2023-2024

TAX PLANNING GUIDE

Year-round strategies to make the tax laws work for you

Kreischer Miller

Dear Clients and Friends,

Although you can't avoid taxes, you can take steps to minimize them. This requires proactive tax planning — estimating your tax liability, looking for ways to reduce it and taking timely action.

To help you identify strategies that might work for you in 2023, we're pleased to present this tax planning guide. It explains recent tax law changes of significance, and it notes some tax law changes that have been proposed. It also provides a refresher on the extensive changes that generally went into effect five years ago under the Tax Cuts and Jobs Act (TCJA) — and their potential impact on tax planning. Finally, it shows how various strategies apply to different situations, and presents charts and case studies to illustrate some specifics of tax planning.

Understanding the ins and outs of recent tax law changes, as well as the TCJA, and determining which steps to take isn't easy. That's why it's important to work with an advisor who understands their complexities and is well versed in the full range of actions you can take to save tax. We can provide the advice you need, based on our deep knowledge of tax law, including even the most recent changes, and our years of experience in helping clients like you minimize taxes.

We would encourage you not to postpone thinking about taxes until filing time. Tax planning is a year-round activity and most tax reduction strategies must be implemented by December 31 — and some even earlier. So the sooner you begin your planning, the better.

We would welcome the opportunity to help you map out a tax plan that takes full advantage of all strategies available to you or discuss other tax matters of interest to you. Please let us know how we can be of assistance.

We look forward to working with you to maximize your tax savings.

Best regards,

Kreischer Miller

Kreischer Miller

Tax planning is as essential as ever for higher-income taxpayers

Minimizing taxes is a critical challenge for higher-income taxpayers subject to higher tax rates and certain additional taxes, as well as to tax-break phaseouts. To meet this challenge, you first need to be aware of relevant tax law changes that are going into effect — or that have expired. For example, the SECURE 2.0 Act, signed into law Dec. 29, 2022, includes significant provisions related to retirement plans, some of which go into effect this year. But one of the last remaining pandemic-relief-related tax provisions expired at the end of 2022: the 100% deduction for certain business meals.

You also can't forget about the massive Tax Cuts and Jobs Act (TCJA) that generally went into effect five years ago but still significantly impacts tax planning. Finally, you need to keep an eye out for any new tax law changes that might still be signed into law this year and affect 2023 planning.

This guide provides an overview of some of the key tax provisions higher-income taxpayers need to be aware of. It offers a variety of strategies for minimizing your taxes in the current tax environment. Use it to identify the best ones for your particular situation with your tax advisor, who also can keep you apprised of any new tax law developments that might affect you.

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Control the timing of income and expenses to your tax advantage

Tax rates on "ordinary income" are often higher than those that apply to investment income. (See page 8 for information about the tax treatment of investments.) Ordinary income generally includes salary, income from self-employment or business activities, interest, and distributions from tax-deferred retirement accounts. Deductions are valuable because they reduce the amount of your income that's subject to federal tax — and in many cases, state tax, too.

Other types of taxes that may apply to ordinary income, such as the alternative minimum tax (AMT) and payroll tax, also must be considered, as well as *when* taxes must be paid to avoid penalties and interest. This is why careful planning for ordinary income and deductible expenses is always important.

Timing income and expenses

Smart timing of income and expenses can reduce your tax liability, and poor timing can unnecessarily increase it. When you don't expect to be subject to the AMT (see page 4) in the current year or the next year, deferring income to the next year and accelerating deductible expenses into the current year may be a good idea. Why? Because it will defer tax, which usually is beneficial.

But when you expect to be in a higher tax bracket next year — or you believe tax rates may rise — the opposite approach may be beneficial: Accelerating income will allow more income to be taxed at your current year's lower rate. And deferring expenses will make the deductions more valuable because deductions save more tax when you're subject to a higher tax rate.

Whatever the reason behind your desire to time income and expenses, you may be able to control the timing of these income items:

- Bonuses,
- Self-employment income,
- U.S. Treasury bill income, and
- Retirement plan distributions, to the extent they won't be subject to early-withdrawal penalties and aren't required. (See page 20.)

Some *expenses* with potentially controllable timing are investment interest expense (see page 11), mortgage interest (see page 12), and charitable contributions (see page 16).

The TCJA is still affecting timing strategies

Timing income and deductions is more challenging under the TCJA because some strategies that taxpayers used to implement no longer make sense. Here's a look at some significant TCJA changes that have affected deductions:

Reduced deduction for SALT. Property tax used to be a popular expense to time. But with the TCJA's limit on the state and local tax deduction, property tax timing will likely provide little, if any, benefit for higher-income taxpayers. Through 2025, your entire itemized deduction for SALT — including property tax and the greater of income or sales tax — is limited to $10,000 ($5,000 if you're married filing separately).

If you reside in a state with no, or low, income tax, this change might be less relevant. But keep in mind that deducting sales tax instead of income tax may be beneficial, especially if you purchased a major item, such as a car or boat.

Finally, be aware that increasing or eliminating the SALT deduction limit has been discussed. Check with your tax advisor for the latest information.

Suspension of miscellaneous itemized deductions subject to the 2% floor. This deduction for expenses such as certain professional fees, investment expenses and unreimbursed employee business expenses is suspended through 2025. While this eliminates the home office deduction for employees who work from home (even if your employer has required it), if you're self-employed, you may still be able to deduct home office expenses. (See page 12.)

More-restricted personal casualty and theft loss deduction. Through 2025, this itemized deduction is suspended except if the loss was due to an event declared a federal disaster by the President. But, under an exception, personal casualty losses not related to a disaster can be deducted to the extent of any personal casualty gains. Such gains occur when the amount you receive from insurance or other reimbursements is more than the cost or adjusted basis of the property.

Chart 1 2023 standard deduction

Filing status	Standard deduction[1]
Singles and separate filers	$ 13,850
Heads of households	$ 20,800
Joint filers	$ 27,700

[1] Taxpayers who are age 65 or older or blind can claim an additional standard deduction: $1,500 if married, $1,850 if unmarried.

Case Study 1 **Saving taxes by bunching medical expenses into one year**

2023 has been challenging for Brendon and Tracy. The married couple's business saw a significant drop in revenue during Q1, so they project their income for the year will be lower than usual. In addition, Tracy had shoulder surgery in April, which has caused the couple's 2023 medical expenses to be higher than usual.

Brendon and Tracy don't normally have sufficient medical expenses to exceed the 7.5% adjusted gross income (AGI) floor. But because of the lower income and higher medical expenses they're experiencing in 2023, it's looking like they will this year.

Fortunately, 2024 is looking brighter: The couple's business is beginning to rebound, Tracy's shoulder is healing well, and the biggest medical expense they anticipate is elective surgery for Brendon that will be mostly covered by insurance. The downside of this potential prosperity is that there's a chance the couple won't exceed the medical expense deduction AGI floor in 2024.

So, Brendon and Tracy decide to accelerate and pay what medical expenses they can in 2023 to take advantage of the deduction:

Brendon schedules his elective surgery for late 2023 instead of early 2024.	$11,000
The couple and their kids undergo eye exams and get new glasses and contact lenses in 2023, which they otherwise would have done in 2024.	$3,500
They move the family's normal January dentist appointments to late November. They also have some follow-up dental work done in December.	$6,000
Total additional deduction	$20,500
Federal tax rate	32%
Tax savings	**$6,560**

Increased standard deduction. The TCJA nearly doubled the standard deduction. While many higher-income taxpayers will still benefit from itemizing, some — such as those in low-tax states, who don't have mortgages or who aren't as charitably inclined — may now save more tax by claiming the standard deduction. (See Chart 1 for the 2023 standard deduction amounts.)

Tax breaks for health care

If medical expenses not paid via tax-advantaged accounts or reimbursable by insurance exceed a certain percentage of your adjusted gross income (AGI), you can claim an itemized deduction for the amount exceeding that "floor." This floor can be difficult for higher-income taxpayers to exceed.

Fortunately, the 7.5% floor that had in recent years been a temporary reduction from 10% is now permanent.

Deductible expenses may include health insurance premiums, medical and dental services, prescription drugs, and long-term-care insurance premiums (limits apply). Mileage driven for health care purposes also can be deducted at 22 cents per mile driven in 2023.

Consider whether there are any medical services and purchases you could bunch into alternating years. This could save tax if it would help you exceed the applicable floor and you'd have enough total itemized deductions to benefit from itemizing. (See Case Study 1.) Of course, your and your family's health is more important than tax savings, so don't adjust timing in a way that would be harmful health-wise.

If one spouse has high medical expenses and a lower AGI, filing separately may allow that spouse to exceed the AGI floor and deduct some medical expenses that wouldn't be deductible if the couple filed jointly. **Warning:** Because the AMT exemption for separate returns is considerably lower than the exemption for joint returns, filing separately to exceed the floor could trigger the AMT.

You may be able to save taxes without having to worry about the medical expense deduction floor by contributing to one of these accounts:

HSA. If you're covered by a qualified high-deductible health plan, you can contribute pretax income to an employer-sponsored Health Savings Account — or make deductible contributions to an HSA you set up yourself — up to $3,850 for self-only coverage and $7,750 for family coverage (plus $1,000 if you're age 55 or older) for 2023. HSAs can bear interest or be invested, growing tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

FSA. You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit — not to exceed $3,050 in 2023. The plan pays or reimburses you for qualified medical expenses. (If you have an HSA, your FSA is limited to funding certain permitted expenses.) What you don't use by the plan year's end, you generally lose — though your plan might give you a 2½-month grace period to incur expenses to use up the previous year's contribution. Or it might allow you to roll over up to $610 to 2024.

Above-the-line deductions

Whether you claim the standard deduction or itemize, you may also be eligible for some "above-the-line" deductions. They're particularly valuable because they reduce your AGI and, depending on the specific deduction, your modified AGI (MAGI). AGI and MAGI are important because they're the triggers for certain additional taxes and the phaseouts of many tax breaks. Examples include deductible IRA contributions (see page 20), HSA contributions if they aren't subtracted pre-tax from your paycheck (see above), and certain business and self-employment expenses.

For example, if you're self-employed, you can claim an above-the-line deduction for part of your self-employment tax (see "Payroll and self-employment taxes" on page 5) and 100% of health insurance costs for yourself, your spouse and your dependents, up to your net self-employment income. You also can deduct contributions to a retirement plan and, if you're eligible, an HSA for yourself. And you might be able to deduct home office expenses. (See page 12.)

Smaller AMT threat

The top AMT rate is 28%, compared to the top regular ordinary-income tax rate of 37%. But the AMT rate typically applies to a higher taxable income base. You must pay the AMT if your AMT liability exceeds your regular tax liability.

The TCJA substantially increases the AMT exemptions through 2025. (See Chart 8 on page 24.) This means fewer taxpayers now have to pay the AMT.

In addition, deductions used to calculate regular tax that aren't allowed under the AMT can trigger AMT liability, and there aren't as many differences between what's deductible for AMT purposes and regular tax purposes. (See Chart 2.) This also reduces AMT risk. However, the AMT will remain a threat for some higher-income taxpayers.

So before timing your income and expenses, determine whether you're already likely to be subject to the AMT — or whether the actions you're considering might trigger it. In addition to deduction differences, some income items might trigger or increase AMT liability, such as:

- Long-term capital gains and qualified dividend income,
- Accelerated depreciation adjustments and related gain or loss differences when assets are sold, and
- Tax-exempt interest on certain private-activity municipal bonds. (For an exception, see the warning on page 11.)

Finally, in certain situations exercising incentive stock options (ISOs) can trigger significant AMT liability. (See the warning at the bottom of page 7.)

