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Year-End Tax Planning 2023

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Contents

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Year-End Tax Planning for 2023

As we come to the end of 2023, we witnessed a relatively quiet year regarding legislation.

But 2022 was not. The Inflation Reduction Act passed in August 2022, and the SECURE 2.0 Act passed late in December 2022.

The Inflation Reduction Act includes a 15% corporate alternative minimum tax on large corporations and a 1% excise tax on stock buybacks. Both are effective in 2023. In addition, there are credits for new and used clean (EV) vehicles; credits for producing clean hydrogen; and credits for the production of zero-emission nuclear power.

The SECURE 2.0 Act contains numerous retirement plan-related changes.

To assist you in developing year-end tax planning strategies for your clients, Checkpoint's tax experts have analyzed current tax rules to identify the unique opportunities and challenges facing taxpayers in the current year.

This Special Report discusses the year-end issues faced by individuals, businesses, and business owners and provides sample checklists and client letters.

Year-End Tax Planning for 2023: Individuals

What's new for individuals in 2023?

- While many of the tax benefits related to the COVID-19 pandemic have expired or reverted to their pre-pandemic levels, expanded health insurance subsidies are extended through 2025. (Tax Planning and Advisory Guide—Health Care Reform—premium tax credit expansion)
- The SECURE 2.0 Act (the "Act") was passed on December 29, 2022.Among the key retirement provisions in the Act are: Expanding automatic enrollment in retirement plans; increasing the age for the required beginning date for mandatory distributions; a higher catch-up limit to apply at age 60, 61, 62, and 63; and the elimination of the additional tax on corrective distributions of excess contributions. The Act also includes a number of smaller non-retirement tax provisions including changes to ABLE accounts under Code Sec. 529A and modifications to the rules governing charitable conservation easements under Code Sec. 170.
- Specifically for 2023, the Act:
    - Increases the age for the required beginning date to start taking mandatory distributions. (Tax Planning and Advisory Guide—Retirement Plans for Self-Employed—requirement minimum distributions)
    - Modifies the rule regarding the 10% early distribution tax as it relates to firefighters and public safety officers. For more details on the Act's changes to retirement planning for both 2023 and 2024, see the Retirement section below. (Tax Planning and Advisory Guide—Retirement Plans for Self-Employed—exceptions to the early distribution tax)

Pending legislation

As of press time, there is no active pending tax legislation in Congress. Congress is expected to pass an omnibus spending bill later this year, which could address various temporary tax provisions.

Filing status and dependents

When recommending year-end tax planning strategies, review the taxpayer's expected filing status this year and next and the number of dependents the taxpayer expects to claim in each year.

Filing status

A taxpayer's marital status for the entire year is determined as of December 31. A taxpayer who is married (or divorced) as of the end of the year is treated as if they were married (or single) all year long. Taxpayers who are separated or divorcing need to consider tax implications of property settlements, alimony, child support, retirement plan allocations, and other related items.

Proper timing when the change in marital status occurs can save taxes. If married filing joint or married filing separate status will result in more total tax than if each spouse files a separate return using single (or head of household) filing status, ending the marriage prior to year-end could result in tax savings. In contrast, if married status results in lower tax liability, delaying the divorce or legal separation until the beginning of the next year might be advisable.

Note. This strategy may not apply in a community property state and other liability concerns related to joint filing may outweigh the potential tax benefit.

If two high-income taxpayers are planning to wed, advise on the effect of a potential marriage penalty. A "marriage penalty" exists whenever the tax on a couple's joint return is more than the combined taxes each spouse would pay if they weren't married and each filed a single return. The marriage penalty can apply to joint filers whose income falls into the 35% bracket. However, even for taxpayers below the 35% bracket, a marriage penalty can nevertheless kick in through the tax treatment of other items including:

- Student loan interest deduction

- Net investment income tax (NIIT)
- Deductible contributions to traditional IRAs by taxpayers who are active participants in an employer-sponsored retirement plan
- MAGI limits on Roth IRA contributions (taxpayers who are married filing joint can still generally contribute, but should consider applicable MAGI limits and the possibility that a spouse's higher income could impact each of them and their ability to contribute)
- Child tax credit and additional child tax credit
- State and local tax deduction
- Qualified business income (pass-through) deduction
- Additional 0.9% Medicare tax
- Taxable amount of social security
- Related party and constructive ownership rules

A taxpayer who currently qualifies for head of household tax status may benefit from pulling more income into this year if changed circumstances (such as getting married) will end their head of household status next year. Accelerating income may also benefit certain widows or widowers whose spouses died in 2022 and who are entitled to use joint return rates in 2023 and 2024.

Dependents

Although the deduction for dependency exemptions is $0 for 2018–2025, certain tax deductions and credits (including the child tax credit for qualifying children under 17) are available with respect to the taxpayer's dependent. A dependent is defined as either a qualifying child or a qualifying relative.

To meet the dependent rules for qualifying child, an individual must be under 19 at the end of the year, a full-time student who is under 24 (the age test) or permanently disabled. To be a qualifying relative the person must have less than $4,700 (in 2023) of income and meet other requirements.

For dependents that need to meet a residence, support, or income test, review whether these tests are likely to be met before year-end.

Recommendation: In joint custody situations, taxpayers planning to claim head of household status should maintain records of the amount of time a child spends in each household.

Increasing and decreasing AGI

For individuals, year-end tax planning commonly involves methods for increasing and decreasing AGI. Generally, taxpayers will aim to decrease AGI to reduce their overall tax liability. But, there are some instances when it will make sense for the taxpayer to increase AGI in a particular tax year.

What's new?

The contribution amounts and carryover periods for unused amounts in a health flexible spending arrangement (health FSA) have changed as follows:

- For plan years beginning in 2023, the contribution limit for health FSAs is $3,050.
- The maximum health FSAs may allow participants to carry over to plan years beginning in 2024 is $610. (Tax Planning and Advisory Guide—Cafeteria Plans—health FSAs)

Who should increase AGI?

A taxpayer who expects to be taxed at a higher rate next year should explore strategies to increase AGI this year by accelerating the recognition of income. An individual taxpayer might be in a higher tax bracket next year if:

- The taxpayer is graduating from school or a training program and moving into the paid workforce.
- Head-of-household or surviving spouse status ends after this year.
- The taxpayer plans to get married next year and will be subject to a marriage penalty.
- The taxpayer expects to be eligible for one or more credits next year (e.g., the child tax credit) that is subject to phaseout when AGI reaches specified limits and is otherwise not eligible for the credit this year.

Caution: Any decision to accelerate income from a later year into an earlier one should consider the time value of money.

Who should decrease AGI?

A taxpayer who expects to be subject to the same or a lower tax rate next year should consider deferring income recognition. A taxpayer might be in a lower tax bracket next year if:

- The taxpayer becomes eligible for head-of-household status next year.
- The taxpayer expects to have a lower income next year due to retirement, job change, or other change in circumstance.
- The taxpayer is currently a child who will escape the kiddie tax next year and be in a lower bracket than their parents.

Numerous tax benefits phase out at specified AGI thresholds. As year-end nears, taxpayers who otherwise qualify for a tax benefit should consider strategies to reduce AGI this year to keep their income level below the relevant phaseout threshold. Some tax benefits that are limited by AGI (or modified AGI) include:

- Nondeductible Roth IRA contributions
- Deductible traditional IRA contributions
- Child tax credits

Observation: Child tax credits phase out in $50 increments meaning that, for some taxpayers, a $1 increase in AGI can trigger a $50 reduction in the credit.

- Qualified adoption expenses
- Student loan interest deductions
- Maximum amount of nonpassive income that can be used to offset passive losses from an active participation rental real estate activity

How to increase or decrease AGI before year-end

Taxpayers may be able to accelerate recognition of income by:

- *Accelerating installment sale gain.* A taxpayer who has unrealized profit on obligations arising out of installment sales made in prior years could sell part or all of the obligations or negotiate with the buyer for accelerated payments.

- *Recognizing savings bond interest.* A taxpayer can redeem U.S. Saving Bonds, or, for unmatured Series EE or I bonds, elect to report interest each year as it accrues. That way, all the income accrued through the end of this year (including interest that accrued in earlier years) is taxed in 2023.

Caution: This election can't be reversed without IRS consent. The taxpayer must, in all future years, pay tax annually on interest as it accrues, and not in the year the bonds mature or are redeemed.

Taxpayers may be able to reduce or defer recognition of income by:

- *Recognizing capital losses.* Taxpayers with unrecognized capital losses should consider recognizing those losses this year to offset capital gains that would otherwise be subject to the 15% or 20% long-term capital gains tax rate. Capital losses can also offset up to $3,000 ($1,500 in the case of a married taxpayer filing a separate return) of ordinary income if capital losses exceed capital gains by at least that amount. Recognizing capital losses to offset capital gains can also reduce the amount of income subject to the net investment income surtax.
- *Increasing contributions to 401(k) plans, SIMPLE pension plans, and Keogh plans.* Some individuals may be able to reduce AGI by increasing contributions to retirement plans such as 401(k) plans, SIMPLE pension plans, and Keogh plans.
- *Making IRA contributions.* Taxpayers have until the tax return filing deadline next April to make IRA contributions for 2023. Unlike Keogh plans, which must be in existence by year-end, IRAs can be set up when the contribution is made next year. Taxpayers might want to make IRA contributions earlier rather than later to maximize tax-deferred income on the contributed amount. Eligible taxpayers can also deduct contributions to traditional IRAs, subject to limitations.
- *Increasing contributions to a health savings account (HSA) or health FSA.* Individuals who are covered by a qualifying high deductible health plan (and are generally not covered by any other health plan that is not a qualifying high deductible health plan) may make deductible contributions to an HSA, subject to certain limits. Becoming HSA-eligible before year-end can salvage an HSA contribution made earlier in the year.
- *Deferring debt cancellation events*. If a taxpayer is planning to make a deal with creditors involving debt reduction, reacquire outstanding obligations for less than face amount, or planning some other debt reduction transaction that may result in the recognition of taxable income, postponing action until January can defer recognition of cancellation of indebtedness (COD) income.

Caution: When determining whether to defer debt cancellation, consider whether the taxpayer might be eligible to exclude COD income under an exception in Code Section 108 for insolvency, bankruptcy, certain student loans, and other circumstances.

Capital gains and losses

The appropriate year-end planning strategy for capital gains and losses depends on many factors including an individual's taxable income, tax rate, amount of adjusted net capital gain, and whether the individual has unrealized capital losses. For high-income taxpayers, planning must also take into account the 3.8% net investment income tax (NIIT).

When to recognize gains and losses

As year-end approaches, the taxpayer's income, gains, and losses for the year become more certain. This provides strategic planning opportunities. Many of these strategies also apply to reducing the impact of the NIIT.

Recognizing long-term capital gains may be beneficial if the taxpayer will be subject to a higher rate in the future. For taxpayers with taxable income below the zero-rate threshold amount, consider recognizing long-term gains up to the threshold amount.

Avoid recognizing long-term capital losses if taxable income from long-term capital gains and other sources will be below the zero-rate threshold amount, or if the taxpayer will be subject to a higher rate next year. However, taxpayers who have no capital gains should consider recognizing capital losses up to $3,000 ($1,500 in the case of a married taxpayer filing a separate return), which can be used to offset ordinary income.

Taxpayers holding municipal bonds that have decreased in value may benefit from a bond swap. This enables a taxpayer to recognize a loss for the decline in a bond's value while maintaining the cash flow generated by the bond. A bond swap is especially beneficial if the taxpayer has short-term capital gains that can be offset by the bond's capital loss, or the taxpayer's overall net capital loss after the bond disposition is $3,000/$1,500 or less (which the taxpayer can offset with other ordinary income).

