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2022 Year-end Tax Planning Letter

To Our Clients and Friends:

Once again, we are approaching the end of the year, which means it's a good time to think about things you can do to help reduce your federal tax bill. Although there are no guarantees, it looks like planning for income taxes may be a little simpler this year than in the past few years. The Inflation Reduction Act of 2022, which was signed into law in August, was a slimmed-down version of the tax changes that were originally included in President Biden's proposed budget. With midterm elections approaching, it might be safe to say that a lot of Congressional attention is focused elsewhere and that we may have all the tax legislation we are going to get this year. We think it's unlikely that the individual income tax rates are going to increase in the near future. If any tax legislation occurs in 2023, the changes will most likely be prospective. Of course, this is Congress. So, never say never.

With that said, here are some things to think about doing before the end of 2022.

Look for Ways to Defer Taxable Income

Conventional wisdom says to defer taxable income (which includes accelerating deductions) when it makes sense. With rising interest rates and inflation, this is worth considering. In an inflationary environment, the longer you defer your tax bill, the more likely you are paying it with "cheaper" dollars. Or, to think of it another way, the amount of interest you can earn on the cash you keep invested (rather than turning it over to the government) grows as interest rates rise. Some ways to defer taxable income follow.

- If you have a small business on the cash method, defer billing clients until January 2023 and pay your bills before year-end.
- If you have appreciated business or investment property that you're thinking of selling, wait until 2023 to close the sale.
- If you will itemize deductions for 2022, make charitable contributions, pay your real property taxes (to the extent possible), and have elective medical procedures, dental work, routine physicals before year-end.

Note: You may have to make or increase your 2023 estimated tax payments to cover income or gains that you defer until 2023. But, you can base your 2023 tax payments (estimated taxes and withholding) on the lesser of (1) your 2022 tax liability [110% of that amount if your 2022 AGI is more than $150,000 ($75,000 if you file MFS)] or (2) 90% of your 2023 tax. So, if you can base your 2023 payments on your 2022 tax amount, you can postpone the tax on deferred gains or large income amounts recognized in 2023 to 4/15/24.

Evaluate Your Investments with an Eye Toward Selling

It's always a good idea to look at your investment portfolio and see if selling before year-end makes tax sense. But, be sure you don't let the tax tail wag the dog. Any decision to sell or hang onto a specific investment should be primarily based on whether you think the asset will increase or decrease in value and on its overall place in your portfolio. Also, note that selling investments to generate a tax gain or loss doesn't apply to investments held in a retirement account or IRA, where the gains and losses are not currently taxed.

If you have already recognized capital losses this year (or have capital loss carryovers from previous years), you can use those losses to shelter 2022 capital gains. So, you can sell some winners before year-end without increasing your 2022 tax liability. In particular, triggering short-term (held one year or less) capital gains that can be sheltered with capital losses is tax-smart because net short-term gains would otherwise be taxed at higher ordinary income tax rates.

Along these lines, if you have some investments that have declined in value, you could sell them before year-end to take the resulting capital losses this year. Those losses would shelter capital gains, including high-taxed short-term gains, from other 2022 sales. Even if you don't have capital gains to shelter this year, selling some losers could make sense, especially if you think they will continue to decline in value. The result would be a net capital loss for the year, which can be used to shelter up to $3,000 ($1,500 if you file MFS) of 2022 ordinary income (such as salaries, bonuses, self-employment income, interest income, rental income, and royalties). Any excess net capital loss over that amount is carried forward indefinitely.

In fact, having a capital loss carryover into 2023 could work to your advantage. The carryover can be used to shelter both short-term and long-term capital gains recognized next year and beyond. This can give you some investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a preferential tax rate, since the gain will be sheltered with the capital loss carryforward.

Caution: If you will only have long-term capital gains for 2022, triggering a capital loss this year generally isn't tax advantageous since the loss will offset capital gain that is taxed at a preferential rate. It might be better to take the capital loss in a year that it can shelter short-term capital gains or ordinary income.

