November 2023

Tax Talk

A quarterly publication of Bridges & Dunn-Rankin, LLP

Inside this issue:

Dear Clients and Friends,

Bridges & Dunn-Rankin is celebrating its 30th anniversary next month. It seems like only yesterday that we were meeting in the dining room of my home (which was temporary world headquarters for BDR while we looked for office space). As I reflect back over these past 30 years (and as I pen these words on the week of Thanksgiving), I realize that God has blessed me and our firm so richly and I have so much for which to be thankful.

I am thankful for parents who instilled in me at an early age a good work ethic and a belief in meeting commitments and treating everyone you meet fairly; for college professors like Ray and Lee Knight and Ed Schnee who made accounting and tax law interesting and provided me with a solid technical foundation; for my early mentors at KPMG; for a supportive wife and children (and for not learning that my wife was expecting our first child until a week after I resigned my job to start this firm); for having sat next to Bill Roberts at a Business & Technology Alliance meeting in 1993 (a chance encounter to which I can trace many of my favorite business and personal relationships); for our vendors; for our referral sources; for friendly competitors; for good health that has enabled me to rarely (if ever) miss a day of work due to illness; and, most of all, FOR OUR CLIENTS.

Kent Bridges, Managing Partner

Most of you receiving this newsletter have been a part of our success over the past 30 years, and for that I thank you. The past 30 years have been great, and I look forward to the next 30.

This is the time of the year for year-end tax planning, and so we will focus on year-end planning in this issue, along with discussing the employee retention credit (ERC) and recent guidelines issued by IRS on how to withdraw an ERC claim, an IRS warning about purchasing art for donation, and our usual annual roundup of changes in amounts indexed to inflation.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges

Year-end Tax Planning Strategies

Late November through year end is the time for year-end tax planning. While every client's situation is unique, here are some of the more common strategies we employ.

Acceleration or deferral of income and deductions – Businesses which use the cash basis of accounting for income tax purposes often have a great deal of control over the timing of income and deductions. Similarly, individuals can often time the recognition of significant gains or a significant deduction (e.g. charitable contributions). Shifting income from a high-rate bracket year to a low-rate bracket year can obviously result in a permanent tax savings. And now, with short-term interest rates fairly high, deferral of the payment of tax for a year can provide a meaningful benefit.

Harvesting of capital losses – Capital losses can, for the most part, only be deducted against capital gains. And while capital losses can be carried forward, for individuals they cannot be carried back to previous years. Accordingly, it is generally a good strategy to go ahead and recognize any potential capital losses you have.

Optimizing the "qualified business income" deduction – The *Tax Cuts and Jobs Act* included a 20% deduction for business income from most flow-through entities (other than "specified services businesses" like accounting and law firms). For individuals with taxable income over the threshold amounts ($182,100 for singles and $364,200 for married couples, with phase-outs up to $232,100 and $464,200, respectively), the deduction is generally limited to the lesser of 20% of the K-1 profit or 50% of your share of the W-2 wages paid by the business. For companies with a significant amount of payroll, this W-2 wages limitation is generally not a problem. However, for companies with few if any employees other than the owners, the deduction may be maximized by paying the optimal level of owners' compensation.

Passthrough entity tax election – Since 2018, there has been a $10,000 per year limit on individuals' deduction for state and local taxes (SALT) on Schedule A as itemized deductions. Since that time, most states with an individual state income tax (including Georgia) have enacted legislation permitting S-corps and partnerships to elect an entity level tax in lieu of the income being taxed at the level of the individual owners, thus providing a potential workaround to the $10,000 limit. For S-corps and partnerships, consideration should be given each year to whether the election is advantageous and, if so, whether the entity needs to make state estimated tax payments.

Use of tax credits to minimize state income tax – There are various tax credits which can be utilized to minimize state income tax. Some must be generated by a business entity (e.g. the

(Continued on page 2)

Member in the Spotlight — Bailey Post

The first voice you usually hear when you call our office and the first face you see when you visit our office is that of Bailey Post. She is also the one who turns rough drafts of tax returns and financial statements into the nice finished package you receive, makes sure your tax returns, extensions and other documents not being filed electronically get filed by certified mail, manages our power of attorney filings with IRS, manages our incoming and outgoing mail, FedEx, UPS and couriers, scans and organizes documents we receive in physical format, gets copies of your tax returns to your bankers when requested, gets invoices out to clients, manages our file room, makes it possible for our professionals to work remotely, and more.

Bailey grew up in Marietta, Georgia and attended Georgia Southern University, from which she received a Bachelors in Business Administration. Outside of work she enjoys reading, traveling, and spending time with family and friends.

Bridges & Dunn-Rankin is proud to have Bailey Post as a member of our firm.

