2022 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

It's hard to believe we are already in the final quarter of 2022. As we begin looking forward to the possibilities of a new year, we believe it's important to take a moment to look back and review 2022 for year-end tax planning opportunities. We believe examining your 2022 tax situation before year-end could lead to tax savings when you file in 2023. To assist you, we have included our 2022 year-end income tax planning letter. We've included selected traditional as well as selected new planning ideas for you to consider. If you have any questions or want to discuss planning ideas not included in our letter, please call our firm so we can discuss.

Caution! The IRS continues releasing guidance on various important tax provisions. We closely monitor new tax legislation and IRS releases. Please call our firm if you want an update on the latest tax legislation, IRS notifications, announcements, and guidance or **if you need additional information concerning any item discussed in this letter.**

Be Careful! We suggest you call our firm before implementing any tax planning technique discussed in this letter. You cannot properly evaluate a particular planning strategy without calculating your overall tax liability with and without that strategy. This letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.**

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POSSIBLE LEGISLATION BEFORE YEAR-END

Each year we work to provide you with our year-end planning letter in time to allow implementation of possible tax saving strategies before December 31st. As a result, it is possible Congress could pass new legislation between your receipt of this letter and year-end. There are over 30 temporary tax provisions that expired at the end of 2021, many of which were energy related and were extended or changed by the Inflation Reduction Act of 2022. However, it appears a December omnibus spending package is the best chance for an extension of several expired or expiring provisions that were not extended by the Inflation Reduction Act in August. We have included a discussion of the Inflation Reduction Act of 2022 as well as selected, expired, and expiring provisions in this letter. Please contact our firm if you would like an update on current legislation and how it could affect you.

HIGHLIGHTS OF TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

We all know the last several years have been anything but normal. In most years, a traditional year-end tax planning strategy would include reducing your current year taxable income by deferring taxable income into later years and accelerating deductions into the current year. This strategy is particularly beneficial where your income tax rate in the following year is expected to be the same or lower than the current year. Consequently, in the following discussion we include traditional year-end tax planning strategies that would allow you to accelerate your deductions into 2022, while deferring your income into 2023. **Caution!** For individuals who expect their taxable income to be much lower in 2022 than in 2023, the opposite strategy might be more advisable. That is, for individuals who have experienced a significant drop in income during 2022, a better year-end planning strategy might include accelerating income into 2022 (to be taxed at lower rates), while deferring deductions to 2023 (to be taken against income that is expected to be taxed at higher rates).

Above-The-Line Deductions Can Generate Multiple Tax Benefits. Traditional year-end planning includes accelerating deductible expenses into the current tax year. So-called **"above-the-line"** deductions reduce both your "adjusted gross income" and your "modified adjusted gross income", while **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce either adjusted gross income or modified adjusted gross income. Deductions that reduce your adjusted gross income (or modified adjusted gross income) can generate multiple tax benefits by: **1)** Reducing your taxable income and allowing you to be taxed in a lower tax bracket; **2)** Potentially freeing up other deductions (and tax credits) that phase out as your adjusted gross income (or modified adjusted gross income) increases (e.g., Certain IRA Contributions, Certain Education Credits, Adoption Credit, Child and Family Tax Credits, etc.); **3)** Potentially reducing your modified adjusted gross income below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8% NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single); **4)** Possibly reducing your household income to a level that allows you to qualify for a "refundable" Premium Tax Credit for health insurance purchased on a government Exchange, **or 5)** As we will discuss later, potentially reducing your taxable income to a level that could maximize your 20% 199A Deduction (i.e., individuals reporting Qualified Business Income will generally find it much easier to qualify for the 20% 199A Deduction if their 2022 taxable income does not exceed **$340,100** if filing a joint return or **$170,050** if single). If you think that you could benefit from accelerating ***above-the-line*** deductions into 2022, consider the following:

- **Identifying Above-The-Line Deductions.** **Above-the-line** deductions include: Deductions for IRA or Health Savings Account (HSA) Contributions; Qualified Student Loan Interest; Qualifying Alimony Payments (if the divorce or separation instrument was **executed before 2019);** Educator Expenses; and, Health Insurance Premiums for Self-Employed Individuals. **Caution!** As discussed in more detail below, un-reimbursed employee business expenses are not deductible at all **for 2018 through 2025.** However, employee business expenses that are reimbursed under an employer's accountable plan are excluded altogether from the employee's taxable income. Moreover, there have been changes to the above-the-line deductions for **Moving Expenses,** and **Alimony Payments,** as follows:

  - **Moving Expenses.** Historically, the deduction for qualified **business-related moving expenses** was an above-the-line deduction. However, **for 2018 through 2025,** the deduction for **moving**

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expenses has been suspended for most individuals. **<u>Planning Alert!</u>** Generally, active members of the Armed Forces who move pursuant to a military order because of a permanent change of station may still deduct un-reimbursed qualified moving expenses as above-the-line deductions and may exclude the employer reimbursements of those moving expenses from income. For 2022, an **Armed Forces Member** may use the standard rate of **18 cents per mile from January 1 – June 30 and 22 cents per mile from July 1 – December 31, 2022** to determine the deduction for automobile expenses related to a qualified move.

- **<u>Alimony Payments.</u>** Historically, an individual making qualified alimony payments was allowed an above-the-line deduction for the payments and the recipient of the payments was required to include the payments in income. **However, effective for "Divorce or Separation Instruments" <u>executed after 2018,</u>** the **deduction for alimony payments has been repealed altogether.** The good news, however, is that these alimony payments **are no longer taxable to the recipient.** Alimony paid under a divorce instrument **<u>executed before 2019</u>** will generally be grandfathered under the previous rules. **<u>Planning Alert!</u>** If you are currently paying or receiving alimony pursuant to a divorce or separation instrument ***executed before 2019,*** the tax treatment of the alimony payments does not change. That is, if your alimony payments were deductible before 2019, they should continue to be deductible (and includible in the recipient's income). **<u>Caution!</u>** Form 1040, Schedule 1 requires individuals who ***receive*** taxable alimony to disclose the "*Date Of Original Divorce Or Separation Agreement,"* and the amount received. Individuals who ***deduct*** the alimony are required to list the social security number of the recipient and the "*Date Of Original Divorce Or Separation Agreement."*

- **<u>Accelerating Above-The-Line Deductions.</u>** As a cash method taxpayer, you can generally accelerate a 2023 deduction into 2022 by *"paying"* the deductible item in 2022. *"Payment"* typically occurs in 2022 if, **before the end of 2022: 1)** A check is delivered to the post office, **2)** Your electronic payment is debited to your account, or **3)** An item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express). **<u>Caution!</u>** If you post-date the check to 2023 or if your check is rejected, no payment has been made in 2022 even if the check is delivered in 2022. **<u>Planning Alert!</u>** The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payments are not deductible in 2022.

