GMS Surgent
CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS

GMS SURGENT 2022 YEAR-END TAX SAVING TIPS

As the year draws rapidly to a close, it's not too late to consider tax planning strategies. This year-end memo includes certain ideas that we have communicated to you in the past, and also includes new suggestions for this year or next. Please call us if you'd like to discuss whether the following ideas and suggestions might be advisable.

President Biden's Inflation Reduction Act includes the following tax-related changes:

- A 15% corporate minimum tax on C corporations with > $1 billion of income.
- A 1% excise tax on certain stock buybacks by publicly traded corporations.
- An extension of the limit on deducting excess business losses for two years, through 2028.
- Enhancements and increases to certain green energy tax credits, such as a $4,000 credit for certain middle and lower-income taxpayers to purchase a used clean-energy vehicle, and a $7,500 credit for the purchase of new clean-energy vehicles. There is also an enhancement to the solar and geothermal tax credits.
- Enhancements to the R&D credit against payroll taxes for small businesses to up to $500,000, from $250,000.
- The creation of a tax credit for the US (or US possession) production of clean energy technology components.
- There were no changes to the following items:
    - Income tax rates (aside from the normal inflationary increase in brackets)
    - Estate and gift tax rules (aside from the normal inflationary increases)
    - Carried interest rules
    - Section 1202 Qualified Small Business Stock exclusion rules

In addition, there have been recent discussions in Washington about certain tax "extenders" that are scheduled to expire or be reduced. These include:

- R&D expensing (new rules require capitalization and amortization of such expenditures beginning in 2022, regardless of whether or not an R&D credit is claimed).
- Section 163(j) business interest expensing (without changes to the contrary, the amount of business interest expense deductible for certain taxpayers will be reduced).
- The child tax credit (this credit was temporarily enhanced in 2021, but automatically reverts back to the prior amount in 2022).
- Bonus depreciation (2022 is the last year that businesses will be able to deduct 100% of certain machinery and equipment via bonus depreciation as the rate decreases to 80% in 2023, then to 60% in 2024, and so on, until it is phased out completely after 2026).

Both sides have suggested they support some sort of extender legislation this year, but so far, there has not been an agreement.

INDIVIDUAL TAX/TRUSTS

- Mortgage interest is deductible on up to two homes on total qualifying debt up to $750,000. Existing mortgages incurred on or before December 14, 2017 are "grandfathered" under the old tax laws. Mortgage debt that is refinanced is also grandfathered under the old laws to the extent that the resulting debt does not exceed the amount refinanced. Interest expense incurred on home equity debt is now disallowed; however, if the home equity loan is used to buy, build, or substantially improve the taxpayer's home that secures the debt, the interest

on the debt is still deductible. (Note: If mortgage proceeds are invested into a business/investment, there may be an ability to deduct the related interest expense against the business/investment income).

- Miscellaneous itemized deductions, such as unreimbursed business expenses, tax return preparation fees, investment advisor fees, etc. remain eliminated.

Planning Point: Employees that incur job-related expenses should consider requesting that their employer reimburse them.

- The medical expense deduction is allowed to the extent medical expenses exceed 7.5% of AGI.

Planning Point: Consider bunching medical deductions in a year to potentially result in a tax benefit.

- Charitable contributions of cash are deductible, subject to percentage limitations based on adjusted gross income (the limitation is currently 60% through 2025).

Planning Point: Consider making a donation of long-term highly appreciated securities to receive the tax deduction at the fair market value and avoid the tax on the capital gains. This may be more difficult due to current conditions in the stock market.

Planning Point: Consider making a contribution through a state-sponsored tax credit program such as Pennsylvania's EITC/OSTC programs. These programs essentially redirect Pennsylvania taxes to certain educational/ scholarship organizations. Programs in Pennsylvania provide for credits of up to 90% of the amount of the contribution, and any amount donated for which a credit is not received is deductible as a normal charitable contribution, making it possible for the contribution (and, therefore, the PA tax liability) to cost very little out-of-pocket.

Planning Point: Consider making a qualified charitable distribution from an IRA. If over age 70 ½, individuals can instruct that up to $100,000 from an IRA be sent directly to a charity. This counts toward the RMD requirement and also excludes the RMD as income. This strategy is especially beneficial to taxpayers that are claiming the standard deduction as it reduces taxable income while still allowing the same standard deduction.