Bailey Post

Year-end Tax Planning Strategies — continued

(Continued from page 1)

Georgia jobs credit, research credit and retraining credit), some can essentially be purchased (e.g. the Georgia low-income housing credit and film credit), and others are based on taking some action which the government is encouraging (e.g. the Georgia credits for donations to provide private school scholarships, and assistance to charter schools, foster child support organizations, law enforcement foundations, and rural hospitals).

Timing of charitable donations – It is generally advantageous to time significant charitable donations to coincide with a year in which you have significant income and are in a higher rate bracket. Because of the percentage of income limitations on charitable deductions and the inability to carry the deduction back to earlier years, making a substantial donation in the year <u>after</u> a big gain can potentially result in the permanent loss of a tax benefit versus having made the donation in the same year as the substantial gain. On the other hand, if you have charitable carryforwards that are in danger of expiring, deferring additional donations to the next tax year may be prudent. For those who want a charitable donations tax deduction in the current year, but want to control the donated assets for a while longer or have a number of years over which to distribute the funds to the ultimate charities, a private foundation or a donor advised fund may work well. A charitable remainder trust can work well where you have an appreciated asset you wish to sell and desire to retain an income stream from the proceeds but are willing to commit the remainder to charity at your death. Those age 70 ½ or older can make charitable gifts directly from their IRA, and have such count towards their IRA required minimum distributions; with a limit of $100,000 per year for each eligible spouse.

Estimated tax payments – In order to avoid a penalty, you are generally required to pay in through withholding or quarterly tax payments the lesser of 90% of your current year tax liability or 110% of your prior year tax liability. With respect to estimated tax payments, you get credit the day you actually make the payment. Withholding, however, is generally deemed to have occurred ratably throughout the year. Accordingly, if you realize late in the year that you have a shortfall for earlier quarters, you can sometimes avoid the penalty by increasing your withholding late in the year (e.g. having all of a year-end bonus withheld for taxes).

S-corp and LLC basis and at-risk limitations – In general, you can deduct your share of losses from S-corps and LLCs, and distributions from such entities are generally tax-free. However, the ability to deduct losses or receive tax-free distributions is limited by the "basis" and "at-risk" rules. Basically, the amount of loss you can deduct or distributions you can receive tax-free is limited to your unreturned investment in the entity (including past undistributed profits and, in the case of partnerships and LLCs, your share of the entity's liabilities which are either bank debt on a real estate project or debts for which you are personally liable). With respect to flow-through entities in which you own a stake, you should review your basis and at-risk amounts prior to year end to determine whether any tax advantage can be gained by increasing such amounts and whether such is prudent from an economic standpoint.

Exercise of ISOs in year not in AMT – "Incentive stock options" (ISOs) hold out the promise of being able to potentially convert what would otherwise be ordinary income into long-term capital gain. However, because the bargain element is an "alternative minimum tax" (AMT) adjustment on the date of exercise, the AMT often eliminates much of the hoped-for benefit. A tax year in which you will not be in the AMT represents an opportunity to exercise some ISOs at no tax cost, meaning a potential permanent tax savings if you hold the stock for the requisite period.

Sale of ISO shares that have fallen in value - If you exercise ISOs and sell in the same tax year, then the AMT issue goes away. Accordingly, we typically advise our clients who want to exercise and hold ISOs to do so early in the year, giving us almost a full year to watch the stock price and to sell the stock before year end if necessary in order to cure the AMT problem. If you exercised ISOs earlier this year, you still hold the shares, and the value of the shares has fallen dramatically, then now may be the time to sell.

Bonus first-year depreciation and Section 179 expense – For most depreciable assets (other than buildings and with some limitation on "luxury automobiles"), 100% of the cost up to $1,160,000 can be deducted immediately (so long as the cost of eligible assets placed in service during the year does not exceed $2,890,000) under IRC 179. Alternatively, 80% of the cost can be expensed immediately in 2023 under the "bonus depreciation" rules (with the percentage set to decline each year going forward).

Selection of accounting methods – New businesses can, within certain limitations, select the tax accounting methods (e.g. cash or accrual) which are most beneficial for them; and existing businesses have some latitude to later change their accounting methods. Your situation should be reviewed each year in order to determine which accounting methods are most advantageous for you.

Conversion of IRA to Roth status - With a traditional deductible IRA, you get a tax deduction on the front end when you make the

(Continued on page 3)

Year-end Tax Planning Strategies — continued

(Continued from page 2)

contribution, but then are subject to ordinary income tax rates on withdrawals. With a nondeductible traditional IRA, you get no tax deduction on the front end, but then a portion of your withdrawals is tax-free recovery of basis. With a "Roth IRA", you get no front -end tax deduction but the appreciation in value permanently escapes tax. Traditional IRAs can be converted to Roth IRAs. The conversion is a taxable event (unless you have tax basis from nondeductible contributions equal to value), so careful planning is necessary to determine if a conversion makes sense for you.