Caution: Watch out for the wash sale rules (discussed below) if the replacement bond is purchased within 30 days of the sale of the old bond and the bonds are substantially identical.

Taxpayers can use the installment method to defer gain recognition on the sale of eligible assets. Under an installment sale, gain is recognized in the year payments are received. A like-kind exchange can also be used to defer gain on eligible exchange property.

Taxpayers should consider donating appreciated securities to an exempt organization instead of selling the securities and donating cash to the organization. That way, the gains will not be included on the donor's return.

Selling a principal residence? Strategic timing can yield tax benefits. A taxpayer who sells property used as a principal residence for at least two of the five years before the sale may exclude up to $500,000 in gain if married and filing a joint return. Taxpayers with another filing status (single, head-of-household and married filing separately) may exclude up to $250,000. A surviving spouse can qualify for the higher $500,000 exclusion if the sale occurs not later than two years after the decedent's death, if the requirements for the $500,000 exclusion were met immediately before death, and the survivor did not remarry before the sale.

Wash sales

The "wash sale" rule prevents a taxpayer from recognizing a loss on disposition of stock or securities when substantially identical stock or securities are bought and sold within a 61-day period (30 days before or 30 days after the date of sale). Thus, a taxpayer can't sell the stock or securities to establish a tax loss and simply buy it back the next day. The wash sale rule also applies if the taxpayer acquires an option to buy substantially identical stock or securities or if the taxpayer acquires substantially identical stock via their IRA. However, it is possible to partially preserve an investment position while realizing a tax loss by using one of these techniques:

- Double up. Buy more of the same stock or securities, then sell the original holding at least 31 days later. The risk here is the possibility of further downward price movement.
- Wait. Sell the original holding and then buy the same stock or securities at least 31 days later.
- Shift investments. Sell the original holding and buy similar securities in different companies in the same line of business. In the case of mutual fund shares, sell the original holding and buy shares in another mutual fund that uses a similar investment strategy. A similar strategy can be used with Exchange Traded Funds.

  (Tax Planning and Advisory Guide—Sales and Exchanges—avoiding the wash sale rules)

Observation: The wash sale rule applies only when stock or securities are sold at a loss. As a result, a taxpayer can recognize a gain on the sale of stock or securities in 2023 and then buy the substantially identical stock or securities back immediately without having to worry about the wash sale rule.

Constructive sales

Under the constructive sale rules, an appreciated financial position in stock is treated as sold, causing the taxpayer to recognize gain if the shareholder enters into a short sale of the same or substantially identical property, or enters into an offsetting notional principal contract, a put option, or similar transaction. The constructive sale causes the shareholder to recognize gain as if the appreciated shares were sold at fair market value on the date of the short sale or other similar transaction.

Under an exception to the constructive sale rules, however, gain may still be deferred with a short sale against the box, or other similar transaction, if (1) the transaction is closed before the 31st day after the close of the tax year; (2) the taxpayer holds the appreciated stock throughout the 60-day period beginning on the date the transaction is closed; and (3) at no time during that 60-day period is the taxpayer's risk of loss on the appreciated stock reduced by an option to sell, a short sale, or other similar position with respect to substantially identical stock.

Short sellers who want to defer a year-end gain on a short position to the beginning of the following year should wait until after year-end to begin to cover their short position. Those that want to take a year-end gain on a short position, for example to be able to use a recognized loss, can do so as late as the last trading day of the year by purchasing the stock that will be used to close the short position. (Tax Planning and Advisory Guide—Sales and Exchanges—constructive sale rules)

Installment sales

An installment sale can be an effective technique for closing certain transactions this year while deferring a substantial part of the tax on the sale to later years.

Consider using the installment sale method when selling Code Sec. 1231 property if the taxpayer has already recognized losses from sales of other Code Sec. 1231 property and would otherwise recognize a net Code Sec. 1231 loss this year. A net Code Sec. 1231 loss is treated as an ordinary loss that offsets ordinary income and is not subject to capital loss limits. Taxpayers have until the due date of their return (including extensions) to decide whether to elect out of installment reporting.

Caution: While maximizing current Code Sec. 1231 losses may produce a currently deductible ordinary loss, it also may cause future Code Sec. 1231 gains to be taxed as ordinary income rather than capital gain. Net Code Sec. 1231 gains are treated as ordinary to the extent of net Code Sec. 1231 losses for the previous five tax years that haven't been offset by Code Sec. 1231 gains in an intervening tax year.

Many types of transactions are not eligible for the installment sale method including sales at a loss, sales of stock or securities traded on an established securities market, and gain that's recapturable under Code Sec. 1245.

Dealers in property generally are barred from reporting current sales or dispositions under the installment method. However, dealers may use the installment method on sales of farm property, and on certain sales of timeshares and residential lots, if the seller elects to pay interest on the tax deferred by installment reporting. (Tax Planning and Advisory Guide—Sales and Exchanges—using the installment method)

Passive activity limitations

Losses generated by passive activities may only be used to offset passive activity income. Passive activity credits may be used only to offset tax on income from passive activities, with a carryover of any unused credits. In addition, the 3.8% NIIT applies to income from passive activities, but not from income generated by an activity in which the taxpayer is a material participant. Taxpayers can employ several year-end strategies for managing passive activity limitations.

Increase participation in the activity before year-end to satisfy the material participation test. A taxpayer can satisfy the material participation test by participating in an activity more than 500 hours during the tax year, participating more than 100 hours if no one else does more, or participating more than 500 hours in all the taxpayer's "significant participation activities."

Illustration: Javier owns interests in a restaurant, a shoe store, and an orange grove. Each of these ventures has several full-time employees. As of October 31, Javier has worked 200 hours in the restaurant, 200 hours in the shoe store, and 75 hours in the orange grove. If, by the end of the year, he puts in another 26 hours in the orange grove, he will have participated more than 500 hours in all his significant participation activities and the material participation standard will be satisfied.

To facilitate the preceding strategy, consider taking advantage of the one-time opportunity to regroup activities for the purpose of applying the passive activity rules.

Consider selling the passive activity. If a taxpayer disposes of their entire interest in the activity in a fully taxable transaction, then any loss from the activity for the tax year of disposition (including losses carried over from earlier years), over any net income or gain for the tax year from all other passive activities (including carryover losses from earlier years), is treated as a nonpassive loss. However, suspended passive activity credits are not freed up when the activity that generated them is sold, but the taxpayer may elect to increase the property's basis by the amount of the unused credits. (Tax Planning and Advisory—Passive Activities—planning to minimize the passive activity loss limitation)

Caution: If a passive activity is disposed of by means of an installment sale, suspended losses will become available for use in offsetting nonpassive income only as the buyer makes payments and in proportion to the amount of gain recognized with respect to these payments. To avoid this result, elect out of the installment method.

Real estate professionals can deduct some rental realty losses. For eligible taxpayers, losses and credits from rental real estate activities in which the taxpayer materially participates are not treated as passive and can be used to offset nonpassive activity income.

If possible, becoming more active in rental and business activities (including those conducted through partnerships and S corporations) will convert these activities from passive to nonpassive by meeting one of the material participation standards.

Standard and itemized deductions

By acting now, before December 31, taxpayers can maximize opportunities to reduce taxable income, whether itemizing deductions or claiming the standard deduction. (Tax Planning and Advisory Guide—Personal Financial Planning—itemized deduction planning)

Non-itemized deduction: charitable contributions

For 2023, there is no non-itemized deduction for charitable contributions. Individuals who want to deduct charitable contributions must itemize.

Above-the-line deductions: educator expenses

Eligible educators can deduct up to $300 of unreimbursed qualified expenses. Eligible educators are K-12 teachers, instructors, counselors, principals, or aides who worked at least 900 hours during a school year in a school providing elementary or secondary education. If both taxpayers on a joint return are eligible educators, each can deduct up to $300 of qualified expenses, for a maximum deduction of $600.

Eligible purchases include items such as books, supplies (athletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services), other equipment and supplementary materials used in the classroom, and personal protective equipment, disinfectant, and other supplies used for the prevention of the spread of COVID-19. Supplies purchased to facilitate online instruction are also eligible. Professional development expenses qualify for the deduction when they're related to either the curriculum in which the teacher provides instruction or the students for whom they provide instruction.

Above-the-line deductions: health savings accounts

Individuals or employees who were covered by a high-deductible health plan at any time during the year and make contributions to an HSA may be eligible for an above-the-line deduction. For 2023, the maximum deduction for an eligible individual with self-only coverage under an HDHP is $3,850. For an individual with family coverage under an HDHP, the limit is $7,750. Individuals who are age 55 or older can make catch-up contributions in addition to their regular contributions for the year. The annual catch-up contribution limit is $1,000.

Becoming eligible in December can salvage a contribution for the entire year. For computing the annual HSA contribution, taxpayers who are eligible individuals in the last month of the tax year are "deemed eligible" during every month of that year. Thus, they can make contributions for months before they enrolled in an HDHP.

Caution: A taxpayer who contributes to an HSA under the "deemed eligible" rule must remain eligible during the entire testing period (a 12-month period beginning with the last month of the tax year). Otherwise, any contributions made during a month when the taxpayer was "deemed eligible" are includible in gross income and subject to a 10% penalty tax.

Taxpayers may make contributions at any time before the contribution deadline, which is the due date (without extensions) for filing the individual's return for the year of the contribution.

Observation: A distribution that is not used to pay qualified medical expenses is includable in the gross income of the account holder. In addition, such a distribution generally is subject to an additional 20% tax. However, the 20% penalty tax does not apply to distributions made on account of death or disability or after the account holder reaches age 65. HSA contributions *can also be used to pay for qualified expenses of a spouse or dependent who is not covered by the HDHP.*

Itemized deductions: charitable contributions

Individuals may deduct contributions to charitable organizations up to a certain percent of their "contribution base" (generally, AGI). Through 2025, that percentage is 60% for cash contributions and 30% for noncash contributions.

For year-end planning, it's beneficial to review whether an individual has charitable contribution carryovers from a prior year. If income will decline, care should be taken to use the carryovers before they expire.

An individual with low basis, highly appreciated stock may want to consider funding a charitable remainder trust with the stock. The trust can sell the stock without incurring any income tax and make distributions over time to the current individual beneficiary (or beneficiaries) that will be taxed at the then-current rates in the years of distribution. The donor can also claim a charitable deduction in the year the trust is funded, equal to the value of the charitable remainder interest, subject to limitations.

Itemized deductions: medical expenses

A taxpayer can deduct medical expenses only to the extent the expenses exceed 7.5% of AGI. When the taxpayer expects to have expenses this year and next, it's important to determine whether bunching the expenses into either 2023 or 2024 can help ensure the taxpayer exceeds the deduction threshold in at least one of the two tax years. Similarly, for a taxpayer who expects to itemize deductions in either 2023 or 2024, but not both years, bunching expenses into the itemizing year can achieve tax savings.

Observation: One way to maximize the benefit of deductions is "bunching" – deferring or accelerating deductions into a single tax year to exceed the standard deduction or other thresholds. Bunching can be especially beneficial for taxpayers subject to the alternative minimum tax (AMT). A taxpayer who is subject to the AMT gets no benefit from the standard deduction.

