HARPER | PEARSON

One Riverway Drive, Ste. 1900
Houston, Texas 77056
Office 713.622.2310
Fax 713.622.5613

December, 2023

Dear Clients and Friends:

The end of the year is often an optimal time for tax planning, but you must be careful to avoid potential pitfalls along the way. Notably, any year-end tax strategies you implement should take all the latest tax developments into account.

In particular, Congress has enacted significant tax legislation in recent years, beginning with the massive Tax Cuts and Jobs Act (TCJA) of 2017. Many provisions in the TCJA are effective for 2018 through 2025. Soon after, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law, designed primarily to enhance retirement savings.

During the height of pandemic, a trio of laws—the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the Consolidated Appropriations Act (CAA) and the American Rescue Plan Act (ARPA)—provided various forms of tax relief. Another law passed in the summer of 2022, the Inflation Reduction Act (IRA), created both new opportunities and obstacles for certain individuals and business entities.

Finally, late in 2022, the law dubbed “SECURE 2.0” built on the foundation of the initial SECURE Act and added several new layers.

Keeping all those laws in mind, we have prepared the following **2023 Year-End Tax Letter**. For your convenience, the letter is divided into three sections:

- Individual Tax Planning
- Business Tax Planning
- Financial Tax Planning

Be aware that the concepts discussed in this letter are intended to provide only a general overview of year-end tax planning. It is recommended that you review your personal situation with a tax professional.

INDIVIDUAL TAX PLANNING

Itemized Deductions

When you file your personal 2023 tax return, you must choose between the standard deduction and itemized deductions. The standard deduction for 2023 is $13,850 for single filers and $27,700 for joint filers. (An additional $1,850 standard deduction is allowed for a taxpayer age 65 or older.)

YEAR-END MOVE: If you come out ahead by itemizing, you may want to accelerate certain deductible expenses into 2023. For example, consider the following possibilities.

- Donate cash or property to a qualified charitable organization (see more below).

- Pay deductible mortgage interest if it otherwise makes sense for your situation. Currently, this includes interest on acquisition debt of up to $750,000 for your principal residence and one other home.

- Make state and local tax (SALT) payments up to the annual SALT deduction limit of $10,000.

- Add home improvements that qualify for mortgage interest deductions as acquisition debt. This includes loans made to substantially improve a qualified residence.

- Schedule non-emergency physician or dentist visits in 2023 if you expect to qualify for a medical deduction this year. Only unreimbursed expenses above 7.5% of your adjusted gross income (AGI) are deductible.

Tip: Conversely, if you do not expect to qualify for a medical deduction in 2023, you might as well delay non-emergency expenses to 2024 when they may do you some tax good.

Charitable Donations

The tax law allows you to deduct charitable donations within generous limits if you meet certain recordkeeping requirements.

YEAR-END MOVE: Step up charitable gift-giving before January 1. As long as you make a donation in 2023, it is deductible in 2023, even if you charge it in 2023 and pay it in 2024.

- If you make monetary contributions, your deduction is limited to 60% of your AGI. Any excess above the 60%-of-AGI limit may be carried over for up to five years.

- If you donate appreciated property held longer than one year (i.e., it would qualify for long-term capital gain treatment if sold), you can generally deduct an amount equal to the property's fair market value (FMV) on the donation date, up to 30% of your AGI. But the deduction for short-term capital gain property is limited to your initial cost.

Tip: Any excess above the 30%-of-AGI limit may be carried over for up to five years.

Alternative Minimum Tax

The complex alternative minimum tax (AMT) calculation features technical adjustments, inclusion of "tax preference items" and subtraction of an exemption amount (subject to a phase-out). After comparing AMT liability for the year to regular tax liability, you effectively pay the higher of the two.

YEAR-END MOVE: Have your tax professional assess your AMT status. When it makes sense, you may shift certain income items to 2024 to reduce AMT liability for 2023. For instance, you might postpone the exercise of incentive stock options (ISOs) that count as tax preference items.

Due to changes in the Tax Cuts and Jobs Act (TCJA), the exemption amounts for the AMT have increased dramatically since 2017, as shown below.

