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2022 - 2023 Tax considerations for families and individuals

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2022–2023 TAX CONSIDERATIONS FOR FAMILIES AND INDIVIDUALS

Legislative changes and other tax concerns that may affect planning

This guide reflects the tax considerations and developments that we believe may create risk or opportunity for individuals in 2022 and beyond. It is not an exhaustive list of all tax issues that may affect you, but it is designed to help you make informed decisions related to year-end tax planning.

Please see **our website** for additional information on many of these issues.

INTRODUCTION

Post-pandemic economics and continued labor and supply shortages led to considerable inflation in 2022. We saw the start of the Federal Reserve's monetary policy to help stifle the effects of inflation bringing rising interest rates and volatility in the stock market. This has been coupled with continued political uncertainty with the proposed Build Back Better Act shrinking into the enacted Inflation Reduction Act of 2022, upcoming midterm elections and potential for a bipartisan tax extenders package.

With this in mind, we have developed this guide for tax planning considerations for 2022—23, which will be updated as new developments arise. With changing market conditions and new policy enactments, RSM is here to provide guidance to help evaluate and optimize the tax impact on your family.

Tax policy update

The Inflation Reduction Act (Act) was passed in August of 2022. The Act included provisions focused on (1) corporate alternative minimum tax, (2) 1% excise tax on certain stock repurchases by corporations, (3) additional IRS funding with an emphasis on enforcement, (4) an extension for two years of the excess business loss limitation provision and (5) many new energy incentives.

The Act allocated an additional $80 billion in IRS funding over the next ten years to improve taxpayer services and increase tax enforcement efforts, operations support and business systems modernization. The consensus is that most increased tax enforcement efforts will be concentrated on households earning more than $400,000 per year. If fully utilized, this additional funding could usher in a new level of importance for supporting documentation for deductions as well as uncertain positions taken by taxpayers, particularly ones over that threshold.

While there were some significant tax changes in the Inflation Reduction Act, it notably excluded an extensive number of provisions that were up for debate and in previous reconciliation bills in 2021. Previous proposals that were not addressed in the Inflation Reduction Act include provisions to:

- Increase the corporate tax rate
- Increase the top individual income tax rate
- Impose surcharges on high-income individuals, estates and trusts
- Eliminate the step-up in basis at death for most appreciated assets
- Expand the net investment income tax
- Implement grantor trust reform
- Repeal like-kind exchange treatment for real property, and
- Accelerate the sunsetting of the doubled estate and gift tax exemption amount

Notable IRS updates

Audit rates

Formed in 2009, the Global High Wealth Industry Group ("GHW" or "the Wealth Squad") is an elite group of IRS field examiners focused on investors with wealth or income greater than $10 million. This highly trained group focuses on a holistic approach to audit and collection of tax from high-net-worth individuals and their complex business enterprises. Wealth Squad audits often start with an audit of an investor and then spiderweb through their investments and entities not only paying attention to income tax, but also transfer taxes and information reporting. 2022 saw a fourfold increase in the number of audits for this class of taxpayers from 2% to 8%. Other individual taxpayers saw an approximate doubling of their audit rate, with taxpayers earning $500,000 to $1 million experiencing a 0.6% audit rate and $1 million to $5 million experiencing a 1.3% audit rate. These are dramatic short-term increases, but they still fall far short of the 2010 audit rate of 16%.

The $80 billion in additional funding could increase these audit rates further; however, this will require both hiring and training employees to be able to handle the complex investments and structures that are utilized by wealthy individual taxpayers. Given the market for qualified accountants, this could be a challenge.

Response times

The IRS is experiencing delays with mailed correspondence as well as telephone challenges. In 2021, it took an average of 251 days or approximately eight months to process taxpayer correspondence. Pre-pandemic, it took an average of 74 days. The IRS is currently only able to answer about 10% of the calls received as of April 23, 2022.

To address pain points, the IRS plans to increase the hiring of more customer service representatives to answer phones during the 2023 tax filing season. The IRS updated its availability and processing times on its website to account for COVID and staffing limitations. With the additional agency funding provided by the Inflation Reduction Act of 2022, shorter wait times may be anticipated next year.