Remember that virtual currency (also known as *cryptocurrency* or *crypto*) such as Bitcoin is treated as property for federal tax purposes. So, you can generate a capital loss (assuming you held the crypto as an investment) by selling before year-end if it's now worth less than you paid for it. Remember that you can specifically identify which units you sell. If you are trying to maximize your tax loss, you should sell your highest-basis units first. But, if you are hanging on to some of your crypto hoping for a price rebound at some point, it may be better to sell your low-basis crypto this year and save the high-basis unit for a year you might sell at a gain.

Beware of the Wash Sale Rules. If you decide that selling some investments at a loss is a good idea, keep in mind that the so-called *wash sale rules* can ruin your plans. A capital loss is disallowed if, within the period beginning 30 days before the date you sell stock or securities at a loss and ending 30 days after that date, you buy *substantially identical s*tock or securities. Mutual fund shares and options to buy stock or securities are considered stock or securities for the wash sale rules.

The theory behind the wash sale rules is that selling a security and acquiring a substantially identical security within the 61-day window results in an economic *wash*. So, you don't get to claim the tax loss that would ordinarily result from selling stock or some other security at a loss. Instead, the disallowed loss is added to the tax basis of the security that you acquired (triggering the wash sale rules).

One bit of good news: The wash sale rules don't apply to *bona fide* sales made to reduce your holdings of a particular stock or security. So, if you buy 200 shares of stock and within the next 30 days sell 100 shares at a loss, the wash sale rules don't apply and the loss is deductible, so long as you don't buy additional shares of that stock within the 30 days following the sale at a loss.

There are a few ways to get around the wash sale rules in the right situation. Call us if you think you will be affected.

Bunch Itemized Deductions to Maximize Their Value

You can deduct the greater of your itemized deductions or your standard deduction. In 2018, the standard deduction for all taxpayers was significantly increased. While that's good news, it means a lot of taxpayers get little or no benefit from their itemized deductions (mortgage interest, charitable contributions, medical expenses, and taxes). For 2022, the standard deduction is $25,900 for joint filers, $19,400 for HOH, and $12,950 for single taxpayers (including taxpayers filing MFS). If your total annual itemizable deductions for 2022 will be close to your standard deduction amount, consider bunching your expenditures so that they exceed the standard deduction in one year, and then use the standard deduction in the following year.

For example, assume your filing status is MFJ and your itemized deductions are fairly steady at around $25,000 per year. In that case, you would end up claiming the standard deduction each year. But, if you can bunch expenditures so that you have itemized deductions of $30,000 in 2022 and $20,000 in 2023, you could itemize in 2022 and get a $30,000 deduction versus a $25,900 standard deduction. In 2023, your itemized deductions would be below the standard deduction (which adjusted for inflation will be at least $25,900), so for that year, you would claim the standard deduction. If you manage to exceed the standard deduction every other year, you'll be better off than if you just settle for the standard deduction each year.

Probably the easiest deductible expenses to bunch are charitable contributions. Choosing the year in which you pay your state and local income and property taxes is another way to get the itemized deductions into the year you want them. In many cases, property tax bills are sent out before year-end, but can be paid after year-end. Likewise, you can make your fourth quarter installment of state income tax (generally due in January) before year-end. Remember, barring any tax law changes, the maximum amount you can deduct for state and local taxes is $10,000 ($5,000 if MFS) per year. But that limit doesn't apply to property taxes on property held for investment or in a trade or business.

Warning: Bunching state and local taxes can be a bad idea if you owe Alternative Minimum Tax (AMT) this year. That's because deductions for state and local income and property taxes are completely disallowed under the AMT rules. Therefore, prepaying state and local taxes may do little or no good if you're subject to AMT in 2022 and won't be in 2023. Contact us if you're unsure about your exposure to AMT.

Also, you can choose when you make your house payment that is due on January 1. Accelerating that will give you 13 months' worth of interest in any given year. Remember that mortgage insurance premiums are not deductible in 2022, like they were in 2021.

