

# 2023 YEAR END TAX PLANNING FOR BUSINESSES AND INDIVIDUALS



As we approach the close of another year, it's time to take stock of your financial strategies and consider smart year-end tax planning. While legislative uncertainties persist, we'll focus on practical considerations that transcend the political landscape. These considerations cover a spectrum of tax planning strategies for individuals in 2023. From maximizing retirement contributions to exploring Roth conversions, leveraging tax credits and making charitable contributions, these insights are designed to help you optimize your financial strategies.

## Individuals

Year-end tax planning is crucial, especially in a dynamic economic environment with factors like rising interest rates, inflation, and market volatility. It's important to note that tax planning is complex and individual circumstances vary. Taking stock of your personal and financial situation at the end of the year is a proactive step in managing your tax planning. By addressing these points and consulting with professionals, you can make informed strategic decisions to minimize your tax liability and take advantage of available opportunities.

## Timing Matters

Typically, postponing income is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to a change in their financial circumstances or those who anticipate being in substantially similar tax brackets. In the past, postponing income went together with accelerating deductions but this may not be the best plan for you as you may see in our Bunching Deductions section below. If you think you will be in a higher tax bracket in the following tax year due to increased income or a different tax situation, then postponing income to the following tax year may not be advisable.

## Capital Gains and Losses

If you currently have large, realized capital gains, consider harvesting capital losses. You can realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, the original holding can be sold, then bought back after 31 days. Minimizing the net capital gains will also help lower the 3.8% surtax on net investment income. If you are in a lower tax bracket, your long-term capital gains tax rate may be as low as 0%, so make sure to analyze your situation before you sell stocks at a loss. At this time, there are no proposals that would increase capital gains tax rates.

## Retirement Savings

Another way to lower your 2023 income is through retirement plans. Employees wishing to defer income to future years should take advantage of maximizing the amount contributed into their employer sponsored retirement plan. For 401(k) plans:

- For 2023, the maximum deferral is \$22,500 with an additional "catch up" contribution of \$7,500 for taxpayers 50 and older.
- For 2024, the maximum deferral is increased to \$23,000 with the same catch-up contribution of \$7,500.

For a list of other [cost of living adjustments](#), we've compiled a three-year side-by-side comparison of the dollar limitations for benefits and contributions.

## Roth IRA Conversions

Depending on your retirement accounts, your personal tax situation and the current decline in the markets, it may be beneficial for you to convert your

traditional IRA, 401k, SEP IRA or SIMPLE IRA to a Roth IRA. The amount converted would be taxable in the current year, but the earnings will grow tax-free and not be taxable when distributed.

When your income is too high to make a Roth IRA contribution, you can still make a nondeductible contribution to a traditional IRA. The “backdoor” Roth IRA strategy consists of establishing a traditional IRA and making nondeductible contributions. You can then convert the traditional IRA to a Roth IRA and you will only have to pay income tax on a percentage of the converted amount. The percentage of the converted amount that is taxable is the percentage of the funds in all your traditional IRAs, SEP and SIMPLE plans combined that consists of pre-tax dollars. There are many items to consider with a Roth IRA conversion so you should talk to your advisor before initiating a conversion.

#### Qualified Business Income (QBI) Deduction

The rules for this deduction are very complex. Adding to the complexity are taxable income limitations, wage limitations and/or asset limitations. If you are in a specified trade or business (most service businesses), the taxable income limitations are critical and will likely make the difference of getting the QBI deduction or not. For these business owners, lowering your taxable income may help you take full advantage of this deduction. Lowering your taxable income can be done in various ways, including:

- postponing income into 2024;
- increasing itemized deductions, such as charitable contributions; or
- increasing retirement plan contributions.

#### Alimony

For divorces finalized on or after January 1, 2019, alimony is no longer deductible for the payer or taxable to the payee. For divorces finalized on or before December 31, 2018, the old rules still apply.

