REILLY, CREPPAGE & CO., INC.
A Professional Corporation
Certified Public Accountants

Bernard L. Creppage, C.P.A.
Dale T. Gormley, C.P.A.
David A. Cyran, C.P.A.

Dwayne M. Ross, C.P.A.
Sherri M. Haigh, C.P.A.

Joseph M. Reilly, Retired
Paul J. Vrabel, Retired

Professional Centre
601 Valley View Boulevard
Altoona, PA 16602

PH (814) 944-6178
FAX (814) 942-0283

www.reillycreppage.com

Dear Client,

It's that time of year again where we should consider meeting to discuss any year end strategies that might reduce your 2023 taxes. The following are some of the tax breaks from which you may benefit, as well as the strategies we can employ to help minimize your taxable income and resulting federal tax liability for 2023.

Filing Status

Your tax return filing status can impact the amount of taxes you pay. For example, if you qualify for head-of-household (HOH) filing status, you are entitled to a higher standard deduction and more favorable tax rates. To qualify as HOH, you must be unmarried or considered unmarried (i.e., legally separated or living apart from a spouse) and provide a home for certain other persons. If you are in such a situation, we need to review whether you qualify for HOH filing status.

If you are married, you'll either be filing your return using the married filing jointly or married filing separately filing status. Generally, married filing separately is not beneficial for tax purposes, but in some unique cases, such as when one party earns substantially less or when one party may be subject to IRS penalties for issues relating to their tax reporting, it may be advantageous to file as married filing separately. Additionally, if one spouse was not a full-year U.S. resident, an election is available to file a joint tax return where such joint filing status would otherwise not apply and this may help reduce a couple's tax liability.

Income, Deductions, and Credits

Standard Deduction versus Itemized Deductions. The Tax Cuts and Jobs Act of 2017 (TCJA) substantially increased the standard deduction amounts, thus making itemized deductions less attractive for many individuals. For 2023, the standard deduction amounts are: $13,850 (single); $20,800 (head of household); $27,700 (married filing jointly); and $13,850 (married filing separately). If the total of your itemized deductions in 2023 will be close to your standard deduction amount, we should evaluate whether alternating between bunching itemized deductions into 2023 and taking the standard deduction in 2024 (or vice versa) could provide a net-tax benefit over the two-year period. For example, you might consider doubling up this year on your charitable contributions rather than spreading the contributions over a two-year period. If these contributions, along with your mortgage interest, medical expenses (discussed below), and state income and property taxes (subject to the $10,000 deduction limitation on such taxes that applies to both single individuals and married couples filing jointly; and the $5,000 limitation on such expenses for married filing separately returns), exceed your standard deduction, then itemizing such expenses this year and taking the standard deduction next year may be appropriate.

Medical Expenses, Health Savings Accounts, and Flexible Savings Accounts. For 2023, your medical expenses are deductible as an itemized deduction to the extent they exceed 7.5 percent of your adjusted gross income. To be deductible, medical care expenses must be primarily to alleviate or prevent a physical or mental disability or illness. They don't include expenses that are merely beneficial to general health, such as vitamins or a vacation. Deductible expenses include the premiums you pay for insurance that covers the expenses of medical care, and the amounts you pay for transportation to get medical care. Medical expenses also include amounts paid for qualified long-term care services and limited amounts paid for any qualified long-term care insurance contract. Depending on what your taxable income is expected to be in 2023 and 2024, and whether itemizing deductions would be advantageous for you in either year, you may want to accelerate any optional medical expenses into 2023 or defer them until 2024. The right approach depends on your income for each year, expected medical expenses, as well as your other itemized deductions.

You may also want to consider health saving accounts (HSAs) if you don't already have one. These are tax-advantaged accounts which help individuals who have high-deductible health plans (HDHPs). If you are eligible to set up such an account, you can deduct the amount you contribute to the account in computing adjusted gross income. These contributions are deductible whether you itemize deductions or not. Distributions from an HSA are tax free to the extent they are used to pay for qualified medical expenses (i.e., medical, dental, and vision expenses). For 2023, the annual contribution limits are $3,850 for an individual with self-only coverage and $7,750 for an individual with family coverage.