Extenders and expiring provisions

Several COVID and 2017 Tax Cuts and Jobs Act provisions are set to expire without further action in 2022, 2023 and beyond. Some of these items may be taken up as an extenders package late in 2022. Some of the most noteworthy items expected to be discussed include:

- **Tax treatment of research and development expenses —** Starting in 2022, these costs are required to be amortized rather than expensed. Domestic costs will be taken over a five-year period and foreign research expenses will require a 15-year amortization period. This is a timing difference; however, increases in inflation and interest rates compound the impact of the deferred deduction and the current decreases in cash flow caused by the provision.
- **Limitation on business interest expenses —** The 2017 Tax Cuts and Jobs Act added a limitation on business interest expense deductions to 30% of a modified EBITDA calculation. The CARES Act increased the limitation from 30% to 50%. In 2022 the limitation will revert to 30%, and depreciation, amortization and depletion are no longer added back in performing the modified EBITDA calculation. The effect of this provision is compounded by increases in interest rates and could be made worse if we see a softening of demand.
- **Phaseout of 100% bonus depreciation —** Starting in 2023, the current 100% expensing of certain fixed assets used in a trade or business will decrease to 80%. This allowance is set to reduce by 20% each year thereafter until it is completely phased out in 2027. Large fixed-asset purchases will require careful planning to ensure you get the best benefit.
- **Child Tax Credit —** The American Rescue Plan Act increased the Child Tax Credit and made the credit fully refundable for certain taxpayers. Unless it becomes part of a tax extenders act later this year, the Child Tax Credit is back to a maximum of $2,000 for 2022 and is only refundable up to $1,500.
- **Child and Dependent Care Tax Credit —** For 2022, this credit is once again not refundable, the maximum credit percentage drops from 50% to 35% and fewer care expenses are eligible.
- **Looking ahead —** An expansive number of the 2017 Tax Cuts and Jobs Act provisions are set to sunset beginning January 1, 2026, impacting individuals and businesses across the board. Along with the reduction of the estate and gift tax exemption amount discussed later, individuals will revert to a top 39.6% income tax rate without benefit of the Qualified Business Income Deduction, potentially a 10% rate increase. Deductions will also change with a decrease to the standard deduction and additions of personal exemptions, miscellaneous itemized deductions, and removal of the state and local tax deduction limitation.

We hope this guide is a helpful summary for you and your family of tax changes and items that may be important as 2022 ends and we look forward to 2023.

Want to learn more? Check out these articles:

- Taxes and the Inflation Reduction Act: What middle market businesses should know
- The IRS takes aim at high net worth individuals

GENERAL CONSIDERATIONS

Tax brackets

The 2022 individual income tax brackets:

Tax rate	Taxable income (single)	Taxable income (married filing jointly)	Taxable income (married filing separately)	Taxable income (head of household)
10%	$0 to $10,275	$0 to $20,550	$0 to $10,275	$0 to $14,650
12%	$10,275 to $41,775	$20,550 to $83,550	$10,275 to $41,775	$14,650 to $55,900
22%	$41,775 to $89,075	$83,550 to $178,150	$41,775 to $89,075	$55,900 to $89,050
24%	$89,075 to $170,050	$178,150 to $340,100	$89,075 to $170,050	$89,050 to $170,050
32%	$170,050 to $215,950	$340,100 to $431,900	$170,050 to $215,950	$170,050 to $215,950
35%	$215,950 to $539,900	$431,900 to $647,850	$215,950 to $323,925	$215,950 to $539,900
37%	$539,900 or more	$647,850 or more	$323,926 or more	$539,900 or more

The 2022 fiduciary income tax brackets:

Tax rate	Taxable income
10%	$0 to $2,750
24%	$2,751 to $9,850
35%	$9,851 to $13,450
37%	$13,451 or over

INSIGHT: For trusts that may have a beneficiary in a lower tax backet, consider making discretionary distributions (either before year-end or within 65 days after year-end and making an election to treat it as made in the prior year) to push income to a lower tax bracket. This can be a complex decision for GST exempt trusts as saving income tax may wind up costing transfer taxes in the future. Projecting the outcome is very important.

The inflation adjustment for 2023 income tax brackets is about 7%. This will bring the 37% bracket for married filing joint filers to almost $700,000.

Standard deduction and personal exemption

The personal exemption was eliminated as part of the Tax Cuts and Jobs Act of 2017 and the standard deduction was significantly increased.

