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Balance sheet

YEAR-END TAX PLANNING

By: Timothy J. Gephart, CPA

Year-end is quickly approaching, so now is the time to consider actions that could help you pay less in taxes both this year and next year. Although there are no guarantees, it looks like planning for income taxes may be a little simpler this year than in the past few years. The Inflation Reduction Act of 2022, which was signed into law in August this year, was a slimmed-down version of the tax changes that were originally included in President Biden's proposed budget. If any additional legislation occurs in 2023, the changes will most likely be prospective. Of course, this is Congress. So, never say never. With that said, here are some things to think about doing before the end of 2022.

Year-end tax planning commonly involves methods for increasing and decreasing your Adjusted Gross Income. Generally, taxpayers will aim to decrease AGI to reduce their overall tax liability. The traditional year-end strategy of deferring income and accelerating deductions to minimize taxes may still yield the best results. This is also true for bundling deductible expenses into this year or the following to avoid limitations and maximize deductions.

Key Individual Tax Considerations

Although many in the United States are still recovering from the COVID-19 pandemic, the expiration of many of the tax-friendly COVID-19 pandemic provisions and inflation-related economic consequences are among the factors that could impact tax planning strategies. These changes should be considered in year-end tax planning, along with other changes in the law and existing provisions that impact end-of-year planning.

<u>Child tax credit and child and dependent care credit</u>

Both the child tax credit and the child and dependent care credit revert to pre-pandemic levels. Therefore, the child tax credit is back to $2,000 per child with only $1,500 refundable and applicable to children under the age of 17. For tax year 2022, the maximum amount of dependent care expenses you are allowed to claim is $3,000 for one person, or $6,000 for two or more people. The percentage credit of your qualified expenses that you can claim ranges from 20% to 35% based on your adjusted gross income.

<u>Charitable contribution deductions</u>

The temporary charitable contribution deduction for nonitemizers expired on December 31, 2021. For 2022, there is no non-itemized deduction for charitable contributions. Individuals who want to deduct charitable contributions must itemize.

Itemized deductions

Many taxpayers will no longer be able to itemize deductions due to the high basic standard deduction amounts that apply for 2022 ($25,900 for joint filers and $12,950 for single filers). Some taxpayers may be able to apply a bunching strategy to pull or push itemized deductions into a year so that they may itemize deductions every other year. For example, making two years' worth of charitable contributions in one year, prepaying state and local taxes such as real estate taxes, and paying your January house payment in December which will give you 13 months' worth of interest.

Although there is much discussion in the news regarding the state and local tax deduction, the maximum itemized deduction amount for 2022 remains at $10,000.

Individuals may deduct contributions to charitable organizations up to a certain percent of their "contribution base". For 2022, that percentage reverts back to 60% for cash contributions and 30% for noncash contributions. For year-end planning, it is beneficial to review whether an individual has charitable contribution carryovers from a prior year. If income will decline, care should be taken to use the carryovers before they expire.

A reminder that the deduction for mortgage insurance premiums expired at the end of 2021 so there is no deduction in 2022.

Required minimum distributions (RMDs)

Required minimum distributions (RMDs) from an IRA or 401(k) plan (or other employer-sponsored retirement plan) have not been waived for 2022. If you were 72 or older in 2022, you must take an RMD. Those who turn 72 this year have until April 1, 2023, to take their first RMD, but may want to take it by the end of 2022 to avoid having to double up on RMDs next year.

Key Small Business Tax Considerations

Employee retention credit (ERC)

There was one major tax bill passed late in 2021 affecting the 2022 tax year: the Infrastructure and Investment Jobs Act (IIJA). This retroactively terminated the employee retention credit back to October 1, 2021.

Small Business

Whether or not tax increases become effective next year, the standard year-end approach of deferring income and accelerating deductions to minimize taxes will continue to produce the best results for most small businesses, as will the bunching of deductible expenses into this year or next to maximize their tax value.

More small businesses can use the cash (as opposed to accrual) method of accounting than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test, which is satisfied for 2022 if, during a three-year testing period, average annual gross receipts do not exceed $27 million (next year this dollar amount is estimated to increase to $29 million).

Meals

The CARES Act which allowed a 100% deduction on food if purchased from a restaurant in 2021 and 2022 is set to expire at the end of year 2022.

State and city tax obligations related to teleworking arrangements

The pandemic previously spawned changes in how people work, and more people are permanently working from home (i.e., teleworking). Such remote working arrangements could potentially have tax implications that should be considered by you and your employer.

Virtual currency/cryptocurrency

Virtual currency transactions are becoming more common. There are many different types of virtual currencies, such as Bitcoin, Ethereum and non-fungible tokens (NFTs). 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 has tax impacts. We can help you understand those consequences.

Retirement planning considerations

We recommend you review your retirement situation at least annually. That includes making the most of tax-advantaged retirement saving options, such as traditional IRAs, Roth IRAs, and company retirement plans. If your business does not already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions. For example, if you are self-employed and set up a SEP-IRA, you can contribute up to 20% of your self-employment earnings, with a maximum contribution of $61,000 for 2022. Other small business retirement plan options include the 401(k) plan (which can be set up for just one person) and the SIMPLE-IRA. Depending on your circumstances, these other types of plans may allow bigger deductible contributions. In addition, you may be eligible for a tax credit of up to $5,000 for three years for the ordinary and necessary costs of starting a plan.

Deductions paid by credit card

Careful timing of year-end payments remitted by credit card or check can yield tax savings. Eligible medical expenses remitted by credit card before the end of the year are deductible on this year's return, even if the taxpayer is not billed for the charge until January. If a taxpayer pays by check dated and postmarked no later than December 31, it will count as a payment incurred this year even if the payee does not deposit the check until January 1 or later (assuming that the check is honored when first presented for payment).

Business Property Expensing Option

Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2022, the expensing limit is $1,080,000, and the investment ceiling limit is $2,700,000. 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.

The 100% bonus depreciation stays in effect until January 1, 2023. At that point, the first-year bonus depreciation deduction decreases as follows:

- 80% for property placed in service during 2023
- 60% for property placed in service during 2024
- 40% for property placed in service during 2025
- 20% for property placed in service during 2026

Year-end planning equals fewer surprises

There are many other opportunities to discuss as year-end approaches. And, many times, there may be strategies such as deferral or acceleration of income, prepayment or deferral of expenses, etc., that can help you save taxes and strengthen your financial position. As always, planning ahead can help you minimize your tax bill and position you for greater success. Please contact us for assistance with tax planning strategies.