In addition, if you are not already doing so and your employer offers a Flexible Spending Account (FSA), consider setting aside some of your earnings tax free in such an account so you can pay medical and dental bills with pre-tax money. Since you don't pay taxes on this money, you'll save an amount equal to the taxes you would have paid on the money you set aside. FSA funds can be used to pay deductibles and copayments, but not for insurance premiums. You can also spend FSA funds on prescription medications, as well as over-the-counter medicines, generally with a doctor's prescription. Reimbursements for insulin are allowed without a prescription. And finally, FSAs may also be used to cover costs of medical equipment like crutches, supplies like bandages, and diagnostic devices like blood sugar test kits.

Charitable Contributions. The tax benefits of making charitable contributions and taking an itemized deduction for such contributions were tamped down as a result of the increase in the standard deduction in the TCJA. More people are forgoing itemized deductions as their standard deduction is more favorable.

If you are itemizing deductions, you can maximize the tax benefit of making a charitable contribution by donating appreciated assets, such as stock, instead of cash. Doing so generally allows you to deduct the fair market value of the asset while also avoiding the capital gains tax that would otherwise be due if you sold the asset. For example, if you own stock with a fair market value of $1,000 that was purchased for $250 and your capital gains tax rate is 15 percent, the capital gains tax you would owe is $113 ($750 gain x 15%). If you donate that stock instead of selling it, and are in the 24 percent tax bracket, your ordinary income deduction is worth $240 ($1,000 FMV x 24% tax rate). You also save the $113 in capital gains tax that you would otherwise pay if you sold the stock; that amount goes to the charity. Thus, the after-tax cost of the gift of appreciated stock is $647 ($1,000 - $240 - $113) compared to the after tax cost of a donation of $1,000 cash which would be $760 ($1,000 - $240). However, it's important to also keep in mind that tax deductions for contributions of appreciated long-term capital gain property may be limited to a certain percentage of your adjusted gross income depending on the amount of the deduction.

In addition, if you have an individual retirement account and are 70 1/2 years old and older, you are eligible to make a charitable contribution directly from your IRA. This is more advantageous than taking a distribution and making a donation to the charity that may or may not be deductible as an itemized deduction. If your itemized deductions, including the contribution, are less than your standard deduction, then you receive no tax benefit from making the donation in this manner. By making the donation directly from your IRA to a charity, you eliminate having the IRA distribution included in your income. This in turn reduces your adjusted gross income (AGI). And because various tax-related items, such as the medical expense deduction or the taxability of social security income or the 3.8 percent net investment income tax, are calculated based on your AGI, a reduced AGI can potentially increase your medical expense deduction, reduce the tax on social security income, and reduce any net investment income tax.

Expenses Incurred While Working from Home. Although more people are working from home these days, related expenses are not deductible if you are an employee. TCJA eliminated the deductibility of such expenses when it suspended the deduction for miscellaneous itemized expenses that was available before 2018. However, if you are self-employed and worked from home during the year, tax deductions are still available. Thus, if you have been working from home as an independent contractor, we should discuss what expenses you have incurred that might reduce your taxable income.

Mortgage Interest Deduction. If you sold your principal residence during the year and acquired a new principal residence, the deduction for any interest on your acquisition indebtedness (i.e., your mortgage) could be limited. The mortgage interest deduction on mortgages of more than $750,000 obtained after December 14, 2017, is limited to the portion of the interest allocable to $750,000 ($375,000 in the case of married taxpayers filing separately). If you have a mortgage on a principle residence acquired before December 16, 2017, the limitation applies to mortgages of $1,000,000 ($500,000 in the case of married taxpayers filing separately) or less. However, if you operate a business from your home, an allocable portion of your mortgage interest is not subject to these limitations.

