sell the identical securities.

If you sell enough loss stock that capital losses exceed your capital gains, the resulting net capital loss for the year can be used to shelter up to $3,000 ($1,500 if MFS) 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.

Having a capital loss carryover into next year and beyond could be a tax advantage. The carryover can be used to shelter both short-term gains and long-term gains. This can give you some investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a lower tax rate on any gains you trigger by selling, since those gains will be sheltered by the capital loss carryforward.

Planning Tip: Of course, nontax considerations must be considered when deciding to sell or hold a security. If you have stock that has fallen in value, but may recover, you might want to keep it rather than trigger the capital loss. Assume that after all factors are considered, you decide to take some capital gains and/or losses to minimize your 2023 taxes. Afterward, you should make sure your overall asset portfolio is still allocated to the types of investments you want based on your investment objectives. You may have to rebalance your portfolio. When you do, be sure to consider investment assets held in taxable brokerage accounts, as well as those held in tax-advantaged accounts like IRAs and 401(k) plans.

Make Your Charitable Giving Plans

If you would like to reduce your 2023 taxable income by making charitable donations, but don't have a specific charity or charities that you are comfortable making large donations to, you can make a contribution to a donor-advised fund instead. Donor-advised funds (also known as *charitable gift funds* or *philanthropic funds*) allow you to make a charitable contribution to a specific public charity or community foundation that uses the assets to establish a separate fund to receive grant requests from charities seeking distributions from the advised fund. Donors can suggest (but not dictate) which grant requests should be honored. You claim the charitable tax deduction in the year you contribute to the donor-advised fund but retain the ability to

recommend which charities will benefit for several years. If you have questions or want more information on donor-advised funds, please give us a call.

Another tax-advantaged way to support your charitable causes is to donate appreciated assets that were held for over a year. If you give such assets to a public charity, you can deduct the full fair market value of the donated asset while avoiding the tax you would have paid had you sold the asset and donated the cash to the charity. Charitable gifts of appreciated property to a private nonoperating foundation are generally only deductible to the extent of your basis in the asset. But there's an exception for qualified appreciated stock (generally, publicly traded stock), which can qualify for a deduction equal to its fair market value if it's donated to a private nonoperating foundation.

If you are age 70½ or older, consider a direct transfer from your IRA to a qualified 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 don't itemize, that's clearly better than taking a fully taxable RMD and then donating the amount to charity with no corresponding deduction. Even if you do itemize and would be able to deduct the full amount transferred to the charity, the QCD does not increase your Adjusted Gross Income (AGI), while a RMD would. Keeping your AGI low can decrease the amount of your Social Security benefits that are taxable, as well as avoid or minimize the phaseout of other favorable tax provisions based on AGI.

Caution: If you are over age 70½ and you're still working in 2023, you can contribute to a traditional IRA. However, if you're considering a QCD for 2023 (or a later year), making a deductible IRA contribution for years you are age 70½ or older will affect your ability to exclude future QCDs from your income.

Planning Tip: To get a QCD completed by year-end, you should initiate the transfer before December 31. Talk to your IRA custodian, but making the transfer no later than December is probably a good idea.

Convert Traditional IRAs into Roth Accounts

Because you must pay tax on the conversion as if the traditional IRA had been distributed to you, converting makes the most sense 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 hit from a conversion this year could be a relatively small price to pay for completely avoiding potentially higher future tax rates on the account's post-conversion earnings. In effect, a Roth IRA can insure part or all of your retirement savings against future tax rate increases.

Planning Tip: If the conversion triggers a lot of income, it could push you into a higher tax bracket than expected. One way to avoid that is to convert smaller portions of the traditional IRA over several years. Of course, this delays getting funds into the Roth IRA where they can be potentially earning tax-free income. There is no one answer here. But keep in mind that you do not have to convert a traditional IRA into a Roth all at once. We can help you project future taxable income and the effect of converting various amounts of your traditional IRA into a Roth IRA.