#### Required Minimum Distribution (RMD)

[The SECURE Act](#) has further increased the age for taking RMDs from 72 to 73. Any individual that turns 72 in 2023 won't have to take an RMD until 2024. In addition, the penalty for not taking an RMD has been reduced to 25%, and possibly to 10% if the missed RMD is timely correct within two years. Please

discuss your potential RMD requirements with your financial advisor before the year end.

### Education Planning

Consider funding a 529 Plan for educational purposes. There is no current-year federal deduction for 529 plan contributions but in Ohio there is a state tax deduction to \$4,000 per beneficiary. In addition, 529 plan distributions can be used for grades K-12 tuition (up to \$10,000 per year) making them even more advantageous. If you have kids in college, you may be eligible for some tuition tax credits, even if they are working on their master's degree.

Contributions made to 529 plans are considered gifts for federal gift tax purposes; however they qualify as part of the gift tax annual exclusion of \$17,000 per donee (\$34,000 if gift-splitting with a spouse). Donors have the option of super-funding contributions to a 529 plan and electing to have the front-loaded contributions treated as being made ratably over a 5-year period. Please discuss with your tax advisor if you are interested in this strategy.

### Verify Your Withholding

The [IRS](#) allows tax to be paid via several methods: payroll withholding, retirement withholding and quarterly estimates. The IRS has two safe harbors to avoid underpayment penalties. The first is by paying 100% of your prior year tax amount (110% if your prior year adjusted gross income was over \$150,000), and the second is paying 90% of your current year tax amount. It is important to verify that you will meet one of these safe harbors to avoid penalties.

### Maximize Above-the-Line Deductions

- **Health Savings Accounts (HSA).** If you become eligible on or before December 2023 to make HSA contributions, you can make a full year's worth of deductible HSA contributions for 2023. Due to inflation adjustments, 2023 HSA contribution limits have increased to \$3,850 for self- only and \$7,750 for family plans with \$1,000 catch-up contribution for taxpayers ages 55 or older.
- **Simplified Employee Pension (SEP) Contribution.** Simplified Employee Pension (SEP) Contribution. If you have self-employed income, consider putting money into a SEP. This option is available to you even if you have

already deferred the maximum amount into your employer-sponsored 401(k) plan. By contributing money to a SEP, you can typically avoid both current-year federal and state taxes on the amount contributed. The maximum SEP contribution for 2023 is \$66,000 and it can be funded as late as the due date of your federal tax return, including extensions.

- **Student Loan Interest.** You may be eligible to take an above-the-line deduction for student loan interest paid up to a maximum of \$2,500.
- **Self-Employed Health Insurance.** Partners and S-Corp shareholders owning more than 2% of the entity's stock and self-employed individuals are permitted a deduction for their health insurance for themselves and their dependents. This is different than the itemized deduction since it is above-the-line and not subject to Adjusted Gross Income limitations.

### Bunching Itemized Deductions

With the Tax Cuts & Jobs Act ("TCJA"), many itemized deductions were either eliminated or severely limited. Bunching deductions may be a way to preserve deductions that would otherwise be wasted or lost due to the higher standard deduction. The deduction for state and local taxes and real estate taxes is limited to \$10,000. If your mortgage is paid off and you don't have any high medical expenses, your only other itemized deduction would be charitable contributions. It may be worth your while to fund several years' worth of charitable contributions in one year to accelerate the deduction into that year, and then use the standard deduction in the subsequent years. One good way to do this is through a Donor-Advised Fund. This vehicle allows you to donate the money one year and get a tax deduction while keeping the money in the fund until you distribute it to various charities in subsequent years.

- **Medical Expense Deduction.** For 2023, medical expenses are only deductible to the extent that they exceed 7.5% of your adjusted gross income. Medical expenses include health insurance premiums, Medicare premiums, amounts paid to doctors for medical care, prescriptions, etc. Unless you have a high amount of medical expenses, you most likely will not qualify for this deduction.
- **State and Local Tax Deduction.** You can deduct up to \$10,000 of state and

local income taxes and real estate. If you can itemize your deductions and have not reached the \$10K limit, you may want to consider paying your real estate taxes in December 2023 as opposed to January 2024. If you have already met the limit, then there is no benefit to pre-paying these taxes.