Interest on Home Equity Indebtedness. You can potentially deduct interest paid on home equity indebtedness, but only if you used the debt to buy, build, or substantially improve your home. Thus, for example, interest on a home equity loan used to build an addition to your existing home is typically deductible, while interest on the same loan used to pay personal expenses, such as credit card debt, is not.

Sale of a Home. If you sold your home this year, up to $250,000 ($500,000 for married filing jointly) of the gain on the sale is excludible from income. However, this amount is reduced if part of your home was rented out or used for business purposes. Generally, a loss on the sale of a home is not deductible. But again, if you rented part of your home or otherwise used it for business, the loss attributable to that portion of the home is deductible.

Discharge of Qualified Principal Residence Indebtedness: If you had any qualified principal residence indebtedness which was discharged in 2023, it is not includible in gross income.

Deductions for Mortgage Insurance Premiums: You may be entitled to treat amounts paid during the year for any qualified mortgage insurance as deductible qualified residence interest if the insurance was obtained in connection with acquisition debt for a qualified residence.

Deductions for Excess Business Losses. Taxpayers other than corporations can deduct excess farm losses; however such taxpayers cannot deduct excess business losses. An excess business loss for the tax year is the excess of aggregate deductions attributable to your trades or businesses over the sum of your aggregate gross income or gain plus a threshold amount. The threshold amount for 2023 is $289,000 or $578,000 for joint returns.

Qualified Business Income Passthrough Tax Break. Under the qualified business income tax break, a 20 percent deduction is allowed for qualified business income from sole proprietorships, S corporations, partnerships, and LLCs taxed as partnerships. If you qualify for the deduction, which is available to both itemizers and nonitemizers, it is taken on your individual tax return as a reduction to taxable income. This tax break is subject to some complicated restrictions and limitations, but the rules that apply to individuals with taxable income at or below a certain threshold ($364,200 for joint filers; $182,100 for other taxpayers) are simpler and more permissive than the rules that apply to individuals with income above those thresholds.

Child Tax Credit. For 2023, a child tax credit of as much as $2,000 is available for each child under age 17, depending on your modified adjusted income. In addition, a $500 nonrefundable credit is available for qualifying dependents other than qualifying children. Where the credit exceeds the maximum amount of tax due, it may be refundable. The maximum amount refundable for 2023 is $1,600 per qualifying child. The $500 credit applies to two categories of dependents: (1) qualifying children for whom a child tax credit is not allowed, and (2) qualifying relatives. The amount of the credit is reduced for taxpayers with modified adjusted gross income over $200,000 ($400,000 for married filing jointly) and eliminated in full for taxpayers with modified adjusted gross income over $240,000 ($440,000 for married filing jointly).

Earned Income Credit. The earned income tax credit (EITC) is determined by multiplying your earned income for the year (but only up to a maximum amount of earned income) by a credit percentage that varies depending on whether you have any qualifying children and, if so, the number of qualifying children. The EITC is also subject to a limitation based on your adjusted gross income. For 2023, the maximum amount of the EITC is (1) $600 for a taxpayer with no qualifying children, (2) $3,995 for a taxpayer with one qualifying child, (3) $6,604 for a taxpayer with two qualifying children, and (4) $7,430 for a taxpayer with three or more qualifying children. In addition, the EITC cannot be claimed if your investment income (including interest, dividends, capital gain net income, and net rental income) exceeds $11,000 for 2023.

Dependent Care Credit: If you incurred expenses to care for a child or another dependent so that you can work, you may be eligible for the child and dependent care credit. This credit is available to individuals who, in order to work or to look for work, have to pay for child care services for dependents under age 13. The credit is also available for amounts paid for the care of a spouse or a dependent of any age who is physically or mentally incapable of self-care. The credit is not available for amounts paid to a dependent or a taxpayer under age 19. The amount of the credit is a specified percentage of your total employment-related expenses - generally, 35 percent reduced (but not below 20 percent) by one percentage point for each $2,000 by which your adjusted gross income for the tax year exceeds $15,000. Employment-related expenses incurred during any tax year which may be taken into account cannot exceed $3,000 for one qualifying individual or $6,000 for two or more qualifying individuals.