- **<u>Deductions For Business Expenses Paid By Partners.</u>** Generally, the IRS allows a partner in a partnership (or owner of an LLC) to take an above-the-line deduction for business expenses the owner **pays on behalf** of the partnership (or an LLC taxed as a partnership) **only if** there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership. **<u>Tax Tip!</u>** If you are a partner or LLC owner paying unreimbursed business expenses on behalf of your partnership or LLC, to be safe, you should have a written agreement in place with the entity stipulating that those expenses are to be paid by you, and that the expenses will not be reimbursed by the partnership or LLC.

- **<u>Be Careful With Employee Business Expenses.</u> Starting in 2018 and through 2025,** ***un-reimbursed*** employee business expenses are not deductible at all. For example, you **will not be able to deduct** any of the following business expenses **you incur as an employee, even if the expenses are necessary for your work: Automobile expenses** (including auto mileage, vehicle depreciation); **Costs of travel, transportation, lodging and meals; Union dues** and expenses; **Work clothes and uniforms;** Otherwise qualifying **home office expenses; Dues** to a chamber of commerce; **Professional dues; Work-Related education expenses; Job search expenses; Licenses and regulatory fees; Malpractice insurance premiums; Subscriptions** to professional journals and trade magazines; and **Tools and supplies** used in your work.

  <u>Note! An Employer's Qualified Reimbursement Of An Employee's Business Expenses Is Deductible By The Employer And Tax Free To The Employee.</u> Generally, employee business expenses that are reimbursed under an employer's qualified **"Accountable Reimbursement**

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Arrangement" are deductible by the employer (subject to the limit on business meals), and the reimbursements are **not taxable to the employee.** However, reimbursements under an arrangement that is ***not*** a qualified accountable reimbursement arrangement generally must be treated as compensation and included in the employee's W-2. In addition, the employee would get no offsetting deduction for the business expense. **Planning Alert!** Generally, for an employer to have a qualified **Accountable Reimbursement Arrangement - 1)** The employer must maintain a reimbursement arrangement that requires the employee to substantiate covered expenses, **2)** The reimbursement arrangement must require the return of amounts paid to the employee that are in excess of the amounts substantiated, and **3)** There must be a business connection between the reimbursement (or advance) and the business expenses.

Please call our firm if you need assistance. We can help you establish a qualifying **Accountable Reimbursement Arrangement** with your employer.

- **Be Careful If You Are Working For Your Own S Corporation.** If you operate your business as an S corporation and you also work for your S corporation as its employee, then it is particularly important that you have your S corporation (i.e., your employer) reimburse all of your employee business expenses under an accountable plan. Under this arrangement, the reimbursement will be deductible by your S corporation, the deduction from the reimbursement will pass through to you as the S corporation shareholder, and your S corporation/employer will be able to exclude the reimbursement from your W-2 wages.

- **Deducting Food And Beverage Expenses.** The Tax Cuts And Jobs Act generally repealed business deductions with respect to entertainment, amusement or recreation activities after 2017. **Planning Alert!** Fortunately, the IRS says that taxpayers can generally deduct 50% (100% for 2021 and 2022 if purchased from a restaurant) of the cost of meals (i.e., food and beverages) with a business associate (e.g., a current or potential business customer, client, supplier, employee, agent, partner, professional advisor). The IRS also says that a taxpayer can deduct 50% (100% for 2021 and 2022 if purchased from a restaurant) of the cost of food and beverages provided during a nondeductible entertainment activity with a business associate provided the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. **Caution!** If an employer reimburses an employee's deductible business food and beverage expense under an Accountable Reimbursement Arrangement, the employer could deduct 50% (100% for 2021 and 2022 if purchased from a restaurant) of the reimbursement. This same rule applies if you are employed by your own S corporation. However, as discussed previously, an employee who is not reimbursed by the employer for the business meal would get no deduction because un-reimbursed employee business expenses are not currently deductible.

Itemized Deductions. Although **itemized** deductions (i.e., below-the-line deductions) do **not** reduce your adjusted gross income or modified adjusted gross income, they still may provide valuable tax savings. **Starting in 2018 and through 2025,** recent legislation substantially increased the Standard Deduction. For 2022, the Standard Deduction is: Joint Return - $25,900; Single - $12,950; and Head-of-Household - $19,400. Recent legislation has also made certain changes to the following popular itemized deductions:

- **Charitable Contributions. Starting in 2018** (with no sunset date), a charitable contribution deduction is not allowed for contributions made to colleges and universities in exchange for the contributor's right to purchase tickets or seating at an athletic event (prior law allowed the taxpayer to deduct 80% as a charitable contribution). **Planning Alert!** If you think your itemized deductions this year could likely exceed your Standard Deduction of $25,900 if filing jointly ($12,950 if single) and you want to accelerate your charitable deduction into 2022, please note that a charitable contribution deduction is allowed for 2022 if the check is **"mailed" on or before December 31, 2022,** or the contribution is made by a credit card charge in 2022. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge. In addition, if you are considering a significant 2022 contribution to a qualified charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash

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proceeds to the charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, Bitcoin, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation. If instead you intend to use "*loss*" stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. **Caution!** As we mention later in our letter, the 100% of AGI limitation for cash charitable contributions by individuals who itemized deductions expired in 2021.

- **Casualty Losses. From 2018 through 2025,** the itemized deduction for personal casualty losses and theft losses has been suspended. However, personal casualty losses attributable to a Federally-declared disaster continue to be deductible. **Planning Alert!** Personal casualty losses generally continue to be deductible to the extent the taxpayer has personal casualty "gains" for the same year. In addition, casualty losses with respect to property held in a trade or business or for investment are still allowed.

  - **Alert! Returns Extended To October 17, 2022 Are Now Due February 15, 2023 For Florida, South Carolina, And North Carolina Residents And Businesses.** On October 5, 2022 the IRS announced that individuals and businesses in North Carolina and South Carolina have until February 15, 2023, to file various federal individual and business tax returns for 2021. The IRS made a similar announcement on September 29 for Florida residents and businesses. In addition, individuals and businesses in these states may deduct losses from Hurricane Ian since Ian has been declared a federal disaster. **Planning Alert!** You have the option to deduct any Hurricane Ian loss not covered by insurance on either your 2021 income tax return or on your 2022 income tax return. You should generally take the deduction on the return which produces the greatest tax benefit. If you are a resident or have a business in one of these states, please call our firm and we will help you decide if it is better to take any loss on your 2021 or 2022 return. In addition, we will gladly provide more details concerning Hurricane Ian relief. Also, more detailed information concerning the Federal Hurricane Ian relief provided for Florida, South Carolina, and North Carolina can be found at https://www.irs.gov/newsroom/help-for-victims-of-hurricane-ian.