Avoiding or reducing AMT

With proper planning, you may be able to avoid the AMT, reduce its impact or even take advantage of its lower maximum rate:

If you could be subject to the AMT *this* year … consider accelerating income into this year, which may allow you to benefit from the lower maximum AMT rate. And deferring expenses you can't deduct for AMT purposes may allow you to preserve those deductions. (But watch out for the annual limit on the state and local tax deduction.) If you also defer expenses you *can* deduct for AMT purposes, the deductions may become more valuable because of the higher maximum regular tax rate. Finally, carefully consider the tax consequences of exercising ISOs.

If you could be subject to the AMT *next* year … consider taking the opposite approach. For instance, defer income to next year, because you'll

Case Study 2 — Payroll tax considerations for owner-employees

Enrique is working with his tax advisor and attorney to select an entity structure for his new business. The advisor tells him that, in addition to income tax and owner liability implications (see page 14 for more information on them), there are important payroll tax considerations for a business owner who also works in the business:

Partnerships and limited liability companies. Generally, all trade or business income that flows through to owner-employees for income tax purposes is subject to self-employment taxes — even if it isn't distributed. (Such income may not be subject to self-employment taxes for limited partners or the limited liability company member equivalent.) Whether the additional 0.9% Medicare tax (see page 5) or the 3.8% NIIT (see Case Study 6 on page 10) will apply depends on the specific circumstances.

S corporations. Only income that owner-employees receive as salary is subject to payroll taxes and, if applicable, the 0.9% Medicare tax. To reduce these taxes, owner-employees may want to keep their salary relatively — but not unreasonably — low and increase the income that is taxed to them through their Schedule K-1 by virtue of their share of the earnings from the business. That income isn't subject to the corporate level tax or the 0.9% Medicare tax and, typically, isn't subject to the 3.8% NIIT.

C corporations. Only income that owner-employees receive as salary is subject to payroll taxes and, if applicable, the 0.9% Medicare tax. Nonetheless, an owner-employee may prefer to take more income as salary (which is deductible at the corporate level) as opposed to dividends (which aren't deductible at the corporate level yet are still taxed at the shareholder level and could be subject to the 3.8% NIIT) if the overall tax paid by both the corporation and the owner-employee would be less.

Enrique's tax advisor warns him that the IRS scrutinizes corporate payments to shareholder-employees for possible misclassification, so he must tread carefully if he chooses one of those structures.

likely pay a relatively lower AMT rate. And, before year end, consider selling any private-activity municipal bonds whose interest could be subject to the AMT.

Also be aware that, in certain circumstances, you may be entitled to an AMT credit.

Payroll and self-employment taxes

In addition to income tax, you must pay Social Security and Medicare taxes on earned income, such as salary and bonuses. The 12.4% Social Security tax applies only up to the Social Security wage base of $160,200 for 2023. All earned income is subject to the 2.9% Medicare tax. Both taxes are split equally between the employee and the employer.

If you're self-employed, you pay both the employee and employer portions of payroll taxes on your self-employment income. The employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line. (See "Above-the-line deductions" on page 3.)

Additional 0.9% Medicare tax

Another payroll tax that higher-income taxpayers must be aware of is the additional 0.9% Medicare tax. It applies to FICA wages and net self-employment income exceeding $200,000 per year ($250,000 if married filing jointly and $125,000 if married filing separately).

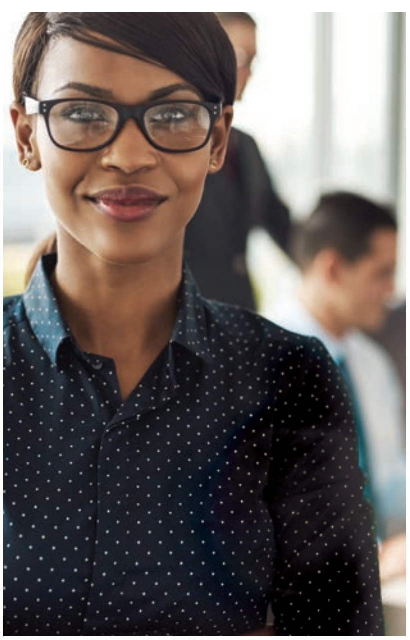


Chart 2 **Which itemized deductions may also be deductible for AMT purposes?**

Expense	Regular tax	AMT	For more information
State and local income tax	●		See "The TCJA is still affecting timing strategies" on page 2.
Property tax	●		See "Home-related deductions" on page 12.
Mortgage interest	●	●	See "Home-related deductions" on page 12.
Interest on home equity debt used to improve your principal residence or second residence	●	●	See "Home-related deductions" on page 12.
Investment interest	●	●	See "Investment interest expense" on page 11.
Medical expenses	●	●	See "Tax breaks for health care" on page 3.
Charitable contributions	●	●	See page 16.

If your wages or self-employment income varies significantly from year to year or you're nearing the threshold for triggering the additional Medicare tax, income-timing strategies may help you avoid or minimize it. For example:

- If you're an employee, perhaps you can time when you receive a bonus or exercise stock options.
- If you're self-employed, you may have flexibility on when you purchase new equipment or invoice customers.
- If you're an S corporation shareholder-employee, you might save tax by adjusting how much you receive as salary vs. distributions. (See Case Study 2.)

Also consider the withholding rules. Employers must withhold the additional tax beginning in the pay period when wages exceed $200,000 for the calendar year — without regard to an employee's filing status or income from other sources. So your employer might withhold the tax even if you aren't liable for it — or it might not withhold the tax even though you are liable for it.

If you *don't* owe the tax but your employer *is* withholding it, you can claim a credit on your 2023 income tax return. If you *do* owe the tax but your employer *isn't* withholding it, consider increasing your income tax withholding, which can be used to cover the shortfall and avoid interest and penalties. Or make estimated tax payments.

Estimated tax payments and withholding

You can be subject to penalties if you don't pay enough tax during the year through estimated taxes and withholding. Here are some strategies to help avoid being subject to underpayment penalties for 2023:

Know the minimum payment rules. Your estimated payments and withholding must equal at least 90% of your tax liability for 2023 or 110% of your 2022 tax (100% if your 2022 adjusted gross income was $150,000 or less or, if married filing separately, $75,000 or less).

Use the annualized income installment method. This method often benefits taxpayers who have large variability in income from month to month due to bonuses, investment gains and losses, or seasonal income (at least if it's skewed toward the end of the year). Annualizing computes the tax due based on income, gains, losses and deductions through each estimated tax period.

Estimate your tax liability and increase withholding. If you determine you've underpaid, consider having the tax shortfall withheld from your salary or year-end bonus by Dec. 31. Because withholding is considered to have been paid ratably throughout the year, this is often a better strategy than making up the difference with an increased quarterly tax payment, which may still leave you exposed to penalties for earlier quarters.

Complex tax consequences demand careful planning

Stock-based compensation, such as restricted stock, restricted stock units (RSUs) or stock options can be valuable. So can nonqualified deferred compensation (NQDC). But the tax consequences of these awards are complex. They involve not only a variety of special rules but also several types of taxes — including ordinary-income taxes, capital gains taxes, employment taxes and more. As a result, careful planning is required.

Restricted stock

Restricted stock is stock your employer grants to you subject to a substantial risk of forfeiture. Income recognition is normally deferred until the stock is no longer subject to that risk (that is, it's vested) or you sell it. When the restriction lapses, you pay taxes on the stock's fair market value (FMV) at your ordinary-income rate. (The FMV will be considered FICA income, so it could trigger or increase your exposure to the additional 0.9% Medicare tax. See page 5.)

But with a Section 83(b) election, you can instead opt to recognize ordinary income when you receive the stock. This election, which you must make within 30 days after receiving the stock, allows you to convert potential future appreciation from ordinary income to long-term capital gains income and defer it until the stock is sold. (See Case Study 3 for an example.)

There are some potential disadvantages of a Section 83(b) election, however. First, prepaying tax in the current year could push you into a higher income tax bracket and trigger or increase your exposure to the additional 0.9% Medicare tax. (See page 5.) But if your company is in the earlier stages of development, the income recognized may be relatively small. Second, any taxes you pay because of the election can't be refunded if you eventually forfeit the stock or sell it at a decreased value. However, you'd have a capital loss in those situations.

Work with your tax advisor to map out whether the Sec. 83(b) election is appropriate for your situation. You also might be eligible for a tax break under the TCJA that allows for the deferral of tax on stock-based compensation in certain circumstances. But it generally will apply only if at least 80% of full-time employees are covered by the stock-based compensation plan.

RSUs

RSUs are contractual rights to receive stock, or its cash value, after the award has vested. Unlike restricted stock, RSUs aren't eligible for the Sec. 83(b) election. So there's no opportunity to convert ordinary income into capital gains.

But they do offer a limited ability to defer income taxes: Unlike restricted stock, which becomes taxable immediately upon vesting, RSUs aren't taxable until the employee actually receives the stock. So rather than having the stock delivered immediately upon vesting, you may be able to arrange with your employer to delay delivery.

Case Study 3 — Saving taxes on restricted stock with a Sec. 83(b) election

Lauren and Megan are executives at a technology start-up, and in the same year each receives 50,000 shares of restricted stock with a fair market value of $1 per share. Lauren doesn't make a Section 83(b) election, but Megan does.

In an initial public offering (IPO) a year later, the stock is offered at $5 per share. More than a year after the IPO, the market price reaches $10 per share and Lauren and Megan both sell all their shares. By making the Sec. 83(b) election, Megan has saved $26,400 in federal income taxes!

	Lauren (doesn't make the election)	Megan (does make the election)
Year the restricted stock is awarded	Recognizes no income related to the stock.	Recognizes $50,000 (50,000 shares at $1 per share) of compensation income, for a federal income tax bill of $18,500.
Year of the IPO (which lifts the substantial risk of forfeiture)	Recognizes compensation income of $250,000 (50,000 shares at the IPO price of $5 per share), for a federal income tax bill of $92,500.	Recognizes no income related to the stock.
Year of the stock sale	Recognizes a long-term capital gain of $250,000 (50,000 shares at $10 per share less basis of $5 per share), for a federal income tax bill of $59,500.	Recognizes a long-term capital gain of $450,000 (50,000 shares at $10 per share less basis of $1 per share), for a federal income tax bill of $107,100.
Total federal income tax paid	$152,000	$125,600

Note: *The figures presume that the 37% marginal income tax rate, the 20% long-term capital gains tax rate and the 3.8% NIIT apply. This case study doesn't factor in payroll taxes.*

Such a delay will defer income tax and may allow you to reduce or avoid exposure to the additional 0.9% Medicare tax (because the RSUs are treated as FICA income). However, any income deferral must satisfy the strict requirements of Internal Revenue Code Section 409A. Also keep in mind that it might be better to recognize income now because of the currently low tax rates.

ISOs

Incentive stock options allow you to buy company stock in the future (but before a set expiration date) at a fixed price equal to or greater than the stock's FMV at the date of the grant. Thus, ISOs don't provide a benefit until the stock appreciates in value. If it does, you can buy shares at a price *below* what they're then trading for, provided you're eligible to exercise the options.

ISOs receive tax-favored treatment but must comply with many rules. Here are the key tax consequences:

- You owe no tax when ISOs are granted.
- You owe no regular income tax when you exercise the ISOs.
- If you sell the stock *after* holding the options for at least one year and then holding the shares for at least one year from the exercise date, you pay tax on the sale at your long-term capital gains rate. You also may owe the NIIT. (See Case Study 6 on page 10.)
- If you sell the stock *before* long-term capital gains treatment applies, a "disqualifying disposition" occurs and any gain is taxed as compensation at ordinary-income rates. (Disqualified dispositions aren't, however, subject to FICA and Medicare tax, including the additional 0.9% Medicare tax.)