Premium Tax Credit. A health insurance subsidy is available in the form of a premium assistance tax credit for eligible individuals and families who purchase health insurance through the Health Insurance Marketplace, also known as the "Exchange." The provision is the result of the Patient Protection and Affordable Care Act (PPACA). This credit is refundable and payable in advance directly to the insurer on the Exchange. In the past, individuals with incomes exceeding 400 percent of the poverty level were not eligible for these subsidies. However, the cap has been eliminated through 2025 and therefore, anyone can qualify for the subsidy. In addition, the percentage of your income paid for a health insurance under a PPACA plan is limited to 8.5 percent of income. Thus, if you buy your own health insurance directly through an Exchange, you can receive increased tax credits to reduce your premiums.

Education-Related Deductions and Credits. Certain education-related tax deductions, credits, and exclusions from income may be available for 2023. For example, tax-free distributions from a qualified tuition program, also referred to as a Section 529 plan, of up to $10,000 are allowed for qualified higher education expenses. Qualified higher education expenses for this purpose include tuition expenses in connection with a designated beneficiary's enrollment or attendance at an elementary or secondary public, private, or religious school, i.e. kindergarten through grade 12. It also includes expenses for fees, books, supplies, and equipment required for the participation in certain apprenticeship programs and qualified education loan repayments in limited amounts. A special rule allows tax-free distributions to a sibling of a designated beneficiary (i.e., a brother, sister, stepbrother, or stepsister). As a result, a 529 account holder can make a student loan distribution to a sibling of the designated beneficiary without changing the designated beneficiary of the account.

Depending on your modified adjusted gross income for the year, you may also qualify for: (1) an American Opportunity Tax Credit of up to $2,500 per year for each eligible student; (2) a Lifetime Learning credit up to $2,000 for tuition and fees paid for the enrollment or attendance of yourself, your spouse, or your dependents for courses of instruction at an eligible educational institution; (3) an exclusion from income for education savings bond interest received; and (4) a deduction for student loan interest.

If you qualified for any student loan forgiveness in 2023, the forgiven amount will generally be excludible from your income for federal tax purposes. However, you may be liable for state or local income taxes as a result of the discharge.

Clean Energy Credits. For 2023, the clean energy tax credits available include (1) residential energy property credits (the energy efficient home improvement credit and the residential clean energy credit) and (2) vehicle-related credits (the new clean vehicle credit, the previously-owned clean vehicle credit, and the alternative fuel refueling property credit). These credits were significantly expanded by the Inflation Reduction Act, generally beginning in 2023.

The energy efficient home improvement credit is credit for 30 percent of the costs of all qualified energy efficiency improvements and residential energy property expenditures you make during the year. This credit is subject to an annual limit of $1,200, and there are also limits for specific types of qualifying improvements. These limits are: (1) $250 for any exterior door ($500 total for all exterior doors), (2) $600 for exterior windows and skylights, (3) $600 for other qualified energy property (including central air conditioners; electric panels and certain related equipment; natural gas, propane, or oil water heaters; oil furnaces; water boilers), and (4) a higher $2,000 annual limit for heat pumps and heat pump water heaters, biomass stoves, and boilers. The Inflation Reduction Act also added a credit of up to $150 per year for home energy audits. Roofs do not qualify for the credit beginning in 2023.

The residential clean energy credit equals 30 percent of the cost of certain qualified property installed on or used in connection with your home. Qualifying properties are: (1) solar electric property, (2) solar water heating property, (3) fuel cell property, (4) small wind energy property, (5) geothermal heat pump property, and (6) battery storage technology. There is no annual or lifetime limit on the residential clean energy credit except with respect to fuel cell property, which is limited to $500 for each half kilowatt of capacity. In addition, if more than one person lives in your home, the combined credit for all residents can't exceed $1,667 for each half kilowatt of fuel cell capacity.