- **Medical Expense Deductions.** If you think your itemized deductions this year could likely exceed your standard deduction of $25,900 if filing jointly ($12,950 if single), but you do not expect your itemized deductions to exceed your Standard Deduction next year, you could save taxes in the long run by accelerating elective medical expenses (e.g., braces, new eye glasses, etc.) into 2022. **Planning Alert!** For 2022, you are allowed to take a medical expense itemized deduction only to the extent your aggregate medical expenses exceed 7.5% of your AGI.

- **$10,000 Cap On State And Local Taxes. From 2018 through 2025,** your aggregate itemized deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes (or sales taxes if elected) is **limited to $10,000** ($5,000 for married individuals filing separately). Foreign real property taxes are not deductible at all unless the taxes are paid in connection with a business or in an activity for the production of income. You are still allowed a full deduction (i.e., an above-the-line deduction) for state, local, and foreign **property** or **sales** taxes paid or incurred in carrying on your **trade or business** (e.g., your Schedule C, Schedule E, or Schedule F operations).

  Planning Alert! Most states have enacted legislation allowing partnerships and S corporations to elect to pay state and local income taxes on the partnership's or S corporation's income. If this election is made, the state and local taxes paid by the partnership or S corporation are deductible by the entity and reduce the income flowing through to the partners or shareholders. This treatment may be beneficial to owners who have state and local taxes above the $10,000 cap discussed above. If the entity pays the state and local income taxes on its income, the owner does not pay tax on the same income. States either give the partners or S corporation shareholders a state credit or deduction on their personal returns for the state and local tax paid or income reported by the entity. Interestingly, the IRS has approved this avoidance of the $10,000 limitation for state and local taxes on partnership and S corporation income. Please give us a call if you would like to know more about your state's law allowing state and local taxes to be paid by the partnership or S corporation.

- **<u>Limitations On The Deduction For Interest Paid On Home Mortgage "Acquisition Indebtedness."</u>** Before the Tax Cuts And Jobs Act (TCJA), individuals were generally allowed an *itemized* deduction for home mortgage interest paid on up to $1,000,000 ($500,000 for married individuals filing separately) of **"Acquisition Indebtedness"** (i.e., funds borrowed to purchase, construct, or substantially improve your principal or second residence and secured by that residence). Subject to certain transition rules, TCJA reduced the dollar cap for **Acquisition Indebtedness incurred after December 15, 2017 from $1,000,000 to $750,000** ($375,000 for married filing separately) for **2018 through 2025.** Generally, any Acquisition Indebtedness incurred on or before December 15, 2017 is "grandfathered" and will still carry the $1,000,000 cap. Moreover, subject to limited exceptions, if you incurred *Acquisition Indebtedness* on or before December 15, 2017 (i.e., grandfathered Acquisition Indebtedness), the refinancing of that indebtedness after December 15, 2017 will still be entitled to the $1,000,000 cap (to the extent of the outstanding balance of the original *Acquisition Indebtedness* on the date of the refinancing). **<u>Caution!</u>** The $750,000 cap that generally applies to Acquisition Indebtedness incurred after December 15, 2017, is reduced by the outstanding balance of any grandfathered Acquisition Indebtedness. **<u>Planning Alert!</u>** If you think your itemized deductions this year could likely exceed your *Standard Deduction*, paying your January, 2023 qualifying home mortgage payment **before 2023** should shift the deduction on the interest portion of that payment **into 2022.**

- **<u>"Home Equity Indebtedness" Suspended For 2018 through 2025.</u>** TCJA suspended the deduction for **interest** with respect to **"Home Equity Indebtedness"** (i.e., up to $100,000 of funds borrowed that do not qualify as Acquisition Indebtedness but are secured by your principal or second residence). **<u>Caution!</u>** Unlike the interest deduction for Acquisition Indebtedness, TCJA **did not grandfather** any interest deduction for **Home Equity Indebtedness** that was **outstanding before 2018. <u>Planning Alert!</u>** A loan that has been labeled by your lender as a home equity loan, home equity line of credit (HELOC), or second mortgage on a Qualified Residence may, in certain situations, actually be classified as **Acquisition Indebtedness.** This would be the case where the borrowed funds were used to **substantially improve** your Qualified Residence that secures the loan. For example, assuming you have not exceeded the dollar caps on Acquisition Indebtedness, you will still be able to deduct the interest on a second mortgage taken out as a home improvement loan so long as the improvement: **1) Adds to the value** of your home that secures the second mortgage, **2) Prolongs** your **home's useful life,** or **3) Adapts** your home to **new uses. <u>Caution!</u>** These new rules can be tricky. We suggest that you talk with us before you sign off on a new mortgage: to buy your main house, to buy a second home, to place a second mortgage on your existing home, or to refinance your existing home mortgage. We will gladly review your situation and determine if there are ways to structure the loan that maximizes your interest deduction.

<u>Postponing Taxable Income May Save Taxes.</u> Generally, deferring taxable income from 2022 to 2023 may also reduce your income taxes, particularly if your effective income tax rate for 2023 will be lower than your effective income tax rate for 2022. Moreover, deferring income from 2022 to 2023 may provide you with the same tax benefits listed previously when you accelerate deductions into 2022 (i.e., Freeing up other deductions and tax credits that phase out as your adjusted gross income or modified adjusted gross income increases; Reducing your modified adjusted gross income below the income thresholds for the 3.8% Net Investment Income Tax; Reducing your household income to a level that allows a "refundable" Premium Tax Credit; or, Reducing your taxable income to a level that maximizes your 20% 199A Deduction).

<u>Planning Alert!</u> If, after considering all factors, you believe deferring taxable income into 2023 will save you taxes, consider the following:

- **<u>Planning For Tax Rates.</u>** The deferral of income could cause your 2022 taxable income to fall below the thresholds for the highest 37% tax bracket (i.e., $647,850 for joint returns; $539,900 if single). In addition, if you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral reduces your 2022 modified adjusted gross income below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), you may avoid this additional 3.8% tax on your investment income.

- **Deferring Self-Employment Income.** If you are a self-employed individual using the cash method of accounting, consider delaying year-end billings to defer income until 2023. **Planning Alert!** If you have already received the check in 2022, deferring the deposit of the check does not defer the income. Also, you *may not* want to defer billing if you believe this will increase your risk of not getting paid.