The 2022 standard deduction:

- Single: $12,950
- Married filing jointly: $25,900
- Head of household: $19,400

The 2023 standard deductions with the inflation adjustment:

- Single: $13,850
- Married filing jointly: $27,700
- Head of household: $20,800

Kiddie tax

Earned income will continue to be taxed at the child's rate. Unearned income from interest, dividends and capital gains are taxed at the parents' marginal rate. For a child with no earned income, the first $1,150 is not taxed in 2022 ($1,250 in 2023), the next $1,150 is taxed at the child's rate ($1,250 in 2023) and any unearned income over the $2,300 ($2,500 in 2023) is taxed at the parents' marginal rate.

Electric vehicle tax credit

As part of the Inflation Reduction Act, the electric vehicle tax credit was extended. While extended, the credit now requires that final assembly of the vehicles must be in North America, with transition rules from August 16, 2022, to January 1, 2023. Another consideration is that some manufacturers have reached their cap of electric vehicle credits and vehicles made by those manufacturers are no longer eligible for the credit. You may check vehicle makes and models, manufacturer, and VIN at https://afdc.energy.gov/laws/inflation-reduction-act to determine if the vehicle you purchase qualifies.

Student loan forgiveness

The Biden administration recently enacted a student debt relief plan. The plan allows for forgiveness of up to $10,000 of student loan debt for individuals with income less than $125,000 (individual or married, filing separately) or up to $250,000 (married, filing jointly or head of household) in 2021 or 2020. If the borrower had received a Pell Grant while in college and meets the income guidelines, the borrower will be eligible for up to $20,000 in student loan debt cancellation. An application to support income criteria requirements should be completed by November 15 to ensure application acceptance. For more information on how to obtain student loan debt relief, visit: https://studentaid.gov/debt-relief-announcement/one-time-cancellation

INSIGHT: The one-time student loan debt relief will not be federally taxable. However, state and local tax rules may tax the amount.

Mileage rate mid-2022 update

The IRS increased the 2022 mileage rate effective July 1, 2022, due to the recent drastic change in gas prices. The rate for the last six months of 2022 is 62.5 cents per mile, up from 58.5 cents for business travel. If a mileage rate is paid in excess of the IRS rate, it will be taxable income to the employee. The 2023 mileage rate has not yet been announced.

Applicable federal rates and the section 7520 rate

While still historically low, the applicable federal rates and the section 7520 rate have jumped since the beginning of 2022. The section 7520 rate has increased from 1.6% in January to 4.8% in November of 2022. The applicable federal rates are broken down into short, mid, and long term. Short-term durations experienced the largest change (same period of January to November 2022) from 0.44% to 4.1% and long-term being the least volatile from 1.82% to 3.92%. These rates are frequently used in intra-family transactions, annuity determinations and remainder interest calculations.

INSIGHT: Rising interest rates are generally not good for many estate planning techniques; however, there are two techniques to pay attention to in this environment. The first is a qualified personal residence trust (QPRT), where the grantor transfers their interest in a personal residence or vacation home to a trust with the right to use the property for a term of years. The higher the interest rate, the lower the gift value of the remainder interest to the trust. Similarly, a charitable remainder annuity trust (CRAT) is more beneficial with higher interest rates, as it reduces the value of the annuity payments to the grantor and creates a higher remainder value to the charity for income tax deduction purposes.

Increased exemption (and GST planning) from inflation and until 2026

Every person is given an amount that is exempt from federal estate and generation skipping transfer tax (GST) that they may use during their lifetime, at death, or a combination of each. These exemption amounts are increased for inflation and are temporarily doubled as part of the 2017 Tax Cuts and Jobs Act. The federal estate tax exemption for 2023 is expected to be $12.92 million per person. This amount is set to be cut in half at the beginning of 2026. Though the GST and estate tax exemptions are the same amount, they may be utilized on separate transfers.

The estate tax rate is a flat 40% of the value of assets above the exemption amount. The generation skipping transfer tax is 40% as well, but generally only applies to amounts over the estate tax exemption when distributed to individuals who are more than one generation below the grantor. Careful consideration of this issue is the best way to incorporate generation-skipping tax mitigation into your estate plan.

The IRS has issued guidance that would prevent the application of a lower exemption upon assets transferred when the exemption was at a higher level (there are some proposed regulations that may create limited exceptions to this broad rule). For example, if someone were to give the full $12.92 million in 2023 and pass away in 2026 when the exemption may be a lower amount ($6 million–$7 million), the IRS would respect that the full $12.92 million is not taxable and out of their estate.

INSIGHTS: The doubled exemption amount is set to sunset beginning 2026—it's use it or lose it, so take advantage of this opportunity now.