Make Your Charitable Giving Plans

In addition to bunching your charitable contributions, you can also use a donor-advised fund to maximize the tax benefit of your charitable giving. Donor-advised funds (also known as *charitable gift funds* or *philanthropic funds*) allow donors to make a charitable contribution to a specific public charity or community foundation that uses the assets to establish a separate fund to receive grant requests from charities seeking distributions from the advised fund. Donors can suggest which grant requests should be honored. Taxpayers can claim the charitable tax deduction in the year they contribute to the donor-advised fund, even though the funds may not be transferred to charities until future years. You can make a sizeable contribution to a donor-advised fund in one year, but retain the ability to recommend which charities will benefit for several years. If you have questions or want more information on donor-advised funds, please give us a call.

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

If you are age 70½ or older, consider a direct transfer from your IRA to a charity [known as a *Qualified Charitable Distribution* (QCD)]. While you will not be able to claim a charitable donation for the amount transferred to the charity, the QCD does count toward your Required Minimum Distribution (RMD). If you don't itemize, that's clearly better than taking a fully taxable RMD and then donating the amount to charity. Even if you do itemize and would be able to deduct the full amount transferred to the charity, the QCD has the added value of not increasing your Adjusted Gross Income (AGI). Keeping your AGI low can decrease the amount of your Social Security benefits that is taxable, as well as avoid or minimize the phaseout of other favorable tax provisions based on AGI.

Caution: Individuals over the age of 70½ who are still working in 2022 can contribute to a traditional IRA. However, if you're considering a QCD for 2022 (or a later year), making a deductible IRA contribution for years you are age 70½ or older will affect your ability to exclude future QCDs from your income.

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

Evaluate Intrafamily Loans

You can lend money to relatives without any tax consequences if you charge interest at least equal to the Applicable Federal Rate (AFR), which is published by the IRS each month. The AFR is typically lower than what commercial lenders offer, thus allowing the borrower to save money on interest expense. Loans with interest rates below the AFR may be subject to gift tax. While it's generally advisable to stay above the AFR to avoid being caught by the gift tax rules, you can use the annual and lifetime gift exclusions to shelter the gift from tax if you choose a lower interest rate to maximize the benefit to the borrower.

Interest rates have been historically low for some time, but now are heading up. If you have loaned any money to family members, be sure the rate you are charging is still at least equal to the AFR if you want to avoid making a taxable gift. Making intrafamily loans is still an attractive opportunity if you are interested in assisting family members financially and transferring assets in a tax-efficient manner, but it's important to be sure you are charging a rate that won't create a taxable gift, unless that is your intention.

To ensure the IRS treats the transaction as a loan (rather than an outright gift), follow these steps: (1) have a properly worded and signed document, (2) file the documents with the necessary authorities, (3) provide the borrower with a formal document that summarizes the amount of interest paid each year, and (4) either collect the loan payments or establish the payments will be gifted. Please contact us if you are interested in taking advantage of intrafamily loans

Take Advantage of the Annual Gift Tax Exclusion

The basic estate, gift, and generation skipping transfer tax exclusion is scheduled to fall from $12.06 million ($24.12 million for married couples) in 2022 to $5 million ($10 million for married couples) in 2026. Those amounts will be adjusted for inflation, but the long and short of it is that many estates that would escape taxation before 2026 will be subject to estate tax after 2025. If you think your estate may be taxable, annual exclusion gifts (perhaps to children or grandchildren) are an easy way to reduce your taxable estate. The annual gift exclusion allows for tax-free gifts that don't count toward your lifetime gifting exemption. For 2022, you can make annual exclusion gifts up to $16,000 per donee, with no limit on the number of donees. If you are married, you and your spouse can elect to gift split, so that a gift that either one of you makes is considered to be made one half by each spouse.

Of course, there are many other strategies for reducing your taxable estate. Please give us a call if you would like to discuss this further.