A taxpayer might accelerate expenses by buying new prescription eye wear now and/or having orthodontic work done before the end of the year instead of putting it off until January or paying any unpaid medical or dental bills before the end of the year. A taxpayer generally can't deduct payments made this year for services that will be performed next year or later. However, special exceptions apply for (1) certain entrance fees to life care facilities allocable to medical care and paid in connection with obtaining lifetime care, and (2) certain medical insurance premiums paid by a taxpayer who is under 65 during the tax year for insurance covering medical care for the taxpayer, spouse, or dependent after the taxpayer reaches 65.

Observation: Careful timing of year-end payments remitted by credit card or check can yield tax savings. Eligible medical expenses remitted by credit card before the end of the year are deductible on this year's return, even if the taxpayer isn't billed for the charge until January. If a taxpayer pays by check dated and postmarked no later than December 31, it will count as a payment incurred this year even if the payee doesn't deposit the check until January 1 or later (assuming that the check is honored when first presented for payment).

Taxpayers can deduct medical expenses paid for medical dependents, subject to the overall AGI floor. The test for determining whether an individual qualifies as a dependent for medical deduction purposes is less stringent than that used to determine whether an individual is a dependent for other tax purposes.

Recommendation: To ensure that medical expenses paid for dependents will be allowed, the taxpayer should be prepared to prove the amount of support provided. Advising clients on best practices for documenting expenses and support will ensure a smoother tax season and fewer hassles down the road.

The taxpayer can deduct medical expenses paid for a medical dependent even if the dependent received gross income of $4,700 or less in 2023, filed a joint return, or if the taxpayer (or spouse if filing jointly) could be claimed as a dependent on someone else's return.

Illustration: Gabi contributed more than half of her mother's support during the tax year. She anticipates that her own medical expenses will exceed 7.5% of her AGI, and that she will be able to itemize her deductions. In December, her mother incurs substantial medical expenses. If Gabi's mother will not receive any tax benefit from these expenses, Gabi should consider paying the medical bills directly before year end. Gabi can then add these expenses to her own medical expenses when calculating the deduction on her return.

Itemized deductions: state and local taxes

Taxpayers who itemize their deductions can deduct certain taxes paid to state and local governments. However, through 2025, the Tax Cuts and Jobs Act limits the state and local tax (SALT) deduction to $10,000 ($5,000 for marrieds filing separately). The SALT deduction cap applies to the aggregate deduction for nonbusiness state and local taxes including real and personal property taxes, income taxes, and (by election) general sales taxes.

Observation: Generally, deductions for state and local business taxes are not subject to the limit–that is, taxes deducted on an individual's Schedule C (Profit or Loss from Business); Schedule E (Supplemental Income and Loss); or Schedule F (Profit or Loss from Farming) (i.e., paid or accrued in carrying on a trade or business or in connection with the production of income). However, property taxes included in a home office deduction are subject to the SALT cap.

Taxpayers with fluctuating income should try bunching their SALT payments, itemizing their deductions in one year and taking the standard deduction in the next. For this strategy to work, however, the tax must have been assessed before the payment is made (as determined by the state or local jurisdiction).

Taxpayers can elect to deduct sales and use tax in lieu of income taxes. Accelerating the purchase of a big-ticket item into this year is a good way to achieve a higher itemized deduction for sales taxes.

Education

Taxpayers who are paying or saving for their own or their dependents' education have several opportunities to maximize education-related tax benefits before year-end.

What's new?

- For tax years 2021-2025, discharges of many public and private student loans are excluded from gross income. (Checkpoint Federal Tax Coordinator ¶ J-7506 and Client Letter ¶ 2428.1) (Tax Planning and Advisory Guide—Education Funding—education loans; Client letter; Advisory Map)

AOTC or Lifetime Learning Credit

There are two credits that taxpayers can claim to offset the cost of education: the AOTC and the Lifetime Learning Credit. Both credits phase out for higher-income taxpayers.

AOTC is a credit for qualified education expenses paid for an eligible student for the first four years of higher education. The maximum annual AOTC is $2,500 per eligible student and it is refundable up to $1,000.

The Lifetime Learning Credit is a credit up to $2000 per return for qualified tuition and related expenses paid for eligible students enrolled in an eligible educational institution. This includes undergraduate, graduate, and professional degree courses, and courses to acquire or improve job skills. There is no limit on the number of years a taxpayer can claim this credit.

Taxpayers can claim credits for eligible expenses paid for education that begins this year or during the first three months of next year. A taxpayer who hasn't already maximized education credits for the student this year should consider making the spring tuition payment before year-end.

Caution: If educational expenses paid and deducted in 2022 are refunded in 2023, be mindful of the tax benefit rule–the taxpayer may need to include the benefit amount in income this year, even if the student is no longer the taxpayer's dependent.

Student loan interest deduction

Interest paid on a qualified student loan is deductible up to $2,500 per return, except for married taxpayers filing separate returns, for whom it is denied. This deduction phases out at higher income levels. Taxpayers who might fall within the phase out range for the student loan interest deduction this year should try to shift income to next year so that their current-year income falls below the phase-out threshold.

Student loan interest deductions might be lower this year for some taxpayers due to COVID-19 relief that reduced the interest on certain student loans to 0% and suspended certain student loan payments. Taxpayers should consider whether making additional student loan payments before December 31 will enable them to fully utilize the student loan interest deduction.

The allocation of payments between principal and interest for purposes of the deduction may not match the allocation stated on Form 1098-E from the lender or loan servicer. A taxpayer may be able to claim a deduction for payments allocated to principal by the lender to the extent the payments represent unpaid capitalized interest. For tax purposes, a payment generally applies first to stated interest that remains unpaid as of the date the payment is due, second to any loan origination fees allocable to the payment, third to any capitalized interest that remains unpaid as of the date the payment is due, and fourth to the outstanding principal.

Savings bonds

If certain requirements are met, an individual who redeems Series EE bonds issued after 1989 or Series I bonds may exclude all or part of the interest income on those bonds that would otherwise be taxable, to the extent used to pay the cost of attending college, vocational school, or other post-secondary educational institution (for the individual, a spouse, or a dependent). The exclusion phases out above a specified income threshold.

Caution: The interest exclusion applies only to bonds issued after the individual has reached age 24. Interest on a bond bought by a parent and issued in the name of their child under age 24 can't be excluded by either the parent or child.

As year-end approaches, consider paying next year's costs in advance if the costs paid during the year are less than the savings bond redemption proceeds during the year. For taxpayers planning to contribute to a 529 plan this year, consider redeeming bonds up to the contemplated contribution amount.

For clients planning to buy bonds as a year-end gift, consider feasibility of gifting cash to the parent of the child to enable the parent to buy the bonds in the parent's name. That way, if the bonds are redeemed to pay for the child's education, the exclusion may be available depending on the parents' income situation at redemption time.

Coverdell and 529 Plans

A 529 plan, also known as a qualified tuition plan, is a tax-advantaged savings plan designed to encourage saving for education costs. 529 plans are sponsored by states, state agencies, or educational institutions and contributions to such plans are considered completed gifts for federal gift tax purposes.

Observation: Although the Code doesn't limit annual contributions to 529 plans, each state has aggregate limits per beneficiary.

529 plans enable participants to prepay tuition costs for a particular beneficiary or contribute to an education savings account established to pay a beneficiary's elementary and secondary school tuition and higher education expenses, certain apprenticeship programs, and up to $10,000 of student loan debt.

Taxpayers may also contribute up to $2,000 annually to a tax-exempt Coverdell Education Savings Account (Coverdell ESA) for an individual under age 18 (and special needs beneficiaries of any age). The maximum contribution is reduced ratably for modified AGI between $190,000 and $220,000 for joint filers, and between $95,000 and $110,000 for others. (Tax Planning and Advisory Guide—Education Funding—education savings accounts, qualified tuition plans)

Disaster losses

Taxpayers with disaster losses in the current tax year need to determine whether to take them on this year's return or elect to deduct them in the immediately preceding year. (PPC's 1040 Deskbook—deducting personal casualty losses)

What's new?

Federally declared disasters for 2023 include the Vermont floods, Lahaina wildfires, and several other storms, floods and wildfires.

Federally declared disasters

For 2018-2025, individuals are not allowed to deduct personal casualty losses unless they are attributable to a federally declared disaster. A taxpayer may elect to deduct a disaster loss in the tax year before the year the loss occurred, instead of in the year the loss occurred (the "preceding year disaster loss deduction"). A disaster loss is a loss that occurs in a disaster area and is attributable to a federally declared disaster.

Observation: A non-casualty loss may be a disaster loss if incurred in the course of a trade or business or profit-seeking transaction.

Deducting disaster losses in the prior year

Net disaster losses of individuals are allowed as an addition to the standard deduction, subject to the $500 per-casualty floor, but exempt from the 10%-of-AGI limitation.

An election to deduct a disaster loss for the year before the year in which the loss occurs is made on an original return or an amended return for the preceding year. The original return or amended return must be filed on or before six months after the original due date for the taxpayer's return for the disaster year. So, a calendar-year taxpayer who suffers a disaster loss in 2023 has until October 15, 2024, to file an original or amended 2022 return to deduct the loss for 2022.

Earned income tax credit

The earned income tax credit (EITC) is determined based on a taxpayer's earned income from wages and other sources.

What's new?

- For 2023, the maximum earned income credit is $7,430 for those with three or more qualifying children.
- For 2023, the maximum amount of earned income on which the earned income tax credit will be computed is $7,840 for taxpayers with no qualifying children, $11,750 for taxpayers with one qualifying child, and $16,510 for taxpayers with two or more qualifying children.
- For 2023, the phaseout of the allowable earned income tax credit will begin at $16,370 for joint filers with no qualifying children ($9,800 for others with no qualifying children), and at $28,120 for joint filers with one or more qualifying children ($21,560 for others with one or more qualifying children).
- The amount of disqualified income (generally investment income) a taxpayer may have before losing the entire earned income tax credit is $11,000 for 2023.

A sample client letter that explains the EITC rules and eligibility requirements appears in Client Letter ¶ 2431.

Maximum EITC amount

An eligible individual is allowed an EITC equal to the credit percentage of earned income (up to an "earned income amount") for the tax year, subject to a phaseout. The maximum EITC for 2023 is $600 (for taxpayers with no qualifying children), $3,995 (one qualifying child), $6,604 (two qualifying children), and $7,430 (three or more qualifying children).

Disqualified income

A taxpayer may earn up to $11,000 of disqualified income in 2023 and still qualify for the EITC.

Caution: The $11,000 limit is a cliff, and there is no phase-out range. A taxpayer who earns $11,001 of disqualified income is denied the EITC entirely.

Disqualified income is, essentially, investment income along with rents and royalties not derived from a trade or business, and includes:

- interest or dividends included in gross income;
- tax-exempt interest;
- net income from nonbusiness rents or royalties;
- capital gain net income for the year (but not Code Sec. 1231 gains); and
- net income from passive activities

Taxpayers who believe they could have greater than $11,000 of disqualified income in 2023 should attempt to reduce or postpone receiving payments until 2024.

Illustration: Mary, an individual who would otherwise be eligible for the EITC owns a building with three apartments. She lives in one unit and rents the other two out for $1,000 each per month. She has $12,000 in deductible expenses associated with the units. If Mary rents out each unit for all 12 months of the year, she will have $12,000 in disqualified income (($1,000 x 2 x 12) - $12,000) and will not be able to take the EITC. If Mary cuts the rent from $1,000 to $900, she will only have $9,600 in disqualified income (($900 x 2 x 12) - $12,000) and will qualify for the credit.

Alternatively, taxpayers may try to postpone items of disqualified income until 2024. However, they should be careful that their strategy is not foiled by the constructive receipt doctrine.