TAX PLANNING FOR INVESTMENT INCOME (INCLUDING CAPITAL GAINS AND NIIT)

Planning With The 3.8% Net Investment Income Tax (3.8% NIIT). The **3.8% Net Investment Income Tax (3.8% NIIT)** applies to the Net Investment Income of higher-income individuals. This tax applies to individuals with modified adjusted gross income exceeding the following **thresholds: $250,000** for **married filing jointly; $200,000** if **single;** and **$125,000** if **married filing separately.** The 3.8% NIIT is imposed upon **the lesser of** an individual's: **1)** Modified adjusted gross income in excess of the **threshold,** or **2)** Net investment income. **Note! Trusts and estates** are also subject to the **3.8% NIIT** on the **lesser of: 1)** The adjusted gross income of the trust or estate in excess of $13,450 (for 2022), or **2)** The undistributed net investment income of the trust or estate. The 3.8% NIIT not only applies to traditional types of investment income (i.e., interest, dividends, annuities, royalties, and capital gains), it also applies to "business" income that is taxed to a "passive" owner (as discussed in more detail below) unless the passive income is subject to S/E taxes. If you believe that the 3.8% NIIT may apply to you, consider the following planning techniques:

- **Shifting To Investments That Generate Income Exempt From The 3.8% NIIT.** Fortunately, the following types of income are **not subject** to the 3.8% NIIT: **tax-exempt bond interest;** gain on the sale of a principal residence otherwise excluded from income under the **home-sale exclusion** rules (i.e., up to $250,000 on a single return, up to $500,000 on a joint return); and **distributions from qualified retirement plans** (e.g., 401(k) plans, IRAs, §403(b) annuities, etc.). **Tax Tip!** Investments that generate tax-exempt income (e.g., tax exempt municipal bonds) potentially provide higher-income individuals with a double benefit: **1)** The interest will not be included in the individual's modified adjusted gross income, thus reducing the chance that the individual will exceed the income thresholds for the 3.8% NIIT, and **2)** The tax-exempt interest itself is exempt from the 3.8% NIIT as well as from Federal income taxes. **Planning Alert!** Although taxable distributions from qualified retirement plans (e.g., IRAs, 401(k) plans, etc.) are exempt from the 3.8% NIIT, the taxable distributions will increase your modified adjusted gross income. Therefore, to the extent the taxable distributions cause your modified adjusted gross income to exceed the thresholds for the 3.8% NIIT (e.g., $250,000 for joint returns; $200,000 for singles), the distributions could cause your other net investment income (e.g., dividends, interest, capital gains, rents, passive income) to be hit with the 3.8% NIIT.

- **Roth IRAs (Including Roth IRA Conversions).** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your modified adjusted gross income (and, thus will not increase your exposure to the 3.8% tax). Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered in the year of conversion would increase your modified adjusted gross income and, therefore, may increase your exposure to the 3.8% NIIT on your net investment income (e.g., dividends, interest, capital gains). **Planning Alert!** If you want a Roth conversion to be **effective for 2022,** you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2022** (you do not have until the due date of your 2022 tax return). **Caution!** Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and the 3.8% NIIT is just one of many factors that you should consider. **Please call us** if you need help in deciding whether to convert to a Roth IRA.

  - **Tax-Deferred Investments.** The 3.8% NIIT does not apply to earnings generated by a **tax-deferred annuity** (TDA) contract **until the income is distributed.** Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your modified adjusted gross income is below the 3.8% NIIT thresholds.

- **Passive Income.** "Net Investment Income" for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a passive owner (unless the income constitutes self-employment income that is subject to the 2.9% Medicare tax). You will generally be deemed a "passive" owner if you do not "materially participate" in the business as determined under the traditional "passive activity loss" rules. For example, under the passive activity loss rules, you may be a passive owner unless you spend more than 500 hours working in the business during the year or meet one of the other "material participation" tests. Furthermore, rental income is generally deemed to be passive income under the passive activity loss rules, regardless of how many hours you work in the rental activity. **Tax Tip!** In certain situations, real estate rentals may not be treated as passive income and could also be exempt from the 3.8% NIIT. For example, if you are a "qualified real estate professional," or you lease property to a business in which you materially participate, the rental income may be exempt from the 3.8% NIIT. If you believe you may qualify for one of these rental real estate exemptions, or you otherwise believe you may have passive income from non-rental business activities, please contact our firm. We will gladly evaluate your situation to determine whether there are steps you could take before the end of 2022 to avoid passive income classification, and thus, reduce your exposure to the 3.8% NIIT.

Traditional Year-End Planning With Capital Gains And Losses. Generally, net capital gains (both short-term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual filing a joint return with taxable income for 2022 of **$517,600 or more ($459,750 or more if single)** paying Federal income tax on **net long-term capital gains** at a **23.8%** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). In addition, an individual's **net short-term capital gains** could be taxed as high as **40.8%** (i.e., 37% plus 3.8%), for Federal income tax purposes. Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities continue to be as important as ever. The following are time-tested, year-end tax planning ideas for sales of capital assets. **Planning Alert!** Always consider the **economics of a sale or exchange first!**

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends.** For individuals filing a **joint return** with 2022 taxable income of **less than $83,350 (less than $41,675 if single),** their long-term capital gains and qualified dividends are taxed at a **zero percent rate. Tax Tip!** Individuals who have historically been in higher tax brackets but are now expecting a significant drop in their 2022 taxable income, may find themselves in the zero percent tax bracket for long-term capital gains and qualified dividends for the first time. For example, a significant drop in 2022 taxable income could have occurred due to the pandemic; or because you are between jobs; or you recently retired; or you are expecting to report higher-than-normal business deductions in 2022. **Planning Alert!** If you are experiencing any of these situations, please call us as soon as possible and we will help you determine whether you can take advantage of this zero percent tax rate for long-term capital gains and qualified dividends. If you wait too late to contact us, you may run out of time before the end of this year to take the recommended steps to maximize your tax savings.

- **Lower-Income Retirees.** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income individuals who then sell the securities could reduce the tax on all or part of the gain from as high as 23.8% to as low as zero percent. **Caution!** If the lower-income individual is subject to the so-called kiddie tax, this planning technique will generally not work.

- **Timing Your Capital Gains And Losses.** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2022, you should consider selling securities **prior to January 1, 2023** that would trigger a capital loss. These losses will be deductible on your 2022 return to the extent of your recognized capital gains, plus $3,000. **Tax Tip!** These losses may have the added benefit of reducing your income and allowing you to qualify for other tax breaks, such as: **1)** The $2,500 American Opportunity Tax Credit, **2)** The $2,000 Child Tax Credit, **3)** The Adoption Credit of $14,890, or **4)** The 20% 199A Deduction (discussed in more detail later). **Planning Alert!** If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the

"wash sale" rules (although the disallowed loss will increase the basis of the acquired stock). **Tax Tip!** If you are afraid of missing an upswing in the market during this 61-day period, consider buying shares of a different company in the same sector. Also, there is no wash sale rule for gains. Thus, if you decide to sell stock at a gain to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Planning With Capital Loss Carryforwards.** If you have substantial capital loss carryforwards coming into 2022, consider selling enough appreciated securities **before the end of 2022** to decrease your net capital loss to $3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your net capital loss (in excess of $3,000) to offset your short-term capital gain, while preserving favorable long-term capital gain treatment for later years. **Planning Alert!** Your net short-term capital gains can be used to free up a deduction for any investment interest you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest.

