The Kiplinger Tax Letter

SPECIAL
YEAR–END
TAX PLANNING

CIRCULATED BIWEEKLY TO BUSINESS CLIENTS SINCE 1925

Reported from Washington, D.C. • kiplinger.com • **Vol. 98, No. 22**

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Dear Client: Washington, Oct. 24, 2023

It's time to review your year-end tax plans. With two months left before 2023 comes to a close, this Letter focuses on actions you can take to cut your federal tax bill. We'll delve into individual planning, investments, gifts, business taxes and much more.

On individual tax planning, look at the overall impact on 2023 and 2024. The goal is to lower your taxes over both years. Most benefit by accelerating write-offs from 2024 into 2023 while deferring taxable income. Others take the opposite approach.

Itemizers have the most flexibility in shifting write-offs, as shown here.

Home interest. If you pay your Jan. 2024 mortgage bill before year-end, you can deduct the interest portion on Schedule A of your 2023 federal tax return.

State and local taxes. If under the $10,000 cap and your locale allows it, pay the property tax bill due in Jan. 2024 in Dec. of this year so you can deduct it.

Bunch into 2023 charitable gifts you would usually give over multiple years.

And think about incurring additional medical expenses before year-end if your medicals are near or have topped the 7.5%-of-adjusted-gross-income threshold. Check out IRS Pub. 502. The list of eligible medicals is broader than you may think.

Heed the timing rules for charitable donations and other tax-deductible items. Put checks in the mail by year-end to lock in a 2023 deduction. For charges made with bank credit cards, you can claim the write-off in the year you charged the expense.

If pondering home upgrades...go green to claim one of two tax credits:

The residential clean-energy property credit is equal to 30% of the cost of solar panels, solar-powered water heaters, geothermal heat pumps and more.

The smaller energy-efficient home improvement credit applies to insulation, boilers, central air-conditioning systems, water heaters, heat pumps, exterior doors, windows and the like that meet certain energy efficiency ratings. This credit for 30% of the cost of these eco-savings upgrades used to have a $500 lifetime limitation, but no more. There is now a general $1,200 aggregate yearly credit limit, but some specific upgrades have lower monetary caps, while others have larger ones. If planning for multiple upgrades, think about staggering them over 2023 and 2024.

Don't forget about the tax credit for buying an electric vehicle. Many new EVs qualify for a credit of up to $7,500. The break is up to $4,000 if buying a used EV.

Some high-cost EVs aren't eligible. The manufacturer's suggested retail price can't exceed $55,000 for sedans and $80,000 for vans, SUVs and pickup trucks.

There's an income limit. Modified adjusted gross income can't exceed $300,000 for couples, $225,000 for household heads or $150,000 for singles. For used-EV buyers, the modified AGI thresholds are $150,000, $112,500 and $75,000, respectively.

If you wait until 2024 to buy an EV, you can opt to monetize the credit by transferring it to the dealer at the time of purchase, thus lowering the amount you will pay for the car. This allows you to take immediate advantage of the credit.

Consider a short-term rental of your home and pocket tax-free cash. The proceeds from a personal residence that is rented out 14 days or less in a year are nontaxable and aren't reported on your return, no matter the rent charged.

The Kiplinger Tax Letter (ISSN 0023-1762) is published biweekly for $156/year, including first-class postage, by The Kiplinger Washington Editors, Inc., part of Future Publishing Limited (company number 2008885), registered in England and Wales. Registered office: Quay House, The Ambury, Bath BA1 1UA. Postmaster: Send address changes to The Kiplinger Letter, P.O. Box 37234, Boone, IA 50037-0234.

DONATIONS & GIFTS

Make the most of your generosity when donating to charitable organizations.

Contribute appreciated property, such as stocks or shares in mutual funds. If you've owned the property for more than a year, you can deduct its full value in most cases if you itemize. Neither you nor the charity pays tax on the appreciation.

Don't donate assets that have dropped in value. If you do, the loss is wasted.

Use your annual gift tax exclusion. You can give each person up to $17,000... $34,000 if you are married...this year without paying gift tax, filing a gift tax return or tapping your lifetime estate and gift tax exemption. Recipients aren't taxed on gifts. Gifts over the exclusion amount will trigger the filing of a gift tax return for 2023. But you won't owe federal gift tax unless your lifetime gifts exceed $12,920,000.

Here are two ways to help your kids or grandkids with their college education:

Pay tuition directly to the school. The payment is nontaxable to the student, it doesn't count against the $17,000 gift tax exclusion, and it reduces your estate.