Filing status	2017	2018	2019	2020	2021	2022	2023
Single filers	$54,300	$70,300	$71,700	$72,900	$73,600	$75,900	$81,300
Joint filers	$84,500	$109,400	$111,700	$113,400	$114,600	$118,100	$126,500
Married filing separately	$42,250	$54,700	$55,850	$56,700	$57,300	$59,050	$63,250

Tip: The AMT rate for both single and joint filers for 2023 is 26% on AMT income up to $220,700 (or $110,350 if married and filing separately) and 28% on AMT income above this threshold. Note that the top AMT rate is still lower than the top ordinary income tax rate of 37%.

Electric Vehicle Credits

If you are in the market for a new vehicle, be aware of the tax benefits of purchasing a plug-in electric vehicle (EV).

YEAR-END MOVE: Consider all the tax and non-tax angles. Notably, the Inflation Reduction Act (IRA) increases the tax credits for some taxpayers buying EVs in 2023 but disallows any credit for others.

Generally, the maximum credit allowed for EVs purchased in 2023 is $7,500. The vehicle must be powered by batteries with materials sourced from the U.S. or its free trade partners and it must be assembled in North America.

However, the credit cannot be claimed by a single filer with a modified adjusted gross income (MAGI) above $150,000 or MAGI of $300,000 for joint filers. Also, the credit is not available for most passenger vehicles that cost more than $55,000. The threshold is $80,000 for vans, sports utility vehicles (SUVs) and pickup trucks.

Furthermore, you cannot claim any credit if you lease an EV instead of buying it. And the credit for EVs is nonrefundable, so you may want time year-end purchases accordingly.

Tip: The IRA eliminates the prior rule phasing out the credit based on the number of vehicles produced by a specific manufacturer, beginning in 2023.

Higher Education Credits

The tax law provides tax breaks to parents of children in college, subject to certain limits. This often includes a choice between one of two higher education credits.

YEAR-END MOVE: When appropriate, pay qualified expenses for next semester by the end of this year. Generally, the costs will be eligible for a credit in 2023, even if the semester does not begin until 2024.

Typically, you can claim either the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit (LLC), but not both. The maximum AOTC of $2,500 is available for qualified expenses for four years of study for each student, while the maximum $2,000 LLC is claimed on a per-family basis for all years of study. Thus, the AOTC is usually preferable to the LLC.

Both credits are phased out based on your MAGI. The phase-out for each credit occurs between $80,000 and $90,000 of MAGI for single filers and between $160,000 and $180,000 of MAGI for joint filers.

Tip: The list of qualified expenses includes tuition, books, fees, equipment, computers, etc., but not room and board.

Miscellaneous

- Minimize "kiddie tax" problems by having your child invest in tax-deferred or tax-exempt securities. For 2023, unearned income above $2,500 that is received by a dependent child under age 19 (or under age 24 if a full-time student) is taxed at the top tax rate of the parents.

- Install energy-saving devices at home that result in either of two residential credits. For example, you may be able to claim a credit for installing solar panels. Generally, each credit equals 30% of the cost of qualified expenses, subject to certain limits.

- Avoid an estimated tax penalty by qualifying for a safe-harbor exception. Generally, a penalty will not be imposed if you pay 90% of your current year's tax liability or 100% of your prior year's tax liability (110% if your AGI exceeded $150,000).

- Pay expenses qualifying for the dependent care credit. Generally, the maximum credit is $600 for childcare costs of one under age-13-child or $1,200 for two or more qualified children.

- Empty out flexible spending accounts (FSAs) for healthcare or dependent care expenses if you will forfeit unused funds under the "use-it-or-lose it" rule. However, your employer's plan may provide a carryover to 2024 of up to $610 of unused funds or a 2½-month grace period.

- If you own property damaged in a federal disaster area in 2023, you may qualify for faster-than-usual casualty loss relief by filing an amended 2022 return. The TCJA suspended the deduction for casualty losses for 2018 through 2025 but retained a current deduction for disaster-area losses.

BUSINESS TAX PLANNING

Depreciation-Based Deductions

As the year draws to a close, a business may benefit from one or more of three depreciation-based tax breaks: (1) the Section 179 deduction; (2) first-year "bonus" depreciation; and (3) regular depreciation.

YEAR-END MOVE: Place qualified property in service before the end of the year. If your business does not start using the property before 2024, it is not eligible for these tax breaks.

1. Section 179 deduction: Under Section 179 of the tax code, a business may currently deduct the cost of qualified property placed in service during the year. The maximum annual deduction, as shown below, is phased out on a dollar-for-dollar basis above a specified threshold.