REMEMBER CHANGES TO IRAS AND QUALIFIED RETIREMENT PLANS

Secure Act Imposes A New 10-Year Pay-Out Requirement. Effective for **individuals dying after 2019,** the Secure Act generally requires a decedent's entire remaining IRA or qualified account balance to be distributed to a named beneficiary, other than an "eligible designated beneficiary", **by December 31 of the 10th year following** the year of the decedent's death. This required 10-year payout does not apply if the named beneficiary is an "eligible designated beneficiary" which includes the decedent's spouse, or an individual with a qualified disability, who is chronically ill, or is no more than 10 years younger than the decedent. If the named beneficiary is a child under age 21, the 10-year pay-out requirement does not kick in until the child reaches age 21. **Planning Alert!** If you currently have an estate plan based on the assumption that the non-spouse beneficiaries of your IRAs or qualified retirement plan accounts will be able to take Required Minimum Distributions (RMDs) over their life expectancies, it might be a good time to review and possibly update your estate plan. We will gladly assist you in determining how this new 10-year payout requirement affects your family's tax planning.

New Development! On February 23, 2022, the IRS issued proposed regulations interpreting this new 10-year rule for beneficiaries that are not "eligible designated beneficiaries." The proposed regulations proposed to require beneficiaries of individuals dying **after April 1st following age 72** to begin required minimum distributions (RMDs) in the calendar year following the year of the decedent's death and also required any remaining account balance of that beneficiary to be distributed to the beneficiary by the end of the 10th calendar year following the year of the decedent's death. However, the proposed regulations allowed beneficiaries who were not "eligible beneficiaries" of a decedent dying **before April 1st following age 72** to take distributions in any manner as long as the entire account balance of the beneficiary was distributed by the end of the 10th calendar year following the year of the decedent's death. Most believed that a beneficiary that was not an "eligible designated beneficiary" was not required to take a distribution prior to the 10th calendar year following the decedent's death whether the decedent died before or after April 1st following the decedent's turning age 72. Even the IRS's own publication seemed to say that was the case. The interpretation in the proposed regulations meant that non-eligible beneficiaries of decedents who died in 2020 or 2021 after the April 1st following the decedent's turning 72 would have a 50% penalty if RMDs were not made in 2021 for beneficiaries of decedents dying in 2020 and in 2022 for decedents dying in 2021. **In October 2022, the IRS announced** that this provision in the proposed regulations will not be effective prior to 2023. In addition, the IRS said that beneficiaries who are not "eligible designated beneficiaries" of individuals dying in 2020 or 2021 after April 1st following age 72 will not be penalized for failing to take an RMD in 2021 or 2022.

Planning For Rollovers By Surviving Spouses. The new 10-year payout requirement does not apply to a surviving spouse who is the named beneficiary of the decedent's IRA or qualified retirement plan. In that event, the surviving spouse would generally treat the IRA as an inherited IRA and would be required to take RMDs over the surviving spouse's *single life expectancy* (with no 10-year payout requirement). However,

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it is generally advisable for the surviving spouse to convert the decedent's IRA into the name of the surviving spouse (i.e., convert it into a spousal IRA). This is generally advisable because, once the decedent's IRA is converted to a spousal IRA: **1)** The surviving spouse will not be required to begin taking RMDs until the April 1st following the year the surviving spouse reaches age 72, and **2)** When the RMDs begin, the surviving spouse's RMDs will be determined using the *Uniform Lifetime Distributions Table* (with no 10-year payout requirement), which will result in a smaller annual required payout than under the single life expectancy computation that would otherwise be required had the surviving spouse not converted the decedent's IRA into a spousal IRA. **Caution!** If you (as surviving spouse) are not yet 59½, leaving the IRA or qualified plan account in the name of your deceased spouse (and not converting it to a spousal IRA) may actually be the better option if you think you will need to withdraw amounts from the retirement account before you reach age 59½. Otherwise, if your deceased spouse's account is transferred into your name as a spousal IRA and you take a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty.

SELECTED MISCELLANEOUS YEAR-END PLANNING CONSIDERATIONS

Consider Contributing The Maximum Amount To Your Traditional IRA. As your income rises and your marginal tax rate increases, deductible IRA contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute to your IRA, consider the following limitations. If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to **$12,000 ($14,000 if you are both at least age 50 by the end of the year)** for contributions to you and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than **$6,000 ($7,000 if at least age 50)** may be contributed to either your IRA account or your spouse's IRA account for 2022. If you are an active participant in your employer's retirement plan during 2022, your IRA deduction is reduced ratably as your adjusted gross income increases from **$109,000 to $129,000** on a joint return (**$68,000 to $78,000** on a single return). However, if you file a joint return with your spouse and your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your IRA deduction is reduced as the adjusted gross income on your joint return goes from **$204,000 to $214,000. Caution!** Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. The sum of your contributions for the year to your Roth IRA and to your traditional IRA may not exceed the $6,000/$7,000 limits discussed above. For 2022, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$204,000 to $214,000** on a joint return or from **$129,000 to $144,000** if you are single. **Planning Alert!** Unlike the rule for traditional IRA contributions, the amount you may contribute to a Roth IRA is reduced if your adjusted gross income falls within these phase-out ranges regardless of whether you or your spouse is a participant in another retirement plan. In addition, contributions to a Roth IRA are not deductible.

IRS Increases Standard Mileage Rates Effective July 1, 2022. The standard mileage deduction rate for your deductible business miles was increased from 58.5 cents per mile to 62.5 cents per mile effective July 1, 2022. In addition, the rate for medical and moving mileage increased from 18.0 cents per mile to 22.0 cents per mile.

- **Planning Alert!** Be sure to keep proper records for business, medical/moving, and charitable mileage for use as a possible deduction for 2022.

The 20% 199A Deduction For Qualified Business Income. Don't overlook the **20% Deduction** under **Section 199A (20% 199A Deduction)** with respect to **"Qualified Business Income," "Qualified REIT Dividends,"** and **"Publicly-Traded Partnership Income."** The 20% 199A deduction does not reduce your adjusted gross income or impact your calculation of self-employment tax. Instead, the deduction simply reduces your taxable income (regardless of whether you itemized deductions or claim the standard deduction). In other words, the 20% 199A Deduction is allowed ***in addition to*** your itemized deductions or your standard deduction. **Note!** The 20% 199A Deduction **expires after 2025!**

- **What Type Of Income Qualifies For The 20% 199A Deduction?** Generally, the following types of income are eligible for the 20% 199A Deduction: *Qualified REIT Dividends*, *Qualified Publicly-Traded Partnership Income*, and *Qualified Business Income*. The rules for determining the 20% 199A Deduction for Qualified REIT Dividends and Publicly-Traded Partnership Income are relatively straightforward. However, the 20% 199A Deduction for **Qualified Business Income** (QBI) is by far having the biggest impact on the greatest number of individual taxpayers, and can be complicated and tricky.