Spend Remaining Funds in Flexible Spending Accounts

If you participate in an employer-sponsored medical or dependent care flexible spending plan, be sure to look at your plan closely. The general rule is that funds not spent before the plan's year-end are forfeited (the use-it-or-lose-it rule). There are a few exceptions. Employers can allow their employees to carry over up to $610 from their 2023 medical FSA into their 2024 account. Or, FSA plans can offer a grace period (up to 2 ½ months after the plan's year-end) during which employees can incur new claims and expenses and be reimbursed. Plans can (but don't have to) have either a carryover or a grace period, but not both.

FSAs can have a run-out period, which is a specific period after the end of the plan year during which participants can submit claims for eligible expenses incurred during the plan year. The run-out period can be in addition to a carryover or a grace period. Note that the runout period differs from a grace period because a runout period only extends the time for submitting claims. A grace period, in effect, extends the plan year so that expenses incurred during the grace period are treated as incurred before the plan year-end.

As you can see, it's important to know how your FSA(s) work so that you can make sure you don't lose any funds. If there is no grace period, be sure you incur qualified expenses before year-end. Also be sure to submit eligible claims by their due date.

Take Advantage of the Annual Gift Tax Exclusion

The basic estate, gift, and generation skipping transfer tax exclusion is scheduled to fall from $12.06 million ($24.12 million for married couples) in 2022 to $5 million ($10 million for married couples) in 2026. Those amounts will be adjusted for inflation, but the long and short of it is that many estates that would escape taxation before 2026 will be subject to estate tax after 2025. If you think your estate may be taxable, annual exclusion gifts (perhaps to children or grandchildren) are an easy way to reduce your taxable estate. The annual gift exclusion allows for tax-free gifts that don't count toward your lifetime gifting exemption. For 2023, you can make annual exclusion gifts up to $17,000 per donee, with no limit on the number of donees. If you are married, you and your spouse can elect to gift split, so that a gift that either one of you makes is considered to be made one half by each spouse.

In addition to potentially reducing your taxable estate, many individuals gift income producing assets to children (or other loved ones) to shift the income from the asset to someone in a lower tax bracket. But, if you give assets to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at your higher marginal federal income tax rate. Please contact us if you have questions about exposure to the Kiddie Tax.

If you are gifting investment assets, avoid gifting assets currently worth less than what you paid for them. The donee's basis for recognizing a loss is the lower of your basis or the property's FMV at the date of the gift. So, in many cases, the loss that occurred while you held the asset may go unrecognized. Instead, you should sell the securities and take the resulting tax loss. Then, give the cash to your intended donee.

Planning Tip: If you think you will be exposed to estate tax in the future, we can help you with an estate plan. And remember, estate planning involves a lot more than avoiding the Federal estate tax. Sound estate planning ensures that your assets go where you want them, considering your desires, family members' needs, and charitable giving, among other things. Please contact us if you would like to discuss conducting an estate planning update.

Year-end Planning Moves for Small Businesses

Section 179 Deductions. For qualifying property placed in service in tax years beginning in 2023, the maximum allowable Section 179 deduction is $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.

Note: 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 also 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.

Warning: Section 179 deductions can't 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 really 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 of your 2023 asset additions on this year's return. However, you should generally write off as much as you can via Section 179 deductions before taking advantage of 80% first-year bonus depreciation.

***De minimis* Safe Harbor Election to Fully Deduct Purchases below a Threshold Amount.** Taxpayers can elect to expense the costs of lower-cost assets provided the costs aren't required to be capitalized under the UNICAP rules. Taxpayers that have an Applicable Financial Statement (AFS) can deduct units of property valued at up to $5,000. For taxpayers without an AFS, the *de minimis* safe harbor threshold is $2,500 per unit of property. An AFS is (1) a Form 10-K, (2) an audited financial statement used for obtaining credit, reporting to owners, or other substantial nontax purposes, or (3) a financial statement other than a tax return required to be provided a federal or state government or agency (other than the IRS or SEC).

