Year-End Tax Memorandum

By Wm. Kelly Sterling

Take Our Compatibility Survey

As another challenging year ends, it is important to keep abreast of changes in the tax laws. While there has been no significant tax legislation this year, there is more certainty about how previous legislation which became effective this year may impact you. This memo provides an overview of tax changes and tax planning opportunities. The summary below includes a synopsis of some provisions included in the SECURE 2.0 Act of 2022, and a discussion of traditional year-end tax planning considerations.

BACKGROUND

The SECURE 2.0 Act builds upon the **S**etting **E**very **C**ommunity **U**p for **R**etirement **E** nhancement (SECURE) Act of 2019. SECURE 2.0 contains 92 new provisions to promote savings, boost incentives for businesses to offer retirement plans, and offer more flexibility to those saving for retirement. Provisions include automatic 401(k) enrollment, an increase in the age for taking RMDs, and much more. Certain provisions will take effect immediately, while other provisions begin in later years.

INDIVIDUAL TAX PROVISIONS

Ordinary income tax rates

Tax rates will remain the same in 2023 and 2024, while tax brackets have been adjusted for inflation. For 2023 the 37% rate will apply to income over $578,126 (single and head of household), and $693,751 (married filing jointly). These income limits will rise to $609,351 and $731,201, respectively, for the 2024 tax year. Please note that two single taxpayers living together may make $1,156,252 before becoming subject to the top rate, while married taxpayers will pay tax at the highest rate at $693,751 of income. The result is a significant “marriage penalty” for high income taxpayers.

Capital gains tax rates

The capital gains tax rate for 2023 is 0% for taxpayers in the lowest two tax brackets, and 15% for taxpayers with income below $492,301 (single) and $553,851 (married). The capital gains tax rate increases to 20% if income exceeds these levels. These limits will increase to $518,901 and $583,751, respectively, for the 2024 tax year.

Capital gains may also be subject to the additional net investment income tax surcharge of 3.8% for high income taxpayers. Under current law, the 3.8% net investment income tax does not generally apply to flow-through income from an S corporation or from other pass-through entities if the individual owner is actively involved in the business.

As many of you know, Washington state has instituted a 7% capital gains tax on long-term capital gains above $250,000. The tax is imposed specifically on long-term gains from the sale or exchange of capital assets. There are a handful of assets that are excluded from this tax. Most notable are real estate, assets held in retirement accounts, and interests in qualified familyowned small businesses.

The 7% capital gains tax is due on or before April 15, 2024. Individuals must create and sign into their Secure Access Washington (SAW) account to access My DOR, the Washington Department of Revenue site, to register for a capital gains tax account and pay the tax.

Personal exemptions and Child Tax Credits

Personal exemptions are eliminated for tax years 2018 through 2025 under current law.

The child tax credit is $2,000 per eligible child for 2023 and 2024. The credit may be reduced for joint filers with AGI greater than $400,000, and single and head of household filers with AGI greater than $200,000.

Standard deduction and itemized deductions

The standard deduction for 2023 is $13,850 for single taxpayers, $20,800 for head of household, and $27,700 for married taxpayers filing jointly. For taxpayers over age 65, the deduction is $15,700 if single, $22,650 for head of household, and $29,200 ($30,700 if both are over 65) if married filing jointly. Due to the high level of the standard deduction, many taxpayers will not itemize deductions in 2023. For 2024, the standard deduction increases to 14,600 ($16,550 if over 65) for single taxpayers, $21,900 ($23,850 if over 65) for head of household, and $29,200 ($30,750 or $32,300 if both over 65) for married taxpayers filing jointly.

Under the 2017 Tax Cuts and Jobs Act the itemized deduction for state and local income and property taxes remains limited to a total of $10,000.

Retirement savings tax incentives

Limits for certain retirement saving accounts are adjusted annually for inflation. Following are the 2023 and 2024 limits on retirement plan contributions:

IRA contributions: $6,500 in 2023 and increasing to $7,000 in 2024 ($7,500 for 2023 and $8,000 for 2024 if 50 or older)

SEP, Keogh, and other qualified employer-sponsored defined contribution plans: $66,000 in 2023 increasing to $69,000 in 2024.

SIMPLE plan deferrals: $15,500 in 2023 and increasing to $16,000 in 2024 ($19,000 and $19,500 respectively if 50 or older)

401(k) deferrals: $22,500 in 2023 and increasing to $23,000 in 2024 ($30,000 and $30,500 if 50 or older).

Required Minimum Distributions: In 2023, the age requirement for RMDs increases to age 73. In addition, the penalty for not taking an RMD is reduced from 50% to 25% and in some cases 10%. Beginning in 2024, the RMD requirement for Roth 401(k) accounts will be eliminated.

Energy efficiency tax breaks

EV (Electric Vehicle) Clean Vehicle Tax Credits: The federal tax credit continues, as certain electric vehicles still qualify for a credit up to $7,500. However, the 2022 Inflation Reduction Act revised the older rules. The law eliminates the manufacturer unit threshold, but places other limitations on EV qualification, phases out the credit for high income earners, and places limits on vehicle cost. The new law also extends the credit to used vehicles. Here are the criteria to receive this credit beginning January 1, 2023:

- Have a battery capacity of at least 7 kilowatt hours
- Have a gross vehicle weight rating of less than 14,000 pounds
- Be made by a qualified manufacturer.
- Undergo final assembly in North America
- Meet critical mineral and battery component requirements (for EVs purchased after April 17, 2023).

