November 2023

HARPER | PEARSON

Tax Newsletter

Seven Year-End Tax Moves for You
Tax-saving ideas for individuals

What a year it has been! Despite the uncertainty of these times, you can still have some peace of mind by taking advantage of tax-saving strategies at the end of the year. Following are seven techniques commonly used by individuals.

1. Capital gains and losses: Under long-standing rules, investors can offset capital gains and losses against each other by "harvesting" securities transactions at year-end. Typically, you may realize capital gains from sales to absorb capital losses from earlier in the year or realize losses to offset capital gains plus up to $3,000 of ordinary income in 2023.

The maximum tax rate on long-term capital gain for assets held longer than a year remains at 15% (20% for high-income taxpayers). In addition, certain low-income taxpayers (e.g., your children) may benefit from a 0% rate. **Caution:** Be aware of potential "kiddie tax" complications.

2. Required minimum distributions: Normally, once you have attained a specific age threshold, you must take annual required minimum distributions (RMDs) from qualified retirement plans, like 401(k)s, and traditional IRAs. Otherwise, you are hit with a tax penalty on top of your regular income tax liability. RMDs are based on life expectancy tables and the balance in your account on December 31 of the prior year.

That is the bad news. Now the good news: Beginning in 2023, the SECURE 2.0 law increases the age threshold for beginning RMDs from 72 to 73 (scheduled to go to 75 in 2033), while reducing the penalty from 50% of the shortfall to 25% (10% if you make a quick fix).

3. Charitable donations: If you itemize deductions, you can boost your charitable write-off by donating more money to charities at year-end. For 2023, the annual limit on your deduction for monetary gifts is equal to 60% of your adjusted gross income (AGI). Any excess may be carried over for up to five years.

Make sure you keep the records needed to substantiate deductions. For monetary gifts of $250 or more, you must obtain a written acknowledgement from the charity. Other special rules may apply.

4. Medical expenses: A taxpayer who itemizes can deduct unreimbursed medical expenses above an annual threshold based on AGI. The current limit of 7.5% of AGI—reduced from 10%—is permanent.

If you are near or over the 7.5%-of-AGI threshold for 2023, you might accelerate non-emergency expenses, such as physical exams or dental cleanings, from 2024 into 2023. Otherwise, you can just wait until 2024 when you may derive some tax benefit.

5. Installment sales: If you sell real estate or other capital assets, you generally owe the full amount of capital gains tax in the year of the sale. However, you may benefit from installment sale reporting if you receive payments over two or more years. Essentially, you are taxed on a pro-rata basis on the amount received from the sale each year.

Not only does this defer tax, you may lower your overall tax liability if a larger portion of the capital gain is taxed over several years at the 15% rate instead of the 20% rate.

6. Electric vehicle credits: If you purchase an electric vehicle (EV) at year-end, you may qualify for an enhanced tax credit if certain conditions are met. The maximum credit of $7,500 comes right off the top of your tax bill.

However, you cannot claim the credit if you are a single filer with a modified adjusted gross income (MAGI) above $150,000 or $300,000 if you are a joint filer. Also, the credit is not available for passenger vehicles costing more than $55,000 or $80,000 for vans, sports utility vehicles (SUVs) and pickup trucks.

7. Estimated tax: If you underpay income tax during the year through any combination of withholding and installment payments, you could be liable for an estimated tax penalty. When it is appropriate, make adjustments to qualify for one of two “safe harbor” exceptions.

Generally, you can avoid the penalty by paying at least 90% of your current tax liability or 100% of the prior year’s tax liability (110% if your AGI for 2022 exceeded $150,000). A third safe-harbor rule provides flexibility for workers who earn most of their income during the holiday season.

Wrapping it up: These are just seven possibilities to consider. With assistance from your professional advisor, develop a personalized tax plan for your situation.

Seven Year-End Tax Moves for Businesses
Tax-saving ideas for business owners

Year-end tax planning is not just for individuals. Following are seven ideas for small business owners to consider as the year winds down.

1. Business property: Under Section 179 of the tax code, you can elect to currently deduct up to $1.16 million of qualified business property placed in service in 2023. But the deduction cannot exceed the taxable income of your business. Plus, the Section 179 deduction is reduced dollar-for-dollar above a threshold of $2.89 million.

Furthermore, a business may be able to claim first-year “bonus depreciation” on any remaining cost. The previous 100% deduction is being phased out over five years, beginning in 2023 when it drops to 80% (60% in 2024). If any amount is still left over, the cost can be written off through regular depreciation deductions.

2. Start-up costs: Are you starting a new business venture? The tax law provides a special write-off of up to $5,000 of qualified start-up expenses. This includes costs normally deductible by an active business. However, you must actually get the business up-and-running before 2024 to qualify for this tax break.

Start-up costs above $5,000 must be amortized over 180 months. In addition, the deduction begins to phase out for expenses above $50,000.

3. Business repairs: Generally, an employer can currently deduct the cost of minor repairs to the business premises made before the end of the year, but the cost of major improvements must be capitalized. Under IRS regulations, you may benefit from a safe-harbor election to currently deduct certain expenses.