Contribute to a 529 plan. You can shelter from gift tax up to $85,000 in contributions per beneficiary this year ($170,000 if your spouse agrees). If you put in the maximum, you'll be treated as gifting $17,000 (or $34,000) to that beneficiary in 2023 and in each of the next four years...2024 through 2027.

IRAs & PLANS

Pay attention to the required minimum distribution rules for traditional IRAs.

People 73 and older must take annual payouts. To arrive at the 2023 RMD, start with your IRA balances as of Dec. 31, 2022, and use the tables in IRS Pub. 590-B.

If 2023 is your first RMD year, you have until April 1, 2024, to take the RMD, though the amount is still based on your total IRA balance as of Dec. 31, 2022.

Similar rules apply to 401(k)s. However, people who work past age 73 can generally delay taking RMDs from their current employer's 401(k) until they retire.

Charitable donations made directly from a traditional IRA can save taxes. People 70½ and older can transfer up to $100,000 yearly from IRAs directly to charity. Qualified charitable distributions can count as RMDs, but they're not taxable and they're not added to your AGI. The QCD strategy is a good way to get tax savings from charitable gifts for taxpayers not itemizing because of higher standard deductions.

The money must generally go to a 501(c)(3) charitable organization...

But the SECURE 2.0 law provides an easing to this rule. IRA owners can do a one-time (not annual) qualified charitable distribution of up to $50,000 through a charitable remainder annuity trust, charitable remainder unitrust or a charitable gift annuity. Many private colleges with charitable gift annuity programs are now touting this QCD option, so you may hear about it from your alma mater.

Max out your 2023 401(k) and IRA contributions. You have until Dec. 31 to put money in 401(k)s and other workplace retirement plans, and until April 15, 2024, to contribute to an IRA for 2023. You can stash up to $22,500 in a 401(k)...$30,000 if age 50 or up. The 2023 payin cap for IRAs is $6,500, plus $1,000 more if 50 or older.

Consider whether it's the right time to convert a traditional IRA to a Roth IRA. You'll have to pay tax on the converted amount, but future earnings are tax-free.

Among the factors to consider in making your decision: Income tax rates for 2023 and later years. If you expect the rate you will pay in retirement to be the same or higher than the rate on the conversion, then switching to a Roth can pay off taxwise.

Roths don't have required minimum distributions, unlike traditional IRAs.

Whether your account value is depressed and/or whether you think it will rise.

And income from the conversion will increase your adjusted gross income, thus potentially triggering higher Medicare premiums two years down the line.

Note you don't need to convert the entire amount to a Roth in one swoop.

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INVEST-MENTS

Your investment portfolio provides plenty of tax-saving opportunities.

See if you qualify for the 0% rate on long-term gains and qualified dividends. If taxable income other than long-term gains or dividends doesn't exceed $44,625 on single returns, $59,750 for head-of-household filers or $89,250 on joint returns, then your qualified dividends and profits on sales of assets owned more than a year are taxed at a 0% federal rate until they push you over the threshold amounts.

The 0% federal rate isn't all gravy. Zero-percent-rate gains and dividends might not be taxed at the federal level, but they do hike adjusted gross income. The extra AGI can cause more of your Social Security benefits to be taxed. Also, your state income tax bill may jump, since many states tax gains as ordinary income.

If you're not eligible for the 0% rate, there is always the 15% or 20% rate. The 20% rate on long-term capital gains and qualified dividends starts at $492,301 for singles, $523,051 for heads of household and $553,851 for couples filing jointly. The 15% rate is for filers with incomes between the 0% and 20% break points.

Take steps to limit the sting of the 3.8% surtax on net investment income... dividends, taxable interest, capital gains, passive rents, annuities, royalties, and income from a passive activity if the taxpayer doesn't materially participate. The tax applies to single filers with modified adjusted gross incomes above $200,000 and joint filers over $250,000. Modified AGI is AGI plus tax-free foreign earned income. The tax is due on the smaller of NII or the excess of modified AGI over the thresholds. Buying municipal bonds is helpful, since tax-free interest is exempt from the 3.8% bite.

Know the rules on capital losses if you have some duds you want to sell. Capital losses offset capital gains plus up to $3,000 of other income. Excess losses are then carried over to the next year and can help offset future capital gains.

If you have capital loss carryforwards, cull your portfolio for capital gains. That's because your net gains...up to the carryover amount...won't be taxed at all.

Tax loss harvesting is one way that investors can lower their tax bill. The strategy involves selling stocks or other holdings in your taxable accounts that have declined in value for the purpose of generating capital losses to offset gains from the sale of winners. Investors commonly do this closer to the end of the year, when they have a better idea of the amount of total capital gains they will have.

