Year-End Tax Planning for Businesses and Individuals

December 19, 2022

As we wrap up 2022, it is important to take a closer look at your tax and financial plans and discuss steps that can be taken to reduce taxes. Though there has been much political attention to tax law changes, inflation and environmental sustainability, political compromise has led to smaller impacts on taxes this year than expected.

However, with the passage of the Inflation Reduction Act and CHIPS Act this year, there are new incentives to consider for your business and individual taxes. Additionally, there are several tax provisions that have expired or will soon. We continue to closely monitor any potential extensions or changes in tax legislation and will keep you informed.

In the meantime, here is a look at some issues impacting businesses and individuals to consider as we approach year-end.

Tax Issues Impacting Businesses

Deferral of Income and Accelerating Expenses

Many times, there are strategies such as deferral or acceleration of income, or prepayment or deferral of expenses, that can help you save taxes and thereby strengthen your financial position. For example, year-end bonuses can be timed for maximum tax effect by both cash and accrual basis employers.

Accelerated Depreciation

Businesses should consider expensing qualifying property purchases under IRC Section 179. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for interior improvements to a building (but not for its enlargement, elevators or escalators, or the internal structural framework) for roofs and for HVAC, fire protection, alarm and security systems.

Businesses can also claim a 100% bonus first year depreciation deduction for machinery, equipment and qualified improvement property bought and placed in service this year. It is important to note the 100% write-off will decline to 80% in 2023. As such, if you are considering any purchases of property that qualify for bonus depreciation, it may be beneficial to finalize the purchase prior to the close of 2022.

Business Meals

As you enter the holiday season and have more social gatherings with your customers and employees, keep in mind the rules for business meal deductions. There is a 100% deduction (rather than the prior 50%) for expenses paid for food or beverages provided by a restaurant. This provision expires at the end of 2022.

Net Operating Losses (NOLs)

If your deductions for the year are more than your income for the year, you may have an NOL. In general, you can use an NOL by deducting it from your income in future year(s), but it is limited to 80% of your taxable business income in any one year.

Energy and Advanced Manufacturing Investment Tax Credits

There are many tax incentives to encourage businesses to decrease their carbon footprint and become more environmentally sustainable. Please visit our article for additional insights on the Inflation Reduction Act.

Congress also created a tax credit to encourage domestic semiconductor manufacturing. The credit is equal to 25% of qualified costs (including the manufacturing of equipment and machinery that assists in the production of semiconductors) incurred after 2022 and before 2027.

The rules regarding these tax credits are complex, and some elements of the law are not in effect until 2023.

Inventory, Inflation and Economy

Businesses who are currently valuing inventory using the First In First Out (FIFO) method and are affected by historical inflation may wish to consider switching to the Last In First Out (LIFO) method of inventory valuation. This change allows the taxpayer to deduct the cost of inflation. Read our recent article about LIFO to learn more.

If a business meets the small business taxpayer gross receipts threshold, the business may be allowed to use simplified accounting and reporting procedures such as the cash basis method, uniform capitalization under 263A, accounting for long-term contracts, accounting for inventories and other items. The three-year average gross receipts threshold is indexed for inflation increasing from $27 million for 2022 to $29 million for 2023.

R&D Expenditures

As a result of the Tax Cuts and Jobs Act, R&D expenditures incurred in 2022 and after must be capitalized and amortized over a period of five years (foreign R&D expenses should be amortized over 15 years) instead of expensed immediately.

Additional Tax and Financial Planning Considerations

- **Business Interest Expense Limitation.** For tax years beginning in 2022, depreciation, depletion and amortization are no longer added back when computing adjusted taxable income. This may cause issues for some businesses by limiting business interest expense.

- **Deferred Self-Employment or Payroll Taxes from 2020.** If you deferred social security taxes from 2020, the second 50% payment is due by December 31, 2022.

- **Employee retention credit (ERC).** The ERC encouraged businesses to keep employees on their payroll during the pandemic. Although these credits relate to tax years 2020 and 2021, applying for these credits is still available. The IRS warned employers to be cautious of third parties taking improper positions related to ERC eligibility, as claiming the credit inaccurately can result in severe consequences. Additionally, the credit amount is required to be included in the business's income.