Tax year	Deduction limit	Phase-out threshold
2010–2015	$500,000	$2 million
2016	$500,000	$2.01 million
2017	$510,000	$2.03 million
2018	$1 million	$2.50 million
2019	$1.02 million	$2.55 million
2020	$1.04 million	$2.59 million
2021	$1.05 million	$2.62 million
2022	$1.08 million	$2.70 million
2023	$1.16 million	$2.89 million

Be aware that the Section 179 deduction cannot exceed the taxable income from all your business activities this year. This rule could limit your deduction for 2023.

2. First-year bonus depreciation: The TCJA authorized 100% first-year bonus depreciation through 2022, subject to a phase-out over a five-year period. The applicable percentage for 2023 is 80% and is scheduled to drop to 60% in 2024.

3. Regular depreciation: If any remaining acquisition cost remains, the balance may be deducted over time under the Modified Accelerated Cost Recovery System (MACRS).

Tip: Special "luxury car" rules limit deductions for business vehicles. Nevertheless, due to the TCJA, you can write off up to $20,200 for such a vehicle placed in service in 2023.

Start-Up Costs

Normally, the costs associated with the start-up of a new business venture must be amortized over 180 months. However, the tax law allows an entrepreneur to claim a current deduction of up to $5,000 for qualified start-up costs, subject to a phase-out above $50,000.

YEAR-END MOVE: Make sure you "open for business" before January 1, 2024. Typically, this means you must begin offering goods or services. Otherwise, you cannot claim the current $5,000 deduction.

Generally, start-up costs are those that would be deductible as business expenses, such as studies of potential markets, products, labor supply, transportation facilities, etc.; advertisements for the opening of the business; salaries and wages for employees who are being trained and their instructors; travel costs to secure prospective distributors, suppliers, customers or clients; and salaries and fees for executives and consultants or similar professional services.

Tip: Your business may be entitled to an additional current deduction of up to $5,000 for qualified organizational expenses (e.g., expenses of a CPA).

Qualified Retirement Plans
The new SECURE 2.0 law includes a number of provisions affecting employers with qualified retirement plans.

YEAR-END MOVE: Position your business to maximize available tax benefits and avoid potential problems. Consider the following key changes of particular interest.

- For 401(k) plans adopted after 2024, an employer must provide automatic enrollment to employees. Certain small companies and start-ups are exempt.

- Beginning in 2023, employers with 50 or fewer employees can qualify for a credit equal to 100% of their contributions to a new retirement plan, up to $1,000 per employee, phased out over five years. The 100% credit is reduced for a business with 51 to 100 employees. This tax break is in addition to an enhanced credit for plan start-up costs.

- Beginning in 2024, employers may automatically provide employees with emergency access to accounts of up to 3% of their salary, capped at $2,500.

- An employer may elect to make matching contributions to an employee's retirement plan account based on student loan obligations, beginning in 2024.

- The new law shortens the eligibility requirement for part-time workers from three years to two years, beginning in 2023, among other modifications.

- Any catch-up contributions to 401(k) plans must be made to Roth-type accounts for employees earning more than $145,000 a year (indexed for inflation).

Tip: This last provision was initially scheduled to take effect in 2024, but a new IRS ruling just delayed it for two years to 2026.

Work Opportunity Tax Credit
If your business becomes busier than usual during the holiday season, it may add to the existing staff. Consider all the relevant factors, including tax incentives, in your hiring decisions.

YEAR-END MOVE: When you have good candidates, you may hire workers eligible for the Work Opportunity Tax Credit (WOTC). The credit is available if a worker falls into a designated "target" group.

Generally, the WOTC equals 40% of the first-year wages of up to $6,000 per employee, for a maximum of $2,400. For certain qualified veterans, the credit may be claimed for up to $24,000 of wages, for a $9,600 maximum. There is no limit on the number of credits per business.

Tip: The WOTC has expired—and then been reinstated—multiple times in the past, but it currently is available through 2025.

Employee Bonuses
Generally, employee bonuses are deductible in the year that they are paid. For instance, you must dole out bonuses before January 1, 2024, to deduct those bonuses on your company's 2023 return. However, there's a special rule for accrual-basis companies. In this case, the bonuses are currently deductible if they are paid within 2½ months of the close of the tax year.