Beware of the sneaky wash-sale rule. It prohibits a capital loss write-off on the sale of securities if you purchase substantially identical securities up to 30 days before or after the sale. The recognized loss isn't gone forever...it's only suspended. That's because the loss is added to the tax basis of your replacement securities.

The wash-sale rule can catch you by surprise. It applies between spouses. You have a wash sale if you sell securities at a loss and your spouse, or a corporation that you control, buys substantially identical securities within the 60-day period. Ditto if you have your IRA purchase stock after you sell the same stock at a loss in your taxable investment account, or if you happen to sell mutual fund shares at a loss less than 30 days after the date a dividend is reinvested to buy more shares.

People who sell crypto at a loss needn't worry about the wash-sale rule. The definition of securities for purposes of the wash-sale rule doesn't include crypto. So, for example, if you own crypto that sharply falls in value, you can sell it, recognize a capital loss, and buy the same digital currency the same day or soon after.

Think about investing in REITs or publicly traded partnerships.

You could get a nice tax break. The 20% deduction for pass-through income also applies to holders of interests in real estate investment trusts and PTPs. Individuals can deduct on their federal return 20% of their qualified REIT dividends... distributions that aren't otherwise taxed under the favorable rules for capital gains and dividends...and 20% of their allocable share of a PTP's qualified income.

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WITH-HOLDING Boost your federal income tax withholding if you expect to owe tax for 2023. It can help avoid an underpayment penalty. You're off the hook for the fine if you prepay, via tax payments or withholding, at least 90% of your 2023 total tax bill or 100% of what you owed for 2022 (110% if your 2022 AGI exceeded $150,000).

You can give your employer a new W-4 to have more tax taken from wages.

Fill out W-4V to have federal tax withheld from your Social Security benefits. You can elect to have 7%, 10%, 12% or 22% of your monthly benefits taken out.

IRA owners taking RMDs can use this income tax withholding strategy: Have more tax withheld from a year-end distribution from your traditional IRA. Tax withheld at any point in the year is treated as if evenly paid throughout the year. By default, IRA custodians withhold 10%, but you can ask for more to be withheld.

Don't forget about the 0.9% Medicare surtax on earned income. It kicks in for joint filers with earnings over $250,000...$200,000 for singles and household heads. Employers must begin to withhold the tax from worker paychecks in the period when wages first exceed $200,000, regardless of the employee's marital status. This can lead to underwithholding for a couple if each spouse earns under $200,000, but their combined wages total more than $250,000. The same goes for an employee with a self-employed spouse if the couple's combined earnings will exceed $250,000.

BUSINESS TAXES There are generous write-offs for business asset purchases this year. Businesses can save lots on taxes with first-year 80% bonus depreciation. Firms can deduct 80% of the cost of new and used qualifying business assets, with lives of 20 years or less, that they buy and place in service by Dec. 31, 2023.

Purchase and place assets in service this year if you want the 80% break. It falls to 60% next year, 40% in 2025, 20% in 2026 and ends after 2026.

Expensing is available. In 2023, businesses can expense up to $1,160,000 of new or used business assets. This limit phases out once more than $2,890,000 of assets are put into service during 2023. Note that the amount expensed can't exceed the business's taxable income. Bonus depreciation doesn't have this rule.

There are lots of breaks for buyers of business vehicles under the tax laws.

For new and used cars first put in use in 2023, if bonus depreciation is taken, the first-year cap is $20,200. The second- and third-year caps are $19,500 and $11,700. After that...$6,960. If no bonus depreciation is claimed, the first-year cap is $12,200.

Buyers of heavy SUVs also get write-offs. Up to $28,900 of the cost of SUVs with vehicle weights over 6,000 pounds can be expensed in 2023. 80% of the balance gets bonus depreciation, and the rest may qualify for regular five-year depreciation.

Up to 100% of the cost of a big truck used in business can be expensed, subject to the rule that total expensing can't exceed taxable income from the business.

See if you can take advantage of the 20% deduction for pass-through income. The self-employed and owners of LLCs, S corporations and other pass-through entities can deduct 20% of their qualified business income, subject to limitations for individuals with taxable incomes of more than $364,200 for joint filers and $182,100 for all others. If you're close to or just above the income limits, consider accelerating deductions or deferring income so that you can come in under the dollar thresholds for the year.

Gig workers who aren't employees can claim this write-off from their earnings.

Schedule E rental income may be eligible for the deduction in some cases.

Yours very truly,

Joy Taylor

Oct. 24, 2023 Joy Taylor, Editor