Retirement

The SECURE 2.0 Act (the Act), passed at the end of 2022, made some major changes to employee and employer retirement plans that take effect in 2023.

What's New?

- *Increase in age for required beginning date for mandatory distributions*. Under the Act, the current required age component used to determine RBDs is referred to as the "applicable age," and increases from age 72 to: (A) age 73 starting on January 1, 2023 (for individuals who attain age 72 after December 31, 2022, and age 73 before January 1, 2033); and (B) age 75 starting on January 1, 2033 (for individuals who attain age 74 after December 31, 2032). This applies to distributions required to be made after December 31, 2022, with respect to individuals who attain age 72 after such date. (Checkpoint Federal Tax Coordinator ¶ H-8276.1 and Client Letter ¶ 1304)

Expert Insight: Due to an apparent drafting error in the Act's statutory language, the amendment increasing the RBD age from 73 to 75 could be interpreted to require application *of that increase to individuals who turn age 74 (rather than age 73) after December 31, 2032. A technical correction may be needed to clarify Congress's intent.*

- *Distributions to firefighters and long-term employees*. If an employee terminates employment after age 55 and takes a distribution from a retirement plan, the 10% early distribution tax does not apply. However, there is a special rule for "qualified public safety employees" in governmental plans, under which age 50 is substituted for age 55 for purposes of this exception from the 10% tax. This exemption applies to public sector firefighters, but not private sector firefighters. The Act extends the age 50 rule to private sector firefighters. In addition, the Act extends the exception to public safety officers with at least 25 years of service with the employer sponsoring the plan. (Checkpoint Federal Tax Coordinator ¶ H-11117 and Client Letter ¶ 2310)

Expert Insight: For distributions made to private sector firefighters under the age 50 rule, the exemption from the 10% early withdrawal tax applies to distributions made from a Code Sec. 401(a) qualified plan, a Code Sec. 403(a) qualified annuity, or a Code Sec. 403(b) tax-sheltered annuity, but not from an IRA.

- *No penalty on early distributions for individuals with terminal illness*. The Act provides that the additional 10% tax does not apply in the case of a distribution to a terminally ill individual. (Checkpoint Federal Tax Coordinator ¶ H-11120 and Client Letter ¶ 2310)

Expert Insight: Distributions made under this provision may be repaid to the plan under rules similar to the repayment rules that apply to qualified birth or adoption distributions.

- Some Act changes are effective in 2024:
  - *Penalty-Free Withdrawals for Certain Emergency Expenses*. The Act adds a new exception to the 10% early withdrawal tax for certain distributions used for emergency expenses, which are unforeseeable or immediate financial needs relating to personal or family emergency expenses. Only one distribution is permissible per year of up to $1,000, and a taxpayer has the option to repay the distribution within three years. No further emergency distributions are permissible during the three-year repayment period unless repayment occurs. (Checkpoint Federal Tax Coordinator ¶ H-11121 and Client Letter ¶ 2310)
  - *Surviving spouse election to be treated as employee*. Under the Act, in the case of an employee who dies before RMDs have begun under an employer-provided qualified retirement plan, and who has designated a spouse as sole beneficiary, the designated beneficiary surviving spouse may elect to be treated as if the surviving spouse were the employee for purposes of the required minimum distribution rules of Code Sec. 401(a)(9). The date on which the distributions are required to begin will not be earlier than the date on which the employee would have attained the applicable age. If the surviving spouse dies before the distributions begin, the surviving spouse is treated as the employee for purposes of determining the distribution period. (Checkpoint Federal Tax Coordinator ¶ H-8277.1 and Client Letter ¶ 1304)
  - *Tax-free rollovers from 529 accounts to Roth IRAs permitted*. The Act permits beneficiaries of 529 college savings accounts to make direct trustee-to-trustee rollovers from a 529 account in their name to their Roth IRA without tax or penalty. This provides an option for 529 accounts that have a balance remaining after the beneficiary's education is complete. (Checkpoint Federal Tax Coordinator ¶ A-4725.1, Client Letter ¶ 2430 (529 plans), and Client Letter ¶ 2331 (Roth IRAs))

- *Indexing IRA catch-up limit*. Under prior law, the limit on IRA contributions is increased by $1,000 (not indexed) for individuals who have attained age 50. The Act indexes that limit beginning in 2024. (Checkpoint Federal Tax Coordinator ¶ H-12215 and Client Letter ¶ 2320)
- *Penalty-free withdrawal from retirement plans for individual case of domestic abuse*. The Act allows retirement plans to permit participants that self-certify that they experienced domestic abuse to withdraw the lesser of $10,000, indexed for inflation, or 50% of the participant's account). This distribution is not subject to the 10% tax on early distributions. Additionally, a participant has the opportunity to repay the withdrawn money from the retirement plan over three years and will be refunded for income taxes on money that is repaid. (Checkpoint Federal Tax Coordinator ¶ H-11118.1 and Client Letter ¶ 2310)

- *Roth plan distribution rules*. Under prior law, required minimum distributions were not required to begin prior to the death of the owner of a Roth IRA. However, pre-death distributions are required in the case of the owner of a Roth designated account in an employer retirement plan (e.g., 401(k) plan). The Act eliminates the pre-death distribution requirement for Roth accounts in employer plans, effective for tax years beginning after 2023.Caution: Those turning 73 (the age to begin taking RMDs) this year who wait until next year to take their first RMD must take a second one by the end of 2024, possibly subjecting them to a higher tax rate. See NIIT considerations, below. (Checkpoint Federal Tax Coordinator ¶ H-12295.6E and Client Letter ¶ 2308)

Contributing to tax-advantaged accounts

A special rule allows taxpayers to deduct certain retirement savings contributions made after year-end. Under this rule, a contribution is treated as made on the last day of the tax year if (a) it is identified as being made for that year, and (b) it is made by the due date of the taxpayer's return, including extensions.

Caution: A qualified retirement plan generally must legally exist by the taxpayer's year-end to claim a deduction for the post-year-end contribution.

Post-year-end traditional IRA contributions are deductible in the prior year if the IRA is established by the tax return due date, *without extensions*, and the contribution is made by that date.

Net investment income tax considerations

Converting a traditional IRA to a Roth IRA will increase modified AGI, and potentially expose income (or more income) to the 3.8% NIIT. If possible, time year-end conversions to keep MAGI below the applicable NIIT threshold. If other net investment income will be lower next year, consider delaying the conversion.

For NIIT purposes, investment income doesn't include distributions from tax-favored retirement plans, such as qualified employer plans and IRAs. However, taxable distributions from these plans, including RMDs, are included in MAGI, potentially exposing other investment income to the extra tax. Taxpayers nearing the MAGI threshold, or who already exceed it because of other income, may have an RMD planning opportunity. The first RMD can be taken without penalty as late as April 1 of the year following the year the participant reaches the required beginning date for mandatory distributions (73 in 2023) (or, if older, retires). The additional distribution may cause the taxpayer to be in a higher tax bracket or become subject to the 3.8% NIIT. However, when making the two RMDs in separate years causes *both* years to be adversely affected, rather than just one, consider delaying the first distribution into the second year if that doesn't result in it being taxed at a higher rate. (Tax Planning and Advisory Guide—Individual Tax Planning—NIIT, Client letter)

Gift and estate tax

What's new?

The annual gift tax exclusion is $17,000 for 2023 and will rise to $18,000 in 2024. (Checkpoint Federal Tax Coordinator ¶ Q-5002 and Client Letter ¶ 2205). The unified estate and gift tax exclusion amount, $12,920,000 for gifts made and decedents dying in 2023, will rise to $13,610,000 for gifts made and decedents dying in 2024. (Checkpoint Federal Tax Coordinator ¶ R-7101 and ¶ Q-8005 and Client Letter ¶ 2205).

Observation: In 2024, because of the portability rules (see Checkpoint Federal Tax Coordinator ¶ R-7107 and Client Letter ¶ 2206), if a deceased spouse so elects, a surviving spouse could apply $27,220,000 against any tax liability arising from subsequent lifetime gifts and transfers at death.

The estate tax exclusion amount is set to revert to $5 million, adjusted for inflation, in 2026 with the expiration of the Tax Cuts and Jobs Act. Thus, unless the sunset date is extended, or the increased exclusion amount is made permanent, in 2026 the exclusion amount will reduce to approximately half of what it currently is.

Annual gift tax exclusion

For 2023, up to $17,000 of gifts made by a donor to each donee is excluded from the amount of the donor's taxable gifts. The exclusion increases to $18,000 in 2024. A gift that qualifies for the exclusion is not subject to gift tax or Generation-Skipping Transfer Tax.

Unused annual exclusions can't be carried over and are forever lost. It is best to make exclusion-eligible gifts as early as possible so as not to lose any of their benefit.

A married couple could, for example, gift another married couple up to $68,000 and still qualify for the exclusion under the split gift rule.

Illustration: Alex and Eliza are married. Alex transfers $34,000 to their adult child, George. If Eliza agrees to split the gift, the $34,000 will be treated as if Alex and Eliza each individually gave $17,000 to George. If George is also married, Alex or Eliza could also transfer $34,000 to George's spouse and treat that transfer as a split gift qualifying for the exclusion.

Recommendation: If a gift is made by check near the end of the year and the donor wants to qualify for this year's exclusion, the donee should deposit the check before year-end so there's no doubt as to when the gift was made.

Gifting income-producing or appreciated property

The donor and donee can realize overall income tax savings when income-earning property is given to a donee who is in a lower income tax bracket than the donor or who is not subject to the NIIT. Estate tax can also potentially be saved because both the value of the gift on the date of transfer and its post-transfer appreciation (if any) are removed from the donor's estate. Income can also be shifted to lower-bracket family members by giving them appreciated property to be sold by them at a gain. A valid gift of property that is completed before the property is sold generally shifts the tax liability on the gain from donor to donee, subject to Kiddie Tax rules.

Tuition and medical expenses

Tuition payments made *directly* to an educational institution and medical expenses paid *directly* to a medical care provider are exempt from gift and Generation-Skipping Transfer (GST) tax. These payments don't count toward the annual gift tax exclusion amount or lifetime unified credit and the donor does not need to file a gift tax return to report the gift.

For this purpose, primary, secondary, preparatory schools, high schools, colleges, and universities are considered "educational institutions." The tuition gift tax exclusion applies to payments for "tuition" only and not for other educational expenses such as books, supplies, and room and board. A donor might want to consider making tuition payments directly to the educational institution while using the $17,000 ($18,000 in 2024) annual exclusion to make a direct gift to the student, or a contribution to a 529 plan, to cover additional expenses such as books, supplies and room and board.

An alternative for those willing and able to make larger current gifts is to elect to take advantage of the special rule for "superfunding" a 529 plan (and certain other tuition programs), and make contributions to a 529 plan that exceed the annual gift tax exclusion into account ratably over a five-year period starting with the calendar year of the contribution, thus allowing a $85,000 gift made in 2023 ($90,000 in 2024) to qualify for annual exclusions.

Regarding medical expense gifts, note that the definition of medical care is broad and includes medical insurance. However, payments to medical providers for cosmetic surgery don't qualify for the exemption unless the surgery corrects a birth defect or disfigurement from injury or disease. (Tax Planning and Advisory Guide—Estate and Wealth Transfer Planning—transfers not considered a gift)

Gifts to minors

The annual exclusion for gifts applies only in the case of "present interests," which can be tricky when dealing with gifts to minors. However, a gift to a minor will be considered a present interest (and qualify for the exclusion) if the gifted property, and all the income generated by the property, may be spent for the minor's benefit before reaching age 21 and any amount not spent by then will go to the minor upon reaching age 21. (Tax Planning and Advisory Guide—Estate and Wealth Transfer Planning—gifts to minors)

Observation: Gifts to minors may be made through custodians designated under the Uniform Transfers to Minors Act (and predecessor acts) as adopted by various states. Such gifts generally qualify for the annual exclusion.