IRA Required Minimum Distributions (RMDs) – Once you attain age 72 (or 73 if you reach age 72 after 2022), and for each year thereafter, you are required to take distributions from your IRAs (and other qualified retirement plans) at least equal to a minimum amount computed using IRS-provided tables. Failure to take at least this minimum amount can subject you to a significant penalty on the shortfall (previously 50%, now 25%, and possibly only 10% if corrected within 2 years). For the year you first reach the RMD age, you have a grace period up through the first three months of the next tax year in which to take your RMD. However, utilizing the grace period will mean doubling up your RMD amount in that next calendar year, which could force some of the income into a higher rate bracket. The years between age 59 ½ (the earliest date at which you can take IRA distributions without incurring an early distribution penalty) and 73 may represent a good time to begin taking some IRA distributions (even though not required) if you are otherwise in a very low-rate bracket for those years or have excess deductions which may otherwise be wasted. Charitable distributions made directly from an IRA can count towards your RMD (up to $100,000 per year for each eligible spouse).

Energy efficiency tax credits – In an effort to continue to encourage electric vehicles, Federal tax law provides (subject now to income limitations and limitation on price of vehicle) a tax credit of up to $7,500. Similarly, but not subject to income limitations, you can receive a Federal tax credit of up to 30% of the cost of installing a residential geothermal system.

Relocation to a tax-friendly state – Most states subject their residents to tax on their worldwide income (while permitting them a credit or partial credit for tax properly paid to other states), whereas non-residents pay tax only on income sourced to the state (e.g. from business conducted in the state or real estate located in the state). State income tax rates on individuals can range from 0% to 13%. Accordingly, substantial savings can often be generated from establishing domicile in a state with no state income tax (while minimizing contact to the extent possible with those states which have an individual income tax). While it is probably too late now to avoid 2023 state income tax, now is an optimal time to position yourself for 2024.

Utilization of annual gifting exclusion – With respect to the estate and gift tax, there is an annual exclusion which permits you to give up to $17,000 per year per donee ($18,000 in 2024), without incurring any tax or eating into your lifetime exemption. For married couples, this amount is effectively doubled to $34,000. For those with a significant number of potential heirs, this represents an opportunity to remove a significant amount of value from the taxable estate, especially when gifting assets that may be subject to discounted valuation. The annual exclusion is on a use-it-or-lose-it basis with no carryover, so if you haven't maximized your annual exclusion gifts yet for 2023, consider doing so before year end.

Utilization of life-time estate and gift tax exemption – For 2023, each person has a lifetime exemption from estate and gift tax equal to an exclusion of $12,920,000 (i.e. almost $26,000,000 for a married couple). For 2026 and beyond, this amount is scheduled to drop to about $6,000,000 (the exact amount is tied to inflation). Accordingly, those who intend to leave their heirs in excess of $6,000,000, may want to go ahead and move a significant amount of assets to trust now in order to take advantage of the high current exemption. Also, by removing assets from your taxable estate now, you are also removing the future appreciation on those assets from your taxable estate.

Setting expectations and avoiding surprises – One of the key advantages to engaging in year-end planning is that it enables you to appropriately plan your required cash outlay for taxes and avoid any unpleasant surprises at April 15 or any regrets as to actions that could have been taken by year end but were not.

IRS Provides Mechanism to Withdraw ERC Claim

As discussed in prior issues of our newsletter, Covid-stimulus legislation enacted in March 2020 and expanded in December 2020 provided for an "employee retention credit" (ERC) to reward employers who continued to pay employees during a time when the business was partially or fully suspended by government orders pertaining to Covid-19 or suffered a substantial decline in revenue during that time period.

As originally enacted in March 2020, the ERC was a maximum of $5,000 per employee (50% of qualified wages of up to $10,000 paid between March 12, 2020 and December 31, 2020). To be eligible, an employer's business had to be partially or fully suspended by orders from a governmental authority due to the Coronavirus or have had a 50% decline in revenue. For employers with 100 or fewer full-time employees (based on 2019 average), qualified wages included up to $10,000 per employee; regardless of whether they were able to work. For employers with more than 100 full-time employees, the amount was limited to being only those employees who were unable to work due to the shutdown. Employers accepting PPP funds were not eligible to claim the ERC. Since the PPP was, in general, more advantageous, the ERC was largely overlooked (except by those who were ineligible for PPP, such as 501(c)(7) organizations or companies with more than 500 employees).