Planning Point: Consider bunching charitable contributions, perhaps via a contribution to a donor-advised fund, in one year if doing so will increase your total deductions above the standard deduction amount for that year. Careful consideration must be given so that the contribution deduction is taken at higher marginal tax rates to maximize tax savings.

Planning Point: Remember to get contemporaneous acknowledgement letters from the charitable organization for all charitable contributions.

- The overall business loss limitation suspends any overall net amount of loss from trade or business partnerships, S corporations, and sole proprietorships that exceeds the threshold ($540,000 for a joint tax return in 2022). Any suspended overall loss cannot offset other income sources and must be carried forward to each subsequent year where it will be considered part of the overall business loss in that year.

Planning Point: Any losses that were previously limited on a 2019 or 2020 tax return can be claimed via the filing of an amended return since the overall business loss limitation was suspended for these tax years.

- For 2022, the child tax credit is $2,000. The modified adjusted gross income (MAGI) level at which the credit is subject to phase-out is $400k for married taxpayers filing jointly. There is also a $500 credit for other dependents that is subject to the same phase-out range.

- Balances in Section 529 plans have historically been available to be used for post-secondary education expenses. Section 529 plans also allow up to $10,000 (per student, per year) to be used for K-12 education. Many states also allow a tax deduction against the state taxable income for contributions to a Section 529 plan. Taxpayers can make a lump-sum contribution to a 529 plan of up to five times the annual gift tax exclusion and elect on a timely-filed gift tax return to spread the gift evenly over five years.

- The alternative minimum tax (AMT) is retained with higher exemption amounts. In addition, the exemption phase-out range increases to $539,900 for single filers and $1,079,800 for married taxpayers filing jointly. This, together with the significant reduction in the amount of deductible real estate and state and local income taxes and miscellaneous itemized deductions will continue to reduce the number of taxpayers subject to the AMT.

Planning Point: It may be advantageous to recognize additional ordinary income in a year when AMT applies because the AMT rate is often less than the taxpayer's marginal tax rate.

- Some taxpayers may be able to take advantage of a 0% long-term capital gains tax rate. For married taxpayers filing jointly with taxable incomes not exceeding $83,350, there is a 0% rate available for long-term capital gains and qualified dividends. For single taxpayers not subject to kiddie tax rules, the 0% rate is available if taxable income does not exceed $41,675.

Planning Point: Consider gifting appreciated stock to take advantage of tax rate differences. For example, a parent subject to a 20% capital gains tax (plus 3.8% net investment income tax) could gift appreciated stock to his 24-year old graduate student son subject to a 0% capital gains tax rate, so that the son could then sell the stock for a lower tax bill.

- Tax harvesting is the selling of stocks and other investments to generate capital losses that can be utilized to offset capital gains. Also note that tax gain harvesting may be advisable to avoid "hanging" capital losses at the state level, as certain states do not provide for carryovers of unused losses.

- Consider disposing of a passive investment before year end in order to trigger the recognition of other current year or prior year suspended passive losses.

- Taxpayers may be able to receive very favorable tax treatment on the sale of investments if the proceeds are reinvested in business property and/or real estate located in a "Qualified Opportunity Zone" within 180 days.

Planning Point: The Federal QOZ program is intended for projects with long-term hold (greater than 10 years) considerations. The program has limited impact on short holding period projects (under 5 years).

- Employees and business owners should always max out their retirement plan contributions, including any employer matches, as they are able.

Planning Point: Due to the drop in the stock market, it may be advisable to convert a portion of your IRA or 401(k) into a Roth IRA/Roth 401(k) because the tax cost of converting in a down market is less than the cost of converting in an up market.

Planning Point: Many taxpayers find that their income exceeds the threshold to make a contribution directly to a Roth IRA. In such cases, it may be advisable to consider making a "backdoor" Roth contribution whereby an after-tax IRA contribution is converted to a Roth IRA. Note that the presence of pre-tax IRA balances hampers the ability to make such a contribution tax-free.

BUSINESS TAX

- Employers who experienced a 50% or greater reduction in gross receipts in the last three quarters of 2020 relative to the same quarters in 2019, or a 20% or greater reduction in gross receipts in the first three calendar quarters in 2021 relative to the same quarters in 2019, may be eligible to claim what is called the employee retention credit (ERC). The credit is a maximum of up to $5,000 per employee for the 2020 taxable year, and up to $7,000 per employee per quarter in the first three calendar quarters of 2021. If there has not been the requisite decline in gross receipts, the employer can also claim the ERC if it was subject to a governmental order that limited its travel, commerce, etc. due to COVID-19.
    - There is also an ERC targeted to startups. Businesses who started on or after February 15, 2020 can receive an ERC of up to $50,000 each for Quarter 3 and Quarter 4 of 2021. Such businesses need not meet the gross receipts test or the suspension of operations test in order to qualify.