A new clean vehicle credit of up to $7,500 may be available if you acquired a qualified electric vehicle and placed it in service (i.e., taken delivery of the vehicle) this year. To qualify, the vehicle must have been assembled in North America. The calculation of the credit amount will depend on when you take delivery of the vehicle. If you took delivery before April 18, 2023, the total new clean vehicle credit equals a base amount of $2,500 and is increased by the amount of propulsion energy produced by the battery. For vehicles delivered on or after April 18, 2023, the credit amount equals $3,750 for vehicles meeting a critical minerals requirement plus $3,750 for vehicles meeting a battery component requirement. Price limits (i.e., MSRP limitations) apply depending on the vehicle type ($80,000 for vans, SUVs, and pickup trucks; $55,000 for other vehicles). The Department of Energy provides a list at FuelEconomy.gov of eligible clean vehicles that meet the requirements to claim this credit, including the applicable MSRP limitation. The credit is not available if your adjusted gross income for the year is over $300,000 (married filing jointly), $225,000 (head of household), and $150,000 (single). Beginning in 2024, the new clean vehicle credit can be transferred to the dealer and used as a down payment at the time of sale.

Beginning this year, a credit is also available for the purchase of a previously-owned clean vehicle. The credit amount is the lesser of (1) $4,000, or (2) 30 percent of the cost of the vehicle. In order to qualify for the previously-owned clean vehicle credit, the vehicle must be sold by a dealer for a sale price not in excess of $25,000, and the sale must be the first transfer of the vehicle since August 16, 2022. In addition, the buyer must be an individual taxpayer who cannot be claimed as a dependent by another taxpayer, who purchases the vehicle for use and not for resale, and who has not been allowed the previously-owned clean vehicle credit in any of the 3 years preceding the sale of the vehicle. The credit is not available to taxpayers with adjusted gross income over $150,000 (married filing jointly), $112,500 (head of household), and $75,000 (single). Like the new clean vehicle credit, this credit will be transferable to the dealer beginning in 2024.

The alternative fuel vehicle refueling property credit is allowed with respect to any single item of qualified alternative fuel vehicle refueling property placed in service during the tax year not in excess of (1) $100,000 in the case of depreciable property, and (2) $1,000 in any other case. Qualifying property includes bidirectional charging equipment, and the credit can also be claimed for electric charging stations for two- and three-wheeled vehicles that are intended for use on public roads.

Retirement Planning

If you can afford to do so, investing the maximum amount allowable in a qualified retirement plan will yield a large tax benefit. If your employer has a 401(k) plan and you are under age 50, you can defer up to $22,500 of income into that plan for 2023. Catch-up contributions of $7,500 are allowed if you are 50 or over. If you have a SIMPLE 401(k), the maximum pre-tax contribution for 2023 is $15,500. That amount increases to $19,000 if you are 50 or older. The maximum IRA deductible contribution for 2023 is $6,500 and that amount increases to $7,500 if you are 50 or over.

Life Events

Life events can have a significant impact on your tax liability. For example, if you are eligible to use head of household or surviving spouse filing status for 2023, but will change to a filing tax status of single for 2024, your tax rate will go up. If you married or divorced during the year and changed your name, you need to notify the Social Security Administration (SSA). Similarly, the SSA should be notified if you have a dependent whose name has been changed. A mismatch between the name shown on the tax return and the SSA records can cause problems in the processing of tax returns and may even delay tax refunds. Let me know if you have been impacted by a life event, such as a birth or death in your family, the loss of a job or a change in jobs, or a retirement during the year. All of these can affect you tax situation.

Impact of Future Legislation

There have been ongoing discussions between Republicans and Democrats about a potential tax deal regarding a reinstatement of the ability to expense 100 percent of a business's research and development expenses, which expired at the end of 2021, in exchange for an enhanced child tax credit that is similar to the 2021 enhanced child tax credit enacted as part of the American Rescue Plan Act of 2021. Because it is unclear what, if any, tax legislation may be passed before the end of the year, we'll need to base our year-end planning on existing law.

Please call me at your convenience so we can set up an appointment to discuss your 2023 tax return and determine if any estimated tax payment may be due before year end.

Sincerely,

Reilly, Creppage & Co., Inc.