- **Charitable Contributions.** For tax year 2022, the maximum allowable contribution deduction is limited to 10% of a corporation's taxable income (as compared to the temporary increase of 25% that was in effect last year).

- **Partnership Audit and Adjustment Rules.** Changes to the partnership audit and adjustment rules have been in effect for a few years but we are still seeing some partnerships and their partners be blindsided by the unpleasant consequences that can arise from these rules. Careful planning today can help mitigate any unfavorable consequences for both the entity and the partners themselves. Also, be aware that even if your business is not a partnership, you will want to evaluate the effect these rules could have if you've invested in any partnership.

- **IRS Forms K-2 and K-3.** These new forms can require much effort and potentially apply to even smaller entities. The IRS announced an additional exception to the requirement to complete and provide these forms that may apply to your business.

- **Digital Assets and Virtual Currency**. The sale or exchange of virtual currencies, the use of such currencies to pay for goods or services or holding such currencies as an investment generally have tax impacts. The IRS continues to enhance its scrutiny in this area.

- **State and Local Tax Considerations.** Businesses have numerous state and local tax matters to consider for compliance and planning purposes, including where income and sales are subject to tax, sourcing of income and the application of elective taxes that many

states have for partnerships and S corporations. Many states now allow for a pass-through entity tax (PTET) election as a way for pass-through entity owners to avoid the $10,000 state and local tax limitation for individuals by paying the tax at the entity level. Taxpayers should have a thorough understanding and plan when considering the PTET.

- **FinCEN Beneficial Ownership Requirements.** In an effort to curb illegal foreign financing activity and increase transparency, most business entities will be required to report certain information to FinCEN regarding their beneficial owners. This rule does not become effective until 2024, but businesses should begin gathering the required information now to avoid any late-filing penalties when the reporting is due.

- **IRS Large Business and International Division (LB&I) Campaigns.** Owners of pass-through entities should pay special attention to losses and distributions in relation to their basis in the entity.

- **199A Qualified Business Income Deduction (QBID).** The 20% deduction is available for individuals, trusts and estates. Businesses should consider the wage and property limitations for optimizing QBID.

Tax Issues Impacting Individuals

Charitable Contribution Planning

Last year, individuals who did not itemize their deductions could take a deduction of up to $300 ($600 for joint filers) for charitable contributions. However, this opportunity is no longer available for tax year 2022. Also, note that it is important to have adequate documentation of all donations, including a letter from the charity for donations of $250 or more.

There are many tax planning opportunities and strategies to consider when making charitable donations. We take a deep dive into planning for charitable contributions in our recent article.

Required Minimum Distributions (RMDs)

RMDs are the minimum amount you must annually withdraw from your retirement accounts once a certain age (generally age 72) is reached. Failure to do so can result in penalties, and withdrawals usually have tax impacts. There are opportunities to roll retirement funds to a qualified charity to satisfy the RMD without incurring taxes. Also, note that the IRS has issued new life expectancy tables effective for the 2022 tax year, resulting in lower RMD amounts.

Digital Assets and Virtual Currency

Digital assets are defined under the U.S. income tax rules as any digital representation of value that may function as a medium of exchange, a unit of account and/or a store of value. Digital assets may include virtual currencies such as Bitcoin, Ether and non-fungible tokens (NFTs).

The sale or exchange of virtual currencies, the use of such currencies to pay for goods or services, and/or holding such currencies as an investment generally have tax impacts and the IRS continues to increase its scrutiny in this area. Please be on the look-out for an article on Digital Assets and Virtual Currency from our firm soon.

Energy Tax Credits

The Inflation Reduction Act of 2022 included newly expanded tax credits for solar panels, electric vehicles and energy-efficient home improvements. The rules are complex, and some elements of the law are not in effect until 2023, so careful research and planning now can be beneficial. Below is a summary of the two energy tax credits for individuals.

