TAX PLANNING GUIDE

2023-2024

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

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Tax planning is as essential as ever

To take advantage of all available breaks, 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 the tax treatment of retirement plans, some of which go into effect this year. But one of the last remaining pandemic-relief 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 you 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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Time deductions and leverage other breaks to minimize taxable income

Deductions are valuable because they reduce the amount of your income that's subject to federal tax — and in many cases, state tax, too. Income can also be tax-free if it comes from certain tax-advantaged accounts or is eligible for some other type of exclusion. In recent years, deduction planning has been greatly impacted by the TCJA. For example, this 2017 law reduced or eliminated many deductions while significantly increasing the standard deduction. Proper timing of deductible expenses and fully leveraging other available breaks can help minimize taxable income and maximize your tax savings.

Standard deduction vs. itemizing

Taxpayers can either itemize certain deductions or take the standard deduction for their filing status. Itemizing saves tax when the total will be larger than the standard deduction, but it makes filing more complicated.

The TCJA nearly doubled the standard deduction for each filing status. Those amounts are to be annually adjusted for inflation through 2025, after which they're scheduled to drop back to the amounts under pre-TCJA law. (See Chart 1 for 2023 amounts.)

The combination of a higher standard deduction and the reduction or elimination of many itemized deductions means that many taxpayers who once benefited from itemizing are now better off taking the standard deduction.

State and local tax deduction

Under the TCJA, through 2025, your entire itemized deduction for state and local taxes — including property tax and the greater of income or sales tax — is limited to $10,000 ($5,000 if you're married filing separately). Increasing or eliminating the limit

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.

has been discussed. Check with your tax advisor for the latest information.

Deducting sales tax instead of income tax may be beneficial if you reside in a state with no, or low, income tax or you purchased a major item, such as a car or boat.

Home-related breaks

Consider both deductions and exclusions in your tax planning:

Property tax deduction. As noted earlier, unless proposed tax law changes come to fruition, through 2025 your property tax deduction is subject to the state and local tax deduction limit.

Mortgage interest deduction. You generally can claim an itemized deduction for 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. If you're an employee and work from home, under the TCJA, home office expenses aren't deductible through 2025. Why? For employees, this is a miscellaneous itemized deduction subject to the 2% of adjusted gross income (AGI) floor, and the TCJA suspended such deductions. (If you're self-employed, you may still be eligible. See Case Study 5 on page 20.)

Personal casualty and theft loss deduction. Through 2025, the TCJA suspends this itemized deduction 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.

Rental income exclusion. 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.

Home sale gain exclusion. 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. **Warning:** Gain that's allocable to a period of "nonqualified" use generally isn't excludable.

Loss deduction. If you sell your home at a loss and part of your home is rented out or used exclusively for your business, the loss attributable to that portion may be deductible.

Moving expense deduction. Under the TCJA, through 2025, work-related moving expenses are deductible only by active-duty members of the Armed Forces (and their spouses or dependents) who move because of a military order that calls for a permanent change of station. (If you're eligible, you don't have to itemize to claim this deduction.)

Charitable deductions

Generally, donations to qualified charities are fully deductible — but only if you itemize deductions. If itemizing usually isn't saving you tax anymore because of the increased standard deduction, you might benefit from "bunching" donations into alternating years so that your total itemized deductions in those years surpass your standard deduction. You can then itemize just in those years.

For large donations, discuss with your tax advisor which assets to give and the best ways to give them. For example, you may want to consider giving appreciated securities instead of cash. Why? In addition to claiming a charitable deduction equal to the fair market value of the securities, you avoid any capital gains tax you would have owed had you sold the securities.

Tax-advantaged saving for health care

You may be able to save taxes without having to worry about the medical expense deduction floor (see Case Study 1) 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, allowing the account to grow.

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

Case Study 1 **Bunching medical expenses to enjoy a deduction**

Chris and Jennifer typically have enough itemized deductions each year to benefit from itemizing, and they incurred what they thought were a lot of medical expenses in 2022. So when they met with a tax advisor about filing their return, they were surprised to learn that they couldn't deduct any of them. The advisor explained that medical expenses can be deducted only to the extent that they exceed 7.5% of adjusted gross income. The couple's 2022 expenses didn't exceed that floor.