Warning: If you don't sell the stock in the year of exercise, a tax "preference" item is created for the difference between the stock's FMV and the exercise price (the "bargain element") that can trigger the alternative minimum tax (AMT). A future AMT credit, however, should mitigate this AMT hit. Plus, you may now be at lower AMT risk. (See page 4.)

Case Study 4 — Acting sooner sometimes can be better when it comes to ISOs

Rakesh was recently awarded a large number of incentive stock options from his employer. He knows holding on to them as long as possible can be beneficial, but he's worried about market risk. He also wants a better understanding of the tax implications. So he consults his tax advisor. She explains that acting sooner can be advantageous in several situations. For example, he can:

- Exercise early to start the holding period so he can sell and receive long-term capital gains treatment sooner,
- Exercise when the bargain element is small or when the market price is close to bottoming out to reduce or eliminate alternative minimum tax (AMT) liability,
- Exercise annually so he can buy only the number of shares that will achieve a breakeven point between the AMT and regular tax and thereby incur no additional tax, or
- Sell in a disqualifying disposition and pay the higher ordinary-income rate to avoid the AMT on potentially disappearing appreciation.

But she points out that, on the negative side, exercising early accelerates the need for funds to buy the stock, exposes Rakesh to a loss if the shares' value drops below his exercise cost, and may create a tax cost if the exercise generates an AMT liability. She's going to run some numbers for Rakesh so he can make a fully informed decision to minimize both risk and negative tax consequences.

If you've received ISOs, plan carefully when to exercise them and when to sell the shares received. Waiting to exercise ISOs until just before the expiration date (when the stock value may be the highest, assuming the stock is appreciating) and holding on to the stock long enough to garner long-term capital gains treatment often is beneficial. But sometimes it makes sense to act sooner. (See Case Study 4.)

It's also important to consider that the timing of ISO exercises could positively or negatively affect your liability for higher tax rates and the NIIT. You also might be eligible for tax deferral under the TCJA. With your tax advisor, evaluate the risks and crunch the numbers to determine the best strategy for you.

NQSOs

The tax treatment of nonqualified stock options is different from the tax treatment of ISOs: NQSOs create compensation income (taxed at ordinary-income rates) on the bargain element when exercised (regardless of whether the stock is held or sold immediately), but they don't create an AMT preference item.

You may need to make estimated tax payments or increase withholding to fully cover the tax on the exercise. Keep in mind that an exercise could trigger or increase exposure to top tax rates, the additional 0.9% Medicare tax and the NIIT.

NQDC plans

These plans pay executives in the future for services to be currently performed. They differ from qualified plans, such as 401(k)s, in several ways. For example, NQDC plans can favor highly compensated employees, but plan funding isn't protected from the employer's creditors.

One important NQDC tax issue is that payroll taxes (see page 5) are generally due once services have been performed and there's no longer a substantial risk of forfeiture — even though compensation may not be paid or recognized for income tax purposes until much later. So your employer may withhold your portion of the payroll taxes from your salary or ask you to write a check for the liability. Or it may pay your portion, in which case you'll have additional taxable income. **Warning:** The additional 0.9% Medicare tax could also apply.

Factoring taxes into your investment planning

Tax treatment of investments varies dramatically based on factors such as type of investment, type of income it produces, how long you've held it and whether any special limitations or breaks apply. And higher-income taxpayers generally face higher tax rates on their investment income.

But there are many additional factors to evaluate before deciding whether to sell or hold an investment, such as investment goals, time horizon, risk tolerance, factors related to the investment itself, fees and charges that apply to buying and selling securities, and your need for cash. Regardless, it's important to factor taxes into your investment planning.

Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. Your marginal long-term capital gains rate can be as much as 20 percentage points lower than your ordinary-income tax rate.

The long-term capital gains rate applies to investments held for more than 12 months. The applicable rate depends on your income level and the type of asset you've sold. (See Chart 3.)

Under the TCJA, through 2025, the top long-term gains rate of 20% kicks in before the top ordinary-income rate does. (See Chart 8 on page 24.) Lawmakers could, however, make changes to the rates sooner. Higher rates already apply to certain types of assets. (See Chart 3.)

Holding on to an investment until you've owned it more than one year may help substantially cut tax on any gain. Keeping it even longer can also make tax sense. But be sure to look at your specific situation, and keep an eye out for possible tax law changes.

Chart 3 What's the maximum 2023 capital gains tax rate?

Type of gain	Rate[1]
Short-term (assets held 12 months or less)	Taxpayer's ordinary-income tax rate
Long-term (assets held more than 12 months)	15%
Some key exceptions	
Long-term gain of certain higher-income taxpayers	20%[2]
Most long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate	0%
Long-term gain on collectibles, such as artwork and antiques	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%
Gain on qualified small business (QSB) stock held more than 5 years	
• Acquired before Feb. 18, 2009	14%[3]
• Acquired on or after Feb. 18, 2009, and before Sept. 28, 2010	7%[4]
• Acquired on or after Sept. 28, 2010	0%

[1] In addition, the 3.8% net investment income tax (NIIT) applies to net investment income to the extent that modified adjusted gross income (MAGI) exceeds $200,000 (singles and heads of households), $250,000 (married filing jointly) or $125,000 (married filing separately).

[2] The 20% rate applies only to those with taxable income exceeding $492,300 (singles), $523,050 (heads of households), $553,850 (joint filers), $276,900 (separate filers) or $14,650 (estates and trusts).

[3] Effective rate based on a 50% exclusion from a 28% rate.

[4] Effective rate based on a 75% exclusion from a 28% rate.

The 0% rate

The 0% rate generally applies to long-term gain that would be taxed at 10% or 12% based on the taxpayer's ordinary-income rate. If you have adult children in one of these tax brackets, consider transferring appreciated or dividend-producing assets to them so they can sell the assets or reap the dividends and enjoy the 0% rate, which also applies to qualified dividends. This strategy can be even more powerful if you'd be subject to the 3.8% NIIT (see Case Study 6 on page 10) or the 20% long-term capital gains rate if you sold the assets.

But keep in mind that the 0% rate applies only to the extent that capital gains "fill up" the gap between your child's taxable income and the top end of the 0% bracket. For 2023, the 0% bracket for singles tops out at $44,625, (just $100 less than the top of the 12% ordinary-income tax bracket).

Warning: If the child will be under age 24 on Dec. 31, first make sure he or she won't be subject to the "kiddie" tax. (See page 18.) Also consider any gift tax consequences. (See page 22.)

Being tax-smart with losses

Losses aren't truly losses until they're realized — that is, generally until you sell the investment for less than what you paid for it. So while it's distressing to see an account statement that shows

Case Study 5 Building up tax losses for the future can be beneficial

Gina has a large investment in her portfolio that seems to be on a downward spiral, with no sign of potential recovery. But she's reluctant to sell because her net capital losses for the year exceed the $3,000 she'll be able to deduct on her 2023 tax return.

Gina talks to her tax advisor, who reminds her that tax considerations shouldn't be the primary driver of investment decisions. If Gina is ready to divest herself of a poorly performing stock because she doesn't think its performance will improve or because her investment objective or risk tolerance has changed, she shouldn't hesitate solely for tax reasons.

Plus, building up losses for future use could be beneficial. This may be especially true for Gina because she owns a large investment portfolio that she expects will generate substantial future gains. Building up losses could also be beneficial for taxpayers owning a closely held business or real estate investments that they might sell at a large profit — or if tax rates increase.

a large loss, the loss won't affect your current tax situation as long as you still own the investment.

Realized capital losses are netted against realized capital gains to determine capital gains tax liability. If net losses exceed net gains, you can deduct only $3,000 ($1,500 for married taxpayers filing separately) of losses per year against ordinary income (such as wages, self-employment and business income, interest, dividends, and taxable retirement plan distributions). If year-to-date you have a net loss, it could provide an opportunity to divest yourself of appreciated investments in a tax-efficient way.

If you don't have enough gains to absorb losses, you could be left with losses in excess of the annual ordinary-income deduction limit. So think twice before selling an investment at a loss. After all, if you hold on to the investment, it may recover the lost value. In fact, a buy-and-hold strategy works well for many long-term investors because it can minimize the effects of market volatility.

Of course, an investment might continue to lose value. That's one reason why tax considerations shouldn't be the primary driver of investment decisions. Plus, you can carry forward excess losses until death, and building up losses for future use could be beneficial. (See Case Study 5.)

Finally, remember that capital gains distributions from mutual funds can also absorb capital losses.

Wash sale rule

If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, consider the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or an option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can:

- Sell the security and immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold,
- Sell the security and wait 31 days to repurchase the same security, or
- Before selling the security, purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

Alternatively, you can do a bond swap, where you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you can achieve a tax loss with virtually no change in economic position.

Warning: You can't avoid the wash sale rule by selling stock at a loss in a taxable account and purchasing the same stock within 30 days in a tax-advantaged retirement account.

Mutual funds

Investing in mutual funds is an easy way to diversify your portfolio. But beware of the tax pitfalls.

First, mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

Second, earnings on mutual funds are often reinvested. Unless you or your investment advisor records increases in your cost basis accordingly, you may report more gain than required when you sell the fund. For mutual funds you acquired after 2011, brokerage firms are required to track (and report to the IRS) your cost basis.

Third, buying equity mutual fund shares late in the year can be costly taxwise. These funds often make capital gains distributions toward year end. If you purchase shares before such a distribution, you'll end up with a capital gain, reportable on your tax return for the year of the distribution. It doesn't matter whether the actual value of the shares has increased or even decreased since you purchased them, or whether you reinvest the proceeds back into the same fund.

Why? The distribution itself is a taxable event. If capital gains distributions from the mutual fund are reinvested in the fund, the distribution itself doesn't change your value in the fund. It simply increases the number of shares you own, yet now at a lower per-share value.

Small business stock

By purchasing stock in certain small businesses, you can diversify your portfolio. You also may enjoy preferential tax treatment:

Conversion of capital loss to ordinary loss. If you sell qualifying Section 1244 small business stock at a loss, you can treat up to $50,000 ($100,000, if married filing jointly) as an ordinary, rather than a capital, loss — regardless of your holding period. This means you can use it to offset ordinary income, reducing your tax by as much as 37% of this portion of the loss. Sec. 1244 applies only if total capital invested isn't more than $1 million.

Tax-free gain rollovers. If within 60 days of selling qualified small business (QSB) stock you buy other QSB stock with the proceeds, you can defer the tax on your gain until you dispose of the new stock. The rolled-over gain reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock's holding period includes the holding period of the stock you sold. To be a QSB, a business must be engaged in an active trade or business and must not have assets that exceed $50 million, among other requirements.

Exclusion of gain. Generally, taxpayers selling QSB stock are allowed to exclude up to 100% of their gain if they've held the stock for more than five years. But, depending on the acquisition date, the exclusion may be less: The exclusion is 75% for stock acquired on or after Feb. 18, 2009, and before Sept. 28, 2010; it's 50% for stock acquired before Feb. 18, 2009.

When the exclusion is less than 100%, the taxable portion of any QSB gain will be subject to the lesser of your ordinary-income rate or 28%, rather than the normal long-term gains rate. (See Chart 3 on page 8.) Thus, if the 28% rate and the 50% exclusion apply, the effective rate on the QSB gain will be 14% (28% × 50%).

Keep in mind that all three of these tax benefits are subject to additional requirements and limits. Consult your tax and financial advisors to be sure an investment in small business stock is right for you.