- **Mortgage Interest Deduction.** The interest you pay on your home is typically deductible to the extent that the average mortgage balance does not exceed \$750,000. For mortgages placed in service prior to December 15, 2017, the limit is \$1,000,000. Home equity loan interest is only deductible if the loan was used to buy, build, or improve the home. The old rule allowing a deduction for the first \$100,000 of home equity interest was eliminated. Also, don't overlook mortgage points paid upon purchase or refinancing as these may be deductible as well.
- **Charitable Contribution Deduction.** Consider making charitable contributions before year-end either in cash or non-cash such as highly appreciated stocks. If you donate highly appreciated stock, you can get a donation deduction for the fair market value of the stock and avoid capital gains tax. You can also make contributions at year-end using your credit card, even if the credit card is not paid until 2023. You can write a check to charity and mail it on December 31, 2023, and take a 2023 tax deduction even if the check doesn't clear your bank by January. Non-cash donations valued over \$5,000 (except publicly traded stock) require a written appraisal and a letter from the charity acknowledging the donation to be deductible.
  - If you are over age 70 ½, you can make a charitable contribution up to \$100,000 directly from your IRA to satisfy the required minimum distribution requirement.
  - Ohio offers tax credits to individuals supporting scholarship-granting organizations (SGOs) and nonprofit organizations that provide private school scholarships to students in need. This tax-credit scholarship program allows taxpayers to receive a dollar-for-dollar tax credit up to \$750 (\$1,500 for married filers) for their donations to SGOs. You can find a list of SGOs on [Tax.Ohio.Gov](https://www.tax.ohio.gov). Please reach out to your trusted tax advisor for more information on the Ohio tuition tax credit.

## Tax Credits

In addition to the changes listed in the sections above, the Inflation Reduction Act has extended and modified a few common credits.

- **Nonbusiness Energy Property Credit** – adjusts the credit rate to 30% for qualified energy efficiency improvements and residential energy property expenditures. Also, changed the \$500 lifetime limit of the credit to a \$1,200 annual limit. Lastly, the credit is extended through 2032.
- **New Clean Vehicle Credit** – adjusts the existing credit in the following ways:
  - Creates new modified adjusted gross income limitation for those eligible.
  - Increases the MSRP dollar limit on vehicles expanded credit eligibility.
  - Implements additional requirements for foreign manufacturing and final assembly effective in 2024 and 2025.
  - Allows a taxpayer to transfer the credit to a registered dealer, as an offset to the purchase price starting in 2024.
  - Credit is extending through 2032.
- **Previously Owned Clean Vehicles Credit** – New refundable personal credit for purchasing previously owned qualifying clean vehicles. Subject to modified adjusted gross income limitation for those eligible. Allows a taxpayer to transfer the credit to a registered dealer, as an offset to the purchase price starting in 2024. Credit is extending through 2032.

## Estate Tax Planning

### Gifts

Take advantage of the annual gift tax exclusion. Make gifts sheltered before the end of the year to save gift and/or estate taxes. The exclusion applies to gifts of up to \$17,000 made in 2023 to each of an unlimited number of individuals and increases to \$18,000 in 2024. You are unable to carry over unused exclusions

from one year to the next. The transfers might also save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

### Lifetime Exemption Planning

Although the estate tax exemption is now \$12,920,000 and is indexed for inflation, there is a sunset clause after December 31, 2025. After this date, the estate tax exemption will decrease to \$6,800,000, and your estate threshold will be the greater of the estate tax threshold or the total taxable gifts you have already made during your lifetime. It is important to consider whether additional wealth transfer strategies should be implemented before any change in lifetime exemption amounts takes effect.

## Businesses

While the business tax rates and regulations largely remain consistent with previous years, it is advisable to review your entity's structure and ensure that you are operating in the most advantageous business form. The Tax Cuts and Jobs Act (TCJA) brought about a permanent reduction in corporate tax rates to 21%. Additionally, the introduction of the Qualified Business Income (QBI) deduction, a 20% deduction on business income for non-corporate taxpayers, mitigates the tax rate on business income at the individual level. It is important to note that this deduction is scheduled to expire after 2025, along with other individual provisions.

