2023 Year-End Tax Planning for Individuals

Dear Client,

2023 has been a relatively quiet year from both a tax standpoint, and an overall economic standpoint for the United States. After 2022 saw historically high inflation as the economy rebounded from the impacts of the pandemic, inflation has cooled somewhat, and it appears that the chances of a recession have abated.

On the tax front, 2023 (as of now) has not seen any major legislation. In the meantime, the IRS has been busy issuing guidance implementing major pieces of 2022 tax legislation. However, much of this legislation, and the ensuing guidance, is very narrowly applicable, largely impacting green energy investment and retirement planning and saving.

This means fewer tax changes in 2023 than in years past. While there are always new strategies to consider, and indeed there are some changes from recent legislation that are in effect for 2023, the usual tactics of deferring income and increasing current deductions still apply for 2023.

LEGISLATION

As mentioned earlier, there have been no major tax bills passed during 2023. With Democrats controlling the Senate and White House, and Republicans controlling the House with a very slim margin, this is hardly surprising. Indeed, very little legislation of any type has been passed by Congress.

As always, however, there is a potential for that to change before the end of 2023. At the end of September, Congress passed a continuing resolution to avoid a government shutdown, but only extended that government funding to November 17. While it is widely believed another continuing resolution will be passed before that date to kick the can a little farther down the road, there is always the potential for any continuing resolution, or any final legislation funding the government for the 2024 fiscal year, to include some sort of tax legislation.

MINIMIZING INDIVIDUAL TAXES

The key to any year-end planning strategy is to minimize taxes. This is generally done by either reducing the amount of income received or increasing the amount of deductions. In recent years, the possibility of increased rates on higher incomes due to proposed legislation, or changes in qualification for various stimulus proposals, made the decision of deferral or acceleration highly dependent upon individual circumstances. However, as the end of 2023 approaches, these factors are not really in play anymore.

The impact of inflation makes deferral of income a likely winner for almost all individuals. While the increase is much lower from 2023 to 2024 (approximately 5%) than it was from 2022 to 2023 (approximately 8%) due to easing inflation, it is still much higher than it was in many years prior to 2023.

Individuals may not necessarily see increases in earnings that keep up with that level of inflation, meaning that if deferral of income from 2023 into 2024 is possible, it would mean that more income would fall into a lower tax bracket. In the long run, that would mean a lower aggregate tax burden.

Delaying and reducing gains

Like taxes on ordinary income, taxes on capital gains also apply at different rates depending upon the amount of taxable income. For 2023, the rates are as follows:

Filing Status	0%	15%	20%
Married Filing Joint/ Qualified Surviving Spouse	$0 - $89,250	$89,251 - $553,850	over $553,850
Maried Filing Separate	$0 - $44,625	$44,626 - $276,900	over $276,900
Head of Household	$0 - $59,750	$59,751 - $523,050	over $523,050
Single	$0 - $44,625	$44,626 - $492,300	over $492,300
Estates & Trusts	$0 - $3,000	$3,001 - $14,650	over $14,650

For taxpayers whose income tends to fluctuate from year to year, it would be wise to examine the impact of sales of investment items. For taxpayers who think they may have lower income in 2024, it would be smart to hold off on a sale of a capital item if their income is at or near a threshold for a higher capital gains bracket.

This type of consideration should not be limited to capital gain taxes, but also the net investment income (NII) tax. The 3.8% NII tax kicks in at $200,000 of modified adjusted gross income for single and head-of-household filers, $250,000 for joint filers, and $125,000 for married taxpayers filing separately.

Since the NII thresholds fall right in the middle of the 15% capital gains bracket, a taxpayer to whom the NII applies because of a sale of a capital item would likely not be able to reduce the tax to 0%. But a taxpayer who is barely in the 20% bracket could defer a sale and get into the 15% bracket, meaning a sale of a capital item would only be taxed at 18.8% instead of 23.8%.

Maximizing deductions

For 2023, the inflation-adjusted standard deduction amounts are $27,700 for joint filers, $20,800 for heads of households, and $13,850 for all other filers. With standard deduction amounts so high, coupled with the $10,000 limitation on the deduction of state and local taxes, it is difficult for many taxpayers to claim enough deductions to make itemizing deductions beneficial. Thus, maximizing deductions may not be beneficial for all taxpayers.