Case Study 6 — Watch out for the NIIT

Earlier this year, Kimberly accepted a new job with a large salary increase. Her investment portfolio also was doing well, so she was concerned that she could become subject to the 3.8% net investment income tax (NIIT). She contacted her tax advisor to learn more.

Her advisor explained that taxpayers with modified adjusted gross income (MAGI) over $200,000 per year ($250,000 if married filing jointly and $125,000 if married filing separately) may owe the NIIT on top of whatever other tax they owe on their investment income. The NIIT equals 3.8% of the lesser of net investment income or the amount by which MAGI exceeds the applicable threshold. Net investment income can include capital gains, dividends, interest, rental income and other investment-related income (but not business income or self-rental income from an active trade or business).

Kimberly's advisor explained that many of the strategies that can help her save or defer income tax on her investments can also help her avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce her MAGI — such as making retirement plan contributions (see page 20) — could also help her avoid or reduce NIIT liability.

Passive activities

If you've invested in a trade or business in which you don't materially participate and where income or loss flows through to your tax return, remember the passive activity rules. Why? Passive activity income may be subject to the 3.8% NIIT (see Case Study 6), and passive activity losses generally are deductible only against income from other passive activities. You can carry forward disallowed losses, subject to the same limits each tax year.

To avoid passive activity treatment, you must "materially participate" in the activity, which typically means you must participate in the trade or business more than 500 hours during the year or demonstrate that your involvement constitutes substantially all of the participation in the activity. But there are other ways to meet the material participation test. Plus, there are special rules that apply to real estate. (See page 13.)

To help ensure your hours claim will be able to withstand IRS scrutiny, carefully track and document your time. Contemporaneous recordkeeping is better than records that are created after the fact.

If you don't pass the material participation test, consider:

Increasing your involvement. If you can exceed 500 hours, the activity no longer will be subject to passive activity rules.

Grouping activities. You may be able to group certain activities together to be treated as one activity for tax purposes and exceed the 500-hour threshold. But the rules are complex, and there are potential downsides to consider.

Looking at other activities. If you have passive losses, one option is to limit your participation in another activity that's generating net income, so that you don't meet the 500-hour test. Another is to invest in an additional income-producing trade or business that will be passive to you. Under both strategies, you'll have passive income that can absorb some or all of your passive losses.

Disposing of the activity. This generally allows you to deduct all passive losses — including any loss on disposition (subject to basis and capital loss limitations). But, again, the rules are complex.

Even if you do pass the material participation test, be aware that your loss deduction might be affected by the TCJA's rules for deducting business losses. (See Case Study 8 on page 15.)

Income investments

Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate. Interest income, however, generally is taxed at ordinary-income rates. So stocks that pay qualified dividends may be more attractive taxwise than other income investments, such as CDs and taxable bonds.

Some dividends are subject to ordinary-income rates. These include certain dividends from:

- Real estate investment trusts (REITs),
- Regulated investment companies (RICs),
- Money market mutual funds, and
- Certain foreign investments.

Also note that the tax treatment of bond income varies. For example:

- Bonds (except U.S. savings bonds) with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it. (See Case Study 7.)
- Corporate bond interest is fully taxable for federal and state purposes.
- Interest on U.S. government bonds is taxable on federal returns but exempt by federal law on state and local returns.
- Interest on state and local government bonds is excludable on federal returns. If the bonds were issued in your home state, interest also may be excludable on your state return, depending on the state.

Case Study 7 — The dangers of "phantom" income

Karl mentions to his tax advisor that he wants to diversify his portfolio and is considering spending $80,000 on a bond with a $100,000 face value and a 10-year maturity date. His tax advisor warns that this investment will produce "phantom" income. Phantom income originates from investments that generate annual interest but don't annually pay you this interest.

In this case, Karl will earn $20,000 in interest that he'll receive as a lump sum at maturity. But because he's earning that interest over 10 years, the IRS will consider him to be earning income of $2,000 annually. And, of course, the IRS will expect Karl to pay taxes on this interest annually.

Because the bond will provide no cash to pay the annual tax due, Karl's advisor suggests that it's best suited for his IRA or another tax-deferred vehicle.

Keep in mind that although state and municipal bonds usually pay a lower interest rate, their rate of return may be higher than the after-tax rate of return for a taxable investment, depending on your tax rate. To compare apples to apples, calculate the tax-equivalent yield, which incorporates tax savings into the municipal bond's yield. The formula is simple:

Tax-equivalent yield = actual yield / (1 – your marginal tax rate)

Warning: Tax-exempt interest from private-activity municipal bonds can trigger or increase alternative minimum tax (AMT) liability. However, any income from tax-exempt bonds issued in 2009 and 2010 (along with 2009 and 2010 re-fundings of bonds issued after Dec. 31, 2003, and before Jan. 1, 2009) is excluded from the AMT. And AMT is less of a risk for most taxpayers now. (See page 4.)

Investment interest expense

Interest on debt used to buy assets held for investment, such as margin debt used to buy securities, generally is deductible for both regular tax and AMT purposes. But special rules apply.

Your investment interest expense deduction is limited to your net investment income, which, for the purposes of this deduction, generally includes taxable interest, nonqualified dividends and net short-term capital gains (but not long-term capital gains), reduced by other investment expenses. Any disallowed interest expense is carried forward, and you can deduct it in a later year against net investment income.

You may elect to treat all or a portion of net long-term capital gains or qualified dividends as investment income in order to deduct more of your investment interest expense. But if you do, that portion of the long-term capital gain or dividend will be taxed at ordinary-income rates.

Payments a short seller makes to the stock lender in lieu of dividends may be deductible as investment interest expense. But interest on debt used to buy securities that pay tax-exempt income, such as municipal bonds, isn't deductible.

Also keep in mind that passive interest expense — interest on debt incurred to fund a passive activity — becomes part of your overall passive activity income or loss, subject to limitations.

Are you maximizing the tax benefits from owning real estate?

There are many ways to make the most of the tax benefits associated with owning a principal residence, vacation home or rental property. Tax planning is also important if you'd like to sell your home or other real estate this year. But don't forget about the TCJA. It impacts some home-related deductions and some tax breaks for real estate investors and other real property businesses.

Home-related deductions

Consider these itemized deductions in your tax planning:

Property tax deduction. Under the TCJA, through 2025, the property tax deduction is subject to a $10,000 limit ($5,000 if you're married filing separately) on combined deductions for state and local taxes (SALT). (See page 2 for more details.)

Mortgage interest deduction. You generally can deduct interest on mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your principal residence also may be deductible. Through 2025, the TCJA reduces the mortgage debt limit from $1 million to $750,000 for debt incurred after Dec. 15, 2017 (from $500,000 to $375,000 for separate filers), with some limited exceptions.

Home equity debt interest deduction. Through 2025, the TCJA effectively limits the home equity interest deduction to debt that would qualify for the home mortgage interest deduction. (Under pre-TCJA law, interest was deductible on up to $100,000 of home equity debt used for any purpose, such as to pay off credit card debt or to buy a car.)

Home office deduction. Under the TCJA, *employees* can no longer deduct home office expenses, because of the suspension of miscellaneous deductions subject to the 2% of adjusted gross income (AGI) floor. (See page 2.) But the self-employed can still claim the deduction if their home office is their principal place of business (or used substantially and regularly to conduct business) and that's the space's only use.

They can deduct from their self-employment income a portion of their mortgage interest, property taxes, insurance, utilities and certain other expenses, and the depreciation allocable to the space. Or they can use the simplified method for calculating the deduction — $5 per square foot for up to 300 square feet. Although taxpayers using this method won't be able to depreciate the portion of their home that's used as an office, they can claim mortgage interest, property taxes and casualty losses as itemized deductions to the extent otherwise allowable, without needing to apportion them between personal and business use of the home.

Home rental rules

If you rent out all or a portion of your principal residence or second home for less than 15 days during the year, you don't have to report the income. But expenses directly associated with the rental, such as advertising and cleaning, won't be deductible.

If you rent out your principal residence or second home for 15 days or more, you'll have to report the income. But you may be entitled to deduct some or all of your rental expenses — such as utilities, repairs, insurance and depreciation. Exactly what you can deduct depends on whether the home is classified as a rental property for tax purposes (based on the amount of personal vs. rental use):

Rental property. You can deduct rental expenses, including losses, subject to the real estate activity rules discussed at right. Property tax attributable to the rental use of the home isn't subject to the SALT limit. You can't deduct any interest that's attributable to your personal use of the home. However, you can take the personal portion of property tax as an itemized deduction (subject to the SALT limit).

Nonrental property. You can deduct rental expenses only to the extent of your rental or other passive income. Any excess can be carried forward to offset rental income in future years. You also can take an itemized deduction for the personal portion of both mortgage interest and property taxes, subject to the applicable limits. In some instances, it may be beneficial to reduce personal use of a residence so it will be classified as a rental property.

WHAT'S NEW! 2 tax credits for home energy efficiency improvements

Taxpayers who take steps to make their homes more energy efficient, such as installing energy efficient windows or adding solar panels, may qualify for a new tax credit under 2022's Inflation Reduction Act:

Energy Efficient Home Improvement Credit. This applies only to improvements to an existing home. The amount of the credit is a percentage of the total improvement expenses in the year of installation. For 2023 through 2032 it's 30%, generally up to $1,200 annually.

Residential Clean Energy Credit. This is available for existing and newly constructed homes. For 2023 through 2032, this credit is 30% of the total improvement expenses, generally with no annual maximum or lifetime limit.

Home sales

When you sell your principal residence, you can exclude up to $250,000 of gain ($500,000 for married couples filing jointly) if you meet certain tests. Gain that qualifies for exclusion will also be excluded from the 3.8% NIIT. (See Case Study 6 on page 10.) To support an accurate tax basis, maintain thorough records, including information on your original cost and subsequent improvements, reduced by any casualty losses and depreciation claimed based on business use. **Warning:** Gain that's allocable to a period of "nonqualified" use generally isn't excludable.

Losses on the sale of any personal residence aren't deductible. But if part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

Because a second home is ineligible for the gain exclusion, consider converting it to rental use before selling. It can be considered a business asset, and you may be able to defer tax on any gains through an installment sale or a Section 1031 exchange. (See "Tax deferral strategies," below right.) Or you may be able to deduct a loss, but only to the extent attributable to a decline in value *after* the conversion.

Real estate activity rules

Income and losses from investment real estate or rental property are passive by definition — unless you're a real estate professional. Why is this important? Passive activity income and losses have some negative tax consequences. (See "Passive activities" on page 10.)

To qualify as a real estate professional, you must annually perform:

- More than 50% of your personal services in real property trades or businesses in which you materially participate, and
- More than 750 hours of service in these businesses during the year.

Keep in mind that special rules for spouses may help you meet the material participation test. **Warning:** To help withstand IRS scrutiny, be sure to keep adequate records of time spent.

Depreciation-related breaks

Valuable depreciation-related breaks may be available to real estate investors:

QIP deduction. Qualified retail-improvement, restaurant and leasehold-improvement property are classified as qualified improvement property. QIP has a 15-year Modified Accelerated Cost Recovery System (MACRS) recovery period and qualifies for Sec. 179 expensing and bonus depreciation.

Section 179 expensing. This election allows you to deduct (rather than depreciate over a period of years) the cost of purchasing eligible assets, including QIP. The TCJA also allows Sec. 179 expensing for certain depreciable tangible personal property used predominantly to furnish lodging and for the following improvements to nonresidential real property: roofs, HVAC equipment, fire protection and alarm systems, and security systems.

For qualifying property placed in service in 2023, the expensing limit is $1.16 million. The break begins to phase out dollar-for-dollar when asset acquisitions for the year exceed $2.89 million. (These amounts are adjusted annually for inflation.) You can claim the election only to offset net income, not to reduce it below zero to create a net operating loss.