The TCJA also expanded the small business gross receipts threshold to \$29 million for 2023, which allows businesses to elect or remain eligible for various accounting methods, such as utilizing the cash method of accounting and treating inventory as non-incidental materials and supplies or to avoid the uniform capitalization rules for resellers and manufacturers. Your business' taxable income could be much lower under the cash method of accounting or through various other method changes allowed for small businesses.

### Timing Items

Generally, the essence of good tax planning is to defer income and accelerate



deductions. However, this may not apply to everyone's unique tax situation. For example, businesses that have net operating losses (NOLs) to utilize or are expecting to have lower income in the future may take a different approach. Tax planning should be evaluated on a business-by-business basis.

### Net Operating Losses (NOLs)

Since 2018, net operating losses are able to be carried forward indefinitely but are limited to 80% of taxable income in the year that they will be utilized.

### Accelerated Depreciation

Take advantage of generous depreciation rules for assets such as computers, software, equipment, furniture, or certain property improvements purchased in 2023. With the reduction of first year bonus depreciation to 80% in 2023 (down from 100% in 2022), it is important to analyze your current depreciation treatment. What had been done in the previous years may not yield the most tax advantageous benefit for 2023.

- **Section 179.** Allows you to expense otherwise depreciable property if placed in service in 2023. You may elect to expense up to \$1,160,000 of fixed asset costs (with a dollar-for-dollar phase-out for purchases greater than \$2,890,000). Additionally, the deduction is limited to business income. Certain real estate improvements can be "Qualified Improvement property" (QIP) and still be eligible for the Sec. 179 deduction.
- **Bonus Depreciation.** In addition to the Sec. 179 deduction, your business can also deduct first-year bonus depreciation equal to 80% of the cost of most fixed assets with a tax life of 20 years or less. The 80% first-year bonus depreciation is the first year of a multi-year phase out, that will see a decrease of 20% every year until 2026. The CARES act has clarified that QIP is 15-year property and is eligible for bonus depreciation. QIP includes most non-residential improvements to the interior of a building.

### De Minimis Safe Harbor Election

The "de minimis safe harbor election" (also known as the book-tax conformity

election) is an annual election that allows businesses to expense lower-cost assets, materials, and supplies. To qualify for the election, the unit of property cost cannot exceed \$5,000 if the taxpayer has an applicable financial statement (e.g., a certified audited financial statement along with an independent CPA's report). If there's no applicable financial statement, the cost of a unit of property can't exceed \$2,500.

### Tax Credits

There are numerous tax credits that can help lessen the tax burden for a business and its owner.

- **R&D Credit.** Businesses that incur certain research and development (R&D) costs, such as wages, supplies and contract research, are eligible for this general business [R&D tax credit](#).
- **Work Opportunity Tax Credit.** Businesses that hire individuals from targeted groups (i.e. qualified veterans, long-term unemployment recipients, ex-felons) are eligible for a tax credit equal generally to 40% of up to \$6,000 of the individual's first-year wages paid (per employee).
- **Small employer Health Insurance.** Up to 50% of employer contributions for employee health insurance may be available for two consecutive years.

### Accounting Method

Review your methods of accounting for tax purposes to determine if you are using the optimal methodologies to maximize tax deductions. Deducting certain prepaid items, accruing for company payroll or bonuses (must be paid within 2.5 months of year-end) and reviewing all depreciation methods are common areas to analyze. Considering your overall accounting method of accrual or cash method of accounting may also create an opportunity for your business.

### Cash Method

Many businesses, especially service-based businesses, commonly utilize the cash method of accounting. This method allows them to expedite deductions for the current year by consolidating expenses whenever possible. Notably, the Tax Cuts and Jobs Act (TCJA) has broadened the eligibility for this method, providing

even more businesses the opportunity to utilize it, specifically those classified as 'small' with average annual gross receipts not exceeding \$29 million over the past three years.