Effect of the kiddie tax

The "kiddie tax" can limit tax savings from intrafamily gifts of income-producing property. Under the kiddie tax rules, a child pays tax at the trust and estate marginal rate on the child's unearned income over the kiddie tax exemption amount ($2,500 for 2023; $2,600 for 2024) if that tax is higher than the tax the child would otherwise pay on the income. Alternatively, the parent can elect in some cases to include the child's income on the parent's return.

Children 18 and older can increase their earned income to exceed more than half of their support and thus avoid the kiddie tax on their unearned income. This does not apply for children under age 18. Also note that in all cases, the child's earned income can be sheltered by the child's standard deduction and other deductions, and earned income exceeding those deductions will be taxed at the child's tax rate.

Election by complex trusts and estates

Complex trust and estate distributions made within the first 65 days of the year may electively be treated as paid and deductible in the prior year. Thus, fiduciaries can wait until next year to decide whether the payments may be more profitably imputed back to 2023 via the 65-day rule or treated as 2024 payments. If an entity elects to treat a 2024 distribution as paid in 2023, the distribution is taxable to the beneficiary in 2023. The election doesn't have to be made for the entire amount distributed; it can apply to only part of the amounts distributed to a beneficiary.

Year-End Tax Planning for 2023: Businesses

What's new for businesses in 2023?

Congress passed the Inflation Reduction Act of 2022 which extends, through 2024, the credit for electricity produced from certain renewable resources; the energy credit; and other energy-related credits (with various extension dates).

The Act also introduced two new corporate taxes and various new clean energy related tax credits effective beginning in 2023. The two corporate taxes are: (a) the 15% corporate alternative minimum tax on the adjusted financial statement income of applicable corporations (sometimes referred to as the "Book Minimum Tax") and (b) the 1% excise tax on the repurchase of corporate stock. (Tax Planning and Advisory Guide—Closely-held C Corporations—corporate alternative minimum tax)

For businesses looking to invest, the Inflation Reduction Act's clean energy tax credits are some of the most impactful federal climate policies to date. Investing in clean energy technology will lower the costs of utilities, reduce carbon waste, and lower your tax bill. ~ Shannon Christensen, Executive Editor

Cash vs. accrual method

Any entity, other than a tax shelter, that meets an inflation-adjusted average annual gross receipts test ($29 million for tax years beginning in 2023; estimated $30 million for 2024) can use the cash method of accounting. A C corporation that is a qualified personal service corporation (PSC) is also allowed to use the cash method, regardless of average annual gross receipts, provided it does not maintain inventories for tax purposes. Use of the cash method provides year-end planning opportunities for shifting income and deductions with an eye to tax savings. Taxes can easily be deferred by (a) postponing billings until next year, and (b) accelerating deductible expenditures into this year subject, however, to the passive activity limitations and the at-risk rules.

Although income-deferral and deduction-acceleration are standard year-end tax planning strategies, this year circumstances may favor doing the opposite. For example, if Congress raises the top individual, capital gain, and corporate tax rates, accelerating income into this year might subject it to a lower tax rate, and deferring deductions into next year could allow them to be taken against higher taxed income.

For cash method taxpayers, business expenses generally are deductible when paid. To increase recognition of expenses for the current year, these taxpayers should consider paying invoices received before year-end, and even prepaying some expenses where feasible. However, a business that could be subject to increased rates next year might want to defer expense payments until then, when feasible from a business standpoint. Note, however, that some prepayments made by cash method taxpayers, such as prepaid compensation, must be prorated over the period to which they apply.

Acceleration of expenses is more difficult for accrual method taxpayers. For them, expenses generally aren't deductible until property is delivered or services are performed. This may be advantageous, however, if tax rates are higher next year, in which case businesses may want to delay some deliveries, or performance of some services. However, prepaid expenses may be deductible in the current year under certain circumstances. For example, when the taxpayer reasonably expects the property or services to be provided or performed within 3.5 months after making the payment, or when the recurring item exception applies, generally when economic performance occurs within 8.5 months after the close of a tax year. The recurring item exception must be consistently applied for a type of item or all items from one year to the next, so it is unlikely that IRS would approve a switch from that method to generate a short-term tax advantage, and, in any event, businesses may not want to forego its advantages permanently. For ratable service contracts, taxpayers can treat economic performance as occurring on a ratable basis over the term of the service contract when certain conditions are met.

The timing of year-end bonus payments is an area where both cash- and accrual-basis employers have some opportunity to time deductions. Cash-basis employers deduct bonuses in the year they are paid, so they can time the payment for maximum tax effect. Accrual-basis employers, on the other hand, deduct a bonus in the accrual year when all events related to it are established with reasonable certainty. However, the bonus must be paid within 2.5 months after the end of the accrual employer's tax year for the deduction to be allowed in the earlier year. Accrual employers looking 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 2.5-month window or change the bonus plan's terms to make the bonus amount not determinable at year end.

Depreciation and expensing

One consideration is the possibility of changes in the taxpayer's tax rate in future years, whether based on predictions about the taxpayer's business or about legislative changes in tax rates. For example, a possibility of sufficiently higher future rates may result in trying to defer deductions by deferring purchases of property eligible for full expensing or bonus depreciation. On the other hand, an example of a reason not to defer purchases is that the 80% rate of bonus depreciation is scheduled to phase down after 2023.

Bonus depreciation

For 2023, a first-year bonus depreciation deduction falls to 80% of the adjusted basis of depreciable property is allowed for qualified property acquired and placed in service during the year. (Checkpoint Federal Tax Coordinator ¶ L-9311.0)

Qualifying property includes tangible property depreciated under MACRS with a recovery period of 20 years or less, most computer software, qualified film, television, and live theatrical productions, and water utility property.

Possible higher tax rates next year might make some businesses want to defer placing bonus-depreciation-eligible property into service until next year, or to opt out of bonus depreciation on their tax return for this year.

President Biden's key business tax provisions for the 2024 fiscal year budget include a proposal to increase the U.S. corporate income tax rate from 21% to 28%. Advising clients to plan for future tax rate increases should include a discussion to hold off on major purchases and defer expense deductions into future years where the tax rate is higher. This will reduce taxable income and lower their future tax bill. ~ Shannon Christensen, Executive Editor

However, taxpayers should remember that under current law the bonus depreciation deduction falls to:

- 60% for property placed in service in 2024,
- 40% for property placed in service in 2025,
- 20% for property placed in service in 2026, and
- 0% for property placed in service in 2027.

What's new?

For 2023, the maximum amount of section 179 property that can be expensed will be $1,160,000 (estimated to be $1,220,000 for 2024). That full amount is available until qualifying property placed in service during the year reaches $2,890,000 ($3,050,000 for 2024), at which point a phase out begins. (Checkpoint Federal Tax Coordinator ¶ L-9907)

Section 179 expensing

Taxpayers (other than estates, trusts, and certain noncorporate lessors) can also elect to deduct expenses for the cost of eligible property placed in service in the taxpayer's trade or business during the tax year, subject to limitations.

Property eligible for 179 expensing includes:

- Tangible Code Sec. 1245 property (generally, machinery and equipment), depreciated under the MACRS rules, regardless of its depreciation recovery period,
- Off-the-shelf computer software,
- Qualified improvements to building interiors, and
- Roofs, HVAC systems, fire protection systems, alarm systems, and security systems.

The eligible property can be new or used.

For 2023, the maximum amount of section 179 property that can be fully expensed is $1,160,000 ($1,220,000 for 2024). That limit phases out dollar-for-dollar once the amount of section 179 property placed in service during the tax for year exceeds $2,890,000 ($3,050,000 for 2024). This means that a business can no longer claim section 179 expensing in 2023 if it places in service $4,050,000 or more of expense-eligible property.

Businesses have much flexibility in choosing whether to elect expensing in response to possible late year legislation. The election can be made or revoked as late as the due date for filing an amended return for the election year.

Business interest deductions

The Internal Revenue Code limits the deduction of business interest expenses. The deduction limit on business interest doesn't apply to businesses with 3-year average gross receipts of $29 million or less for 2023. ($30 million or less for 2024). The limitation also does not apply to deductions for interest paid by vehicle dealers on carried inventory. In addition, some real estate related businesses can opt out of the limitation, if they forego accelerated depreciation. Interest that can't be deducted due to the limitation is carried forward indefinitely.

What's new?

Two changes made by the Inflation Reduction Act of 2022 became effective on January 1, 2023. First, a 15% corporate alternative minimum tax will apply to corporations with average annual adjusted book income over $1 billion for a period of three consecutive years.

The second change is a 1% corporate stock buyback excise tax. This tax applies to corporations with stock traded on an established securities market that repurchase more than $1 million of stock over the course of a tax year. In late 2022, the IRS issued a Notice providing interim guidance on the operation of the tax and in June 2023 the IRS announced that taxpayers would not be required to report or pay the stock repurchase tax before the IRS issues regulations. For a discussion of the buyback tax and available guidance, see Checkpoint Federal Tax Coordinator ¶ F-11920 et seq. A client letter on the buyback tax can be found at Client Letter ¶ 2157.3.

Expert Insight: The buyback tax may apply to more than just public company buyback arrangements. It may also factor into corporate reorganizations where there is boot involved, split-off transactions, leveraged buyouts, preferred stock redemptions, including mandatorily redeemable preferred stock, and special purpose acquisition company redemptions. Moreover, there are netting rules for stock issuances to be considered.

A key business tax provision proposed by President Biden is to raise the 1% excise tax on corporate stock repurchases from 1% to up to 4%. Advise your corporate clients that they will save on taxes if they repurchase outstanding corporate stock in 2023, before any potential increase to the excise tax takes effect. ~ Shannon Christensen, Executive Editor

Qualified business income deduction

Through 2025, eligible taxpayers can deduct up to 20% of qualified business income (QBI) from a domestic sole proprietorship, partnership, S corporation, trust, or estate, and up to 20% of the combined qualified real estate investment trust (REIT) dividends and publicly traded partnership income (PTP) of the taxpayer. The combined deduction cannot exceed 20% of the excess of the taxpayer's taxable income over net capital gain for the year. Trades or businesses involving the performance of services in fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business whose principal asset is the reputation or skill of one or more of its employees or owners do not qualify for the QBI deduction unless the individual taxpayer's income is below a phase-out threshold.

For 2023, specified service businesses qualify for the QBI deduction if their taxable income is less than $182,100 for single and head of household filers, and $364,200 for joint filers and $182,100 for separate filers. (For 2024 projected to be $191,900 for $383,850 for joint filers, and $191,925 for married filing separate returns).

The deduction phases out ratably over the next $50,000 of taxable income over the thresholds ($100,000 phaseout for joint return filers). For 2023, the deduction totally phases out at $232,100 for singles, heads of household and married separate filers and $464,200 for joint filers for 2023. (For 2024 projected to be $241,900 for singles, heads of household and separate filers and $483,850 for joint filers). (Tax Planning and Advisory Guide—QBI; Advisory Map)

Year-end strategies

Taxpayers with income near the threshold for this year may benefit from accelerating deductions or deferring income, when possible, so their taxable income falls below the threshold. Similarly, if the taxpayer is well below the threshold this year but expects to exceed it next year, consider options to pull more income into 2023. This could have the added benefit of lower tax on the accelerated income in the event of higher tax rates next year.