- **Who Can Qualify For The 20% 199A Deduction For Qualified Business Income (QBI)?** Taxpayers who may qualify for the 20% 199A Deduction generally include taxpayers who report Qualified Business Income from a trade or business such as: Individual owners of S corporations and partnerships; Sole Proprietors; Trusts and Estates; and Certain beneficiaries of trusts and estates. It is not feasible to provide a thorough discussion of the 20% 199A Deduction with respect to **Qualified Business Income (QBI)** in this letter. However, if you own an interest in a business as a sole proprietor, an S corporation shareholder, or a partner in a partnership, you are a very good candidate for the 20% 199A Deduction. If you want more information on the 20% 199A Deduction, please call our firm and we will be glad to provide you with more details.

No Deduction For Expenses Of A "Hobby". Before the 2017 Tax Cuts and Jobs Act, otherwise deductible trade or business expenses attributable to an activity that was *"not engaged in for profit"* (i.e., a hobby loss activity) were deductible: **1)** only as *miscellaneous itemized deductions,* and **2)** only to the extent of the activity's gross income. Since these hobby loss expenses are classified as miscellaneous itemized deductions, no deduction is allowed for these expenses ***from 2018 through 2025.*** **Planning Alert!** This makes it even more important for owners engaged in activities commonly subject to IRS scrutiny, to take steps to demonstrate the business is operated with the intent to make a profit.

- **Three Out Of Five Year Rule Or 2 Out Of Seven Year Rule.** To reduce the potential controversy over the question of profit motive, Congress provided that if an activity generates gross income in excess of expenses in three years out of five (two years out of seven in the case of raising, showing or racing horses) the activity is presumed to be engaged in for profit. **Planning Alert!** If the IRS challenges your business losses for the first few years of activity, let us know. We may be able to make an election to extend the statute and prevent a "hobby loss" disallowance until the business has been operating for 5 years (7 years for a horse activity).

- **Protecting Against Hobby Classification.** To avoid a loss of all deductions related to a business activity that is not profitable, you should: **1)** investigate the potential profitability of a new business activity and document the investigation before entering into the business; **2)** prepare a business plan before entering into a new business activity; **3)** maintain a separate business bank account and good books and records; and **4)** document any changes made and persons consulted to help produce a profit. **Please call us if you need help with this process.**

Tax Benefits For Clergy And Members Of The Military. Clergy and military members are able to exclude housing allowances from their income. In addition, if they itemize, they may deduct their mortgage interest, and up to the $10,000 max for state and local taxes. **Planning Alert!** Clergy and members of the military as well as other taxpayers who usually take the standard deduction should consider accelerating their mortgage payments and other itemized deductions into 2022 if doing so would allow their itemized deductions to exceed the standard deduction.

Gift And Estate Tax Planning. For 2022, a donor can **gift $16,000** to each donee. It is not a taxable gift to the donor and gifts are not included in the recipient's income. That exclusion amount will **go to $17,000 in 2023. Planning Alert!** Using the annual gift tax exclusion is an effective tool to move assets out of your estate without creating any gift tax.

IRS Advises Taxpayers To Check Withholding Now To Avoid Surprises Later. It's always a good idea to revisit your withholding and estimated tax payments before year-end to avoid an unexpected tax bill

which could include penalties and interest. In a recent news release the IRS reminded taxpayers that taxes are a "pay as you go" system where taxes are paid throughout the year through salary withholding and/or quarterly estimated tax payments. In addition, the IRS encourages taxpayers to use its Tax Withholding Estimator at https://www.irs.gov/individuals/tax-withholding-estimator to ensure they have the correct amount of taxes paid-in before December 31st. **Planning Alert!** It is especially important to review your withholding if you have had a significant event occur during 2022 such as a job change or loss, additional income stream, marriage, divorce, etc. If you believe your tax liability has been affected because of a significant event, and you have questions, please call our firm so we can discuss.

Be Aware Of IRS 2022 "Dirty Dozen List" Of Tax Scams. On June 1, 2022 the IRS issued its first installment of its "Dirty Dozen" Tax Scams. For your information, we have listed a few of these items below.

- **Economic Impact Payment And Tax Refund Scams.** The IRS says "*identity thieves who try to use Economic Impact Payments (EIPs), also known as stimulus payments, are a continuing threat to individuals. Similar to tax refund scams, taxpayers should watch out for tell-tale signs of a scam including any text messages, random incoming phone calls or emails inquiring about bank account information. Any request to click a link or verify data should be considered suspicious and deleted without opening. This includes not just stimulus payments, but tax refunds and other common issues."*

  The *IRS says it "will not initiate contact by phone, email, text or social media asking for Social Security numbers or other personal or financial information related to Economic Impact Payments."* The IRS also says to *"be alert to mailbox theft. Routinely check your mail and report suspected mail losses to postal inspectors."* The IRS also points out that it *"has issued all Economic Impact Payments. Most eligible people already received their stimulus payments. People who are missing a stimulus payment or got less than the full amount may be eligible to claim a Recovery Rebate Credit on their 2020 or 2021 federal tax return."*

- **Fake Charities That Steal Your Money.** The IRS says *"Bogus charities are always a problem. They tend to be a bigger threat when there is a national crisis like the pandemic. Taxpayers who give money or goods to a charity may be able to claim a deduction on their federal tax return. Taxpayers must donate to a qualified charity to get a deduction. To check the status of a charity, use the IRS Tax Exempt Organization Search tool."* https://www.irs.gov/charities-non-profits/tax-exempt-organization-search

- **Text Message Scams.** The IRS says *"Bogus texts may purport to come from the IRS and concern economic impact payments or other COVID-19 tax relief. Links in the text may then direct victims to sites where they are asked to enter their information. The IRS said that it does not contact taxpayers by text message to discuss personal tax issues such as tax bills or refunds, either by SMS protocol or by messaging on social media platforms. It does send a text message as a second factor to authenticate users' identity when they access online self-help tools, but only after the user has entered valid login information on the IRS's website. Taxpayers receiving an unexpected fraudulent text that masquerades as being from the IRS should take a screenshot of it (without clicking on any links) and send it in an email to phishing@irs.gov with the date and time (including time zone) received and phone number on which it was received."*

- **Email Scams.** The IRS said it initiates contact with taxpayers by postal mail in most instances. If taxpayers receive a "phishing" email that purports to be from the IRS or a related program, they may report it by forwarding it (without opening any links or attachments) to phishing@irs.gov.

- **Phone Scams.** The IRS reminded taxpayers that **criminals can "spoof" a caller ID to make phone calls appear to be from the IRS.** Such bogus calls may also impersonate an IRS agent and threaten arrest, deportation, or license revocation if the taxpayer does not immediately make a payment. The IRS suggests taxpayers receiving such calls hang up immediately. The Service reminded taxpayers that it initiates collection actions only via postal mail and that legitimate tax payment requests are payable only to the U.S. Treasury.