The tax credit is calculated differently for vehicles purchased after April 17, 2023, as these vehicles must meet the critical mineral and battery component requirements.

The website provided by US Department of Energy includes a list of qualified EV cars: www.fueleconomy.gov.

Beginning January 1, 2023, the income threshold for those being able to receive tax credit is $150,000 for single filers, $225,000 for Head of Household filers, and $300,000 for married filing joint filers.

Under the new law, credits will only be allowed on vehicles with a Manufacturer's Suggested Retail Price (MSRP) of less than $55,000 for EV cars, and $80,000 for pick-up trucks, vans, and SUVs.

Beginning in 2024, dealers can provide the credit at point of sale. Prior to that date, the credit is limited to the lesser of $7,500 or the income tax on the purchaser's tax return.

Beginning January 1, 2023, there will be a Used EV tax credit of 30% of purchase price limited to $4,000 on vehicles priced below $25,000. This credit includes income threshold caps of one half the thresholds for new EV purchases.

Clean Energy Tax Credits:

The Inflation Reduction Act increased the credit for assets placed in service from 2023 through 2032. These credits are broken down into two categories:

Energy Efficient Home Improvement Credit. The credit is now a $1,200 annual limit through 2032 with no lifetime limit. This change allows for home improvement planning combined with tax planning. Starting in 2023, the credit will be equal to 30% of costs for all eligible home improvements up to the $1,200 annual limit. However, there are individual component credit limits for each year ranging from $150 to $2,000 (certain items can exceed the $1,200 annual credit limit).

Residential Clean Energy Credit. The credit amount is now 30% of the cost of eligible solar water heaters, solar electric property, fuel cell property, small wind energy property, geothermal heat pump property, and battery storage. There is no annual maximum or lifetime limit.

Please contact us with questions on qualifying improvements and their annual credit limitations. All taxpayers qualify for tax credits, and low- and middle-income consumers also qualify for rebates to reduce their up-front costs.

Education Credit

The American Opportunity Credit is a $2,500 tax credit for qualified tuition and fees paid on behalf of a student who is enrolled on at least a half time basis. The credit is available for the first four years of the student's post-secondary education. Qualified tuition and related expenses include course materials such as books, supplies and equipment needed for a course of study. For 2023, the credit phases out at modified AGI levels between $160,000 and $180,000 for joint filers, and between $80,000 and $90,000 for other taxpayers.

BUSINESS TAX PROVISIONS

Corporate Tax Rate

The corporate tax rate continues at the 21% rate.

Equipment purchases

Under the TCJA, the 2023 Section 179 deduction limit for capital purchases is $1,160,000, with the threshold for reducing the deduction up to $2,890,000 on capital purchases. Expensing is permanently allowed for qualified real property, primarily leasehold improvements. This allows for immediate expensing of qualified improvements as in prior years.

Bonus depreciation for qualifying property under current law will be reduced to 80% for property placed in service starting January 1, 2023. It changes to 60% in 2024 and further reduces to 40% in 2025.

Qualified Business Income Deduction

Beginning in 2018, individual taxpayers may be entitled to a deduction of up to 20% of their qualified business income from partnerships, S Corporations, LLC's, and sole proprietorships. For 2023, if taxable income exceeds $364,200 for a married couple filing jointly, or $182,100 for all other taxpayers, the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health or consulting), the amount of W-2 wages paid by the business, and/or the unadjusted basis of machinery and equipment held by the trade or business. The limitations are phased in for joint filers with taxable income between $364,200 and $464,200 and for all other taxpayers with taxable income between $182,100 and $232,100.

Meals Deduction

The deduction reverts to 50% starting in 2023.

YEAR END AND OTHER TAX CONSIDERATIONS MOVING FORWARD

Year's end signals your last chance to balance the timing of income and deductions for tax purposes between the current and the upcoming year to your maximum advantage. This is especially important considering the pending changes. Historically, the best year-end tax planning strategy has been to follow the time-honored approach of deferring income and accelerating expenses to minimize current year taxes.

Taxpayers should consider whether they hold substantial basis within their aggregate pre-tax IRA accounts (Traditional, SEP, and SIMPLE combined) and if they could be converted to Roth IRAs at little or no tax cost.

When considering changes to charitable giving, Donor Advised Funds are a popular option. These funds allow for a deduction upfront when a donation is made to the fund and then allows the donor to make grants to charities from the fund in subsequent years. Also, for taxpayers who are over 70 1/2, there is a benefit for giving up to $100,000 of IRA withdrawals directly to charities ($105,000 in 2024). This strategy allows them to reduce the taxable amount of their required distributions, and reduce their IRMMA adjustment, while still being allowed the full standard deduction for the tax year.

Lastly, here are several other year-end tax planning considerations –

- If your income is lower than normal this year, or lower than you anticipate for future years, consider converting a portion of your Traditional IRA to a Roth IRA.
- If you are self-employed, consider establishing a retirement plan before year-end.
- If you own a business, consider purchasing equipment prior to year-end.
- Consider donating appreciated stock prior to year-end
- Make gifts to 529 education accounts.

If you have any questions about what steps you may take before year-end to save tax, please do not hesitate to contact our office.

Explore Our Private Wealth Page

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