The advisor suggested that, for 2023 and 2024, Chris and Jennifer consider "bunching" nonurgent medical procedures (and any other services and purchases whose timing they can control without negatively affecting their health) into one year to exceed the 7.5% floor. Eligible expenses may include:

- Health insurance premiums,
- Long-term care insurance premiums (limits apply),
- Medical and dental services,
- Prescription drugs, and
- Mileage (22 cents per mile driven in 2023 for health care purposes).

Expenses that are reimbursable by insurance or paid through a tax-advantaged account aren't deductible.

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.

More considerations

Keep in mind that legislation could be signed into law that would suspend or alter some of the TCJA provisions affecting deductions or make other changes to deduction rules. Check with your tax advisor for the latest information.

Also be aware that there are other types of taxes that could affect you and should be factored into your planning, such as the AMT. (See "Pay attention to thresholds" on page 30.) Your tax advisor can help you determine if you're among the small number of taxpayers who still need to plan for the AMT.

Turn saving taxes into a family tradition

Many ways to save tax dollars are available to parents, students and even grandparents. So take advantage of the deductions, credits and tax-advantaged savings opportunities available to you and your family. You can turn saving taxes into a family tradition!

Child, dependent and adoption credits

Under the TCJA, these two tax credits for families are available through 2025:

1. For each child under age 17 at the end of the tax year, you may be able to claim a $2,000 credit. The credit phases out for higher-income taxpayers (see Chart 2) but the income ranges are much higher than before the TCJA. Up to $1,500 of the credit is refundable.

2. For each qualifying dependent other than a qualifying child (such as a dependent child over the age limit or a dependent elderly parent), you may be able to claim a $500 family credit. But it's also subject to the income-based phaseout.

Chart 2 **2023 child and education tax breaks: Are you subject to an income-based phaseout?**

Tax break	MAGI[1] phaseout range	
	Single / Head of household[2]	Married filing jointly
Child credit	$ 200,000 – $ 240,000	$ 400,000 – $ 440,000
Adoption credit	$ 239,230 – $ 279,230	$ 239,230 – $ 279,230
American Opportunity credit	$ 80,000 – $ 90,000	$ 160,000 – $ 180,000
Lifetime Learning credit	$ 80,000 – $ 90,000	$ 160,000 – $ 180,000
Student loan interest deduction	$ 75,000 – $ 90,000	$ 155,000 – $ 185,000
ESA contribution	$ 95,000 – $ 110,000	$ 190,000 – $ 220,000

[1] Modified adjusted gross income.

[2] These ranges also apply to married taxpayers filing separately, except that separate filers aren't eligible for the American Opportunity or Lifetime Learning credit or the student loan interest deduction.

If you adopt in 2023, you may qualify for the adoption credit — or for an employer adoption assistance program income exclusion. Both are $15,950 for 2023, but the credit is also subject to an income-based phaseout. (See Chart 2.)

Care-related 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.

529 plans

If you're saving for education expenses, consider a Section 529 plan. You can choose a prepaid tuition plan to secure current tuition rates or a tax-advantaged savings plan to fund education expenses:

- Although contributions aren't deductible for federal purposes, any growth is tax-deferred. (Some states do offer tax breaks for contributing.)
- 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.
- The plans usually offer high contribution limits, and there are no income limits for contributing.

- You can 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.
- You can make tax-free rollovers to a 529 plan for another qualifying family member.
- Starting in 2024, unused 529 plan funds can be rolled into a Roth IRA for the beneficiary, subject to various limits.

The biggest downside of 529 plans may be that your investment options — and when you can change them — are limited.

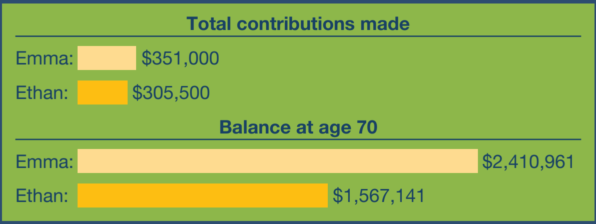
ESAs

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 you want to pay elementary or secondary school expenses in excess of $10,000 or that aren't tuition.

But the $2,000 contribution limit is low, and it's phased out based on income. (See Chart 2 on page 6.) Also, contributions can generally be made only for beneficiaries under age 18. When the beneficiary turns age 30, the ESA generally must be distributed, and any earnings may be subject to tax and a 10% penalty.