If you have already utilized your full exemption, you have an additional $860,000 to utilize due to inflation adjustments for 2023. It may make sense to utilize this while asset values may be lower. If you have yet to utilize your exemption and have significant wealth, it may be time to think about it. With amounts set to be cut in half in 2026, qualified planners are already in high demand, and scarcity will only continue to increase through the change in laws.

Annual exclusion and other gifting

In addition to every person receiving an estate tax exemption amount, each year an individual may gift up to $16,000, adjusted for inflation, to another person without using any estate tax exemption. This may add up quickly for added estate tax savings. Consider a married couple with three children and five grandchildren. Since each person is allowed annual exclusion gifts, every year each spouse may each give up to $128,000, or $256,000 for the couple, to their family. Over ten years this is about $2.5 million transferred without using any estate tax exemption and over $1 million of additional estate tax savings.

INSIGHT: Annual exclusion gifting may be done at any time during the year, but it is best not to wait until the end of the year to plan or execute. This ensures the recipient cashes the check in the year of the gift and you can capitalize upon the opportunity. Annual exclusion gifting is the gift that gives all year!

On top of the estate tax exemption and annual exclusion gifting, individuals may make payments directly to educational and medical facilities for qualifying expenses on behalf of a beneficiary. If the entity and expenses qualify, the payments will be disregarded for estate tax purposes. This may help relieve stress for family members going through significant health issues or the ability to help make college more affordable and beneficiaries less indebted after graduation.

Gift of a business interest

Gifting does not have to be in the form of cash or marketable securities. Some of the best gift plans include the use of business interests, even if the business consists of marketable securities. By gifting business interests, there are terms and restrictions associated with ownership that can reduce the taxable fair market value of the gift. While the gift of an operating entity will usually result in the largest value discount for gifting purposes, a business entity holding liquid assets is still currently allowed a smaller discount, but with potential future limiting regulations. For example, a gift of $10 million in securities or cash is $10 million used of your estate tax exemption; but a 50% gift of a business that holds $20 million in assets may only be worth $8.5 million. Thus, you are using $1.5 million less of your estate tax exemption while transferring the same value of assets.

INSIGHT: Some of these fair market value discounts may be limited in the future for intra-family asset transfers, so gifting these types of interests now ensures the ability to use the associated benefits.

Gifting of business interests may also be a preferential type of gift since it may help start a business transition plan, and successful operating businesses usually have a higher growth rate than other assets. By gifting business interests during your lifetime, you get to use the value of the interests now, instead of at death, generating significant asset growth outside of your estate that will not be subject to estate tax.

INSIGHT: Gifting of a business interest requires a business valuation performed as part of the gift tax return filing. If the business interests are transferred at year-end, then the same valuation may be used for duplicate gifting at the beginning of the following year, reducing the costs associated with this type of transfer.

Interest rates

Interest rates are on the rise, but higher statutory rates required on related party transactions are still relatively low. Many planning opportunities exist that may create larger tax savings in lower interest rate environments.

Lending to family members or trusts for their benefit is a popular estate planning strategy, as favorable loan terms may be used. Cash flow considerations should be made to ensure that the loan payments will be feasible to the borrower. The seller could also periodically forgive part of the debt that usually qualifies for annual exclusion gifting if under the current annual exclusion amount. Debt forgiveness does not require a business valuation, so many people choose to use this method in conjunction with an initial business interest gift.

INSIGHT: Even with recent interest rate increases, statutory rates on related party transactions may provide leveraged opportunities for your estate plan by enabling you to lend funds to family at favorable terms, while creating an instrument with an option for easy and effective annual exclusion gifting.

Some charitable trusts also benefit from the current interest rate environment. With a charitable lead trust, the charity receives payments for a certain term and then designated family members or trusts for their benefit receive the remaining assets at the end of the charitable term. If, based on the current interest rates and charitable term, the actuarial value of the remaining interest is zero, then no estate tax exemption will be used while your beneficiaries will get the residual assets after the charitable distribution period.

Grantor trusts

Grantor trusts have historically been a great estate planning technique. The most common types of grantor trusts include a Grantor Retained Annuity Trust (GRAT) and an Intentionally Defective Grantor Trust (IDGT) (also known as a Spousal Lifetime Access Trust if a spouse is a trust beneficiary as well).