- The Residential Clean Energy credit is restored to 30% of qualifying expenditures for renewable energy producing properties. This credit may be applicable for second homes and vacation homes that are occupied at some point during the year by the taxpayer.

- The Energy Efficient Home Improvement Credit is for 30% of qualified energy efficiency improvements and residential energy property expenditures for property placed in service in 2023 and

after. The maximum amount of credit per year is $1,200 for most taxpayers.

Additional Tax and Financial Planning Considerations

We recommend reviewing your retirement plans at least annually to ensure saving options, such as traditional individual retirement accounts (IRAs), Roth IRAs and company retirement plans are maximized. It is also advisable to take advantage of health savings accounts (HSAs) that can help you reduce your taxes and save for medical-related expenses.

Also, if you withdrew a Coronavirus distribution of up to $100,000 in 2020, you will need to report the final one-third amount on your 2022 return (unless you elected to report the entire distribution in 2020 or have recontributed the funds to a retirement account). If a distribution was taken, you could return all or part of the distribution to a retirement account within three years, which will be a date in 2023.

Here are a few additional tax and financial planning items to consider:

- **Capital Gains/Losses.** Consider capital loss harvesting techniques by selling portfolio investments that are down before the end of the year. Net capital losses can offset up to $3,000 of the current year's ordinary income. The unused excess net capital loss can be carried forward to use in subsequent years. Wash sale rules may apply if the investment is repurchased shortly after the sale.

- **Estate and Gift Tax Planning.** The gift tax annual exclusion and lifetime transfer tax exemption are indexed for inflation and will be increased in 2023 (see following chart for U.S. domiciled individuals and U.S. citizens). Importantly, the increased lifetime exemption amount is to sunset at the end of 2025 and will return to its pre-TCJA amount of $5,000,000 (for U.S. domiciled individuals and U.S. citizens) adjusted for inflation without additional legislative action.

Gift Tax Annual Exclusion and Lifetime Transfer

	Annual Exclusion	Lifetime Exemption
2021	$15,000	$11,700,000
2022	$16,000	$12,060,000
2023	$17,000	$12,920,000

- **Deferred Social Security Tax.** If you deferred any Social Security taxes for the 2020 tax year as a self-employed individual or as a household employer, the final half of the deferred amount is due by December 31, 2022.

- **Roth IRA Conversions.** Consider converting your traditional IRA to a Roth IRA (backdoor Roth) to lock in lower tax rates on some of your pre-tax retirement accounts.

- **Education Expenses.** An eligible educator may deduct up to $300 of qualifying expenses in 2022. The annual deduction limit will be adjusted each year in increments of $50 based on inflation adjustments. In addition, COVID-19 protective items are now eligible expenses.

- **Gig Economy Scrutiny.** Congress reduced the threshold for filing Form 1099-K for a taxpayer from $20,000 to $600. Therefore, clients working in the gig economy may be receiving Forms 1099-K for the first-time next year. This is part of an IRS initiative to reduce the number of taxpayers who avoid including gig income on their tax returns.

- **Home Mortgage Interest Deduction.** As a reminder, mortgage interest from acquisition debt on a taxpayers' principal or second home incurred after December 15, 2017 may be limited if the combined debt is greater than $750,000.

- **Estimated Tax Payments.** Review withholding and estimated tax payment

requirements. For individuals, the fourth quarter 2022 estimated tax payment is due January 17, 2023. Individuals can use IRS Direct Pay to remit their tax payments to the IRS electronically.

On the Horizon

During the last two weeks of this year, the lame duck congress has opportunities to pass significant legislation. The Government funding has been extended on another continuing resolution until December 23, at which point either another continuing resolution or omnibus spending bill will need to be passed to avert a government shutdown. Tax provisions with bi-partisan support such as preservation of expensing research and development costs, delaying the bonus depreciation phase down, and business interest expense limitation relief may be included. Lastly, bi-partisan support has been reported on the Secure 2.0 changes to retirement accounts. We will be monitoring the legislation to keep you informed of any changes that could impact you or your business.

Closing

If you have questions about how to optimize your business or personal tax planning strategy, please contact us to discuss further.

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