Case Study 2 **It's never too early to save for retirement**

Roth IRAs can be perfect for teenagers if they have some earned income — just look at how much difference starting contributions early can make: Both Emma and Ethan contribute $6,500 per year to their Roth IRAs through age 69. But Emma starts contributing when she gets her first job at age 16, while Ethan waits until age 23, after he's graduated from college and started his career. Emma's additional $45,500 of early contributions results in a tax-free nest egg at age 70 that's $843,820 larger!



Note: *This example is for illustrative purposes only and isn't a guarantee of future results. The figures presume $6,500 is contributed at the end of each year over the ages shown and a 6% rate of return. (See page 23 for more information on Roth IRA contribution rules.)*

Education credits

If you have children in college now or are currently in school yourself, you may be eligible for a credit:

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. If you're paying postsecondary education expenses beyond the first four years, you may benefit from the Lifetime Learning credit (up to $2,000 per tax return).

Warning: Income-based phaseouts apply to these credits. (See Chart 2 on page 6.) If your income is too high for you to qualify, your child might be eligible.

Student loan breaks

If you're paying off student loans, you may be able to deduct up to $2,500 of interest (per tax return). An income-based phaseout applies. (See Chart 2 on page 6.)

If your employer pays some of your student loan debt, you may be eligible to exclude up to $5,250 from income. (Student loan interest payments for which the exclusion is allowable can't be deducted.) This break is scheduled to expire after 2025.

Forgiven debt is typically treated as taxable income, but tax-free treatment is available for student loan debt forgiven after Dec. 31, 2020, and before Jan. 1, 2026. **Warning:** Some states may tax such forgiven debt.

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 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).

What you need to know when tax planning for investments

Tax planning for investments demands careful thought. You must consider the tax consequences of your investments as you buy and sell, but not let tax concerns propel your investment decisions. Your investment goals, time horizon and risk tolerance also should come into play. So, too, should factors related to the investment itself plus any fees and charges that apply to buying and selling securities. Nevertheless, tax factors are important. Here's a look at what you need to know.

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 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, current rates are scheduled to be in effect through 2025. Lawmakers could, however, make changes to the rates sooner.

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.

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 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. (See Case Study 3 on page 12.)

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%

[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).

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 may continue to lose value. That's one reason why tax considerations shouldn't be the primary driver of investment decisions. If you're ready to divest yourself of a poorly performing stock because, for example, you don't think its performance will improve or because your investment objective or risk tolerance has changed, you shouldn't hesitate solely for tax reasons.

Plus, you can carry forward excess losses until death, and building up losses for future use could be beneficial. This may be especially true if you own a closely held business that might generate substantial future gains. Building up losses could also be beneficial if you have a large investment portfolio or real estate holdings — or if tax rates increase.

Mutual funds

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 tax dollars because of the lower long-term rates.

Case Study 3 **Turning a capital loss into a tax-saving opportunity**

Helena's year-to-date net realized losses are $13,000. Her portfolio includes $20,000 of stock that she paid only $10,000 for. Helena has been thinking about selling it to diversify her portfolio, but she's been concerned about the capital gains tax.

Her tax advisor suggests that now might be a good time to sell the stock because her $10,000 gain would essentially be tax-free: The gain would absorb $10,000 of losses, leaving Helena with the maximum $3,000 net loss that she could use to offset ordinary income.

Also pay attention to earnings reinvestments. Unless you or your investment advisor record 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.

Finally, beware of buying equity mutual fund shares late in the year. These funds often make capital gains distributions toward year end. If you purchase shares before such a distribution, you'll end up with capital gains 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.

Income investments

Some types of investments produce income in the form of dividends or interest. Here are some tax consequences to consider:

Dividend-producing investments. Qualified dividends are taxed at the favorable long-term capital gains tax rate rather than at your higher ordinary-income tax rate.

Interest-producing investments. Interest income 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. But also consider nontax issues, such as investment risk, rate of return and diversification.

Bonds. These also produce interest income, but the tax treatment varies:

- 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.
- Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the alternative minimum tax (AMT), but the AMT now occurs much more rarely.
- Corporate bond interest is taxable for federal and state purposes.
- Bonds (except U.S. savings bonds) with original issue discount 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.