Consider An Identity Protection PIN For Filing Tax Returns. An Identity Protection PIN (IP PIN) is a six-digit number that takes the place of an individual's social security number on the individual's income tax return. Previously, IP PINs were only available to victims of identity theft and individuals in select states who were not victims of identity theft. Beginning in 2021, individuals are able to voluntarily opt into the IP PIN program as a proactive way to protect themselves from tax-related identity theft. Individuals who wish to receive an IP PIN must pass a rigorous identity verification process. In addition, spouses and dependents are eligible for an IP PIN if they can pass the identity proofing process. Individuals wishing to obtain an IP PIN should use the online "Get an IP PIN" tool. If an individual does not already have an account on IRS.gov, the individual must register to validate the individual's identity. Also, an IP PIN is valid for one calendar year. Therefore, an individual will be issued a new IP PIN each year. If you would like more information about IP PINs, please visit the IRS website at https://www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin.

HIGHLIGHTS OF PROVISIONS INCLUDED IN THE INFLATION REDUCTION ACT OF 2022

On August 16, 2022, President Biden signed the Inflation Reduction Act of 2022. The following is a summary of selected provisions included in the Inflation Reduction Act that could impact your 2022 tax planning.

Extension Of American Rescue Plan Act Premium Tax Credit Provisions Through 2025

- **Modification Of Premium Tax Credit Tables.** The American Rescue Plan Act modified the tables for calculating the Premium Tax Credit. The modification results in a greater Premium Tax Credit than for years prior to 2021. These new tables were extended through 2025 by the Inflation Reduction Act.

- **Premium Tax Credit Now Available For Those With Household Incomes Greater Than 400% Of Federal Poverty Line.** The American Rescue Plan Act removed the provision denying the Premium Tax Credit where household income exceeded 400% of the Federal Poverty Line. For example, according to the Congressional Budget Office, a 45-year-old single individual with income of $58,000 (450% of the FPL) in 2021 would not have been eligible for the Premium Tax Credit under pre-American Rescue Plan Act law. Under the American Rescue Plan Act, that individual would be eligible for a PTC of about $1,250 for 2021. This provision was also extended through 2025 by the Inflation Reduction Act through 2025.

Credit For Energy Efficient Residential Property Improvements

- **Pre-Inflation Reduction Act Credit Extended Through 2022.** The credit for residential energy property improvements made to an individual's principal residence was 10% of the amount paid or incurred up to a maximum **$500 lifetime limitation**. The credit expired at the end of 2021. The Inflation Reduction Act extends this credit through 2022 and provides a new expanded credit for qualifying improvements to residential property after 2022 and before 2032. **Planning Alert!** If you are planning to make residential property improvements qualifying for the new increased credit, you may want to wait until 2023 since the credit could be much larger. In addition, you would receive no credit in 2022 if you have already exceeded your $500 lifetime limitation for energy efficient improvements prior to 2022.

- **Increased Credit Limitation After 2022.** The Inflation Reduction Act provides an increased 30% credit generally with an **annual $1,200 limitation** for qualified energy efficient residential property improvements after 2022 and before 2032. The credit for a tax year equals **30%** of the sum of **1)** the amount paid or incurred by the taxpayer for qualified **Energy Efficiency Improvements installed during that year, 2)** the amount of the **Residential Energy Property Expenditures paid or incurred** by the taxpayer during that year, and **3)** amounts paid or incurred during the year for home energy audits of the taxpayer's principal residence. The maximum credit for home energy audits is **$150.**

- **Qualified Energy Efficiency Improvements.** Qualified Energy Efficiency Improvements are improvements to a dwelling unit located in the U.S. owned and used as the **taxpayer's principal residence,** the original use of which begins with the taxpayer, and reasonably expected to be in use

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for at least 5 years. Qualified Energy Efficiency Improvements include energy efficient building envelope components such as insulation, exterior windows (including skylights), and exterior doors. The maximum credit for any taxable year resulting from expenditures for all exterior windows and skylights **may not exceed $600.** And, the maximum credit for a taxable year **may not exceed $250 for any one exterior door and $500 for all exterior doors.**

- **Residential Energy Property Expenditures.** Qualified Residential Energy Property Expenditures are expenditures made by the taxpayer for Qualified Energy Property, the original use of which begins with the taxpayer, installed on or in connection with a dwelling unit located in the U.S. owned and **used as a residence by the taxpayer.** Qualified Residential Energy Property Expenditures include any of the following which meet or exceed the highest efficiency tier (not including any advanced tier) established by the Consortium for Energy Efficiency in effect as of the beginning of the calendar year in which the property is placed in service: **an electric or natural gas heat pump or heat pump water heater; a central air conditioner; a natural gas, propane, or oil water heater; a natural gas, propane, or oil furnace or hot water boiler. For a full list of qualifying expenditures, please call our firm!**

  Qualified Residential Energy Property Expenditures include expenditures for labor costs properly allocable to the **onsite preparation, assembly, or original installation** of the property. **Caution!** The maximum credit for any taxable year resulting from any item classified as an energy property expenditure **generally cannot exceed $600.**

- **Higher Credit Limitation For Qualifying Heat Pumps, Heat Pump Water Heaters And Biomass Stoves And Boilers.** Notwithstanding the $1,200 and $600 limitations on the credit discussed previously, the **maximum credit is $2,000** for amounts paid or incurred in a taxable year for **1)** qualified electric or natural gas heat pumps and heat pump water heaters which meet or exceed the highest efficiency tier (not including any advanced tier) established by the Consortium for Energy Efficiency which is in effect as of the beginning of the calendar year in which the property is placed in service and **2)** biomass stoves and boilers with a thermal efficiency rating of at least 75 percent (measured by the higher heating value of the fuel) used in a dwelling unit in the U.S. and used as a residence by the taxpayer. **Note!** Expenditures otherwise qualifying for the credit are reduced by any subsidized energy financing.

Modification To Existing EV Credit Qualification For Vehicles Purchased After August 16, 2022

- **Final Assembly Must Occur In North America.** Changes made by the Inflation Reduction Act to the electric vehicle (EV) credits are generally effective for vehicles purchased after 2022. However, for an EV purchased after August 16, 2022, the IRA requires the final assembly of the vehicle to occur in North America to qualify for the credit. However, this “final assembly requirement” does not apply where the taxpayer entered into a written binding contract to purchase a new qualifying EV before August 16, 2022 but took possession of the EV on or after August 16, 2022.

  Planning Alert! IRS says *“If you purchase and take possession of a qualifying electric vehicle after August 16, 2022 and before January 1, 2023, aside from the final assembly requirement, the rules in effect before the enactment of the Inflation Reduction Act for the EV credit apply (including those involving the manufacturing caps on vehicles sold).”*

- **Determining If Final Assembly Occurred In North America.** The Department of Energy has provided a list of Model Year 2022 and early Model Year 2023 electric vehicles that may meet the final assembly requirement. The list can be found at https://afdc.energy.gov/laws/inflation-reduction-act. However, because some models are built in multiple locations, the IRS says there may be vehicles on the Department of Energy list that do not meet the final assembly requirement in all circumstances. Therefore, the IRS says to identify the manufacture location for a specific vehicle, we should search the vehicle identification number (VIN) of the vehicle on the VIN Decoder website for the National Highway Traffic Safety Administration (NHTSA). The NHTSA website, can be found here https://www.nhtsa.gov/vin-decoder.