The GRAT is a similar concept to the charitable lead trust described above, where term payments are made but to the grantor, and the remainder goes to family beneficiaries. If the grantor survives the trust term, the remaining assets will have been transferred out of the grantor's estate to the beneficiaries, potentially without using estate tax exemption. However, if the grantor dies during the term of the GRAT, the trust assets will be included in the grantor's estate and there are no realized estate tax benefits. While GRATs are a great estate planning tool, they are usually used for the benefit of children instead of further generations below the grantor since a GRAT cannot allocate generation-skipping tax exemption until the expiration of the GRAT term.

The other type of common grantor trust is the IDGT. IDGTs are a great planning tool because the grantor may gift assets and combine this with a low interest sale of assets to the trust, while not having the same income tax consequences. Since it is deemed a grantor trust, any gain from a sale is disregarded for income tax purposes. Additionally, the grantor is responsible for any income tax derived from the assets held by the trust, which reduces the grantor's estate by the amount of income tax paid. This income tax paid is not considered a gift, even though it's in the interest of the trust beneficiaries by allowing more growth of trust assets.

INSIGHTS: Grantor trust status is achieved through various provisions included in the trust, most commonly a swap power. Here the grantor may swap assets equal in value with the trust. Consensus is assets transferred to the trust, through swap or otherwise, will not get a step-up in basis at the grantor's death. This can allow the grantor an opportunity to stuff high basis assets inside of the trust to receive a step-up in basis on other low-basis assets, saving income tax on a future sale.

In volatile markets, the swap power can be utilized to pull underperforming assets from a GRAT. This can either provide the old GRAT the chance to grow, or potentially allow the grantor to create a new GRAT with the same depressed value assets.

Due to the notable benefits, Congress and federal agencies have been reviewing ways to limit the use of grantor trusts. Any changes are anticipated to be prospective, so setting up trusts now under current rules should still allow for all the advantages to be maximized.

Reviewing estate plans

All the above planning techniques are subject to constantly changing external factors through inflation, interest rates and policy that make it wise to periodically review your estate plan to ensure that it has not been adversely impacted or if there are ways to adjust your plan to be more effective.

Your estate plan is also impacted by any changes that may be happening within your family or pertaining to your assets. You may have an upcoming marriage, a child or grandchild on the way, or unfortunately experience a death or divorce. You may or may not have a family member that is able to take over the family business which would involve business transition planning, or you may consider an asset or business sale.

Thus, there are plenty of reasons to periodically review your estate plan with your advisors to ensure that your plan is still achieving your goals and optimizing tax strategies and savings.

INSIGHT: Periodically reviewing your estate plan ensures that important changes are incorporated, enabling you to continue to accomplish your family and business goals and to maximize all potential tax benefits.

Want to learn more? Check out these articles:

- Estate planning and income tax: Key considerations and planning points
- Multigenerational wealth planning: A guide to do's and don'ts
- Valuation and timing are critical when making a gift
- Tax issues that arise when a shareholder or partner dies
- Income tax, charity and estate planning strategies for digital assets

INCOME TAX PLANNING CONSIDERATIONS

Inflation considerations—loss harvesting, interest rates and excess business losses

Volatile markets, increasing interest rates and inflation also bring opportunities from a tax and business standpoint. Consideration should be given to each of the following items, as they are not one-size-fits-all.

With decreasing values in the stock market there comes an opportunity to utilize the depressed values to harvest tax losses. Picking specific assets that are generating losses can allow you to lessen the impact of gains each year. Typically, these losses are going to be capital in nature, which can reduce capital gains to zero. After netting with capital gains, the capital loss will be limited to $3,000 per year with a carryforward of the excess. Keep in mind that if you purchase a like security 30 days prior to or after the sale, the loss could be disallowed.

Interest rates are on the rise, creating a cost of money that isn't insignificant. There may be some planning opportunities to consider if you are using debt to fund transactions instead of potentially selling an asset. Generally, the determination of interest deductibility is based on the usage of the debt funds. Excluding a home mortgage, deductible sorts of interest are those funds that are utilized for investments or in a trade or business. Provided all other terms are similar, this may allow you to find a lower-cost loan option while still achieving the deductibility status that you desire. For example, you may utilize a margin loan to fund a real estate investment.