3.8% NIIT

Taxpayers with modified adjusted gross income (MAGI) over \$200,000 (\$250,000 if married filing jointly and \$125,000 if married filing separately) may owe the net investment income tax. The NIIT equals 3.8% of the lesser of your net investment income or the amount by which your MAGI exceeds the applicable threshold. Net investment income can include capital gains, dividends, interest, passive business income, rental income and other investment-related income (but not business or self-rental income from an active trade or business).

Many of the strategies that can help you save or defer income tax on your investments can also help you avoid or defer NIIT liability. And because the threshold for the NIIT is based on MAGI, strategies that reduce your MAGI could also help you avoid or reduce NIIT liability.

Is your business tax savvy?

The business environment continues to present challenges in 2023, from supply chain and staffing shortages to rising prices and higher interest rates. Yet many businesses are thriving. Whatever your business's situation, it's important to be tax savvy. This means taking advantage of available tax breaks while balancing the potential 2023 tax savings with any possible negative impact on your current cash flow, your customers or your overall business strategy. Tax law changes under the TCJA still demand attention, too.

Business structure

Income taxation and owner liability are the main factors that differentiate business structures. Many 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 on 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.)

Depending on your situation, 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 proprietorships and owners of pass-through entities. 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 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).

Projecting income

Projecting your business's income for this year and next can allow you to time income and deductions to your advantage. It's generally — but not always — better to defer tax, so consider:

Deferring income to next year. If your business uses the cash method of accounting, you can defer billing for products or services at year end. If you use the accrual method, you can delay shipping products or delivering services.

Accelerating deductible expenses into the current year. If you're a cash-basis taxpayer, you may pay business expenses

Chart 4 2023 income tax differences based on business structure

Pass-through entity or sole proprietorship	C corporation
One level of taxation: The business's income flows through to the owner(s).	Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.
Losses flow through to the owner(s).	Losses remain at the corporate level.
The top individual tax rate is 37%, but, for eligible taxpayers, up to 20% of qualified business income is deductible.	The flat corporate tax rate is 21%, and the top rate on qualified dividends is 20%.

by Dec. 31, so you can deduct them this year rather than next. Both cash- and accrual-basis taxpayers can charge expenses on a credit card and deduct them in the year charged, regardless of when the credit card bill is paid.

Warning: Don't let tax considerations get in the way of sound business decisions. For example, the negative impact on your cash flow or customers may not be worth the tax benefit.

Taking the opposite approach. If your business is a pass-through entity and it's likely you'll be in a higher tax bracket next year, accelerating income and deferring deductible expenses may save you tax over the two-year period.

Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be preferable to other methods because you'll get larger deductions in the early years of an asset's life.

But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention. Careful planning can help you maximize depreciation deductions in the year of purchase.

Other depreciation-related breaks and strategies may be available:

Section 179 expensing. This election allows you to currently deduct the cost of purchasing eligible new or used assets. Examples include equipment, furniture, off-the-shelf computer software, QIP (see "QIP deduction" on page 18) and certain personal property used predominantly to furnish lodging. The following improvements to nonresidential real property are also eligible: 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. 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 new tangible property with a recovery period of 20 years or less (such as office furniture and equipment), off-the-shelf computer software, QIP (see "QIP deduction" on page 18) and water utility property. Under the TCJA, through Dec. 31, 2026, the definition has been expanded to include used property and qualified film, television and theatrical productions.

Case Study 4

Demystifying vehicle-related deductions

Andre is considering buying some new vehicles for his business this year. He wants to know how the tax breaks available to him might be affected by the type of vehicle he buys or how the vehicle is used. So he consults his tax advisor.

She tells Andre that purchases of new or used vehicles may be eligible for Section 179 expensing, and he may want to buy a large truck or SUV to maximize his deduction. The normal Sec. 179 expensing limit (see "Section 179 expensing" on page 16) generally applies to vehicles with a gross vehicle weight rating of more than 14,000 pounds. A $28,900 limit applies to vehicles (typically SUVs) rated at more than 6,000 pounds, but no more than 14,000 pounds.

But even if Andre prefers to buy a smaller vehicle, he can still potentially enjoy a valuable first-year deduction. Vehicles rated at 6,000 pounds or less are subject to the passenger vehicle limits, and for 2023 the first-year depreciation limit is $20,200 ($12,200 plus $8,000 bonus depreciation).

Andre's advisor also explained that, if he uses a vehicle for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and nondeductible personal use. She also warns him that, if business use is 50% or less, he won't be able to use Sec. 179 expensing or the regular Modified Accelerated Cost Recovery System (MACRS); he'll have to use the straight-line method.