Net operating losses

Changes to the NOL deduction in 2021 as well as other recent-year changes impact year-end planning opportunities and strategies.

Some recent changes to the NOL deduction and carryback rules are worth noting:

- 2018, 2019, and 2020 NOLs may be carried back five years and carried forward indefinitely; and
- Post-2020 NOLs may not be carried back (except for farm losses, which may be carried back two years), but may be carried forward indefinitely.

- Starting with the 2021 tax year, the NOL deduction is subject to an 80% of taxable income limitation (not counting the NOL or the qualified business income deduction)

NOLs from before 2018 could be carried back two years and carried forward only 20 years.

What this boils down to is that for earlier tax years, NOL carryovers and carrybacks could fully offset taxable income, but unused losses couldn't be carried forward indefinitely. Starting with the 2021 tax year, deductions for NOLs generated after 2017 are limited by the 80% standard, but unused losses may be carried forward indefinitely.

NOL carryforwards of noncorporate taxpayers are increased by their nondeductible "excess business losses," which are, with many modifications, the excess of the taxpayer's aggregate trade or business deductions for the tax year over its aggregate gross business income or gain plus $250,000 ($500,000 for joint return filers), as adjusted for inflation. For 2023, the threshold amount is $578,000 ($610,000 in 2024) for joint filers and $289,000 ($305,000 in 2024) for all other filers.

Making the most of NOLs

A taxpayer that may have difficulty taking advantage of the full amount of an NOL carryforward this year should consider shifting income into and deductions away from this year. By doing so, the taxpayer can avoid the intervening year modifications that would apply if the NOL is not fully absorbed in 2023. This may also avoid potentially higher tax rates next year on the accelerated income and increase the tax value of deferred deductions.

When to avoid an NOL

A corporation (other than a large corporation) that anticipates a small NOL this year and substantial net income next year may find it worthwhile to accelerate just enough of its 2024 income (or to defer just enough of its 2023 deductions) to create a small amount of net income for this year. This will permit the corporation to base next year's estimated tax payments on the lower income shown on its 2023 return, rather than having to pay estimated taxes based on its higher 2024 taxable income.

Partnership and S corporation losses

Losses and shareholder or partnership basis

A shareholder can deduct its pro rata share of S corporation losses only to the extent of the total of its basis in the S corporation stock and debt. This determination is made as of the end of the S corporation tax year in which the loss occurs. Any loss or deduction that can't be used on account of this limitation can be carried forward indefinitely. If a shareholder wants to claim a 2023 S corporation loss on its own 2023 return, but the loss exceeds the basis for its S corporation stock and debt, it can still claim the loss in full by lending the S corporation more money or by making a capital contribution by the end of the S corporation's tax year (in the case of a calendar year corporation, by December 31).

Similarly, a partner's share of partnership losses is deductible only to the extent of their partnership basis as of the end of the partnership year in which the loss occurs. Basis can be increased by a capital contribution, or in some cases by the partnership itself borrowing money or by the partner taking on a larger share of the partnership's liabilities before the end of the partnership's tax year. (Advisory Map: Maximizing a Partner's Outside Basis and Allocating Liabilities; Advisory Map: Maximizing an S Corporation Shareholder's Basis)

Passive activity limitations

The impact of the passive activity loss limitation rules must also be considered. Limited partners always have passive activity interests except to the extent IRS regs say otherwise. If an individual who is a limited partner meets the material participation test under the 500-hours-of-participation rule, the five-of-ten-years-of-material-participation rule, or the any-three-prior-year-material-participation rule for a personal service activity, the partner is treated as materially participating in any activity of the limited partnership. This will affect the application of the passive activity rules to their share of any income, gain, loss, deduction, or credit attributable to the limited partnership interest and to any gain or loss from the activity recognized on the sale or exchange of the interest.

Year-End Tax Planning for 2023: Payroll

What's new for businesses in 2023?

Reduced Threshold for Required Electronic Filing

The Taxpayer First Act (TFA, PL 116-25) contained a provision that permitted the IRS to issue regulations to reduce the 250-return threshold that triggers the electronic filing mandate of wage statements (Checkpoint Payroll Guide ¶4261) and information returns (Checkpoint Payroll Guide ¶4264). The IRS released final regulations in February 2023 that reduced e-filing threshold mandate from 250-return of a single type of information return to 10 information returns in aggregate for the 2023 tax year (2024 filing year). This is a significant decrease and will trigger more electronic filing in the 2024 processing year. Payroll-related forms impacted by the reduced threshold include:

- Form W-2
- Form 1099 series, including Form 1099-NEC, 1099-MISC, and 1099-R.
- Affordable Care Act returns, including Form 1094 series, Form 1095-B, and 1095-C.
- Forms 3921 and 3922
- Form 5498
- Form 8027

The reduced filing threshold will impact smaller employers. Early preparation is the key for a smooth transition to electronic filing. Newly impacted businesses should identify their resources to comply with the electronic filing requirements. Also, tax professionals should verify state electronic filing requirements. Some states may follow the federal threshold reduction. ~ Debbie Tam CPP, Senior Editor

Employee Retention Credit Processing Moratorium

The IRS announced a moratorium on the processing of new Employee Retention Credit (ERC) claims through December 31, 2023, in response to a surge in questionable claims resulting from aggressive ERC promoters and marketing (Checkpoint Payroll Guide ¶20,905). The ERC, now expired, was established during the height of the COVID-19 pandemic to provide relief to businesses and workers. New claims may be filed, however, the IRS will be pausing processing until at least 2024.

The IRS noted that the number of fraudulent ERC claims has increased. However, for those taxpayers with legitimate claims, the ERC may be claimed for the 2020 tax periods by April 15, 2024, and for the 2021 tax periods by April 15, 2025, using Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund.

Since the COVID-19 pandemic, the IRS has had a significant Form 941-X backlog. Currently, the form can only be filed on paper. Some of the IRS funding from 2022's Inflation Reduction Act will be dedicated to expanding electronic filing options, including for employment tax returns (and corrected returns). In addition, the IRS has said it will work with Congress to legislatively address ERC fraud. These and other actions may help the ERC process when the moratorium is lifted in 2024. ~ Christopher Wood CPP, Senior Editor

Employee Retention Withdrawal Process and Settlement Initiative

The IRS will be introducing a withdrawal process that allows taxpayers to withdraw a previously filed ERC claim. For businesses that already received an ERC payment, the IRS is establishing a special settlement program that will allow taxpayers to make repayments for the improperly received ERC payment. Details on the withdrawal process and settlement initiative are forthcoming (Checkpoint Payroll Guide ¶20,905).

Employers and practitioners should revisit any ERC tax credit claims to ensure eligibility. The IRS provides an ERC eligibility checklist for assistance. If any questions arise, look for future IRS guidance on the withdrawal and settlement programs to help navigate this complicated subject. ~ Christopher Wood CPP, Senior Editor

FUTA Credit Reduction

Under the Federal Unemployment Tax Act (FUTA), employers generally pay FUTA tax on the first $7,000 in wages for each employee each year. The FUTA tax rate is 6.0%. However, most employers benefit from a 5.4% FUTA credit, resulting in a FUTA rate of 0.6% on the first $7,000 in wages per employee, each year (Checkpoint Payroll Guide ¶4075).

During the COVID-19 pandemic, a number of states took federal loans to keep their unemployment trust funds solvent. States that default on these loans for two or more consecutive years are subject to a reduction in credits otherwise available against the FUTA tax.

Currently, California, Connecticut, Illinois, New York, and the U.S. Virgin Islands are listed by the U.S. Department of Labor as potential FUTA credit reduction states for 2023. These tax jurisdictions have until November 10, 2023, to repay their loans or their FUTA tax credit will be reduced. All of these tax jurisdictions were subject to a FUTA credit reduction for 2022.

The DOL finalizes the list of FUTA tax credit reduction states shortly after November 10. IRS Form 940 (Employer's Annual Federal Unemployment (FUTA) Tax Return) and Schedule A (Form 940) (Multi-State Employer and Credit Reduction Information) provide further information to employers about FUTA tax credit reductions (e.g., reporting and paying the additional taxes). Employers in potential FUTA tax credit reduction states should monitor both the DOL and IRS's websites for announcements and form releases. ~ Debbie Tam CPP, Senior Editor

What's new for businesses in 2024?

IRIS Form 1099 Filing Portal

The Taxpayer First Act (TFA) (TFA, PL 116-25) required the IRS to develop an internet platform that will allow taxpayers to electronically file Forms 1099. The platform, the Information Returns Intake System (IRIS) was launched in January 2023. All 1099 series forms, including Form 1099-NEC used for reporting nonemployee compensation, can be filed via the platform. The Filing Information Returns Electronically (FIRE) system will remain available for bulk filing of Form 1099 series and the other information returns through at least the 2023 filing season. Form 1099-NEC is due by January 31, while Forms 1099-MISC must be filed by March 31 (Checkpoint Payroll Guide ¶4264).

2024 ACA Affordability Percentage

The 2024 ACA affordability percentage for employers to avoid the employer-shared responsibility payment (ESRP) is 8.39% (a decrease from 9.12% in 2023). *Effective January 1, 2023*, the affordability percentage applies to family plans that cover the employee and family members rather than just self-only coverage (Checkpoint Payroll Guide ¶3401).

The 2024 ACA affordability percentage is the lowest percentage since the ACA was enacted. Employers should evaluate their health plans and ensure that at least one plan in their package is available to their full-time equivalent employees that meets the affordability percentage or face a possible ESRP. ~ Debbie Tam CPP, Senior Editor

2024 Thresholds for Health Savings Account and Excepted Health Reimbursement Arrangements

Health Savings Accounts. "Eligible individuals" may, subject to statutory limits, make deductible contributions to an HSA. In general, a person is an "eligible individual" if he or she is covered under a high deductible health plan (HDHP) and is not covered under any other health plan that is not a high deductible plan, unless the other coverage is permitted insurance (e.g., for worker's compensation, a specified disease or illness, or insurance providing a fixed payment for hospitalization) (Checkpoint Payroll Guide ¶3408).

Employers, as well as other persons such as family members, may also contribute on behalf of an eligible individual. Employer contributions generally are treated as employer-provided coverage for medical expenses under an accident or health plan and are excludable from income.

Annual contribution limitation. For 2024, the maximum annual contribution to an HSA is $4,150 for self-only coverage and $8,300 for family coverage.

High deductible health plan defined. For calendar year 2024, an HDHP is a health plan with: (1) an annual deductible of at least $1,600 for individual coverage, or $3,200 for family coverage; and (2) maximum out-of-pocket expenses of $8,050 for individual coverage, or $16,100 for family coverage.

Annual contribution limitation. For 2024, the maximum annual contribution to an HSA is $4,150 for self-only coverage and $8,300 for family coverage.

Health Reimbursement Arrangements

HRAs are a type of account-based health plan that employers can use to reimburse employees for their medical care expenses. Benefits are paid up to a specific dollar amount from funds provided exclusively by the employer (and not through a salary reduction or otherwise under a cafeteria plan) (Checkpoint Payroll Guide ¶3405).

Employers are permitted to offer traditional group health plans to provide an excepted benefit HRA of up to limits that are indexed to inflation and adjusted annually, even if the employee doesn't enroll in the traditional group health plan, and to reimburse an employee for certain qualified medical expenses, including premiums for vision, dental, and short-term, limited-duration insurance.