The Tax Cuts and Jobs Act of 2017 instituted a limitation on the deductibility of excess business losses for noncorporate taxpayers ($250,000 single, $500,000 married filing joint). These limitations were suspended during the COVID years but are reinstituted starting with 2022. Congress considered more severe limitations on the carryover of these losses last fall, but only extended them for an additional two years through 2028 with enactment of the Inflation Reduction Act. With rumors that excess business losses were earmarked for the extension of the Qualified Business Income deduction under section 199A in 2026, some are concerned about those extension prospects. Only time will tell.

INSIGHT: Different economic times allow for various strategic plans to be implemented. The current inflationary period provides opportunities to realize losses that may be offset against future gains. Carefully review new loans for interest rates and interest deductibility.

Proposed regulations under the SECURE Act

In February of 2022, the IRS released the proposed amendments to the required distribution regulations for a retirement plan with a proposed effective date of Jan. 1, 2022. These proposed regulations were generally taxpayer friendly as they relate to trusts as designated beneficiaries. It should be noted that these regulations are only proposed at this point and not final or guaranteed to be adopted by the Treasury Department in their current form.

It is important to consider who the beneficiaries of your retirement assets will be and how the proposed regulations will impact the timing of distributions to that beneficiary. Depending on which individuals or trusts are inheriting the asset, the following could be true:

- The SECURE Act changed the IRA distribution rules so that only "eligible designated beneficiarys" (EDB) can stretch the required distributions out over their life expectancy. To be considered an EDB, the beneficiary must be the decedent's surviving spouse, the decedent's minor child under age 21, a disabled or chronically ill individual, or an individual not more than 10 years younger than the decedent.
- If a descendent was receiving required minimum distributions, the beneficiary will be required to continue, except in certain situations involving spousal beneficiaries.
- If the beneficiary is not an EDB, then the IRA must be fully distributed within 10 years if the beneficiary is an individual or certain trusts and five years for all other beneficiaries.

INSIGHT: With these considerable changes in rules for IRA distributions to beneficiaries, it is important to review all beneficiary designations for your desired goals. It may be especially important if the beneficiary is older than the descendent. You may also want to consider utilizing a charitable trust as your beneficiary to extend the distribution time periods and associated tax savings.

Roth IRA conversions

Roth IRAs are post tax-dollars. This provides two benefits: They are not taxable on distribution, providing access to cash without a tax hit, and are not subject to required minimum distributions. Roth IRAs can provide for future beneficiaries by allowing for the accumulation to grow tax-free until they are required to withdraw the funds based on the new SECURE Act rules discussed above.

Traditional IRAs can be converted to Roth IRAs. The downside is that you will have to pay the tax on the traditional deferrals today. The benefit is that ordinary income tax rates are currently set to increase to 39.6% in 2026 from their current rate of 37%. This can protect the future accumulation in the account against ordinary and anticipated higher income tax rates. Market values are currently trending lower, so the value of the IRA to pay tax on a conversion would be less than when the markets recover. Finally, any income tax paid also reduces your taxable estate and related taxes.

INSIGHT: Roth conversions now may allow you to take advantage of lower tax brackets, and considering current market volatility, there may be a large increase in value that could escape taxation. Getting there, however, could require significant cash.

Entity selection—still meet objectives and goals

When first setting up your business, a decision was made as to what type of entity would be best for your circumstance and strategy. This entity selection determines the federal and state taxation rules of your business. At different points in that entity's life cycle, it may make sense to pose the question, "Is that entity type still the most effective for my business?"

Entity and owner taxation varies in many regards: Who is responsible for filing a return, who needs to pay the tax on business income, what are the tax implications of distributing assets or income, and what are the tax consequences if someone dies or the business is sold?

As a general rule, you should revisit entity selection if there has been a change in strategy; this includes any significant changes to owners, assets, or distribution policy, or if there's an intent to sell the business. Another reason to review your entity type is changes in tax rates. In 2026, the qualified business income deduction is set to expire, and individual rates are set to increase to 39.6%. This could increase tax on a flow through entity by 10%. With a permanent C corporation rate of 21%, this could be a beneficial change for your business, given all the right factors.

INSIGHT: Just like estate planning, periodically ensuring that your business entity type is still optimal based on your business objectives may provide tax savings to the business and owners. This is a complex situation that requires weighing a lot of factors.

Pass-through entity decisions that affect individual (PTE elections, bonus depreciation)

Decisions made at the company level will directly affect the owners of pass-through entities. Two such items include pass-through entity (PTE) tax elections and bonus depreciation.