Note: Small taxpayers meeting the three-year average gross receipts test threshold of $29 million in 2023 are not required to apply the UNICAP rules.

Bottom Line: To take advantage of favorable federal income tax depreciation rules, consider making eligible asset acquisitions between now and year end. The bonus depreciation percentage decreases to 60% for assets placed in service in 2024. So, if you are thinking about acquiring qualifying assets, getting them placed in service in 2023 rather than 2024 means that the higher bonus depreciation rate will apply. Contact us for full details on applicable depreciation rules and planning opportunities.

Time Business Income and Deductions for Tax Savings. If you conduct your business as a sole proprietorship or using a pass-through entity (S corporation, partnership, or LLC classified as such), your shares of the business's income and deductions are taxed at your personal rates. Assuming no legislative changes, next year's individual federal income tax rates will be the same as this year's, with significant bumps in the rate bracket thresholds thanks to inflation adjustments.

The traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. Deferring income and accelerating deductions will, at a minimum, postpone part of your tax bill from 2023 until 2024. And, after the inflation adjustments to 2024 rate bracket thresholds, the deferred income might be taxed at a lower rate. That would be nice!

On the other hand, if you expect to be in a higher tax bracket in 2024, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2024. That way, more income will be taxed at this year's lower rate instead of next year's higher rate. Contact us for details on how to implement business income and deduction timing strategies.

Timing of Year-end Bonuses. Year-end bonuses can be timed for maximum tax effect by both cash and accrual basis employers. Cash basis taxpayers should pay bonuses before year end to maximize the deduction available in 2023 if they expect to be in the same or lower tax bracket next year. Cash basis taxpayers that expect to be in a higher tax bracket in 2024 because of significant revenue increases, should wait to pay 2023 year-end bonuses until January 2024. Accrual basis taxpayers deduct bonuses in the year when all events related to the bonuses are established with reasonable certainty. However, for accrual basis taxpayers, the bonus must be paid no later than 2 ½ months of the accrual year end for a current year deduction (by March 15 for calendar year- end taxpayers). Accrual method employers who want to defer deductions to a higher-taxed future year should consider changing their bonus plans before year-end to set the payment date later than the 2 ½ month window or consider changing the bonus plan's terms to make the bonus amount indeterminable at 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, single-member LLCs that are treated as sole proprietorships for tax purposes, partnerships, S corporations, and LLCs that are classified as partnerships or S corporations for tax purposes.

For 2023, if taxable income exceeds $364,200 for taxpayers that are married filing jointly (about half that for others), the QBI deduction is limited if the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting). At that income level, the deduction may also be limited by the amount of W-2 wages paid by the business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the business. The limitations are phased in; for example, the limits start to apply to joint filers when taxable income exceeds $364,200 and are fully phased in when taxable income is $100,000 above the threshold. For other filers, the limits are fully phased in when taxable income is $50,000 above their threshold. The phase in range ends at $464,200 for married filing jointly filers and at about half that for all others.

Note: The QBI deduction is only available to individuals, trusts, and estates.

Because of the various limitations on the QBI deduction, tax planning moves (or non-moves) can have the side effect of increasing or decreasing your allowable QBI deduction. For example, claiming big first-year depreciation deductions can reduce QBI and lower your allowable QBI deduction. So, if you can benefit from the deduction, you must be careful in making tax planning moves. We can help you put together strategies that give you the best overall tax results.

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.

Conclusion

This letter only covers some of the year-end tax planning ideas that could reduce your 2023 tax bill. Please contact us if you have questions about any of the strategies described here or for more tax-saving ideas. We would love to help you develop a year-end tax planning strategy that delivers results.

Very truly yours,

Adams Samartino CPAs