Bonus depreciation. This additional first-year depreciation is available for qualified assets, which include QIP. Unfortunately, the 100% bonus depreciation that has been available in recent years generally expired Dec. 31, 2022. Unless legislation is signed into law extending the 100% amount (check with your tax advisor for the latest information), bonus depreciation will generally be only 80% for qualified assets placed in service in 2023. And it is scheduled to continue to drop and to eventually be eliminated:

- 60% for 2024,
- 40% for 2025,
- 20% for 2026, and
- 0% for 2027 and future years.

So, to the extent to which the Sec. 179 expensing election isn't available and it otherwise makes strategic and financial sense for your business, consider accelerating QIP investments into 2023, before bonus depreciation drops further.

Interest expense deduction for real estate businesses

Generally, under the TCJA, interest paid or accrued by a business is deductible only up to 30% of adjusted taxable income (ATI). For 2023, taxpayers with average annual gross receipts of $29 million or less for the three previous tax years generally are exempt from the limitation.

Larger real property businesses can *elect* to continue to deduct 100% of their interest. But then they're required to use the alternative depreciation system for real property used in the business and can't claim bonus depreciation.

Tax deferral strategies

It's possible to divest yourself of appreciated investment real estate but defer the tax liability. Such strategies may even help you keep your income low enough to avoid triggering the 3.8% NIIT and the 20% long-term capital gains rate (see page 8). Consider these tax deferral strategies:

1. Installment sale. An installment sale allows you to defer gains by spreading them over several years as you receive the proceeds. But ordinary gain from certain depreciation recapture is recognized in the year of sale, even if no cash is received.

2. Section 1031 exchange. Also known as a "like-kind" exchange, this technique allows you to exchange one real estate investment property for another and defer paying tax on any gain until you sell the replacement property.

But these strategies aren't without risks. For example, if tax rates go up, you could ultimately end up paying more in taxes.

Tax planning is a juggling act for business owners

As a business owner, you must keep your eye on your company's income, expenses and applicable tax breaks, which the complexities of the TCJA make especially challenging. But you also need to look out for your own financial future, which requires retirement planning and exit planning. And if you might sell your business or acquire another, it's critical to consider the tax consequences.

Business structure

Income taxation and owner liability are the main factors that differentiate business structures. Many business owners choose entities that combine pass-through taxation with limited liability, namely limited liability companies (LLCs) and S corporations.

The TCJA significantly changed the tax consequences of business structure. The now-flat corporate rate (21%) is substantially lower than the top individual rate (37%), providing sizable tax benefits to C corporations and mitigating the impact of double taxation for their owners. (The new 15% corporate alternative minimum tax imposed by the Inflation Reduction Act effective for tax years beginning after Dec. 31, 2022, applies only to the very largest C corporations.) But the TCJA also introduced a powerful deduction for some owners of pass-through entities. (See "199A deduction for pass-through businesses" below.)

For tax or other reasons, a structure change may sound like a good idea. But keep in mind that increases to both the corporate rate and the top individual rate have been proposed. Even if there are no tax increases, a change could have unwelcome tax consequences. Consult your tax advisor if you'd like to explore whether a structure change could benefit you.

199A deduction for pass-through businesses

Through 2025, the TCJA provides the Section 199A deduction for sole proprietors and owners of pass-through entities, such as partnerships, S corporations and LLCs that are treated as sole proprietorships or partnerships for tax purposes. The deduction generally equals 20% of qualified business income (QBI), not to exceed 20% of taxable income. QBI is generally defined as the net amount of qualified items of income, gain, deduction and loss that are connected with the conduct of a U.S. business.

Additional limits begin to apply if 2023 taxable income exceeds the applicable threshold — $182,100 or, if married filing jointly, $364,200. The limits fully apply when 2023 taxable income exceeds $232,100 and $464,200, respectively. One such limit is that the 199A deduction generally can't exceed the greater of the owner's share of:

- 50% of the amount of W-2 wages paid to employees by the qualified business during the tax year, or
- The sum of 25% of W-2 wages plus 2.5% of the cost (not reduced by depreciation taken) of qualified property, which is the depreciable tangible property (including real estate) owned by a qualified business as of year end and used by the business at any point during the tax year to produce QBI.

Another limit if income exceeds the applicable threshold is that the 199A deduction generally isn't available for income from "specified service businesses." Examples include businesses that provide investment-type services and most professional practices (other than engineering and architecture).

Retirement saving

If most of your money is tied up in your business, retirement can be a challenge. So if you haven't already set up a tax-advantaged retirement plan, consider doing so this year. If you might be subject to the 3.8% NIIT (see Case Study 6 on page 10), this may be particularly beneficial because retirement plan contributions can reduce your modified adjusted gross income (MAGI) and thus help you reduce or avoid the NIIT.

You generally can set up a plan and make deductible 2023 contributions as late as the due date of your 2023 income tax return, including extensions. Keep in mind that, if you have employees, they generally must be allowed to participate

Chart 4 **Profit-sharing plan vs. SEP: How much can you contribute?**

Profit-sharing plan	SEP
2023 maximum contribution: $66,000 or $73,500	**2023 maximum contribution:** $66,000
Additional limits: You can't contribute more than 25% of your compensation generally. But you can contribute 100% up to the 401(k) limits if the plan includes a 401(k) arrangement. To qualify for the $73,500 limit 1) your plan must include a 401(k) arrangement, and 2) you must be eligible to make catch-up contributions (that is, be age 50 or older).	**Additional limits:** You can't contribute more than 25% of your eligible compensation. (Special rules apply if you're self-employed.) To make the maximum contribution, your eligible compensation must be at least $264,000 ($330,000 before the deduction if you're self-employed).

Note: *Other factors may further limit your maximum contribution.*

in the plan, provided they work enough hours and meet other qualification requirements.

Here are a few options:

Profit-sharing plan. This is a defined contribution plan that allows discretionary employer contributions and flexibility in plan design. If you're age 50 or older, you may be able to contribute more than you could to a SEP. (See Chart 4 for contribution limits.)

SEP. A Simplified Employee Pension is a defined contribution plan that provides benefits similar to those of a profit-sharing plan, but a SEP is easier to administer. (See Chart 4 for contribution limits.)

Defined benefit plan. This plan sets a future pension benefit and then actuarially calculates the contributions needed to attain that benefit. The maximum compensation for benefit purposes for 2023 is generally $265,000 or 100% of average earned income for the highest three consecutive years, if less. Because it's actuarially driven, the 2023 contribution needed to attain the future benefit may exceed the maximum contributions allowed by other plans, depending on your age and the desired benefit. **Warning:** Employer contributions generally are mandatory.

Exit planning

An exit strategy is a plan for passing on responsibility for running the company, transferring ownership and extracting your money from the business. This requires planning well in advance of the transition. Here are the most common exit options:

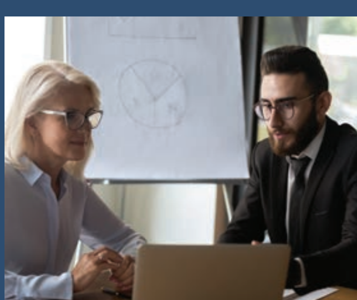
Buy-sell agreement. When a business has more than one owner, a buy-sell agreement can control what happens to the business when a specified event occurs, such as an owner's retirement, disability or death. It's critical to factor in tax and funding issues when drafting a buy-sell agreement.

Succession within the family. You can pass your business on to family members by giving them interests, selling them interests or doing some of each. Now may be a particularly good time to transfer ownership interests in your business. (See page 22 to learn why.)

ESOP. An employee stock ownership plan is a qualified retirement plan created primarily to own your company's stock. It can provide liquidity and various tax benefits.

Sale to an outsider. If you can find the right buyer, you may be able to sell the business at a premium.

Case Study 8 — The impact of business loss deduction limits



Omar's business has been struggling in 2023 and, while things have been improving, he thinks that his business's expenses and other deductions for the year will exceed its revenue. He's wondering what the impact on his tax situation will be for 2023 and beyond, so he consults his tax advisor. She explains that some limits apply to business loss deductions:

NOLs. The TCJA generally reduces the amount of taxable income that can be offset with net operating loss deductions from 100% to 80%. It also generally prohibits NOLs from being carried back to an earlier tax year — but allows them to be carried forward indefinitely (as opposed to the previous 20-year limit).

Pass-through entity "excess" business losses. Through 2025, the TCJA applies a limit to deductions for current-year business losses incurred by noncorporate taxpayers: Such losses generally can't offset more than $250,000 ($500,000 for married couples filing jointly) of income from other sources, such as salary, self-employment income, interest, dividends and capital gains. (The limit is adjusted annually for inflation and is $289,000 for 2023 — $578,000 for joint filers.) Excess losses are carried forward to later tax years and can then be deducted under the NOL rules. In 2022, the Inflation Reduction Act extended the limit through 2028.

Business sale or acquisition

Whether you're selling your business as part of your exit strategy or acquiring another company to help grow it, the tax consequences can have a major impact on the transaction's success or failure. Here are a few key tax considerations:

Asset vs. stock sale. With a corporation, sellers typically prefer a stock sale for the capital gains treatment and to avoid double taxation. Buyers generally want an asset sale to maximize future depreciation write-offs.

Taxable sale vs. tax-deferred transfer. A transfer of ownership of a corporation can be tax-deferred if made solely in exchange for stock or securities of the recipient corporation in a qualifying reorganization. But the transaction must comply with strict rules. Although it's generally better to postpone tax, there are some advantages to a taxable sale:

- The seller doesn't have to worry about the quality of buyer stock or other business risks that might come with a tax-deferred transfer.
- The buyer benefits by receiving a stepped-up basis in its acquisition's assets.
- The parties don't have to meet the technical requirements of a tax-deferred transfer.

Installment sale. A taxable sale might be structured as an installment sale if the buyer lacks sufficient cash or pays a contingent amount based on the business's performance. An installment sale also may make sense if the seller wishes to spread the gain over a number of years — which could be especially beneficial if it would allow the seller to stay under the thresholds for triggering the 3.8% NIIT (see Case Study 6 on page 10) or the 20% long-term capital gains rate (see page 8).

But an installment sale can backfire on the seller. For example, depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives. And, if tax rates increase, the overall tax could wind up being more. Of course, tax consequences are only one of many important considerations when planning a merger or acquisition.

Generosity can pay tax dividends

Giving to charity provides not only the satisfaction of doing good but also valuable tax savings (as long as you itemize deductions). On top of that, it's one of the most flexible tax planning tools because you can control the timing, manner and amount of your donations to meet your needs. The more generous you are, the bigger the potential tax dividends.

Cash donations

Outright gifts of cash (which include donations made via check, credit card and payroll deduction) are the easiest to make. The substantiation requirements depend on the gift's value:

- Gifts under $250 can be supported by a canceled check, credit card receipt or written communication from the charity.
- Gifts of $250 or more must be substantiated by the charity.

Deductions for cash gifts to public charities normally can't exceed 60% of your adjusted gross income (AGI). But the AGI limit is only 30% for cash donations to nonoperating private foundations. Contributions exceeding the applicable AGI limit can be carried forward for up to five years.

Warning: Charitable contribution deductions are allowed for alternative minimum tax (AMT) purposes (see page 4), but your tax savings may be less if you're subject to the AMT. For example, if you're in the 37% tax bracket for regular income tax purposes, but the 28% tax bracket for AMT purposes, your deduction may be worth only 28% instead of 37%.