One of the best ways to maximize the amount of deductions is to develop a bunching strategy. This involves accumulating charitable contributions, or even medical expenses, from two or more years into one year. For example, a taxpayer may have not made any of his or her normal charitable contributions in 2022, and then made double the normal amount in 2023 in order to help surpass the standard deduction amount.

Again, the impact of inflation must be considered here, as the standard deductions are higher for 2024 as compared with 2023. Even with bunching, it might be difficult to achieve itemized deductions high enough in 2024 to surpass the standard deduction.

The same strategy can be employed for deductible medical expenses where the timing is somewhat flexible, such as for elective procedures (remember that purely cosmetic procedures are not deductible).

Bunching can be a very effective strategy, but it has to be effectively used, and potentially planned out two or three years in advance to maximize the benefit, while also taking into account shifts in tax policies as a result of political change.

Green energy

Some new or expanded provisions are in effect for the 2023 tax year as a result of the Inflation Reduction Act of 2022.

2023 is the first year that the new Energy Efficiency Home Improvement Credit is available. The credit is generally equal to 30% of the taxpayer’s qualified expenses up to annual maximum of $1,200 (which can include doors, windows, other qualifying energy property, and even a home energy audit). Also available is the Residential Clean Energy Credit, which is also equal to 30% of qualified expenses but with no annual maximum or lifetime limit. This credit is applicable to the installation of certain energy property like solar cells, small wind turbines, or battery storage. Restrictions and limitations do apply to both credits.

The much more broadly applicable credit for the purchase of electric vehicles was eliminated upon the passage of the Inflation Reduction Act of 2022. In its place are two new credits, one $7,500 credit for the purchase of a new clean vehicle (with much more stringent requirements as compared to the old credit) and a $4,000 credit for the purchase of a used clean vehicle.

Claiming any of these credits is not urgent. They are not scheduled to expire for many years. But there is no time like the present to claim a tax credit, and taxpayers looking to make these types of investments can realize immediate tax benefits for 2023 if they act before the end of the year. Additionally, these credits are not necessarily supported on a bipartisan basis, so any shift in control of Congress could lead to an accelerated expiration.

Retirement savings

Many of the changes made by the SECURE Act 2.0 are not applicable until 2024. However, there is one significant change applicable to 2023, and that is in the increase in the age at which required minimum distributions (RMDs) must begin. Starting in 2023, the age is increased to 73 for individuals who turn 72 after 2022 and age 73 before 2033.

Remember that taxpayers who are in their first RMD year have until April 15 of the following year to make that first RMD. So, while action isn't absolutely necessary before the end of the year, affected taxpayers should start to plan for those RMDs.

SALT deduction

The Tax Cuts and Jobs Act capped the amount of the deduction for state and local taxes (SALT) at $10,000. As a result, many states have enacted legislation that permits certain pass-through entities (PTE) to elect to pay income tax at the entity level. By electing to be subject to income tax at the entity level, a PTE may reduce the federal income tax liability of its owners. Additionally, taxes paid by a PTE can be deducted by its owners and do not count towards the owner's $10,000 limit of their SALT deduction. Requirements vary from state to state, so taxpayers looking to take advantage of this new strategy should speak with their tax professionals.

Other year-end strategies

A number of other traditional year-end strategies may apply. These include:

- Maximizing Education Credits – Individuals can claim a credit for tuition paid in 2023 even if the academic period begins in 2024, as long as the period begins by the end of March.
- Increasing 401(k) Contributions – Adjusted gross income (AGI) can be reduced if individuals increase the amount of their 401(k) contributions.
- IRA Contributions – Individuals eligible for deductions for IRA contributions can claim deductions, and thus reduce AGI, for amounts contributed generally through April 15, 2024.
- Teacher deductions – Educators can claim a deduction for up to $300 of classroom expenses (like books, supplies, and computer equipment, as well as personal protective equipment, disinfectant, and other supplies used to prevent the spread of COVID-19), and should maximize those expenses by year-end.

Contact Us

Please call our office to schedule an appointment to discuss your year-end strategy. In addition to these year-end planning issues unique to 2023, the usual year-end planning strategies also still apply: maximizing qualified retirement contributions, managing gains and losses from taxable investments, considering year-end gifts and charitable contributions, and considering postponing income and accelerating deductions. There is no one size fits all for tax planning and any strategy may have unintended consequences if the taxpayer's situation is not evaluated holistically considering the changing landscape. Please call our office to discuss all your options.

Sincerely,

Kevin Silva, EA