For plan years beginning in 2024, the maximum amount that may be made newly available for the plan year for an excepted benefit HRA is $2,100.

Year-end Tax Planning for 2023: Practice Aids

Extenders and expiring provisions 2023

Tax provisions expiring in 2023 (per Joint Committee on Taxation)

The following Airport and Airway Trust Fund excise taxes:

- All tax rates (except for the permanent 4.3-cents-per-gallon rate) on noncommercial aviation kerosene and noncommercial aviation gasoline (IRC Secs. 4081(d)(2)(B) and 4083(b))
- Domestic and international air passenger ticket taxes and ticket tax exemption for aircraft in fractional ownership aircraft programs (IRC Secs. 4261(k) and (j))
- Air cargo tax (IRC Sec. 4271(d))
- Surtax on fuel used in aircraft in a fractional ownership program (IRC Sec. 4043(d))

Provisions extended through December 31, 2024, via the Inflation Reduction Act of 2022.

- Credit for electricity produced from certain renewable resources
- Energy credit for solar panels
- Credit for use of biodiesel and other alternative fuels
- Credit for nonbusiness energy-efficient placed placed in service before January 1, 2033
- Residential energy efficient property (REEP) credit,extended for property installed in years before 2035
- New Energy Efficient Home Credit (NEEHC) extended for new energy efficient homes acquired before January 1, 2033

Provisions recently extended through December 31, 2025:

- CARES Act exclusion for employer payments of student loans
- Exclusion for canceled mortgage debt

New Markets Tax Credit

- Work Opportunity Credit
- Empowerment Zone Tax Incentives
- Employer Credit for paid family and medical leave

Year-End Tax Planning Checklist for Individuals

- Determine whether the client's marital status has changed during the year. Has there been a change in the number of their dependents?
- High-income taxpayers must be careful of the 3.8% net investment income (NII) tax. Taxpayers who may be subject to this tax should consider ways to minimize NII for the remainder of the year by, for example, not selling stock or other investment property.
- Analyze capital gains. Should the client consider selling capital loss assets to shelter capital gains? Also, remember individuals may deduct $3,000 a year in capital losses against ordinary income.
- Clients should postpone income until next year and accelerate deductions into this year if doing so will enable the client to claim larger claim larger deductions, credits, and other tax breaks for this year that are phased out over varying levels of AGI. Postponing income to next year also is desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances.
- In some cases, it may pay to accelerate income into 2023. For example, when a person expects to be in a higher tax bracket next year or who will have a more favorable filing status this year than next (e.g., head of household versus single filing status). This will also apply to individuals who will be subject to a higher tax rate next year under pending tax legislation.
- Clients interested in converting a traditional IRA to a Roth IRA should consider converting traditional-IRA money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in the current year if eligible to do so. Keep in mind, however, that such a conversion will increase AGI for the current year, and possibly reduce tax breaks geared to AGI.
- Consider whether a client should defer a year-end bonus from an employer until next year. Be careful of the doctrine of constructive receipt.
- Determine whether the client should take the standard deduction or itemize. It may be advantageous to push itemized deductions into next year and take the standard deduction this year. Be careful, though, many itemized deductions are disallowed:
  - Miscellaneous itemized deductions are disallowed.
  - Taxpayers can only deduct medical expenses to the extent they exceed 7.5% of AGI.
  - No more than $10,000 of state and local taxes may be deducted.
  - Personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI limits are met.
- Consider whether to employ a bunching strategy to pull or push discretionary medical expenses and charitable contributions (and SALT payments, if the limits are repealed) into the year where they will do some tax good. Individuals could consider using a credit card to pay deductible expenses before the end of the year. Under the cash method of accounting, these expenses are deductible in the current year, even if the credit card bill is paid after the end of the year.
- If the client has education expenses, did they take full advantage of the AOTC and Lifetime Learning Credit? If not, consider trying to accelerate expenses into this year.
- The age at which taxpayers must begin taking RMDs from a 401(k) plan or IRA has increased to 73.
- Taxpayers who are 70½ or older by the end of the year should consider whether to make a charitable contribution (qualified charitable distribution, or QCD) from their traditional IRA. QCDs are excluded from the taxpayer's income but are not deductible. However, the taxpayer may still claim the entire standard deduction.
- Review with clients the amount set aside for next year in their employer's health FSA and HSAs to ensure they're able to fully utilize these amounts in 2023. Roll them over to the next year to the extent necessary and possible.
- Make sure clients are taking full advantage of their annual gift tax exclusion ($17,000 for 2023), if they sometimes run up against (or exceed) this exclusion amount. Remember this amount is per person, for both donors and donees. For example, a married couple could give a married child and their spouse up to $68,000 (4 x $17,000) without incurring gift tax.

- Consider whether to claim uninsured, unreimbursed casualty or theft losses related to a federally declared disaster on this year's return or on last year's return. The client should settle insurance or damage claims related to this disaster by year's end to claim the deduction.
- For low-income clients, analyze the changes to the EITC to determine how the amounts of and eligibility for the credit have changed.
- Review whether the client has any kiddie tax issues.

Year-End Tax Planning Checklist for Businesses

- Determine if a corporate client will be subject to the corporate alternative minimum tax in 2023 and plan accordingly if this looks likely.
- For clients other than C corporations, review issues related to the Qualified Business Income deduction, with particular attention to where the client stands on the dollar thresholds and amount of W-2 wages.
- If the client has placed less than $1,160,000 of section 179 property in service during the year, consider whether to place more of such property in service to take full advantage of the limits.
- Consider whether the client can take advantage of the bonus depreciation deduction. This write-off is available without proration, even if qualifying assets are in service for only a few days in the current year.
- Consider purchasing items that qualify for the de minimis safe harbor ("book-tax conformity") election under the repair regs.
- Consider whether a corporate client that anticipates a small net operating loss (NOL) for the current year and substantial net income next year may find it worthwhile to accelerate just enough of next year's income (or to defer just enough of its current deductions) to create a small amount of net income for the current year. This will permit the corporation to base its estimated tax installments for next year on the relatively small amount of income shown on its current return, rather than having to pay estimated taxes based on 100% of its much larger next-year taxable income.
- Consider whether the client can postpone cancellation of debt income by deferring a debt-cancellation event until next year.
- If the client has a passive activity with suspended losses, consider disposing of the activity before the end of the year to take the losses.
- Review business interest paid or incurred by the client to see if limitations apply.

Year-End Tax Planning Checklist for Payroll

- Identify payroll processing needs for upcoming company holidays.
- Review key figures, pension and retirement limits, Social Security wage base limit, standard mileage rates, state unemployment wage base limits, and federal and state withholding tables for 2024.
- Register for the SSA's Business Services Online (BSO) portal. If registered, verify your BSO password in November or December before the W-2 filing season in January. Passwords expire every 90 days. Requesting a new password can take up to 10 business days since these are mailed via USPS.
- Register for the IRS's FIRE or IRIS system to electronically file Forms 1099 series. Note that Transmitter Control Codes (TCC) must be current to file in either system. Separate TCCs are required for each system. An IR Application for TCC must be completed by users that did not claim a legacy FIRE TCC by August 1 deadline to file in 2024 for the 2023 tax year. Register for the Affordable Care Act Information Return (AIR) system to electronically file ACA Forms 1094-B, 1095-B, 1094-C, and 1095-C. An ACA TCC is required to use the AIR system.
- Determine what employee notices must be provided annually (e.g., Earned Income Tax Credit notices are required by some states).
- Evaluate whether a voluntary contribution to the employer's unemployment tax account is advantageous. State deadlines for voluntary contributions vary. Check your applicable state to determine the deadline for the voluntary contribution. Remember that a refund will not be issued in the event there is an overpayment.
- Verify whether the state electronic filing thresholds have changed for the 2023 tax year (2024 filing year). Some states have reduced the threshold to follow the federal reduction. If newly subject to electronic filing requirements, register for electronic filing with the state tax agency and review the electronic filing specifications.
- Review the electronic filing specifications for W-2s, 1099s, and other annual information returns (e.g., 1094/1095 series and 8027).
- Advise employees to review W-4 information and provide new forms when requested. Note that exemption from withholding must be renewed annually.
- Employers should identify noncash fringe benefits and prepare applicable withholding tax for these benefits to ensure all withholding occurs by December 31. Such benefits may include the personal use of an employer-provided vehicle or group-term life insurance in excess of $50,000). Early calculation will allow the withholding to occur over a period of pay periods rather than a single pay period.
- Identify any payments that must be pulled into the 2023 tax year and process a special payroll to reflect these payments. These may include any manual or voided checks. These payments must be included in employment tax returns and be reflected in Forms W-2.
- Prior to December 31, file Form 941-X to adjust figures in prior quarters. Such figures may include any COVID-19 related credits.
- Make appropriate adjustments to the final tax deposit after a reconciliation of Forms 941 or 944 (and Forms 941-X filed for current-year adjustments), 940, and W-3.
- Review any third-party sick pay information and determine if deposits and returns reflect the information.
- File Forms 940, 941, 944 (as applicable) by January 31 (10-day extension for timely payers).
- Forms W-2 must be filed with the SSA and furnished to employees by January 31.
- Furnish Affordable Care Act information statements as required by January 31 (automatic 30-day extension to furnish forms).
- Review the unemployment tax rate notice and determine if a protest is needed. Note the deadline for an appeal.

Sample Year-End Planning Client Letter: Individuals

Dear Client:

With year-end approaching, it is time to start thinking about moves that may help lower your tax bill for this year and next. This year's planning is more challenging than usual due to changes made by the Inflation Reduction Act of 2022 and the SECURE 2.0 Act.

Whether or not tax increases become effective next year, the standard year-end approach of deferring income and accelerating deductions to minimize taxes will continue to produce the best results for all but the highest income taxpayers, as will the bunching of deductible expenses into this year or next to avoid restrictions and maximize deductions.

If proposed tax increases do pass, however, the highest income taxpayers may find that the opposite strategies produce better results: Pulling income into 2023 to be taxed at currently lower rates, and deferring deductible expenses until 2023, when they can be taken to offset what would be higher-taxed income. This will require careful evaluation of all relevant factors.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all of them will apply to you, but you (or a family member) may benefit from many of them. We can narrow down specific actions when we meet to tailor a particular plan for you. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves might be beneficial:

- New tax credits for EVs. If you are looking to buy a new car this year, remember that the Inflation Reduction Act has introduced various credits for buying both new and used electric vehicles.
- Higher-income individuals must be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of MAGI over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case).
- As year-end nears, the approach taken to minimize or eliminate the 3.8% surtax will depend on the taxpayer's estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to reduce MAGI other than NII, and some individuals will need to consider ways to minimize both NII and other types of MAGI. An important exception is that NII does not include distributions from IRAs or most other retirement plans.
- The 0.9% additional Medicare tax also may require higher-income earners to take year-end action. It applies to individuals whose employment wages and self-employment income total more than an amount equal to the NIIT thresholds, above. Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. This would be the case, for example, if an employee earns less than $200,000 from multiple employers but more than that amount in total. Such an employee would owe the additional Medicare tax, but nothing would have been withheld by any employer.
- Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. If you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains that can be sheltered by the 0% rate. The 0% rate generally applies to net long-term capital gain to the extent that, when added to regular taxable income, it is not more than the maximum zero rate amount (i.e., $89,250 for a married couple; estimated to be $94,050 in 2024). If, say, $5,000 of long-term capital gains you took earlier this year qualifies for the zero rate then try not to sell assets yielding a capital loss before year-end, because the first $5,000 of those losses will offset $5,000 of capital gain that is already tax-free.
- Postpone income until 2024 and accelerate deductions into 2023 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2022 that are phased out over varying levels of AGI. These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may

actually pay to accelerate income into 2023. For example, that may be the case for a person who will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or who expects to be in a higher tax bracket next year. That's especially a consideration for high-income taxpayers who may be subject to higher rates next year under proposed legislation.

