Hellam | Varon
CERTIFIED PUBLIC ACCOUNTANTS

mgi BUSINESS SOLUTIONS WORLDWIDE

November 29, 2022

### *Dear Clients and Friends:*

As December 31st approaches, now is an excellent time to consider planning actions that could lower your tax bill for this year and possibly next year.

Despite major tax changes from recent years generally remaining in place, including lower income tax rates and larger standard deductions, the time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers. So, too, does bunching expenses into this year or next to minimize income taxes overall.

2022 continues to provide opportunities for tax planning. Below we have included summaries of tax planning strategies for individuals and businesses.

The following may help you save tax dollars if you act before year-end. Not all will apply to you, but we can certainly help you determine which might be of benefit. Please look at the list below for items to consider and reach out to us with any questions. We look forward to hearing from you!

## *Electric Vehicle Credit*

The Inflation Reduction Act extended the electric vehicle credit of up to $7,500 per vehicle through 2032. For vehicles purchased after January 1, 2023, the act removes the cap of 200,000 per automaker for claiming the EV tax credit, which will allow taxpayers to take credits for GM vehicles and Tesla once again to qualify for the credit.

It also added a new requirement that the final assembly of the vehicle must take place in North America, effective August 17, 2022. Starting on January 1, 2023, the credit will be limited based on your modified adjusted gross income for both the current <u>and the previous tax year</u>. No credit is allowed for taxpayers filing a joint return or surviving spouse with income over $300,000, taxpayers filing as head of household with income over $225,000, and over $150,000 for single filers.

Also starting on January 1, 2023, vehicles will not be eligible for the credit if they exceed an MSRP limit: $80,000 for vans, pickup trucks, and sport utility vehicles; $55,000 for other vehicles.

**Tip – If you are considering purchasing an electric vehicle, you may want to expedite your purchase by the end of 2022.**

### *Energy Efficient Home Improvement Credit*

Starting in 2023 , the Energy Efficient Home Improvement Credit will be equal to 30% of the costs for all eligible home improvements made up to $1,200 per year**.**

The Residential Clean Energy Credit allows a nonrefundable tax credit of up to 30% of expenses paid for installing clean household energy, including solar, wind, or geothermal property as well as battery storage technology.

For business owners and investors, a 30% credit for clean energy producing property is significantly improved by extending it through 2032.

Tax credits for qualified commercial clean vehicles are available for vehicles placed in service starting January 1, 2023, including up to a $40,000 credit for heavy vehicles. Businesses that install new EV chargers or EV charging equipment can also benefit from a tax incentive of up to 30% of the total cost of equipment and installation.

### *Research and Development Credit*

Effective January 1, 2022, expenses related to Research and Development activities will no longer be allowed as a current deduction. Instead, these costs must be capitalized and amortized over 5 or 15 years. Currently, an R&D tax credit of up to $250,000 can be allowed to be elected to apply against the share of the Social Security, or FICA, tax for employees, rather than against income tax.

Under the Inflation Reduction Act, qualified small businesses may apply an additional $250,000 in qualifying research expenses as a payroll tax credit against the employer share of Medicare tax liability effective for the 2023 tax year. Businesses can qualify for a maximum tax credit of $2.5 million over five years. The credit cannot exceed the tax imposed for any calendar quarter, with unused amounts of the credit carried forward.

### *Bonus Depreciation*

Bonus depreciation remains 100% for new qualified assets placed in service by the end of December 2022. It is scheduled to be phased out in 20% intervals from 2023-2026. Bonus depreciation will drop to 80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026 and 0% in 2027.

The §179 deduction is also available for businesses to expense up to $1,080,000 on qualified new and used qualified assets, subject to taxable income limitations. This is not prorated so the full amount can be expensed if placed in service by the end of December.

**Tip – Make large purchases by the end of 2022 to take 100% bonus deprecation.**

### *Annual Gift Tax Exclusion*

The annual gift tax exclusion allows you (and your spouse) to give up to $16,000 to as many other people (or contribute to a Section 529 College Savings Account!) as you like in 2022 without using up any of your lifetime gift/estate tax exemption ($12,060,000 in 2022) or requiring that a gift tax return be filed.

In addition to these annual gifts, you can pay unlimited amounts of tuition or medical expenses directly to the providers, and those payments do not count as gifts. Looking ahead to 2023, the annual gift exclusion will go up to $17,000 and the lifetime exclusion will be $12,920,000. Keep in mind, though, that the lifetime exclusion is currently set to be reduced by approximately half in 2026. Please contact us to review the best ways to take advantage of these considerable gifting opportunities.

### *Roth Conversions*

You may wish to consider converting a portion of your traditional IRA to a Roth IRA. Since this involves recognizing ordinary income on the amount converted, this may be an especially attractive technique in a year when your income is lower than usual, or in cases where favorable tax attributes need to be consumed before they expire - such as charitable deduction carry-forwards or Net Operating Losses (NOLs). There can also be substantial estate planning benefits in the right situation.

A recent change in the law eliminates the ability to reverse Roth conversions, so please contact us in advance to determine how this might impact you if considering a conversion!

### *Washington State Capital Gains Tax*

A Washington State Capital Gains Tax of 7% was passed by the Legislature in 2021 to apply to capital gains for residents of Washington and certain sales sourced to Washington. In March 2022, the Douglas County Superior Court ruled that the tax was an unconstitutional income tax and struck it down. In July 2022, the Washington State Supreme Court granted a direct appeal with arguments expected in winter 2023. **There will likely not be a final ruling on the tax until late 2023**. If the tax is upheld, it is not currently clear when the payment of tax would be due.