  It is not too late to claim an ERC for 2020 or 2021, but note that amended returns will need to be filed, as the amount of the ERC claimed is taxable income in the year of the credit.

- The 199A (20% qualified business income deduction) for sole proprietorships, certain rentals, and passthrough businesses may reduce your tax bill if applicable.

Planning Point: At the entity level, review compensation structure prior to year-end, and revisit partnership agreement allocations.

Planning Point: If a business is operating as a sole proprietorship or a solely-owned LLC, and is not able to maximize the deduction via the current business structure, consider an S election with salary compensation to the owner. This may provide the ability to increase the 199A deduction and it also may decrease the Social Security taxes paid by the owner.

Planning Point: At the entity or individual level, consider increasing retirement plan funding levels and other tax strategies for certain business types to fall below 199A income limits.

Planning Point: At the individual level, consider whether aggregation elections are available or beneficial; and if not available, whether factors can be changed to allow for aggregation.

- The deduction for certain meals provided to employees is reduced to 50% until 2025, and then eliminated after 2025. For 2022, meals purchased from a restaurant qualify for a 100% deduction. Team-building expenses such as employee happy hours and holiday parties continue to qualify for a 100% deduction, even after 2022.

Planning Point: Consider creating separate general ledger accounts to separate the 0%, 50%, and 100% deductible amounts to achieve the maximum tax deduction.

- The immediate expensing (via enhanced "bonus depreciation" rules) is allowed for certain types of assets (tangible personal property, certain nonstructural, nonresidential interior

property) placed into service in a trade or business between September 28, 2017 and December 31, 2022. For years beginning after December 31, 2022, the amount of the deduction is decreased from 100% to 80%, then decreases by 20% each year thereafter.

Planning Point: Consider making purchases prior to December 31, 2022 to take advantage of the 100% bonus depreciation.

- The Section 179 expensing election is available for nonresidential building improvements such as roofs, HVAC equipment, fire protection and alarm systems, and security systems, as well as for tangible personal property used to furnish lodging, such as residential rental property or a hotel. The maximum value that may be deducted for the Section 179 election is $1,080,000, with a phase-out that begins at $2,700,000 of property placed into service.

- Certain qualified improvement property ("QIP") (nonstructural, interior, nonresidential, placed into service after the building was first placed into service) are now allowed a 15-yr tax life, and qualify for bonus depreciation and 179 expensing. Note that improvements which enlarge a building do not qualify as QIP.

Planning Point: Consider a cost segregation study to split out the cost of the purchase of a building, for example, into assets with shorter depreciable lives.

Planning Point: Consider accelerating income into a year in which there are significant depreciation deductions available.

- There is a $10,000 cap on the total amount of property and state and local income taxes that may be deductible as an itemized deduction at the individual level. To circumvent this cap, certain states have provided a mechanism whereby a business entity such as a partnership or S corporation makes a state income tax payment and is allocated a credit that the partners/shareholders can claim on their state income tax return.

Planning Point: Consider whether any 2022 non-resident withholding payments should be remitted as mentioned above to provide for a better tax deduction.

- Certain businesses should consider the research and development tax credit. Businesses in various industries qualify for this credit, such as manufacturing, certain construction activities, architecture and engineering services, and several other industries. Note that beginning in 2022, research and development expenditures require capitalization and are to be amortized over five years (regardless of whether a research and development tax credit is claimed). Previously, these expenditures were expensed in the year incurred.

Planning Point: Consider whether your business should pursue a research and development credit opportunity for 2022. These credits can either flow through to certain owners in a pass-through entity, or the credits may be applied against C corporation taxes. In addition, there is an ability to apply the credits to payroll taxes for certain businesses.

Planning Point: Businesses should consider the capitalization requirement mentioned above in year-end tax projections, though we are hoping that the ability to deduct such expenditures is extended.

- The maximum allowable deduction of interest expense for certain businesses cannot exceed 30% of the business' EBIT (earnings before interest and taxes), with no addback for depreciation or amortization starting in 2022. Many businesses with average annual gross receipts of less than $27 million are not subject to this limitation. However, an entity that is

defined as a “tax shelter” (i.e. more than 35% of losses are allocated to limited partners) is subject to the limitation even if gross receipts do not meet the $27 million threshold.