Stock donations

Appreciated publicly traded securities you've held more than one year are long-term capital gains property, which often makes one of the best charitable gifts. Why? You can deduct the current fair market value and avoid any capital gains tax you would have owed had you sold the property. This will be especially beneficial to taxpayers facing the 3.8% NIIT (see Case Study 6 on page 10) or the top 20% long-term capital gains rate (see page 8) this year.

Donations of long-term capital gains property are subject to tighter deduction limits, however: 30% of AGI for gifts to public charities and 20% for gifts to nonoperating private foundations.

Don't donate stock that's worth less than your basis. Instead, sell the stock so you can deduct the loss and then donate the cash proceeds to charity.

IRA QCDs

Taxpayers age 70½ or older are allowed to make direct contributions from their IRA to qualified charitable organizations, up to $100,000 per tax year. A charitable deduction can't be claimed for these qualified charitable distributions. But QCDs aren't included in taxable income and can be used to satisfy an IRA owner's required minimum distributions (RMDs).

Note that the age for QCDs hasn't changed even though the age after which RMDs generally must begin is now higher. (See "What's new!" on page 21 for more information on the RMD age as well as some QCD enhancements.)

Chart 5 How much can itemizers deduct for their donations?

Cash. This includes not just actual cash but gifts made by check, credit card or payroll deduction. You may deduct 100%.

Ordinary-income property. Examples include stocks and bonds held one year or less, inventory, and property subject to depreciation recapture. You generally may deduct only the lesser of fair market value or your tax basis.

Long-term capital gains property. You may deduct the current fair market value of appreciated stocks, bonds and other securities and real estate held more than one year.

Tangible personal property. Your deduction depends on the situation:

- If the property *isn't* related to the charity's tax-exempt function (such as an antique donated for a charity auction), your deduction is limited to your basis.
- If the property *is* related to the charity's tax-exempt function (such as an antique donated to a museum for its collection), you can deduct the fair market value.

Vehicle. Unless it's being used by the charity, you generally may deduct only the amount the charity receives when it sells the vehicle.

Use of property. Examples include use of a vacation home and a loan of artwork. Generally, you receive no deduction because it isn't considered a completed gift. There may, however, be ways to structure the gift to enable you to get a deduction.

Services. You may deduct only your out-of-pocket expenses, not the fair market value of your services. You can deduct 14 cents per charitable mile driven.

Note: *Your annual charitable deductions may be reduced if they exceed certain limits based on your AGI, the type of donation and the type of charity receiving the donation. If you receive some benefit from the charity relating to your donation, such as services or products, your deduction must be reduced by the value of the benefit you receive. Various substantiation requirements also apply. Consult your tax advisor for additional details.*

A QCD might be tax-smart if you won't benefit from the charitable deduction or you face AGI-based limits. To be a QCD, the transfer must be made by the IRA trustee directly to an eligible charity.

Making gifts over time

If you don't know which charities you want to support but you'd like to start making large contributions now, consider a private foundation. It offers you significant control over how your donations ultimately will be used. You must comply with complex rules, however, which can make foundations expensive to run. Also, the AGI limits for deductibility of contributions to nonoperating foundations are lower. (See "Cash donations" and "Stock donations.")

If you'd like to influence how your donations are spent but avoid a foundation's downsides, consider a donor-advised fund (DAF). Many larger public charities and investment firms offer them. **Warning:** To deduct your DAF contribution, obtain a written acknowledgment from the sponsoring organization that it has exclusive legal control over the assets contributed.

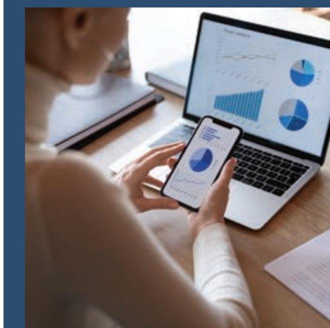
Charitable remainder trusts

To benefit a charity while helping ensure your own financial future, consider a CRT. Here's how it works:

- For a given term, the CRT pays an amount to you annually (some of which generally is taxable).
- At the term's end, the CRT's remaining assets pass to one or more charities.
- When you fund the CRT, you can claim an income tax deduction for the present value of the amount that will go to charity.
- The property is removed from your taxable estate.

You may owe capital gains tax when you receive the payments. However, because the payments are spread over time, much of the liability will be deferred. Plus, a portion of each payment might be considered tax-free return of principal. This may help you reduce or avoid exposure to the 3.8% NIIT and the 20% top long-term capital gains rate. A CRT can be especially beneficial if you hold highly appreciated stock and you'd like to diversify your portfolio. (See Case Study 9.)

Case Study 9 — A CRT can reduce single-stock exposure risk



Maia's portfolio consists of $1.5 million in a single publicly traded stock (from when her company went public) with a low tax basis and other securities valued at $500,000. She feels the time is right to diversify her portfolio, but she's been reluctant to do so because of the tax she'd have to pay on the gain.

After consulting her tax advisor, she decides to contribute $1 million of the stock that has only a $100,000 basis to a charitable remainder trust. The trust can sell the stock without paying any current capital gains tax on the $900,000 gain — avoiding the $214,200 in tax that Maia would have owed had she sold the stock herself (assuming the 20% long-term capital gains tax rate and the 3.8% NIIT apply). The trust can use the sale proceeds for other investments, which in turn helps diversify Maia's portfolio because of her income interest in the trust. She can also use her trust payouts to make investments to further diversify her portfolio.

Maia will receive a payment each year for the trust's term, part of which will be taxable depending on the trust's net income and provisions for reserving long-term capital gains. When she establishes the trust, Maia also will be able to claim a current-year charitable deduction for the present value of the remainder amount going to charity.

You can name someone other than yourself as income beneficiary or fund the CRT at your death, but the tax consequences will be different.

Charitable lead trusts

To benefit charity while transferring assets to loved ones at a reduced tax cost, consider a CLT. It works as follows:

- For a given term, the CLT pays an amount to one or more charities.
- At the term's end, the CLT's remaining assets pass to one or more loved ones you name as remainder beneficiaries.
- When you fund the CLT, you make a taxable gift equal to the present value of the amount that will go to the remainder beneficiaries.
- The property is removed from your taxable estate.

For gift tax purposes, the amount of the remainder interest is determined using the assumption that the trust assets will grow at the current Section 7520 rate. The lower the Sec. 7520 rate, the smaller the remainder interest and the lower the gift tax — or the less of your lifetime gift tax exemption you'll have to use up. If the trust's earnings outperform the Sec. 7520 rate, the excess earnings will be transferred to the remainder beneficiaries gift- and estate-tax-free.

As interest rates have risen overall, the Sec. 7520 rate has also risen. So a CLT may not be as attractive as it had been for the last several years. But if you're still interested in a CLT, you may want to set one up soon, in case rates rise further. Keep in mind, however, that the increased gift and estate tax exemption may reduce the tax benefits of a CLT, depending on your specific situation. (For more on estate and gift taxes, see page 22.)

You can name yourself as the remainder beneficiary or fund the CLT at your death, but the tax consequences will be different.

Qualified charities

Before you donate, it's critical to make sure the charity you're considering is indeed a qualified charity — that it's eligible to receive tax-deductible contributions.

The IRS's online search tool, Tax Exempt Organization Search, can help you more easily find out whether an organization is eligible to receive tax-deductible charitable contributions. You can access the tool at IRS.gov. According to the IRS, you may rely on this list in determining deductibility of your contributions.

Also, don't forget that political donations aren't deductible.

How to start children on the right financial track

Whether you're a parent or a grandparent, you likely want to do what you can to start the children in your life on the right financial track. To pave the way, it's important to show young people the value of saving and provide them with the best education possible. By taking advantage of tax breaks for you and your children, you can do both. If you're a grandparent, you also may be able to take advantage of some of these breaks — or help your grandchildren take advantage of them.

Child and adoption credits

Tax credits reduce your tax bill dollar for dollar (unlike deductions, which just reduce the amount of income subject to tax). So they're particularly valuable.

Some higher-income taxpayers who couldn't benefit from the child credit before the TCJA went into effect are now finding that they do. The TCJA significantly raised the modified adjusted gross income (MAGI) phaseout ranges for the credit — which also apply to the TCJA's family credit. Through 2025, the credits begin to phase out when MAGI exceeds $200,000, or $400,000 for married couples filing jointly, and are fully phased out when MAGI reaches $240,000 and $440,000, respectively. Under the TCJA:

- For each child under age 17 at the end of the tax year, you may be able to claim a $2,000 credit.
- For each qualifying dependent other than a qualifying child (such as a dependent child over the age limit or a dependent elderly parent), a $500 family credit may be available.

If you adopt, you might be eligible for the adoption credit. It's $15,950 for 2023, but it's subject to a MAGI-based phaseout that's lower than the phaseout for the child credit ($239,230 – $279,230 for all taxpayers).

Dependent care breaks

A couple of tax breaks can offset the costs of dependent care:

Child and dependent care tax credit. For children under age 13 or other qualifying dependents, generally a credit is available that equals 20% of the first $3,000 of qualified expenses for one child or 20% of up to $6,000 of such expenses for two or more children. So, the maximum credit is usually $600 for one child or $1,200 for two or more children.

Child and dependent care FSA. For 2023, you can contribute up to $5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The plan pays or reimburses you for these expenses. Your contributions will reduce your qualified expenses for purposes of the tax credit.

Kiddie tax

The "kiddie tax" generally applies to unearned income beyond $2,500 (for 2023) of children under age 19 and of full-time students under age 24 (unless the students provide more than half of their own support from earned income). Such income is generally taxed at the parents' tax rate.

The purpose of the kiddie tax is to minimize the ability of parents to significantly reduce their family's taxes by transferring income-producing assets to their children in lower tax brackets. Keep the kiddie tax in mind before transferring income-producing assets to children (or grandchildren) who'd be subject to it.

IRAs for teens

One of the best ways to get children on the right financial track is to set up IRAs for them. Their retirement may seem too far off to warrant saving now, but IRAs can be ideal for teenagers precisely because they likely will have many years to let their accounts grow tax-deferred or tax-free.

The 2023 contribution limit is the lesser of $6,500 or 100% of earned income. A teen's traditional IRA contributions typically are deductible, but distributions will be taxed. Roth IRA contributions aren't deductible, but qualified distributions will be tax-free.

If your children or grandchildren don't have earned income and you own a business, consider hiring them. As the business owner, you can deduct their pay, and other tax benefits may apply. **Warning:** The children must be paid in line with what you'd pay nonfamily employees for the same work.

529 plans

Section 529 plans provide another tax-advantaged savings opportunity. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund education expenses. Here are some of the possible benefits of such plans:

- Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states do offer tax breaks for contributing.)
- The plans usually offer high contribution limits, and there are no income limits for contributing.
- A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make up to an $85,000 contribution (or $170,000 if you split the gift with your spouse) per beneficiary in 2023.
- There's generally no beneficiary age limit for contributions or distributions.
- You can control the account, even after the child is of legal age.

One drawback is that options are limited when all the funds aren't needed for college expenses. However, a new option will soon be available. (See "What's new!")

Prepaid tuition vs. savings plan

With a *529 prepaid tuition plan*, if your contract is for four years of tuition, tuition is guaranteed regardless of its cost at the time the beneficiary actually attends the school. One downside is that there's uncertainty in how benefits will be applied if the beneficiary attends a different school. Another is that the plan doesn't cover costs other than tuition, such as room and board.

A *529 savings plan*, on the other hand, can be used to pay a student's expenses at most postsecondary educational institutions. Distributions used to pay the following expenses are income-tax-free for federal purposes and potentially also for state purposes, making the tax deferral a permanent savings:

- Qualified postsecondary school expenses, such as tuition, mandatory fees, books, supplies, computer equipment, software, internet service and, generally, room and board,
- Elementary and secondary school tuition of up to $10,000 per year per student, and
- Up to $10,000 of student loan debt per beneficiary.