The 2017 Tax Cuts and Jobs Act limited individual taxpayer deductions for state and local tax (SALT) payments to $10,000 a year ($5,000 for a married person filing a separate return). Individual SALT payments (including income and real property taxes) in excess of these amounts are no longer deductible. This provision is currently scheduled to expire in 2026.

In response to the change many states have enacted an (in most cases elective) tax regime upon pass-through entities. These regimes generally switch responsibility for paying tax to the pass-through entity. Each state has its own unique rules, and they will need to be evaluated as to the requirements of the election and other filing requirements. In a sparsely worded interpretation, the Treasury Department has stated that these taxes may be deductible in addition to the $10,000 individual limit. Though the advice was positive, there are still many questions regarding applicability in many situations.

INSIGHT: Pass-through entity tax elections could be a good way to avoid the $10,000 SALT deduction limitation, but the decision isn't clear. Some states require an increased rate for the elective regime, and others don't allow an offset to the partner or shareholder's taxes, nullifying the benefit. The decision can also get tricky when trusts are involved as the income tax savings may not be outweighed by the estate tax cost. A careful analysis will be required in each situation.

Bonus depreciation allows taxpayers to immediately expense 100% of the purchase price of certain fixed assets utilized in a trade or business. Assets placed in service in 2023 will only receive the benefit of an 80% expensing, and the provision will be fully phased out by 2027.

INSIGHT: Fixed-asset acquisition planning and documenting the placed-in-service date will become more important as the phaseout of 100% bonus depreciation is set to reduce to 80% in 2023, and 20% each year thereafter until completely phased out in 2027.

Want to learn more? Check out these articles:

- Taxes and the Inflation Reduction Act: What middle market businesses should know
- Planning and proper application of interest expense allocation
- Qualified small business stock: Making the most of the exclusion

Donating appreciated assets

When you make a gift to a public charity of an asset held longer than a year, your charitable deduction is typically equal to the fair market value of the asset on the date of the gift, subject to limitations based on your adjusted gross income (AGI). If you were to sell long-term capital gain assets, e.g., publicly traded stock, you would first have to pay capital gains tax on the appreciation of the asset over your basis in the asset. Therefore, giving long-term capital gain assets to a charity is often a tax efficient way to benefit charity. You can claim a charitable deduction for the value of the asset and avoid paying the tax that you would have had to pay if you sold that appreciated asset and then contributed the cash to charity. The charity then has the option to sell the appreciated asset itself without the payment of income tax. Unfortunately, if the asset has depreciated in value and is contributed to charity, the loss is not allowed and the contribution is still valued at fair market value.

INSIGHT: Donating appreciated long-term capital assets generally provides the donor with double the benefit of forgoing income recognition and receiving a charitable deduction against other ordinary income at the fair market value of the asset donated. If you have a depreciated asset that you would like to contribute, consider selling the asset first to get the benefit of the loss as well as the charitable contribution deduction.

Giving a business interest to charity

Selling a business interest not only causes a substantial increase in your liquid wealth, but can substantially increase your income taxes for the year of the sale. To minimize the income tax liability, a business owner may contribute part of the business interest to a charity, which will give rise to a charitable deduction. The gift will also reduce the business owner's estate for estate tax purposes. Although these tax benefits may be significant, the transfer of a business interest to a charity includes several complex issues that must be addressed well before the contribution of the asset or sale of the business.

The donor may find that a charitable deduction for transferring a business interest to charity is limited, results in recognition of some gain or is not allowed. For example, the transfer of a partnership interest may reduce the donor's deduction if the partnership holds certain assets, such as inventory and accounts receivable, or if the partnership interest contributed is subject to a debt obligation. Gifts of certain assets to a private foundation may be prohibited if the donor is a "disqualified person" (e.g., a founder or board member), or the donor may get a very low deduction because of valuation limitations.

A charity will often want to carefully evaluate the business interest before accepting a gift, and may not be willing to accept the gift. For example, the charity will want to know whether holding the business interest will require the charity to be involved in the management of the business. Further, the charity will often want to have a clear idea of when and how it can liquidate the interest for cash. There may also be an issue if there is associated debt or any potential liabilities or claims against the interests.

While charities are generally tax-exempt entities, holding a business interest may cause the charity to pay tax on unrelated business income. If the charity is a private foundation, the business interest may be prohibited as an excess business holding.

INSIGHT: Donating business interests to charity may optimize what the charity and your family receive due to the charitable deduction and income timing, but may be complex and should be carefully reviewed with your advisors.