Planning Point: This 30% limitation can be avoided by an election available to “real property trades or businesses” that by definition are engaged in: leasing, construction, development, acquisition, operation, management, or brokerage of real property. Such an election would necessitate the use of a less favorable depreciation method.

- Small businesses have the ability to contribute the lesser of 25% of employees’ salaries or an annual maximum ($61,000 in 2022, $66,000 in 2023) to a retirement plan known as a Simplified Employee Pension (SEP) plan by the extended due date of the employer’s federal income tax return for the year that the contribution is made. This provides an ability for a sole-proprietor or a partner in certain partnerships to make a significant retirement plan contribution. There are several types of retirement plans that small businesses can adopt, each of which has its own set of unique rules and benefits.

- Many small businesses can use the cash method of accounting, as opposed to the accrual method of accounting. To qualify for the cash method, the taxpayer must have average gross receipts for the preceding three years of less than $27 million. The cash method of accounting may allow taxpayers to defer tax reporting of revenue until the following year by deferring customer payment due dates until the following year and may allow the acceleration of expenses into the current year, such as by paying bills early or prepaying certain expenses.

- In a closely-held business setting, consider employing children to perform work for the business. This shifts income to the child’s usually lower tax bracket from the parents, and it provides for an ability for the child to make a Roth IRA contribution. In addition, depending on the business structure, self-employment taxes may be avoided by doing this as well.

- State tax business compliance has become more complex as states are increasingly looking for additional revenues. A recent Supreme Court case paved the way for states to assess sales tax nexus depending on factors such as the dollar value of sales in that state or the number of sales made in that state. This could potentially require out-of-state sellers to collect and remit sales tax in states in which they do not do business or have a physical presence.

- For state income tax purposes, many states have adopted “economic presence” standards, which may require the filing of tax returns in a given state for certain businesses that “direct business activities” into the state, even if the out-of-state seller does not have any physical presence in the state.

Planning Point: Many states offer voluntary disclosure programs where taxpayers can voluntarily reveal themselves. In addition, some states offer amnesty programs that may provide enhanced benefits such as reduced or eliminated penalty waivers assessed on tax amounts due.

- The C corporation rate remains at 21% and the C corporation AMT is still repealed. This may make a C corporation appear more attractive to certain businesses but the “double taxation” of C corporation earnings still applies. In addition, state corporate income taxes may make the C corporation option remain unattractive to businesses in many states, as the C corporation tax rate may be higher than the pass-through rate.

Planning Point: Pennsylvania's 9.99% corporate net income tax is scheduled to decrease to 8.99% in 2023, then to continue to slowly decrease until it reaches 4.99% in 2031. This might make a C corporation option attractive to certain businesses operating in Pennsylvania.

ESTATE AND GIFT TAX

- The basic exemption for federal estate and gift tax purposes is $12.06 million per individual in 2022, increasing to $12.92 million in 2023. Note that many states have a much lower threshold for filing and/or paying state death taxes. The higher exemption amounts are scheduled to return to the prior (much lower) amounts after December 31, 2025, so it may be advisable to take steps to reduce your estate while the above exemption amounts are available. Assuming the exemption amounts are reduced in the future, IRS regulations grandfather any gifting done under the higher exemption amounts. Both the Federal estate and gift tax exemptions are indexed for inflation.

Planning Point: The annual exclusion is $16,000 in 2022. This may provide an ability to reduce the size of your taxable estate over time. Note that the annual exclusion increases to $17,000 in 2023.

Planning Point: Taxpayers may make unlimited gifting for tuition (K through college) and medical expenses. This provides for an additional ability to reduce your taxable estate over time as gifting for tuition and medical expenses paid directly to the applicable institution do not count toward the annual $16,000 exclusion mentioned above.

Please reach out to us if you'd like to discuss any of the above items further.

About Us

GMS Surgent is a mid-sized, full service, certified public accounting and advisory firm serving business and individual clients located primarily (but not limited to) the Greater Philadelphia area. We warmly invite you to click around our website to learn a little more about our firm, our clients and the ways in which our services could benefit you.

"Personal Attention – Valuable Results", is the principal component of our mission statement. It highlights the GMS Surgent commitment to forging strong relationships and ensuring constructive communication while earning consistently effective results for our clients. It plays an essential role throughout every aspect of our firm, guides our actions and acts as a benchmark for the services we provide.