One downside is that you don't have direct control over investment decisions; you're limited to the options the plan offers. Additionally, for funds already in the plan, you can make changes to your investment options only twice during the year or when you change beneficiaries. For these reasons, some taxpayers prefer ESAs.

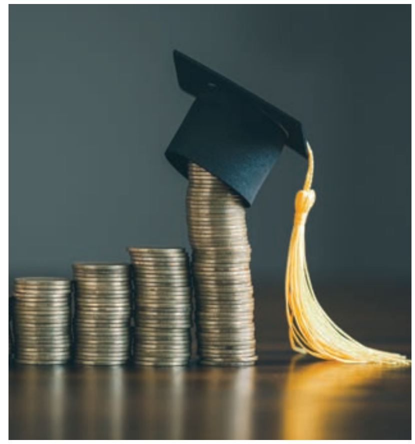
But each time you make a new contribution to a 529 savings plan, you can select a different option for that contribution, regardless of how many times you contribute throughout the year. And every 12 months you can make a tax-free rollover to a different 529 plan for the same child.

ESAs

Coverdell Education Savings Accounts are similar to 529 savings plans in that contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free.

ESAs are worth considering if you'd like to have direct control over how your contributions are invested or if you want to fund elementary or secondary education expenses in excess of $10,000 per year or that aren't tuition.

But the $2,000 contribution limit is low, and it begins to phase out at a MAGI of $190,000 for married couples filing jointly and $95,000 for other filers. No contribution can be made when MAGI hits $220,000 and $110,000, respectively.



Also, contributions can generally be made only for beneficiaries under age 18. When the beneficiary turns age 30, the ESA generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

ABLE accounts

Achieving a Better Life Experience accounts offer a tax-advantaged way to fund qualified disability expenses for a beneficiary who became blind or disabled before age 26. For federal purposes, tax treatment is similar to that of 529 savings plans.

Under the TCJA, through 2025, 529 plan funds can be rolled over to an ABLE account without penalty if the ABLE account is owned by the beneficiary of the 529 plan or a member of the beneficiary's family. Such rolled-over amounts count toward the ABLE account annual rollover and contribution limit ($17,000 for 2023).

Education credits

If you have a child in college or graduate school, you may not qualify for one of these credits because your income is too high (phaseout range of $80,000 – $90,000; $160,000 – $180,000 for joint filers), but your child might:

American Opportunity credit. This tax break covers 100% of the first $2,000 of tuition and related expenses and 25% of the next $2,000 of expenses. The maximum credit, per student, is $2,500 per year for the first four years of postsecondary education.

Lifetime Learning credit. This tax break — up to $2,000 per tax return — is available for postsecondary education expenses beyond the first four years.

WHAT'S NEW! 529 plans soon to be more flexible

Some parents and grandparents have hesitated to contribute to 529 plans — or to make large contributions to them — because of the potential tax consequences if the beneficiary doesn't go to college, earns scholarships and grants to cover college costs or simply doesn't need the entire balance for college expenses.

Currently, when 529 plan beneficiaries don't use up all of their 529 plan funds on qualified education expenses, the options are generally limited to either making a tax-free rollover to a 529 plan for another qualifying family member or paying income tax and a 10% penalty on the portion of nonqualified withdrawals attributable to earnings (though, unlike with ESAs, there's no time limit on when funds must be withdrawn).

But a new option will be available starting in 2024: Up to $35,000 in unused 529 plan funds can be rolled into a Roth IRA for the beneficiary. Various rules apply, such as:

- The 529 plan must have been set up for at least 15 years.
- No contributions from the last five years (or earnings on them) can be rolled over.
- The rollovers are generally subject to the Roth IRA annual contribution limits — but not the AGI-based phaseout. (See page 20.)

IRS guidance on the new provision is expected. Check with your tax advisor for the latest information.

Reap the benefits of tax-advantaged plans while avoiding tax traps

It's true that the amount higher-income taxpayers are allowed to contribute to tax-advantaged retirement plans is limited. However, the exponential power of tax-deferred (or in the case of Roth accounts, tax-free) compounding makes these plans worth considering. Plus, contributions to a traditional plan reduce your adjusted gross income (AGI) and, therefore, could help preserve your eligibility for certain tax breaks and avoid triggering certain taxes or higher rates. But be careful when taking retirement plan distributions — they could have the opposite effect. To fully reap retirement plan advantages, look ahead and watch out for tax traps.

Retirement plan contributions

Contributing the maximum you're allowed (see Chart 6) to an employer-sponsored defined contribution plan, such as a 401(k), is often a smart move:

- Contributions are typically pretax, reducing your modified AGI (MAGI). This in turn can help you reduce or avoid exposure to the 3.8% NIIT. (See Case Study 6 on page 10.)
- Plan assets can grow tax-deferred, meaning you pay no income tax until you take distributions.
- Your employer may match some or all of your contributions.

If you participate in a 401(k), 403(b) or 457 plan, it may allow you to designate some or all of your contributions as Roth contributions. While Roth contributions don't reduce your current MAGI, qualified distributions will be tax-free. The opportunity to make such Roth contributions may be beneficial for higher-income earners because they're ineligible to contribute to a Roth IRA. Roth contributions may soon be your *only* option for catch-up contributions. (See "What's new!")

Roth IRA conversions

If you have a traditional IRA, a partial or full conversion to a Roth IRA can allow you to turn tax-*deferred* future growth into tax-*free* growth. It also can provide estate planning advantages. Unlike other retirement plans, Roth IRAs don't require you to take distributions during your lifetime, so you can let the entire balance grow tax-free for the benefit of your heirs.

But the converted amount is taxable in the year of the conversion. Whether a conversion makes sense for you depends on factors such as:

- Your age,
- Whether the conversion would push you into a higher income tax bracket or trigger the 3.8% NIIT,
- Whether you can afford to pay the tax on the conversion,
- Your tax bracket now and expected tax bracket in retirement, and
- Whether you'll need the IRA funds in retirement.

With tax rates particularly low now under the TCJA (and perhaps a better chance that your rate at retirement will be higher), it may be a good time for a Roth conversion. Your tax advisor can run the numbers and help you decide if a conversion is right for you this year.

If you don't have funds in a traditional IRA, consider "back door" Roth IRA contributions. You set up a traditional account and make a nondeductible contribution to it. After the transaction clears, you convert the traditional account to a Roth account. The only tax due will be on any growth in the account between the time you made the contribution and the date of conversion.

Early withdrawals

With a few exceptions, retirement plan distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. This means that, if you're in the top tax bracket of 37%, you can lose almost half of your withdrawal to taxes and penalties — and perhaps more than half if you're also subject to state income taxes and/or penalties. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you have a Roth account, you can withdraw up to your contribution amount without incurring taxes or penalties. But you'll be losing the potential tax-free growth on the withdrawn amount.

Chart 6 Retirement plan contribution limits for 2023

	Regular contribution	Catch-up contribution[1]
Traditional and Roth IRAs	$ 6,500	$ 1,000
401(k)s, 403(b)s, 457s and SARSEPs[2]	$ 22,500	$ 7,500
SIMPLEs	$ 15,500	$ 3,500

[1] For taxpayers age 50 or older by the end of the tax year.

[2] Includes Roth versions where applicable.

***Note:** Other factors may further limit your maximum contribution. If you're a business owner or self-employed, you may be able to set up a plan that allows you to make much larger contributions. (See Chart 4 on page 14.)*

WHAT'S NEW! SECURE 2.0: Mostly good news for retirement saving

The SECURE 2.0 Act, signed into law Dec. 29, 2022, builds on the 2019 Setting Every Community Up for Retirement Enhancement Act. SECURE 2.0 makes major changes in a variety of areas that affect retirement planning. Here are a few highlights:

RMDs. Historically, after reaching age 70½, taxpayers had to begin taking annual required minimum distributions from their IRAs (except Roth IRAs) and, generally, from any defined contribution plans. However, the SECURE Act raised the age to 72 for taxpayers who didn't turn age 70½ before Jan. 1, 2020.

SECURE 2.0 raises the age again, to 73, for taxpayers who didn't turn age 72 before Jan. 1, 2023 (that is, were born after Dec. 31, 1950). It then will boost the age to 75 on Jan. 1, 2033.

SECURE 2.0 also relaxes the penalty for failing to take full RMDs, from 50% to 25% beginning in 2023. If the failure is corrected in a "timely" manner, the penalty drops to 10%.

QCDs. Taxpayers age 70½ or older are allowed to make direct contributions from their IRA to qualified charitable organizations up to $100,000 per tax year. (See "IRA QCDs" on page 16.)

Under SECURE 2.0, the $100,000 limit will be annually indexed for inflation starting in 2024. In addition, the new law allows you to make a one-time QCD of up to $50,000 through a charitable gift annuity or charitable remainder trust (CRT — see page 17 for more on CRTs).

Catch-up contributions. One downside of SECURE 2.0 is that it makes some changes to the taxation of catch-up contributions that could reduce the upfront tax savings for some taxpayers. Beginning in 2024, it requires catch-up contributions to be treated as post-tax Roth contributions if you earned more than $145,000 (annually indexed for inflation) during the prior year. But, the IRS is providing an "administrative transition period" that gives employers and plan providers more time to make the changes needed to comply. Essentially, for 2024 and 2025, the Roth requirement won't apply.

A SECURE 2.0 catch-up contribution enhancement is that, beginning in 2025, taxpayers ages 60 to 63 will be able to make catch-up contributions to most employer-sponsored plans up to the greater of $10,000 ($5,000 for SIMPLEs) or 150% of the amount allowed for those age 50 and over. (This will also be indexed for inflation.)

So if you're in need of cash, consider tapping your taxable investment accounts rather than dipping into your retirement plan. (See page 8 for information on the tax treatment of investments.)

Leaving a job

When you change jobs or retire, avoid taking a lump-sum distribution from your employer's retirement plan because it generally will be taxable, plus potentially subject to the 10% early-withdrawal penalty. These options help avoid current income tax and penalties:

Staying put. You may be allowed to leave your money in your old plan. But if you'll be participating in a new employer's plan or you already have an IRA, keeping track of multiple plans can make managing your retirement assets more difficult.

A rollover to your new employer's plan. If you're changing jobs and this will leave you with only one retirement plan to keep track of, it may be a good solution. But evaluate how well the new plan's investment options meet your needs.

A rollover to an IRA. If you participate in a new employer's plan, this will require keeping track of two plans. But it may be the best alternative because IRAs offer nearly unlimited investment choices.

If you choose a rollover, request a direct rollover from your old plan to your new plan or IRA. Otherwise, you'll need to make an indirect rollover within 60 days to avoid tax and potential penalties.

Warning: If you don't do a direct rollover, the check you receive from your old plan may be net of 20% federal income tax withholding. Your subsequent indirect rollover must be of the gross amount (making up for the withheld amount with other funds) or you'll be subject to income tax — and potentially the 10% penalty — on the difference.

RMDs

Generally, you must begin taking required minimum distributions annually from your IRAs (except Roth IRAs) and defined contribution plans once you reach a certain age. If you don't comply with RMD rules, you can owe a penalty on the amount you should have withdrawn but didn't. Fortunately, SECURE 2.0 has increased the age at which RMDs must begin and decreased the penalty. (See "What's new!")

Waiting as long as possible to take distributions generally is advantageous because of tax-deferred compounding. But a distribution (or larger-than-required distribution) in a year your tax rate is lower than usual may save tax in the long run.

Be sure, however, to consider the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect other tax breaks with income-based limits.