Bunching charitable gifts

As stated above, in 2022 individuals can claim a standard deduction of $12,950 if single ($14,700 if over age 65) or $25,900 if married ($27,300 if over age 65). As an itemized deduction, you would not choose to claim a charitable deduction for gifts to charity unless the value of your gifts to charity (plus your other itemized deductions, such as the limited state and local income tax deduction and mortgage interest expense) in one year exceeds your standard deduction. Therefore, your charitable gifts made in a year in which you claim the standard deduction provide no income tax benefit to you.

To make charitable gifts and claim a charitable deduction for those gifts, donors will often "bunch" or "lump" their charitable gifts for multiple years into a single year. Let's say you are married and give around $15,000 to a particular charity each year. Those gifts provide no tax benefit to you since you will claim the higher standard deduction each year if you do not have other itemized deductions to bring you above the standard deduction threshold. However, if you skipped the charitable gift in year one and gave $30,000 to the charity in year two when your standard deduction is $25,900, you would claim your charitable deduction in year two since it will be higher than your standard deduction. Most people communicate their plan with the organizations which they regularly donate to help them understand their motives and plan for cash flow for the organization. The organizations are welcoming to these conversations, as they are receiving the same amount, just with different timing. You could also time your bunching of charitable gifts for a year in which you have a higher-than-normal tax liability, such as a year in which you sold a highly appreciated investment.

If you want to bunch charitable gifts but are unsure about which charities to benefit, you could give yourself some time to decide by establishing a donor-advised fund with a sponsoring organization (e.g., a brokerage firm or community foundation). You can make the charitable gift to the donor-advised fund and claim the same charitable deduction in the year of the gift. Although the sponsoring organization has ultimate control over distributions from the donor-advised fund, you can make recommendations regarding which charities to benefit when you are ready to do so. While the funds stay in the donor-advised fund, they can grow tax-free.

INSIGHT: Alternating years of charitable gifting or establishing a donor-advised fund may provide income tax savings by using the standard deduction in non-gifting years and taking advantage of higher itemized deductions in gifting years.

Charitable rollovers

A charitable rollover (referred to in the tax laws as a "qualified charitable distribution" or QCD) is a special tax benefit available for those who are over age 70 1/2 and wish to use distributions from their traditional IRA to benefit charity. This strategy is most often used by those individuals who have reached age 72 and must withdraw required minimum distributions (RMDs) each year from their IRA and pay income tax on those distributions and those with taxable estates, as distributions to charity reduce your taxable estate. If you don't need the RMD for living expenses and wish to benefit charity, you can simply direct your RMD to be paid directly to a charity. On your tax return, you will exclude the RMD from income completely; you won't need to include the RMD in income and then claim an offsetting charitable deduction. Excluding the income provides a better result, because the RMD won't increase your adjusted gross income. This will help avoid increases in Medicare premiums, net investment income tax, taxation of social security benefits and other adverse tax consequences.

Of course, there are limitations. In addition to being at least age 70 1/2, the rollover is limited to $100,000 per year. However, if you are married, both you and your spouse have reached age 70 1/2 and you file a joint return, then each of you can contribute up to $100,000 through a charitable rollover. Also, the distribution must be made directly from the IRA custodian to the charity. Only public charities and certain private foundations can receive a charitable rollover. A donor-advised fund cannot receive a charitable rollover.

INSIGHT: Charitable rollovers reduce your estate and are not included in your taxable income, which may result in a lower income tax liability through reduced calculation of your adjusted gross income.

Substantiation of charitable gifts

The charitable gift strategies discussed above, as well as other charitable gifts, are not available unless the gifts are properly substantiated by certain records and on an income tax return. For example, you generally must keep written records of your contributions and receive a contemporaneous written acknowledgment from the charity confirming your gift. For gifts of non-cash assets, you may need to include a completed form 8283 and a qualified written appraisal of the assets with your return. As recent court cases have shown, one seemingly minor mistake in substantiating a charitable gift can disqualify the entire charitable deduction. These substantiation requirements are another important reason to work closely with your RSM tax professional to ensure that you claim all the charitable deductions to which you are entitled.

INSIGHT: Ensure your charitable gifting results in planned estate and income tax savings by documenting the strict substantiation requirements.

Want to learn more? Check out these articles:

- Estate planning and income tax: Key considerations and planning points
- Estate planning after the sale of a business interest
- Income tax, charity and estate planning strategies for digital assets

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