Be careful to have repairs made separately from capital improvements. If repairs are lumped in with improvements, the entire cost of this "general betterment plan" may have to be capitalized.

4. Cash accounting: Generally, small business owners prefer to use the simplified cash method of accounting. However, under prior law, a C corporation that was not a personal service corporation generally could not use the cash method if its average gross receipts for the three prior tax years exceeded $5 million. This limit was recently increased to $25 million (inflation-indexed to $29 million in 2023).

Weigh the benefits of a switch to the cash accounting method. Review all the implications with your professional tax advisor.

5. Business interest: Prior to 2018, business interest was fully deductible. However, under current law, the deduction for business interest is limited to 30% of adjusted taxable income (ATI).

Determine if you qualify for a special exception. The 30%-of-ATI limit does not apply to a business with average gross receipts of $25 million ($29 million for 2023) or less for the three prior years.

6. Work Opportunity Tax Credit: An employer looking to bolster its staff at year-end may claim the Work Opportunity Tax Credit (WOTC) for hiring disadvantaged workers from one of several specific "target" groups. Generally, the WOTC equals 40% of first-year wages of up to $6,000 per employee, for a maximum of $2,400. For certain veterans, the credit is available for up to $24,000 in wages, for a maximum of $9,600.

The WOTC has expired and been reinstated numerous times in the past. However, Congress recently extended the credit for five years, through 2025.

7. Holiday parties: Finally, legislation has permanently eliminated the deduction for entertainment expenses, beginning in 2018. But the law change does not affect deductions for parties and other get-togethers where the entire work staff is invited.

Best of all, the deduction for holiday parties is equal to 100% of the cost, as opposed to the usual 50% limit previously allowed for most entertainment expenses. Enjoy all the tax benefits of your year-end planning!

Age-Old Retirement Planning Benefits
Take advantage of favorable provisions

There are some perks of growing older like qualifying for discounts on movie tickets and lower prices in restaurants. Even better, you may benefit from several special provisions affecting retirement-savers. Here's a brief rundown.

Social Security benefits: Generally, you must wait until your "normal retirement age" (NRA) before you can claim the full amount of your Social Security retirement benefits. The NRA, which is based on your year of birth, maxes out at age 67. However, you may opt to claim a lower monthly benefit amount at age 62 or a higher amount by postponing your application until age 70. With professional assistance, you can crunch the numbers and figure out the best approach for your situation.

Catch-up contributions: Although the tax law provides generous annual limits on contributions to qualified retirement plans where you work, like a 401(k) plan, and traditional and Roth IRAs, you can do even better after reaching age 50. To help you save more for retirement later in your working years, you can add a "catch-up contribution" to your regular contribution. For instance, in 2023 you can increase the maximum 401(k) deferral of $22,500 by $7,500 or tack on another $1,000 to the maximum $6,500 IRA contribution. **Note:** Recent legislation enhances catch-up contributions after 2023.

Early distributions: Typically, you cannot withdraw funds from a qualified plan or IRA prior to age 59½ without paying a penalty tax—on top of regular income tax—unless a special exception applies. However, you may tap into a qualified plan (but not an IRA) in the year you turn age 55 if you retire, quit or are laid off from your job (age 50 for public safety workers). Another provision allows you to take substantially equally periodic payments (SEPPs) under one of three IRS-approved methods. SEPPs are made over your life expectancy or the joint life expectancies of you and a designated beneficiary.

Note: Recent legislation allows 401(k) participants to benefit from penalty-free emergency withdrawals, up to certain limits, beginning in 2024.

Required minimum distributions: On the downside, you are currently required to begin taking required minimum distributions (RMDs) from qualified plans and IRAs in the year after the year you turn age 73 (recently increased from 72). This requirement is postponed for qualified plans until you retire, however, if you are still working full-time and you do not own 5% or more of the company. Furthermore, the rule for RMDs does not apply to Roth IRAs during your lifetime.

Qualified charitable distributions: Normally, distributions from traditional IRAs are taxable at ordinary income rates, even if you subsequently donate the funds to charity. (Contributions may be deductible by itemizers.) However, if you are older than 70½, you can transfer IRA funds directly to charity with no tax consequences. This "qualified charitable distribution" (QCD) counts as an RMD.

In summary: Age clearly matters in retirement planning. Take advantage of the tax breaks at your disposal.

Facts and Figures
Timely points of particular interest

Works of Art—The IRS is warning taxpayers about scam artists promoting inflated deductions for charitable donations of art. **How it works:** A promoter convinces a well-to-do individual to purchase the art and then wait more than a year to donate it to charity. Then they establish an artificially high value for the art for tax deduction purposes. Avoid these schemes at all costs and use a reputable appraiser for artwork donations.

Estimated Tax Penalties—Are you required to make quarterly estimated tax payments? The IRS has been imposing more penalties for non-compliance. According to the latest available IRS statistics, there was a 24% increase in the number of estimated tax penalties levied between 2017 and 2022, following a 42% boost between 2012 and 2017. Be aware if you face this responsibility: The next installment covering the fourth quarter of 2023 is due **January 16, 2024**.

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