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
- 0% for 2027 and future years

(For certain property with longer production periods, these reductions are delayed by one year.)

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, you should consider accelerating qualified asset investments into 2023, before bonus depreciation drops further.

Warning: Under the TCJA, in some cases a business may not be eligible for bonus depreciation. Examples include real estate businesses that elect to deduct 100% of their business interest expense and dealerships with floor-plan financing, if they have average annual gross receipts of more than $29 million for the three previous tax years. (This amount is annually indexed for inflation.)

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

Employee benefits

Offering a variety of benefits not only can help you attract and retain the best employees, but also may save tax because you generally can deduct your contributions:

Qualified deferred compensation plans. These include pension, profit-sharing, SEP and 401(k) plans, as well as SIMPLEs. (For information on the benefits to employees, see page 22.) Certain small employers may also be eligible for a tax credit when setting up a retirement plan.

Fringe benefits. Certain fringe benefits aren't included in employee income, yet the employer can still deduct the portion, if any, that it pays and typically also avoid payroll taxes. Examples are employee discounts, group term-life insurance (up to $50,000 per person) and health insurance.

Warning: You might be penalized for not offering health insurance. The Affordable Care Act can in some cases impose

WHAT'S NEW!

Keeping up with deduction rules for meals, entertainment and transportation

Businesses used to commonly claim deductions for a wide variety of meal, entertainment, vehicle and travel expenses, as well as employee reimbursements of such expenses. But the TCJA changed some of the rules related to these expenses, and there also were some more recent but temporary changes to the rules regarding meals specifically. So, many business owners aren't 100% clear on the current rules. Here's an overview of what is and isn't deductible for 2023:

Meals. Under the TCJA, business-related meal expenses, including those incurred while traveling on business, remain 50% deductible. But, the TCJA expanded the 50% disallowance rule to meals provided via an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer. (Such meals used to be 100% deductible.)

Also, some temporary relief that generally increased the deduction to 100% for food and beverages provided by a restaurant in 2021 or 2022 has not been extended. So, unless an extension is signed into law, such meals will be only 50% deductible for 2023 and beyond. (Check with your tax advisor for the latest information.)

Entertainment. Under the TCJA, these expenses are no longer deductible.

Transportation. Employer deductions for providing commuting transportation (such as hiring a car service) aren't allowed under the TCJA, unless the transportation is necessary for the employee's safety. The TCJA also eliminated employer deductions for qualified employee transportation fringe benefits (for example, parking allowances, mass transit passes and van pooling). But, those benefits are still tax-free to recipient employees. Transportation expenses for business travel are still 100% deductible, provided they meet the applicable rules.

a penalty on "large" employers if they don't offer full-time employees "minimum essential coverage" or if the coverage offered is "unaffordable" or doesn't provide "minimum value."

HSAs, FSAs and HRAs. If you provide employees with a qualified high-deductible health plan (HDHP), you can also offer them Health Savings Accounts. (See page 4.) Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts for health care. (See page 4.) You can also offer FSAs for child and dependent care. (See page 7.)

A Health Reimbursement Account reimburses an employee for medical expenses up to a maximum dollar amount. Unlike an HSA, no HDHP is required. Unlike an FSA (other than when an exception applies), any unused portion can be carried forward to the next year. But only the employer can contribute to an HRA.

Interest expense deduction

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.

Some other taxpayers are also exempt. For example, larger real property businesses can *elect* to fully deduct their interest, but then would be required to use the alternative depreciation system for real property used in the business and can't claim bonus depreciation.

Loss deductions

A loss occurs when a business's expenses and other deductions for the year exceed its revenue:

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). So if your business is headed for a loss this year due to temporary business conditions, consider accelerating income if possible to reduce the amount of the loss.

Pass-through entity "excess" business losses. The TCJA applies a limit to deductions for current-year business losses incurred by noncorporate taxpayers: For 2023, such losses generally can't offset more than $289,000 ($578,000 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.) 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.

Tax credits

Tax credits reduce tax liability dollar for dollar, making them particularly beneficial. Here are some potentially valuable tax credits:

Research credit. This credit gives businesses an incentive to increase their investments in research. Certain start-ups (in general, those with less than $5 million in gross receipts) can, alternatively, use the credit against their payroll tax. While the credit is complicated to compute, the tax savings can prove significant.