Michael A. Sudduth, CPA

Legislation enacted in late 2020 (CAA 2021) changed the rules to provide that you could claim the ERC even if you accepted a PPP loan; just not for the same costs. The legislation extended the ERC through June 30, 2021 (later extended to 12/31/21 by subsequent legislation, and then later suspended for the 4th quarter of 2021), reduced the definition of substantial decline in revenue to 20% (beginning with Q4 2020 when compared to same quarter of 2019), increased the credit amount

(Continued on page 4)

IRS Provides Mechanism to Withdraw ERC Claim— continued

(Continued from page 3)

from 50% of qualified wages to 70% of qualified wages (effective 1/1/21), increased the limit on qualified wages (1/1/21) from $10,000 per employee in total to $10,000 per employee per quarter (with the wage limitation being based on amounts paid each specific individual, not by dividing total wages by number of employees) and increased to 500 the number of employees for small employer status. With these enhancements, the credit for 2020 and 2021 combined can potentially be as much as $26,000 per employee.

As discussed above, to be eligible for the ERC, the employer must have either suffered a "substantial decline in revenue" or have been subject to a government-mandated partial or full suspension of operations. The decline in revenue test is fairly mechanical. It is with the government-mandated partial or full suspension of operations where the action appears to be. IRS position is that to be eligible under this standard the suspension must be due to an order (not a suggestion or guidance) from a government with jurisdiction over the business, which limits commerce, travel or group meetings due to Covid-19, and results in a suspension of more than a nominal portion of the business (with "nominal" defined as being at least 10% of the revenue or employee service hours of the business).

In September, the IRS announced (IR-2023-169) that due to "aggressive marketing to ineligible applicants" it was placing an immediate moratorium through at least the end of the year on processing new ERC claims and that "hundreds of criminal cases are being worked, and thousands of ERC claims have been referred for audit." A month later (IR-2023-193), the IRS provided guidelines for businesses which wish to withdraw an ERC claim.

Could Art Donations Be the Next Syndicated Conservation Easements?

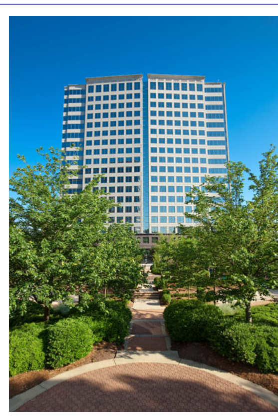
Anytime we are dealing with a charitable donation of something other than cash or publicly-traded stock, valuation becomes a major issue. For the past two decades, the IRS has been pursuing syndicated conservation easements (SCEs), where highest-and-best-use value of land is the principal issue. Congress has essentially shut SCEs down for donations after December 29, 2022 (with a new rule limiting deduction to 2.5x amount invested). As SCEs for earlier years continue to work their way through IRS examination, appeal, and Tax Court, the IRS has now become aware of promoters suggesting that high-income taxpayers purchase art at a "discount", hold it for a year, and then donate it to a museum or other charitable organization at an appraised value substantially higher than the amount paid. Understandably, the IRS is skeptical of such purchases at a "discount" and/or rapid increases in value, and has recently announced (IR 2023-185) that it is conducting promoter investigations and taxpayer audits involving art donations.

Quick Notes

- For 2024, the Social Security wage base increases to $168,600, the maximum wage base for computing retirement plan contributions increases to $345,000, the maximum benefit amount for a defined benefit plan increases to $275,000, the maximum amount which may be contributed to a defined contribution plan increases to $69,000, the maximum permissible elective 401(k) deferral increases to $23,000 ($30,500 for those age 50 and older), and the maximum permissible contribution to an IRA increases to $7,000 ($8,000 for those age 50 and older). Also, for 2024, the maximum amount which can be contributed to an HSA plan increases to $4,150 for individual coverage and $8,300 for family coverage. Those over age 55 can contribute an additional $1,000.
- The annual gift tax exclusion increases to $18,000 for 2024, and the lifetime estate and gift tax exclusion amount will increase to $13,610,000 (per spouse).
- The IRS has not yet announced the business mileage rate for 2024, but it will likely be in the range of 67 - 68 cents per mile.
- If you have opted into the IRS Identity Protection PIN program at any time in the past, the IRS should mail to you in December or January a new IP PIN for your 2023 income tax return. There is a separate IP PIN for each spouse who made the election. You must provide this number(s) to your tax return preparer. Otherwise, your returns will not go through electronically.

Bridges & Dunn-Rankin, LLP
CERTIFIED PUBLIC ACCOUNTANTS

400 Galleria Parkway, Suite 1050
Atlanta, GA 30339
Phone: 770-563-8888
Fax: 770-563-8885
www.bridgesdunnrankin.com



Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth families.