Year-end Planning Moves for Small Businesses

Maximize Retirement Plan Contributions. If your business doesn't already have a retirement plan, now's a good time to consider one. You can make deductible contributions to several types of retirement plans, while earnings in the plan accumulate tax-free until they are withdrawn. For example, if you're self-employed and set up a SEP-IRA, you can contribute up to 20% of your self-employment earnings, with a maximum contribution of $61,000 for 2022. If you're employed by your own corporation, up to 25% of your salary can be contributed, with a maximum contribution of $61,000.

Other small business retirement plan options include 401(k) plans (which can be set up for just one person), defined benefit pension plans, and SIMPLE-IRA plans. Depending on your circumstances, these other types of plans may allow bigger deductible contributions.

If you have a retirement plan, consider making the maximum deductible contribution in 2022. Note, that in some cases, you can take a 2022 deduction for contributions to a retirement plan made as late as 10/16/23. But, this reduces the time frame for generating tax-deferred earnings.

In addition to making deductible contributions, you may be eligible for two tax credits when you establish a retirement plan for your business. A small employer who starts a new retirement plan is eligible for a nonrefundable income tax credit of up to $5,000 for the administrative and retirement-education expenses of adopting a new qualified plan [including a 401(k)], a SIMPLE IRA plan, or a SEP. There is also a tax credit for small employers who include an auto-enrollment feature in a qualified plan. Eligible employers that include an Eligible Automatic Contribution Arrangement (EACA) in a qualified plan can claim an annual credit of $500 for up to three tax years. The credit also is available to employers who convert an existing plan to an automatic enrollment design.

Contact us for more information on small business retirement plan options, and be aware that if your business has employees, you may have to cover them too.

Plan Your Business Asset Purchases. The bonus depreciation rate is scheduled to drop from the current 100% deduction to 80% of the cost of qualified property placed in service after 2022. So, placing a qualified asset in service by the end of 2022, rather than waiting until 2023, can have a big impact since you will be able to deduct the entire cost of that asset this year. If you wait until 2023, 80% of the asset's cost will be deductible as bonus depreciation, with the remaining 20% written off over the asset's recovery period, which depending on the asset, can be up to 20 years.

Some assets that don't qualify for bonus depreciation are eligible for Section 179 expensing. For qualifying property placed in service in tax years beginning in 2022, the maximum Section 179 deduction is $1.08 million. The Section 179 deduction begins to phase-out when the cost of Section 179-eligible property placed in service during the year exceeds $2.7 million. This means that you could possibly write off the entire cost of business asset purchases in 2022. Given that, you might consider purchasing additional assets before year-end.

Caution: *Placed in service* generally means that the asset is ready to be used for its intended purpose. For many assets (such as a personal computer or cell phone) that's the day you buy it. Some assets (like heavy equipment) require installation and/or assembly before they can be used. So, if you decide you want to take any bonus depreciation or Section 179 deduction for an asset in 202**2**, be sure that you make all the necessary arrangements to have that asset ready for use before year-end.

Take Advantage of Larger Deductions for Business Meals. Normally, the deduction for business meals is limited to 50% of the meal's total cost. However, the cost of food and beverages provided by a restaurant that is paid or incurred in 2022 is 100% deductible (assuming the meal qualifies as a business meal). If you use the per diem method to reimburse employees for business expenses, you can treat the entire meal portion of the per diem rate paid or incurred in 2022 as being attributable to food or beverages provided by a restaurant, making the meal per diem 100% deductible. As such, you may want to move any business meals originally planned for early 2023 into late 2022 to obtain the higher deduction. If you use the cash method, consider prepaying the cost of business meals to be provided in a restaurant in 2023. Note that you can generally only prepay and deduct an expense if will be incurred within 12 months.

Conclusion

This letter only covers some of the year-end tax planning moves that could potentially benefit you, your family, and your business. Please contact us if you have questions, want more information, or would like us to help in designing a year-end planning package that delivers the best tax results for your particular circumstances.

Best regards,

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