- If you believe a Roth IRA is better for you than a traditional IRA, consider converting traditional-IRA money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in 2023 if eligible to do so. Keep in mind that the conversion will increase your income for 2023, possibly reducing tax breaks subject to phaseout at higher AGI levels. This may be desirable, however, for those potentially subject to higher tax rates under pending legislation.
- It may be advantageous to try to arrange with your employer to defer, until early 2024, a bonus that may be coming your way. This might cut as well as defer your tax. Again, considerations may be different for the highest income individuals.
- Many taxpayers won't want to itemize because of the high basic standard deduction amounts that apply for 2023 ($27,700 for joint filers, $13,850 for singles and for marrieds filing separately, $20,800 for heads of household), and because many itemized deductions have been reduced (such as the $10,000 deduction limit on state and local taxes) or abolished (such as the miscellaneous itemized deduction and the deduction for non-disaster related personal casualty losses). You can still itemize medical expenses that exceed 7.5% of your AGI, state and local taxes up to $10,000, your charitable contributions, plus mortgage interest deductions on a restricted amount of debt, but these deductions won't save taxes unless they total more than your standard deduction.
- Some taxpayers may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, a taxpayer who will be able to itemize deductions this year but not next will benefit by making two years' worth of charitable contributions this year.
- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2023 deductions even if you don't pay your credit card bill until after the end of the year.
- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2023, consider asking your employer to increase withholding of state and local taxes (or make estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2023. But this strategy is not good to the extent it causes your 2023 state and local tax payments to exceed $10,000.
- New rules for required minimum distributions (RMDs) from an IRA or 401(k) plan (or other employer-sponsored retirement plan). In general, an IRA owner must take their first RMD for the year in which they reach age 72 (73 if they reach age 72 after December 31, 2022). However, they can delay taking their first RMD until April 1 of the following year. Those who reach age 72 in 2022 must take their first RMD by April 1, 2023, and the second RMD by December 31, 2023. If they reach age 72 in 2023, their first RMD for 2024 (the year they reach 73) is due by April 1, 2025.[1]
- If you are age 70½ or older by the end of 2023, and especially if you are unable to itemize your deductions, consider making 2023 charitable donations via qualified charitable distributions from your traditional IRAs. These distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. However, you are still entitled to claim the entire standard deduction. (The qualified charitable distribution amount is reduced by any deductible contributions to an IRA made for any year in which you were age 70½ or older, unless it reduced a previous qualified charitable distribution exclusion.)
- Take an eligible rollover distribution from a qualified retirement plan before the end of 2023 if you are facing a penalty for underpayment of estimated tax and increasing your wage withholding won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2023. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2023, but the withheld tax will be applied pro rata over the full 2023 tax year to reduce previous underpayments of estimated tax.
- Consider increasing the amount you set aside for next year in your employer's FSA if you set aside too little for this year and anticipate similar medical costs next year.

[1] Note that a previous version of the guide contained incorrect RMD transition rules.

- If you become eligible in December 2023 to make HSA contributions, you can make a full year's worth of deductible HSA contributions for 2023.
- Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to $17,000 made in 2023 to each of an unlimited number of individuals. You can't carry over unused exclusions to another year. These transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.
- If you were in federally declared disaster area, and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim them either on the return for the year the loss occurred (in this instance, the 2023 return normally filed next year), or on the return for the prior year (2022), generating a quicker refund.
- If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2023 to maximize your casualty loss deduction this year.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Sample Year-End Planning Client Letter: Businesses

Dear Business Client:

With year-end approaching, it is time to start thinking about moves that may help lower your business's taxes for this year and next. This year's planning is more challenging than usual due to recent changes made by the Inflation Reduction Act of 2022 and the potential change in congressional balance of power resulting from the midterm elections.

Whether or not tax increases become effective next year, the standard year-end approach of deferring income and accelerating deductions to minimize taxes will continue to produce the best results for most small businesses, as will the bunching of deductible expenses into this year or next to maximize their tax value.

If proposed tax increases do pass, however, the highest income businesses and owners may find that the opposite strategies produce better results: Pulling income into 2023 to be taxed at currently lower rates, and deferring deductible expenses until 2024, when they can be taken to offset what would be higher-taxed income. This will require careful evaluation of all relevant factors.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all of them will apply to you or your business, but you may benefit from many of them. We can narrow down specific actions when we meet to tailor a particular plan for your business, In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves might be beneficial:

- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2023, if taxable income exceeds $364,200 for a married couple filing jointly, (about half that for others), the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), 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 phase-in applies to joint filers with taxable income up to $100,000 above the threshold, and to other filers with taxable income up to $50,000 above their threshold.
- Taxpayers may be able to salvage at least some of this deduction, by deferring income or accelerating deductions to keep income under the dollar thresholds (or be subject to a smaller deduction phaseout) for 2023. Depending on their business model, taxpayers also may be able increase the deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting us.
- More small businesses are able to use the cash (as opposed to accrual) method of accounting than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test, which is satisfied for 2023 if, during a three-year testing period, average annual gross receipts don't exceed $29 million (next year this dollar amount is estimated to increase to $30 million). Not that many years ago it was $1 million. Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.
- Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2023, the expensing limit is $1,160,000, and the investment ceiling limit is $2,890,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for interior improvements to a building (but not for its enlargement), elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems.
- Generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. So expensing eligible items acquired and placed in service in the last days of 2023, rather than at the beginning of 2024, can result in a full expensing deduction for 2023.

- Businesses also can claim bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2023.
- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs aren't required to be capitalized under the UNICAP rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS, e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, and where potentially increasing tax rates for 2024 aren't a concern, consider purchasing qualifying items before the end of 2023.
- A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2023 (and substantial net income in 2024) may find it worthwhile to accelerate just enough of its 2024 income (or to defer just enough of its 2023 deductions) to create a small amount of net income for 2023. This allows the corporation to base its 2024 estimated tax installments on the relatively small amount of income shown on its 2023 return, rather than having to pay estimated taxes based on 100% of its much larger 2024 taxable income.
- Year-end bonuses can be timed for maximum tax effect by both cash- and accrual-basis employers. Cash-basis employers deduct bonuses in the year paid, so they can time the payment for maximum tax effect. Accrual-basis employers deduct bonuses in the accrual year when all events related to them are established with reasonable certainty. However, the bonus must be paid within 2½ months after the end of the employer's tax year for the deduction to be allowed in the earlier accrual year. Accrual employers looking 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 2.5-month window or change the bonus plan's terms to make the bonus amount not determinable at year end.
- To reduce 2023 taxable income, consider deferring a debt-cancellation event until 2024.
- Sometimes the disposition of a passive activity can be timed to make best use of its freed-up suspended losses. Where reduction of 2023 income is desired, consider disposing of a passive activity before year-end to take the suspended losses against 2023 income. If possible 2024 top rate increases are a concern, holding off on disposing of the activity until 2024 might save more in future taxes.
- The pass-through state income tax deduction allows business owners to deduct state income tax on their business income without limit. This deduction allows a pass-through entity to elect to pay the state income tax due on the business income that would otherwise pass through and get paid on the owner's personal tax returns. The federal itemized deduction cap of $10,000 ($5,000 if MFS) for state and local taxes doesn't apply when a pass-through entity pays state and local tax on its earnings at the entity level. As of 2023, 36 states and one locality have passed legislation allowing the pass-through tax deduction work-around, and some states have even passed retroactive legislation.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Sample Year-End Planning Client Letter: Payroll

Dear Business Client,

With year-end approaching, it's a good time to consider ways to lower your business's payroll-related taxes for the current tax year as well as the 2024 tax year.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all of them will apply to you or your business, but you may benefit from many of them. We can narrow down specific actions when we meet to tailor a particular plan for your business, In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves might be beneficial:

- Employers may claim a general business credit for paid family and medical leave they provide to their employees. This credit has been extended through 2025. Employers that paid family and medical leave to qualifying employees may take a credit equal to 12.5% of eligible wages if the rate of payment is 50% of such wages and may be eligible for a higher percentage credit under certain conditions. To qualify, the employer must have a written policy that meets specified criteria. Employers do not need to be subject to the FMLA to claim the credit.
- A small employer pension plan startup credit is available to employers with 100 or fewer employees who adopt a new qualified retirement plan, provided that the plan covers at least one non-highly compensated employee. The credit is the greater of: (1) $500 or (2) the lesser of (a) $250 multiplied by the number of non-highly compensated employees of the eligible employer who are eligible to participate in the plan or (b) $5,000. The credit applies for up to three years beginning with the year the plan is first effective, or, at the election of the employer, with the year preceding the first plan year. For the 2023 tax year, the credit is 100% of qualified start-up costs for employers with up to 50 employees. For employers with more than 50 and up to 100 employees, the credit is 50% of qualified start-up costs.
- Small businesses may claim a general business credit of $500 for any tax year occurring in the credit period (generally three tax years beginning with the first tax year for which the employer includes an eligible automatic enrolment in its qualified employer plan (e.g., 401(k) or SIMPLE IRA). The credit is also available to employers that convert an existing plan to an automatic enrollment design. The credit is in addition to the small employer pension plan start-up credit.
- The Small Business Health Care Tax Credit allows small employers with fewer than 25 full-time employees to claim a credit for nonelective contributions to purchase health insurance for their employees. The maximum credit amount is 35% to 50% for premiums paid by eligible small employers and 25% to 35% of premiums paid for tax-exempt small employers.
- Certain food and beverage establishments may take a business tax credit of an amount equal to the employer's FICA tax (7.65%) paid on tip income less the FICA tax due on the excess of the federal minimum wage over the employee's actual hourly rate of pay. The credit is part of the general business credit.
- Businesses that hired certain employees in specified target groups in 2023 may qualify for the Work Opportunity Tax Credit which has been authorized through the 2025 tax year. Generally, this is a one-time credit for each new hire in a target group. Certification that the worker is an eligible member of the target group is required. The credit may be applied against business income tax liability or for tax-exempt employers, the credit may be applied against payroll taxes.
- Year-end bonuses can be timed for maximum tax effect by both cash- and accrual-basis employers. Cash-basis employers deduct bonuses in the year paid, so they can time the payment for maximum tax effect. Accrual-basis employers deduct bonuses in the accrual year, when all events related to them are established with reasonable certainty. However, the bonus must be paid within 2½ months after the end of the employer's tax year for the deduction to be allowed in the earlier accrual year. Accrual employers looking 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 2.5-month window or change the bonus plan's terms to make the bonus amount not determinable at year end.
- While states determine the unemployment tax rate schedule at different times of the year, some operating on a fiscal year basis, many states will announce tax schedules by December and notify employers of their contribution rate sometime between December to February. Businesses should carefully review the annual

rate information and determine whether a voluntary contribution, if permitted by the state, to buy down the rate would be advantageous. I am happy to discuss whether this is an option for your business. Also, employers should examine their rate notices to determine if the rate accurately reflects their unemployment experience in the applicable period. Time to protest the rate is limited.
- For businesses that claimed the Employee Retention Credit, a review of eligibility is strongly recommended to determine if the claim is legitimate. We can discuss next steps to withdraw the claim or repay the credit to mitigate further penalties and interest that may accrue for the erroneous claim.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,