### LIFO (Last-in-First-Out) Inventory

While not new, this method allows for deductions of cost of goods sold to be maximized in periods of rising inflation, substantially reducing taxable income.

### State and Local Taxes

We are seeing an increase in changes to state tax laws and regulations, as well as their approach to tax audits. Most states are becoming increasingly aggressive in trying to capture tax revenue from [out-of-state businesses](#). The Wayfair decision will require increased sales tax filings for most out-of-state sellers of goods. It is important to make sure your business is not caught off guard. Specific state and local tax areas to be mindful of include income tax, sales and use tax, payroll, and property tax. Additionally, pass through entities may want to revisit how they choose to file at the state level. In certain states, opting for an entity-level assessment of income tax can bypass the \$10,000 itemized deduction limitation at the individual level. This allows taxes to be deducted from the business's income, serving as a reduction of taxable income on the individual return rather than an itemized deduction. For 2023, over 30 states [including Ohio](#) now have a Pass-Through Entity Tax.

Beginning in January 2024 there will be notable changes to [Ohio's Commercial Activity Tax](#) (CAT). Some key changes include the elimination of the annual minimum tax and no filing requirement for smaller businesses. Businesses with taxable gross receipts of \$3 million or less in 2024 and \$6 million or less in 2025 will no longer be required to file a return with the Department of Taxation. If your business is anticipated to fall under the filing threshold, it is advised to cancel your CAT account by December 31, 2023.

### Tax Basis

If you own an interest in a partnership or S corporation where losses may be limited due to basis limitations, consider whether you need to increase your basis in the entity to deduct a loss from it for this year.

### Meals & Entertainment

An important change for 2023 is the expiration of the Cares Act provision allowing a 100% deduction for business meals purchased from a restaurant. Beginning in 2023, the deductibility of meals reverts to the previous regulations, allowing for a 50% deduction. It's important to note that entertainment remains non-deductible. Business activities involving both a meal and an entertainment component should be separated and tracked as distinct line items to maximize the allowable deduction.

### Interest Deductions

If your business is not 'small' (average annual gross receipts in the three previous years exceed \$29 million), your interest deductions may be suspended. The rules in this area are complex and wide ranging but proper planning can ensure that deductions are not missed unexpectedly. In general, the interest expense is limited to 30% of adjusted taxable income.

### Passive Losses

To reduce 2023 taxable income, consider disposing of a passive activity in 2023 if it will allow you to deduct suspended passive activity losses.

### IC-DISC

If your business has foreign sales, consider utilizing an IC-DISC. A business that has export sales and utilizes an IC-DISC can create a tax benefit in which a portion of its income is taxed at the long-term capital gains rate.

### Foreign Reporting

The foreign reporting [requirements](#) are comprehensive and complex for businesses with activities outside of the United States. Business owners and employees who have any financial interest in or signature authority over a foreign financial account exceeding \$10,000 at any time in a calendar year must file a [Report of Foreign Bank and Financial Accounts](#) (FBAR). [The Foreign Account Tax Compliance Act](#) (FATCA) requires businesses to report and possibly withhold payments made to foreign entities. Investments, assets, and legal entities outside the U.S. may subject the business to various reporting requirements.

The Corporate Transparency Act (CTA), implemented on January 1, 2021, mandates that specific new and existing companies reveal pertinent information about their actual primary owners, referred to as "beneficial owners," to the [Financial Crimes Enforcement Network](#) (FinCEN) of the US Department of the

Treasury. Any reporting company formed within the United States before January 1, 2024, is required to submit a report to FinCEN by January 1, 2025. Please consult with your legal counsel to determine if you have a filing requirement.

These are some of the year-end steps that can be taken to minimize your tax burden. We can help tailor a customized plan that will work best for your tax planning goals. Please contact your [BMF Advisor](#) if you would like to review any of the items mentioned, schedule a tax planning strategy session or discuss potential implications of the various tax law changes.