Work Opportunity credit. This credit is designed to encourage hiring from various disadvantaged groups, such as certain veterans, ex-felons, the long-term unemployed and Supplemental Nutritional Assistance Program benefits recipients. The maximum credit is generally $2,400 per hire but can be higher in some cases — up to $9,600 for certain veterans, for example. This credit is scheduled to expire Dec. 31, 2025.

New Markets credit. This gives investors who make "qualified equity investments" in certain low-income communities a 39% credit over a seven-year period. This credit is scheduled to expire Dec. 31, 2025.

Family and medical leave credit. The TCJA created a tax credit for qualifying employers that begin providing paid family and

Case Study 5 — Many deductions available for the self-employed

Alicia left her full-time job earlier this year to join the gig economy and had to begin making estimated tax payments for the first time in her life. To be sure she was doing everything correctly, she visited her tax advisor.

He let Alicia know that along with the extra tax-paying responsibilities come some additional tax deductions. First, while she has to pay both the employee and employer portions of employment taxes on her self-employment income, the employer portion (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible "above the line," which means she doesn't have to itemize to claim the deduction.

In addition, Alicia can deduct 100% of health insurance costs for herself, and if she were married or had children, she could deduct these costs for them, too. This above-the-line deduction is limited to net self-employment income. Alicia also can take an above-the-line deduction for contributions to a retirement plan (see page 22) and, if she's eligible, an HSA (see page 4) for herself.

Alicia asks whether she can deduct her home office expenses. Her advisor explains that, if her home office is her principal place of business (or used substantially and regularly to conduct business) and that's the only use of the space, she probably can deduct home office expenses from her self-employment income.

Finally, depending on her income level, Alicia may qualify for the 199A deduction. (See page 14.)

medical leave to their employees. The credit is equal to a minimum of 12.5% of the employee's wages paid during that leave (up to 12 weeks per year) and can be as much as 25% of wages paid. This credit is scheduled to expire Dec. 31, 2025.

Additional rules and limits apply to these credits. Other credits may also be available to you. Check with your tax advisor for more information.

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 page 13) or the 20% long-term capital gains rate (see page 10).

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.

Address some key tax questions to help ensure a golden retirement

Planning for your retirement means making a series of financial decisions that will impact you both today and tomorrow: What type of plans should you invest in? How much should you save? When should you start taking withdrawals? In what amounts? Whether you're just starting to think about retirement planning, are retired already or are somewhere in between, addressing the tax questions relevant to your situation will help ensure your golden years are truly golden.

401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined contribution plan is usually a good first step:

- Contributions are typically pretax, reducing your taxable income.
- 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.

Chart 5 shows the 2023 employee contribution limits. Because of tax-deferred compounding, increasing your contributions sooner rather than later can have a significant impact on the size of your nest egg at retirement. If your employer offers a match, contribute at least the amount necessary to get the maximum match so you don't miss out on that "free" money.

Employees age 50 or older can also make "catch-up" contributions. But be aware that some rules for catch-up contributions will soon be changing. (See "What's new!" on page 24.)

Chart 5 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.*

More tax-deferred options

In certain situations, other tax-deferred saving options may be available:

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 than you could make to an employer-sponsored plan as an employee. You might not have to make 2023 contributions, or even set up the plan, before year end.

Your employer doesn't offer a retirement plan. Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited if your spouse participates in an employer-sponsored plan. You can make 2023 contributions until the 2023 income-tax-return-filing deadline for individuals, not including extensions. (See Chart 5 for the annual contribution limits.)

Roth alternatives

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Roth plans, however, allow tax-free distributions; the tradeoff is that your contributions don't reduce your current-year taxable income:

Roth IRAs. An income-based phaseout may reduce or eliminate your ability to contribute. But estate planning advantages are an added benefit: 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.

Roth 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 and take advantage of a Roth IRA's estate planning benefits. The converted amount is taxable in the year of the conversion. Discuss with your tax advisor whether a conversion makes sense for you.

"Back door" Roth IRA contributions. If your income is too high to make Roth IRA contributions and you don't have funds in a traditional IRA, consider setting up a traditional account and making a nondeductible contribution to it. You can then immediately convert the contributed amount to a Roth account with minimal or no tax impact.