New "Clean Vehicle Credit" For Vehicles Purchased After 2022 And Before 2033

Prior to the IRA, credits were provided for new "Qualified Plug-In Electric Drive Motor Vehicles." In addition, before 2022, a credit was available for qualified fuel cell motor vehicles. The IRA amends the law to provide credits for "Clean Vehicles" after 2022 and before 2033. A "Clean Vehicle" includes a qualified electric vehicle (EV) and a qualified fuel cell motor vehicle. The IRA removes the disallowance of the EV credit when the number of electric vehicles sold by a manufacturer exceeds 200,000, effective **for vehicles sold after December 31, 2022. Planning Alert!** Vehicles manufactured by Tesla and General Motors do not qualify for the EV credit for 2022 since these manufacturers exceeded their 200,000 limits in prior years. Therefore, individuals purchasing vehicles manufactured by Tesla or GM may wish to wait until 2023 to acquire a qualifying vehicle. However, please remember that vehicles purchased after 2022 must meet the new requirements under the IRA to qualify for the Clean Vehicle Credit.

After 2022, taxpayers are allowed a credit for purchasing a qualifying EV. The **maximum credit amount is $7,500 for new EVs.** The vehicle must have a minimum battery capacity of seven kilowatt hours; be manufactured primarily for use on public streets, roads, and highways; have at least 4 wheels, and have a gross vehicle weight rating (GVWR) of less than14,000 lbs. The credit is calculated as follows:

- **$3,750 credit** if at least **40% of the critical minerals contained in the battery** are extracted or processed in the U.S., in a country with which the U.S. has a free trade agreement in effect, or are recycled in North America. This 40% requirement applies to vehicles placed in service after the IRS issues guidance concerning the critical minerals and battery component requirements. The 40% critical minerals requirement is increased as follows: to 50% for EVS placed in service in 2024; 60% for 2025; 70% for 2026; and 80% after 2026.

- **$3,750 additional credit** if at **least 50%** of the battery components are **manufactured or assembled in North America.** This 50% requirement applies to vehicles placed in service after the IRS issues guidance concerning the critical minerals and battery component requirements. The 50% battery component requirement is increased as follows: to 60% for EVS placed in service in 2024 & 2025; 70% for 2026; 80% for 2027; 90% for 2028 and 100% after 2028.

Caution! No credit will be allowed for a new vehicle if the manufacturer's suggested retail price of the vehicle exceeds: **$80,000** for SUVs, pickups, and vans; and **$55,000** for other vehicles. In addition, no credit will be allowed for a new vehicle if the **lesser of** current or prior year modified adjusted gross income is more than **$300,000** for joint filers, **$225,000** for head of households, and **$150,000** for others. **Please call our firm** if you need additional information and assistance.

Extension And Increase In Individual Energy Credit For "Qualified Fuel Cell Property," "Qualified Small Wind Energy Property," "Qualified Solar Electric Property," "Qualified Solar Water Heating Property," "Qualified Geothermal Heat Pump Property," And "Qualified Biomass Fuel Property"

The credit for: **1)** *"Qualified Fuel Cell Property Expenditures*," **2)** *"Qualified Small Wind Energy Property Expenditures*," **3)** "Qualified Solar Electric Property *Expenditures*," **4)** "Qualified Solar Water Heating Property *Expenditures*," **5)** *"Qualified Geothermal Heat Pump Property Expenditures,"* and **6)** "Qualified Biomass Fuel Property *Expenditures*" was amended by the Consolidated Appropriations Act to be a 26% credit for qualifying property expenditures in 2021 and 2022, with a reduction of the credit to 22% for qualifying property expenditures in 2023 and no credit for expenditures after 2023.

The IRA provides that for qualified property expenditures after 2019 and before 2022, the credit is 26%. For qualified property expenditures after 2021 and before 2033, the credit is 30%. In addition, "Qualified Biomass Fuel Property" only qualifies for the credit before 2023. For property expenditures after 2022 "Qualified Battery Storage Technology Expenditures" replace "Qualified Biomass Fuel Property Expenditures" as property qualifying for the credit.

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Note! This credit for the above qualified energy property applies to expenditures by individuals for the above qualified energy property installed in a dwelling located in the United States and used as a residence by the taxpayer.

HIGHLIGHTS OF INDIVIDUAL PROVISIONS THAT EXPIRED AFTER 2021

Several provisions available in 2021 have expired and, as of now, are no longer available for 2022 year-end planning consideration. Below are a few of those provisions you should be aware of while planning for your 2022 tax liability.

Increased Child Tax Credit From $2,000 To $3,000 For Children Age 6 Through 17 And $3,600 For Children Under Age 6. The increase in the child tax credit, and the increase in the refundable amount of the credit to 100% by the American Rescue Plan Act **expired** after 2021. **Beginning in 2022,** the child tax credit reverts to **$2,000** for a qualifying child and **$500** for dependents other than qualifying children. The total credits are reduced by $50 for each $1,000 of modified adjusted gross income over: **$400,000** for joint filers, and **$200,000** for all others. In addition, the credit is no longer fully refundable. **Planning Alert!** If you are able to take the child credit in 2022, make sure you take this into consideration when estimating your 2022 tax liability.

Refundable And Enhanced Child And Dependent Care Credit. The increase in the maximum expenses eligible for the child and dependent care credit to $8,000 for one qualifying individual and to $16,000 for two or more individuals, the increase in the credit percentage, and the modified phase-out provisions provided by the American Rescue Plan Act, **expired** after 2021. **Beginning in 2022,** the maximum expenses eligible for the child and dependent care credit revert to **$3,000 for one** qualifying individual and **$6,000 for two** or more qualifying individuals. In addition, taxpayers with adjusted gross income **over $43,000** will receive a maximum **20% credit of $600** for one qualifying individual and **$1,200** for two or more qualifying individuals. Also, the **credit is no longer refundable. Note!** The advance payment of projected child tax credits **expired** on December 31, 2021.

Deduction For Charitable Contributions In 2021 For Individuals Who Do Not Itemize. For 2021, the Consolidated Appropriations Act provided an additional standard deduction for cash charitable contributions by individuals who did not itemize. The maximum deduction was $300 for singles and for married individuals filing separately and $600 for married individuals filing joint returns. This deduction **expired** for taxable years beginning after 2021.

Increased Itemized Deduction For Charitable Contributions. The 100% of AGI limitation for cash charitable contributions by individuals who itemized deductions **expired** after 2021.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our Firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

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