Also keep in mind that, while retirement plan distributions aren't subject to the additional 0.9% Medicare tax (see page 5) or 3.8% NIIT, they are included in your MAGI. That means they could trigger or increase the NIIT, because the thresholds for that tax are based on MAGI.

If you've inherited a retirement plan, consult your tax advisor about the distribution rules that apply to you. **Warning:** The time period for distributions has been reduced to 10 years for beneficiaries — other than surviving spouses and certain others — inheriting plans after Dec. 31, 2019.

Seizing opportunities while they're available

Because the TCJA has put estate, gift and generation-skipping transfer (GST) tax exemptions at record-high levels, far fewer taxpayers are worrying about these taxes. But the high exemptions are only temporary. So whether or not you'd be subject to estate taxes under the current exemptions, it's a good idea to consider whether you can seize opportunities to potentially lock in tax savings today.

Estate tax

While the TCJA keeps the estate tax rate at 40%, it has doubled the exemption base amount from $5 million to $10 million. The inflation-adjusted amount for 2023 is $12.92 million. (See Chart 7.)

Without further legislation, the estate tax exemption will return to an inflation-adjusted $5 million in 2026. So taxpayers with estates in the roughly $6.5 million to nearly $13 million range (twice that for married couples), whose estates would escape estate taxes if they were to die while the doubled exemption is in effect, still need to keep potential post-2025 estate tax liability in mind.

Gift tax

The gift tax continues to follow the estate tax, so the gift tax exemption also has increased under the TCJA. (See Chart 7.) Any gift tax exemption used during your lifetime reduces the estate tax exemption available at death. Using up some of your exemption during your lifetime can be tax-smart, especially if your estate might exceed roughly $6.5 million (twice that if you're married).

Under the annual exclusion, you also can exclude certain gifts of up to $17,000 per recipient in 2023 (up from $16,000 in 2022) — twice that if your spouse elects to split the gift with you or you're giving joint or community property — without depleting any of your gift and estate tax exemption.

Warning: Each year you need to use your annual exclusion by Dec. 31. The exclusion doesn't carry over from year to year. For example, if you didn't make an annual exclusion gift to your granddaughter last year, you can't add $16,000 to your 2023 exclusion to make a $33,000 tax-free gift to her this year.

GST tax

The GST tax generally applies to transfers (both during your lifetime and at death) made to people more than one generation below you, such as your grandchildren. This is in addition to any gift or estate tax due. The GST tax exemption also has increased under the TCJA. (See Chart 7.)

The GST tax exemption can be a valuable tax-saving tool for taxpayers with large estates whose children also have — or may eventually have — large estates. With proper planning, they can use the exemption to make transfers to grandchildren and avoid any tax at their children's generation. (See Case Study 10.)

State taxes

Even before the TCJA, some states imposed estate tax at a lower threshold than the federal government did. Now the differences in some states are even more dramatic. To avoid unexpected tax liability or other unintended consequences, consult a tax advisor familiar with the law of your particular state.

Exemption portability

If part (or all) of one spouse's estate tax exemption is unused at that spouse's death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining exemption. This exemption "portability" provides flexibility at the first spouse's death, but it has some limits. Portability is available only from the most recently deceased spouse, doesn't apply to the GST tax exemption and isn't recognized by many states.

And portability doesn't protect future growth on assets from estate tax like applying the exemption to a credit shelter (or bypass) trust does. Such a trust also offers creditor and remarriage protection, GST tax planning, and possible state estate tax benefits.

So married couples should still consider these trusts — and transferring assets to each other as necessary to fully fund them at the first death. Such transfers aren't subject to gift or estate tax as long as the recipient spouse is a U.S. citizen.

Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate. Here are some strategies for tax-smart giving:

Choose gifts wisely. Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- To minimize *estate tax*, gift property with the greatest future appreciation potential.

Chart 7 2023 transfer tax exemptions and rates

	Estate tax	Gift tax	GST tax
Exemption	$12.92 million[1]	$12.92 million	$12.92 million
Rate	40%	40%	40%

[1] Less any gift tax exemption already used during life.

Case Study 10

Now's the time to create a dynasty

Gary is a widower who recently sold the business he'd spent 40 years building. His adult children are successful professionals, and he has several grandchildren, with more expected. He'd like to leave a financial legacy for this third generation — and beyond.

Gary hasn't yet used any of his gift and estate tax exemption, so his tax advisor suggests he set up a dynasty trust. Gary decides to transfer $12 million to it, and there's no gift tax on the transaction because it's within his unused exemption amount. And the funds, together with all future appreciation, are removed from his taxable estate.

Most important, by also allocating his GST tax exemption to his trust contributions, Gary ensures that any future distributions or other transfers of trust assets to his grandchildren or subsequent generations will avoid GST taxes. This is true even if the value of the assets grows well beyond the exemption amount or the exemption is reduced in the future.

- To minimize *your beneficiary's income tax*, gift property that hasn't appreciated significantly while you've owned it.
- To minimize *your own income tax*, don't gift property that's declined in value. Instead, consider selling the property so you can take the tax loss and then gifting the sale proceeds.

Plan gifts to grandchildren carefully. Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts to a grandchild that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

Gift interests in your business or an FLP. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts for lack of control and marketability. For example, you could gift an ownership interest worth up to $22,666 (on a controlling basis) tax-free, assuming a combined discount of 25%. That's because the discounted value of the gift wouldn't exceed the $17,000 annual exclusion.

Another way to benefit from valuation discounts is to set up a family limited partnership. You fund the FLP with assets such as public or private stock and real estate, and then gift limited partnership interests.

Warning: The IRS may challenge valuation discounts; a professional, independent valuation is recommended. The IRS also scrutinizes FLPs, so be sure to set up and operate yours properly.

Pay tuition and medical expenses. You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

Make gifts to charity. Donations to qualified charities aren't subject to gift tax. They may also be eligible for an income tax deduction. (See page 16.)

Consider "taxable" gifts. Making some gifts beyond annual exclusion gifts and using some or all of your lifetime exemption can make sense if you have a large estate. These "taxable" gifts can protect transfers from gift and estate tax, even if the exemption drops in the future. They also remove the future appreciation from your estate.

You do, however, need to keep in mind your beneficiaries' income tax. Gifted assets don't receive the "step-up" in basis that bequeathed assets do. This means that, if beneficiaries sell assets gifted to them, their taxable capital gains will be determined based on *your* basis in the assets. So their capital gains tax could be higher than if they inherited the same assets.

Trusts

Trusts can provide a way to transfer assets and potentially enjoy tax savings while preserving some control over what happens to the transferred assets. For those with large estates, funding trusts now, while the gift tax exemption is high, may be particularly tax-smart. Here are some types of trusts to consider:

QPRT. A qualified personal residence trust allows you to give your home to your children today — removing it from your taxable estate at a reduced gift tax cost (provided you survive the trust's term) — while you retain the right to live in it for a specified period.

GRAT. A grantor-retained annuity trust works on the same principle as a QPRT but allows you to transfer other assets; you receive payments back from the trust for a specified period.

Crummey trust. This allows you to enjoy both the control of a trust that will transfer assets to loved ones at a later date and the tax savings of an outright current gift.

Chart 8 2023 individual income tax rates

Regular tax brackets				
Tax rate	**Single**	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
10%	$ 0 – $ 11,000	$ 0 – $ 15,700	$ 0 – $ 22,000	$ 0 – $ 11,000
12%	$ 11,001 – $ 44,725	$ 15,701 – $ 59,850	$ 22,001 – $ 89,450	$ 11,001 – $ 44,725
22%	$ 44,726 – $ 95,375	$ 59,851 – $ 95,350	$ 89,451 – $ 190,750	$ 44,726 – $ 95,375
24%	$ 95,376 – $ 182,100	$ 95,351 – $ 182,100	$ 190,751 – $364,200	$ 95,376 – $ 182,100
32%	$ 182,101 – $ 231,250	$ 182,101 – $ 231,250	$364,201 – $462,500	$ 182,101 – $ 231,250
35%	$ 231,251 – $ 578,125	$ 231,251 – $ 578,100	$ 462,501 – $ 693,750	$ 231,251 – $ 346,875
37%	Over $ 578,125	Over $ 578,100	Over $ 693,750	Over $ 346,875
Alternative minimum tax (AMT) brackets				
Tax rate	**Single**	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
26%	$ 0 – $ 220,700	$ 0 – $ 220,700	$ 0 – $ 220,700	$ 0 – $ 110,350
28%	Over $ 220,700	Over $ 220,700	Over $ 220,700	Over $ 110,350
AMT exemptions				
	Single	**Head of household**	**Married filing jointly or surviving spouse**	**Married filing separately**
Amount	$ 81,300	$ 81,300	$ 126,500	$ 63,250
Phaseout[1]	$ 578,150 – $903,350	$ 578,150 – $903,350	$ 1,156,300 – $ 1,662,300	$ 578,150 – $ 831,150

[1] The AMT income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

Note: *Consult your tax advisor for AMT rates and exemptions for children subject to the "kiddie tax" and for estates and trusts.*

Chart 9 2023 corporate income tax rates

Tax rate	Type of corporation
21%	C corporation
21%	Personal service corporation

Chart 10 2023 estate and trust income tax rates

Tax rate	Tax brackets
10%	$ 0 – $ 2,900
24%	$ 2,901 – $10,550
35%	$10,551 – $14,450
37%	Over $14,450

How can *you* maximize tax savings this year?

The tax strategies that can save you the most will depend on your particular situation. For example, if you're a parent, a tax-advantaged education savings plan may be a smart move. (See the "Family & Education" section.) Or, if you're married, a credit shelter trust might save your family estate taxes. (See the "Estate Planning" section.) Here are five more key tax savers for different types of taxpayers:

1. Investors: *Review after-tax returns to evaluate the performance of investments.*

The impact of taxes in a given year may not be significant. But over time, compounding can have a huge impact on a portfolio's growth. For example, the difference between a $100,000 portfolio growing after tax at 8% vs. 6% a year amounts to almost $150,000 over 20 years.

2. Business owners: *Watch out for buy-sell agreement tax pitfalls.*

Buy-sell agreements control what happens to a business when a specified event occurs, such as an owner's death or disability. Often such agreements are funded with life insurance, and proceeds are generally excluded from the beneficiary's taxable income. But an exception is the transfer-for-value rule, under which proceeds will be taxable if an existing policy was acquired "for value" by someone other than the insured or certain other parties. The issue often arises when structuring or changing a buy-sell agreement using existing insurance policies.

3. Donors: *Time donations to save more tax.*

By considering current and future income tax rates before giving, you can significantly increase the tax benefit of your charitable gifts (assuming you itemize deductions). Deductions are more powerful when you're taxed at a higher rate. So if you expect to be in a higher tax bracket next year, you could save more tax by deferring a charitable contribution until 2024. On the other hand, if you expect to be in a lower tax bracket next year, you might benefit from accelerating charitable contributions into 2023.

4. Retirees: *Choose your source of retirement cash wisely.*

Generally, it's best to use money from your taxable accounts first and let your retirement plan assets grow tax-deferred as long as possible. Also, remember that you may benefit from the long-term capital gains rate when you sell assets in taxable accounts, but you'll be taxed at your higher ordinary-income rate when you take distributions from traditional IRAs and 401(k)s. So you may want to take retirement plan distributions in years when you're in a lower income tax bracket. If you must take required minimum distributions, make sure you follow the rules so you avoid penalties.

5. All taxpayers: *Check with us before you take action.*

This guide presents many other ways to minimize your taxes for 2023 and beyond. Please read it and note those sections that seem especially relevant to your situation. Then contact us to see which of these strategies — or others this guide doesn't have room to cover — you should look into.

Kreischer Miller

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