The tax would apply to net long-term capital gains over $250,000.

- The tax does not apply to real estate, including a residence, or sales of a “family-owned” business that had less than $10,000,000 of revenue in the previous 12-months and meets certain other criteria.
- There is a deduction of up to $100,000 for charitable donations in excess of $250,000 made to a Washington based non-profit.

### *2022 Itemizing Deductions*

- Only if higher than the standard deduction amounts:
    - $25,900 for joint filers / $12,950 for single / $19,400 for Head of Household
- Only $10,000 of taxes may be deducted (including state and local taxes paid)
    - Business Owners should consider a “SALT Cap Workaround” (discussed below) for taxes paid to states other than Washington
- Consider bunching expenses in one year to maximize itemized deductions. It may be tax advantageous for you to double your charitable giving in a single year, and claim the standard deduction in another year.
- Other gifting strategies:
    - Consider making additional donations before the end of the year, including donations to a donor advised fund. Donor advised funds allows you to make a tax deductible donation in one year, and then spread out contributions to charities over a multiple year period.
    - Consider donating appreciated assets that you have held for more than 12 months, including real estate and stock, to charities. You can take a tax deduction for the full fair market value without also paying capital gains tax - a double tax benefit.

### *Tax Bracket Management*

- Take into account which tax bracket you will be in each year – you may want to accelerate retirement plan distributions or recognize income in a future year if possible.
- Consider harvesting capital losses from selling assets at a loss by the end of 2022 to offset 2022 capital gains. Be sure to consider the 30+ day wash loss rules if you intend to repurchase the identical investment.
- Capital losses are most effective if they can be used to offset short-term capital gains that are taxed at higher rates

### *Other Saving Ideas for Individuals*

- Compare your medical costs this year to what you anticipate next year and consider if you contributed enough to your employer's health Flexible Spending Account (FSA). Be sure to use all of your FSA account before the end of the year.
- If you become eligible in December of 2022 to make Health Savings Account (HSA) contributions, you can make a full year's worth of deductible contributions for 2022. If

you haven't already made the maximum contribution for the year, consider maxing out your contribution.
- Consider converting traditional IRAs into a Roth IRA in 2022, known as a "backdoor Roth", if eligible.

## *Required Minimum Distribution ("RMD") Rules*

Here are the required minimum distribution rules for 401(k) plans and IRAs:

- For those who turned 70 ½ in 2020 or later, you now only need to take distributions <u>after</u> you reach age 72.
- For a 401(k) plan, you must take your first RMD no later than April 1 of the year following the year you turn 72. You may be able to delay the RMD depending on the provisions of your 401(k) plan if you're still working and do not own at least 5% of the company.
- For an IRA, you must take your first RMD by April 1 of the year following the year in which you turn 72 regardless of whether you're still employed.
    - Roth IRAs do not require withdrawals until after the death of the owner.
    - All subsequent RMDs (after the initial distribution) must be taken by 12/31 of the year.
- IRA owners who are 70-1/2 or older are eligible to direct up to $100,000 per year of their IRA distributions to charity. These distributions are known as qualified charitable distributions, or QCDs. The money given to charity counts toward the donor's required minimum distribution (RMD). These QCDs do not provide a deduction on Schedule A but doesn't increase the donor's adjusted gross income or generate a tax bill. These are especially beneficial if you are not already itemizing your deductions.

## *Maximizing Qualified Business Income Deduction (QBID)*

Taxpayers, other than corporations, may be entitled to a deduction of up to 20% of their qualified business income. Strategies to maximize the QBID include:

- Timing income or deductions to fall under the above thresholds (beginning at $340,100 for married filing jointly and $170,050 for all others).
- Paying "reasonable" wages to increase the amount of deduction allowed:
    - To an employee-owner of an S-Corp, or
    - To any other employee included bonuses paid by year-end
- Placing equipment in service before year-end because of the limitation on taxable income (equipment expensing, bonus depreciation or Section 179 will also reduce total income)

## *Cash Method of Accounting*

Taxpayers on the cash method may find it a lot easier to shift income. If, over the 3-year testing period, average gross receipts do not exceed $27 million, a business may be eligible to use the cash method of accounting as opposed to the accrual method. This opens the possibility of reducing income by holding off billings and paying expenses a little earlier. Your business may be able to change to this method.

### *Net Operating Loss ("NOL") Carryback*

If your deductions (or your C corporation's deductions) for the year are more than income for the year, you may have an NOL. <u>2022 net operating losses may no longer be carried back</u> to offset taxable income as in previous tax years.

In general, you can use an NOL by deducting it from your income in other years, but it is limited to 80**%** of your taxable business income in any one year. We can advise you on any potential tax benefits and limits.

### *State Tax Issues*

- "SALT Cap Workaround" – Currently on an individual tax return, only $10,000 of state taxes—state income, sales, and real estate taxes—can be deducted on Schedule A. The SALT Cap Workaround would allow an S-Corp or Partnership to make tax payments on behalf of an individual that would be deductible on business return and then to pass the state tax credit to the individual. Many states have enacted rules allowing this and most others are enacting these rules.

**Tip – make your "SALT Workaround" payments by the end of 2022 to take the deduction in 2022.**

These are just some of the year-end steps that can help you save taxes. Please call us to find out which works best for you.

Very truly yours,

***Your Team at Hellam Varon & Co., Inc.***