YEAR-END MOVE: If your company qualifies, determine bonus amounts before year-end. As a result, the bonuses can be deducted on the company's 2023 return as long as they are paid by March 15, 2024. Keep detailed corporate minutes to support the deductions.

This special deduction rule does not apply to bonuses paid to majority shareholders of a C corporation or certain owners of an S corporation or a personal service corporation.

Tip: Note that the bonuses are taxable to employees in the year in which they receive them—2024. Thus, the employees benefit from tax deferral for a year even if the company claims a current deduction.

Miscellaneous

- Stock the shelves with routine supplies (especially if they are in high demand). If you buy the supplies in 2023, they are deductible this year even if they are not used until 2024.

- If your business realizes a net operating loss (NOL) in 2023, it can no longer be carried back under current law, but the NOL may be carried forward indefinitely (subject to a limit of 80% of taxable income).

- Maximize the qualified business interest (QBI) deduction for pass-through entities and self-employed individuals. Note that special rules apply if you are in a "specified service trade or business" (SSTB). See your professional tax advisor for more details.

- If you buy a heavy-duty SUV or van for business, you may claim a first-year Section 179 deduction of up to $28,900. The luxury car limits do not apply to certain heavy-duty vehicles.

- Keep records of collection efforts (e.g., phone calls, emails and dunning letters) to prove debts are worthless. This may allow you to claim a bad debt deduction.

- Under the IRA, a start-up business can elect to use up to $500,000 of qualified research credits to offset payroll taxes instead of income taxes, if it has gross receipts of less than $5 million.

FINANCIAL TAX PLANNING

Securities Sales

Traditionally, investors time sales of assets like securities at year-end to maximize tax advantages. For starters, capital gains and losses offset each other. If you show an excess loss for the year, you can then offset up to $3,000 of ordinary income before any remainder is carried over to the next year. Long-term capital gains from sales of securities owned longer than one year are taxed at a maximum rate of 15% or 20% for high-income investors. Conversely, short-term capital gains are taxed at ordinary income rates reaching as high as 37% in 2023.

YEAR-END MOVE: Review your portfolio. Depending on your situation, you may want to harvest capital losses to offset gains, especially high-taxed short-term gains, or realize capital gains that will be partially or wholly absorbed by losses.

Be aware of even more favorable tax treatment for certain long-term capital gains. Notably, a 0% rate applies to taxpayers below certain income levels, such as young children. Furthermore, some taxpayers who ultimately pay ordinary income tax at higher rates due to their investments may qualify for the 0% tax rate on a portion of their long-term capital gains.

However, watch out for the "wash sale rule." If you sell securities at a loss and reacquire substantially identical securities within 30 days of the sale, the tax loss is disallowed. A simple way to avoid this adverse result is to wait at least 31 days to reacquire substantially identical securities.

Note: A disallowed loss increases your basis for the securities you acquire and could reduce taxable gain on a future sale.

Tip: The preferential tax rates for long-term capital gains also apply to qualified dividends received in 2023. These are most dividends paid by U.S. companies or qualified foreign companies.

Net Investment Income Tax

When you review your portfolio (see above), do not forget to account for the 3.8% "net investment income tax" (NIIT). The NIIT applies to the lesser of "net investment income" (NII) or the amount by which MAGI for the year exceeds $200,000 for single filers or $250,000 for joint filers. (These thresholds are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest and distributions from qualified retirement plans and IRAs.

YEAR-END MOVE: Have an estimate made of your potential liability for 2023. Depending on the results, you may be able to reduce the tax on NII or avoid it altogether.

For example, you may invest in municipal bonds ("munis"). The interest income generated by munis does not count as NII, nor is it included in the MAGI calculation. Similarly, if you turn a passive activity into an active business, the resulting income may be exempt from the NII tax.

Tip: When you add the NII tax to your regular tax, you could be paying an effective 40.8% tax rate at the federal level alone. Factor this into your investment decisions.

Required Minimum Distributions
For starters, you must begin "required minimum distributions" (RMDs) from qualified retirement plans and IRAs after reaching a specified age. After the SECURE Act raised the age threshold from 70½ to 72, SECURE 2.0 bumped it up again to 73, beginning in 2023 (scheduled to increase to 75 in 2033). The amount of the RMD is based on IRS life expectancy tables and your account balance at the end of last year.

