November 21, 2022

Dear Clients and Friends,

After a couple of tough years, it has been refreshing to return to a version of normalcy. As the year-end approaches, it is time to start thinking about moves that may help lower your tax bill for this year and next.

This year's planning is more challenging than usual due to recent changes made by the Inflation Reduction Act of 2022 and the potential change in congressional balance of power resulting from the midterm elections. 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 all but the highest income taxpayers, as will the bunching of deductible expenses into this year or next to avoid restrictions and maximize deductions.

If proposed tax increases do pass, however, the highest income taxpayers may find that the opposite strategies produce better results: Pulling income into 2022 to be taxed at currently lower rates, and deferring deductible expenses until 2023, when they can be taken to offset what would be higher-taxed income. This will require careful evaluation of all relevant factors.

Below is a checklist of items that may benefit you if you act before year-end. We can better identify the actions you can take if we meet with you to tailor a particular plan. Meanwhile, please review the following list. Contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

Year-End Tax Planning Moves for Individuals

- **Surtax on Unearned Income for Higher Income Earners**
  Accelerating some of this type of income into 2022 could help avoid some Net Investment Tax (NIIT) under 2022 rules.
  The surtax is 3.8% of the lesser of: (1) Net Investment Income (NII) (e.g. – bonds, stocks, mutual funds, etc.) or (2) The excess of modified adjusted gross income (MAGI) over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case).

  Some taxpayers should consider ways to minimize (e.g. - through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

- **An additional Medicare Tax for Higher-Income Earners**
  The 0.9% additional Medicare tax also may require higher-income earners to take year-end action. It applies to individuals whose employment wages and self-employment income total more than an amount equal to the NIIT thresholds, above.

Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax.

There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. This would be the case, for example, if an employee earns less than $200,000 from multiple employers but more than that amount in total. Such an employee would owe the additional Medicare tax, but nothing would have been withheld by any employer.

- **Long-term Capital Gain**
  Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on your taxable income. The 0% rate generally applies to net long-term capital gain to the extent that, when added to regular taxable income, it is not more than the maximum zero rate amount (e.g., $83,350 for a married couple; estimated to be $89,250 in 2022). If, say, $5,000 of long-term capital gains you took earlier this year qualifies for the zero rate then try not to sell assets yielding a capital loss before year-end, because the first $5,000 of those losses will offset $5,000 of capital gain that is already tax-free.

- **Postpone income until 2023 and accelerate deductions into 2022**
  Deferring income and accelerating deduction may enable you to claim larger deductions, credits, and other tax breaks for 2022 that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income is also desirable for those of you who anticipate being in a lower tax bracket next year due to changed financial circumstances.

- **Roth IRA**
  If you believe a Roth IRA is better for you than a traditional IRA, consider converting traditional-IRA money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in 2022 if eligible to do so. Keep in mind that the conversion will increase your income for 2022, possibly reducing tax breaks subject to phaseout at higher AGI levels. This may be desirable, however, for those potentially subject to higher tax rates under pending legislation.

- **Payroll Bonuses**
  If you have a bonus coming your way at the end of 2022, it may be of benefit to have your employer defer it until 2023. This change could lower, as well as defer your tax.

- **Itemized Deductions**
  Similar to last year, if you routinely claimed itemized deductions, you may not have been able to do so on your Federal return. That is because the basic standard deduction was increased. For the 2022 tax year, it is as follows:

- $27,700 for joint filers,
- $13,850 for singles,
- $20,800 for heads of household
- $13,850 for married filing separately

Many itemized deductions remain either cut back or abolished.

For example:

(1) No more than $10,000 of state and local taxes may be deducted.

(2) Miscellaneous itemized deductions (e.g. – investment advisory fees) and unreimbursed employee expenses are no longer deductible.

(3) Personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI limits are met.

You can still itemize medical expenses to the extent they exceed 7.5% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, and interest deductions on a restricted amount of qualifying personal residence debt. But, payments of those items will not save on Federal taxes if they do not cumulatively exceed the new, higher standard deduction.

For those filing Oregon returns, itemizing is still beneficial to many. Be sure to still hang on to required documentation to support your itemized deductions.

Here are some possible strategies to help with these limitations that remain in effect.

- Some of you may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, if you will be able to itemize deductions this year but not next will benefit by making two years' worth of charitable contributions this year. The COVID-related increase for 2022 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy.

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2022 deductions even if you don't pay your credit card bill until after the end of the year.

- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2022, consider asking your employer to increase withholding of state and local taxes (or make estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2022. But this strategy is not good to the extent it causes your 2022 state and local tax payments to exceed $10,000.

- If you were 72 or older in 2022 you must take an required minimum distribution (RMD) during 2022. Those who turn 72 this year have until April 1 of 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.

- If you have an inherited IRA, please be aware that IRS has clarified the 10-year rule regarding to distributions. In 2019, the Secure Act was passed, which made several changes to retirement accounts. One change was the requirement that certain beneficiaries empty the inherited IRA account within ten years of the original owner's death. This rule made many believe that RMDs did not have to be paid. However, IRS recently clarified that RMDs still must be paid each year and the account has be emptied within ten years. If you have an inherited IRA, it is important that you reach out to your investment adviser. We can also assist with planning in regards to how the RMDs will affect your taxes.

- If you are age 70½ or older by the end of 2022, and especially if you are unable to itemize your deductions, consider making 2022 charitable donations via qualified charitable distributions from your traditional IRAs. These distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. However, you are still entitled to claim the entire standard deduction. (The qualified charitable distribution amount is reduced by any deductible contributions to an IRA made for any year in which you were age 70½ or older, unless it reduced a previous qualified charitable distribution exclusion.)

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2022 if you are facing a penalty for underpayment of estimated tax and increasing your wage withholding will not sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2022. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2022, but the withheld tax will be applied pro rata over the full 2022 tax year to reduce previous underpayments of estimated tax.

- Consider increasing the amount you set aside for next year in your employer's FSA if you set aside too little for this year and anticipate similar medical costs next year. If you become eligible in December of 2022 to make HSA contributions, you can make a full year's worth of deductible HSA contributions for 2022.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to $16,000 made in 2022 to each of an unlimited number of individuals. You can't carry over unused exclusions to another year. These transfers may 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.

- If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2022 to maximize your casualty loss deduction this year.

Year-End Tax-Planning Moves for Businesses & Business Owners

- **Oregon Pass-Through Entity Election**
  Oregon established an elective Pass-Through Entity Tax (PTE-E), a business alternative income tax in response to the $10,000 cap on the federal State and Local Tax (SALT) deduction added in the 2017 federal Tax Cuts and Jobs Act. Entities taxed as S corporations and partnerships may elect annually to be subject to the PTE-E tax at a rate of 9 percent tax on the first $250,000 of distributive proceeds and 9.9 percent tax on any amount exceeding $250,000. The law will expire if the federal SALT deduction limitation expires or is repealed.

  Qualifying members of an electing PTE are eligible for a credit equal to 100 percent of the member's distributive share of the PTE-E tax paid. This allows for the State tax on the pass-through earnings to be paid at the entity level, thereby lowering the Federal taxable income for the shareholder or partner’s income tax return.

- **Qualified Business Income (QBI)**
  Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income (QBI).

  For 2022, if taxable income for joint filers exceeds $340,100 (about half of that for others), the deduction may be limited based on whether you are engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in; for example, the phase-in applies to joint filers with taxable income up to $100,000 above the threshold, and to other filers with taxable income up to $50,000 above their threshold.

- **Cash Method of Accounting**
  More small businesses are able to use the cash (as opposed to accrual) method of accounting in 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. For 2022, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $27 million (next year the dollar amount is estimated to increase to $29 million). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.

- **Business Property Expensing**
  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 qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems.

  The generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is in service during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2022, rather than at the beginning of 2023, can result in a full expensing deduction for 2022.

- **Bonus Depreciation**
  Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The 100% write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2022.

- **De Minimis Safe Harbor Election**

Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2022.

- **Net Operating Loss (NOL)**
  A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2022 (and substantial net income in 2023) may find it worthwhile to accelerate just enough of its 2023 income (or to defer just enough of its 2022 deductions) to create a small amount of net income for 2022. This will permit the corporation to base its 2032 estimated tax installments on the relatively small amount of income shown on its 2022 return, rather than having to pay estimated taxes based on 100% of its much larger 2023 taxable income.

- **Other Ideas to reduce 2022 taxable income**
  - To reduce 2022 taxable income, consider deferring a debt-cancellation event until 2023.
  - To reduce 2022 taxable income, consider disposing of a passive activity in 2022 if doing so will allow you to deduct suspended passive activity losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Cheers to a safe and peaceful rest of 2022.

Sincerely,

HMW CPAs & Associates, LLC