Roth 401(k), Roth 403(b) and Roth 457 plans. Employers may offer one of these in addition to the traditional, tax-deferred version. No income-based phaseout applies, so even higher-income taxpayers can contribute.

Early withdrawals

Early withdrawals from retirement plans should be a last resort. With a few exceptions, distributions before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. Additionally, you'll lose the potential tax-deferred future growth on the withdrawn amount.

If you must make an early withdrawal and you have a Roth account, consider withdrawing from that. You can withdraw up to your contribution amount without incurring taxes or penalties.

Another option: If your employer-sponsored plan allows it, take a plan loan. You'll have to pay it back with interest and make

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 have 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. A charitable deduction can't be claimed for these qualified charitable distributions. But the QCD amounts aren't included in taxable income and can be used to satisfy an IRA owner's RMD. A QCD might be especially tax-smart if you won't benefit from the charitable deduction. (See "Charitable deductions" on page 4.)

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.

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.

regular principal payments, but you won't be subject to current taxes or penalties. (You can't borrow from an IRA.)

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. To avoid current income tax and penalties, consider staying put (if your plan allows), rolling over to your new employer's plan, or rolling over to an IRA.

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 bracket is low 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 tax breaks with income-based limits.

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 6.)

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 6.) 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

Chart 6 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.

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 6.)

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 6 on page 28.)

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.
- 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.

Case Study 6

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.

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 "Charitable deductions" on page 4.)

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.

What's your marginal tax rate?

Your marginal tax rate is the rate you'll pay on your next dollar of income, so in your planning it's important to know what it likely will be.

Pay attention to thresholds

The TCJA replaced graduated tax rates for corporations with one flat rate. (See Chart 7.) When businesses are structured as pass-through entities, income is taxed at the owners' individual rates. (See Chart 9.) So there are some big differences between tax rates for corporations and pass-through entities (though a special deduction for pass-throughs is available; see page 14).

For individuals, the taxable income thresholds vary significantly based on filing status. (See Chart 9.) The thresholds for estates and trusts are much lower. (See Chart 8.) There are also alternative minimum tax (AMT) rates to consider. (See Chart 9.)

The AMT is a separate tax system that disallows some deductions and treats certain income items differently. You must pay the AMT if your AMT liability exceeds your regular tax liability. Because of TCJA changes such as the reduction or elimination of many itemized deductions and a substantial increase to the AMT exemptions, far fewer taxpayers are subject to AMT risk now.

Chart 7 **2023 corporate income tax rates**

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

Chart 8 **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

Chart 9 2023 individual income tax rates

Regular tax brackets

Tax rate	Single	Head of household
10%	$ 0 – $ 11,000	$ 0 – $ 15,700
12%	$ 11,001 – $ 44,725	$ 15,701 – $ 59,850
22%	$ 44,726 – $ 95,375	$ 59,851 – $ 95,350
24%	$ 95,376 – $ 182,100	$ 95,351 – $ 182,100
32%	$ 182,101 – $ 231,250	$ 182,101 – $ 231,250
35%	$ 231,251 – $ 578,125	$ 231,251 – $ 578,100
37%	Over $ 578,125	Over $ 578,100

Tax rate	Married filing jointly or surviving spouse	Married filing separately
10%	$ 0 – $ 22,000	$ 0 – $ 11,000
12%	$ 22,001 – $ 89,450	$ 11,001 – $ 44,725
22%	$ 89,451 – $ 190,750	$ 44,726 – $ 95,375
24%	$ 190,751 – $ 364,200	$ 95,376 – $ 182,100
32%	$ 364,201 – $ 462,500	$ 182,101 – $ 231,250
35%	$ 462,501 – $ 693,750	$ 231,251 – $ 346,875
37%	Over $ 693,750	Over $ 346,875

Alternative minimum tax (AMT) brackets

Tax rate	Single	Head of household
26%	$ 0 – $ 220,700	$ 0 – $ 220,700
28%	Over $ 220,700	Over $ 220,700
Exemption	$ 81,300	$ 81,300
Phaseout[1]	$ 578,150 – $ 903,350	$ 578,150 – $ 903,350

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

Tax rate	Married filing jointly or surviving spouse	Married filing separately
26%	$ 0 – $ 220,700	$ 0 – $ 110,350
28%	Over $ 220,700	Over $ 110,350
Exemption	$ 126,500	$ 63,250
Phaseout[1]	$ 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.

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