YEAR-END MOVE: Assess your obligations. If you can postpone RMDs still longer, you can continue to benefit from tax-deferred growth. Otherwise, make arrangements to receive RMDs before January 1, 2024 to avoid any penalties.

Conversely, if you are still working and do not own 5% or more of a business with a qualified plan, you can postpone RMDs from that plan until your retirement. This "still working exception" does not apply to RMDs from IRAs or qualified plans of other employers.

Previously, the penalty for failing to take timely RMDs was equal to 50% of the shortfall. SECURE 2.0 reduces it to 25%, beginning in 2023 (10% if corrected in a timely fashion).

Tip: Under the initial SECURE Act, you are generally required to take RMDs from recently inherited accounts over a ten-year period (although previous inheritances are exempted). These rules are complex, so consult with your tax advisor regarding your situation.

Section 1031 Exchanges
Beginning in 2018, the TCJA generally eliminated the tax deferral break for Section 1031 exchanges of like-kind properties. However, it preserved this tax-saving technique for swaps involving investment or business real estate. Therefore, you can still exchange qualified real estate properties in 2023 without paying current tax, except to the extent you receive "boot" (e.g., cash or a reduction in mortgage liability).

YEAR-END MOVE: Make sure you meet the following timing requirements to qualify for a tax-deferred Section 1031 exchange.

1. Identify or actually receive the replacement property within 45 days of transferring legal ownership of the relinquished property.

2. Have the title to the replacement property transferred to you within the earlier of 180 days or your 2023 tax return due date, plus extensions.

Tip: Note that the definition of "like-kind" is relatively liberal. For example, you can exchange an apartment building for a warehouse or even raw land.

Estate and Gift Taxes
During the last decade, the unified estate and gift tax exclusion has gradually increased, while the top estate rate has not budged. For example, the exclusion for 2023 is $12.92 million, the highest it has ever been. (It is scheduled to revert to $5 million, plus inflation indexing, after 2025.)

YEAR-END MOVE: Reflect this generous tax law provision in your overall estate plan. For instance, your plan may involve various techniques, including bypass trusts, that maximize the benefits of the estate and gift tax exemption. The following table shows the exemption and top estate tax rate for the last ten years.

Tax year	Estate tax exemption	Top estate tax rate
2014	$5.34 million	40%
2015	$5.43 million	40%
2016	$5.45 million	40%
2017	$5.49 million	40%
2018	$11.18 million	40%
2019	$11.40 million	40%
2020	$11.58 million	40%
2021	$11.70 million	40%
2022	$12.06 million	40%
2023	$12.92 million	40%

In addition, you can give gifts to family members that qualify for the annual gift tax exclusion. For 2023, there is no gift tax liability on gifts of up to $17,000 per recipient (up from $16,000 in 2022). You do not even have to file a gift tax return. Moreover, the limit is doubled to $34,000 for joint gifts by a married couple, but a gift tax return is required in that case.

Tip: You may "double up" again by giving gifts in both December and January that qualify for the annual gift tax exclusion for 2023 and 2024, respectively.

Miscellaneous
* Contribute up to $22,500 to a 401(k) in 2023 ($30,000 if you are age 50 or older). If you clear the 2023 Social Security wage base of $160,200 and promptly allocate the payroll tax savings to a 401(k), you can increase your deferral without any further reduction in your take-home pay. Note: SECURE 2.0 further enhances catch-up contributions for older employees after 2023.

- If you rent out your vacation home, keep your personal use within the tax law boundaries. No loss is allowed if personal use exceeds the greater of 14 days or 10% of the rental period.

- From a tax perspective, it is often beneficial to sell mutual fund shares before the fund declares dividends (the ex-dividend date) and buy shares after the date the fund declares dividends.

- Sell real estate on an installment basis. For payments over two years or more, you can defer tax on a portion of the sales price. Also, this may effectively reduce your overall tax liability.

- Consider a qualified charitable distribution (QCD). If you are age 70½ or older, you can transfer up to $100,000 of IRA funds directly to charity, free of tax (but not deductible). SECURE 2.0 authorizes a one-time transfer of up to $50,000 to a charitable remainder trust (CRT) or charitable gift annuity (CGA) as part of a QCD.

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if additional tax legislation is enacted by Congress before the end of the year.

Finally, remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require careful examination. We would be glad to schedule a meeting with you to assist with all your tax-planning needs.

Very truly yours,

Harper & Pearson Company, P.C.