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DECEMBER 2022

### CASH GIFTS – CHRISTMAS OR NEW YEAR’S EVE?

As the year-end approaches, thoughts turn increasingly to holidays and family. More mundanely, some thoughts might turn to tax planning. Sometimes, however, the two thoughts can share a purpose. Annual gifts to family members utilizing the current \$16,000 annual gift exclusion can be an effective way to reduce a potential taxable estate and to shift the related future taxable income to family members with a lower tax rate. Such annual giving commonly occurs at or near year end. A recent tax case involving a decedent’s cash gifts shortly before his death illustrates a potential trap that can apply to year-end cash gifts.

William Demuth made family gifts by check on September 6, 2015 shortly before his death on September 11. All of the donees deposited their checks prior to Mr. Demuth’s death. Only one check, however, cleared Mr. Demuth’s account by that time. The remaining checks cleared his account by September 14 or later.

As the Tax Court explained, ownership is determined by state law (Pennsylvania, in this case). Federal tax law controls the federal income tax consequences of those ownership interests. Under Pennsylvania law, the amount of a check still belongs to the payer until the payer can no longer direct the bank to stop payment of the check. That time elapses once the bank makes payment of the check. Accordingly, since Mr. Demuth could have made a stop-payment order on the outstanding checks as of the date of his death, the funds in the account were still his on that date and, therefore, were not annual exclusion gifts and were included in the value of his taxable estate. We understand that Louisiana has similar banking laws regarding stop-payment orders.

So, to make sure that your holiday season cash gifts by check to family members count for the intended year, you might want to make them not on New Year’s Eve but on Christmas with holiday instructions that they be deposited without delay.

### SOCIAL SECURITY TAXES AND INCREASED BENEFITS

In October, the Social Security Administration announced that benefits for approximately 70 million Americans will increase by a cost-of-living adjustment of 8.7 percent beginning in January 2023. The increase is the largest in over 40 years and follows a 5.9 percent increase for 2022.

Income taxes are due on 85 percent of Social Security benefits for almost all taxpayers with

incomes above \$25,000.

The maximum amount of earnings subject to the Social Security taxes (15.3 percent of compensation – 7.65 percent each to the employee and employer) will increase to \$160,200. The one-half directly paid by the worker continues to be non-deductible.

Some other 2023 limitation changes are listed on the reverse of this page.

## 2023 LIMITATION CHANGES

The following is a list of some 2023 limitations regarding Social Security, payroll taxes, and income taxes with 2022 limitations for comparison (most changes resulting from inflation indexing). Some very early planning for 2023 is suggested by the limitation changes. Where possible, those funding Health Savings Accounts, IRAs, and other tax-favored accounts might consider funding these accounts early to take advantage of the additional tax-sheltered investment time.

	<u>2023</u>	<u>2022</u>
<b>Current Earnings Allowed Before Social Security Benefits Reduction:</b>		
Worker Below Full Retirement Age	\$ 21,240	\$ 19,560
Worker Full Retirement Age and Above	- No Change - Unlimited	Unlimited
<i>(Full Retirement Age is 66 for those Born in 1943 through 1954. For those Born After 1954, Full Retirement Age Increases by Two Months for Every Birth Year Until it Reaches 67 for People Born in 1960 or Later)</i>		
<b>Social Security Taxes:</b>		
<i>Old Age, Survivors, and Disability Insurance Income Portion of Tax:</i>		
Maximum Base for Tax	\$ 160,200	\$ 147,000
Tax Rate (Employee and Employer)	- No Change - 6.20%	6.20%
Tax Rate (Self-employed)	- No Change - 12.40%	12.40%
Maximum Tax (Employee)	\$ 9,932	\$ 9,114
Maximum Tax (Self-employed)	\$ 19,865	\$ 18,228
<i>Medicare Portion of the Tax:</i>		
Tax Rate (Employee and Employer)	- No Change - 1.45%	1.45%
Tax Rate (Self Employed)	- No Change - 2.90%	2.90%
Tax Rate (Employee and Self Employed) – Earnings in Excess of \$200,000 (\$250,000 Joint Return)	- No Change - 0.9%	0.9%
Maximum Base and Maximum Tax	- No Change - Unlimited	Unlimited
<b>Louisiana Unemployment Tax:</b>		
Maximum Base for Tax	- No Change - \$ 7,700	\$ 7,700
<b>Auto Standard Mileage Deduction:</b>		
Business Use (Mid-Year Increase)	Not	58.5/62.5¢
Use for a Charitable Organization	Yet	14¢
Use for Medical or Moving (Mid-Year Increase)	Published	18¢/22¢
<b>401(k) Maximum Elective Deferral:</b>		
Below Age 50	\$ 22,500	\$ 20,500
Age 50 or Above	\$ 30,000	\$ 27,000
<b>Maximum Contribution to Defined Contribution Retirement Plan:</b>		
General Limit – All Plans	\$ 66,000	\$ 61,000
With 401(k) Feature (Age 50 and or Above)	\$ 73,500	\$ 67,500
<b>Individual Retirement Account Contribution (IRAs):</b>		
Below Age 50	\$ 6,500	\$ 6,000
Age 50 or Above	\$ 7,500	\$ 7,000
<b>SIMPLE IRA Maximum Deferral:</b>		
Below Age 50	\$ 15,500	\$ 14,000
Age 50 or Above	\$ 19,000	\$ 17,000
<b>Maximum Sec. 179 Deduction of Certain Depreciable Property</b>	\$1,160,000	\$1,080,000
<b>Maximum Bonus Depreciation of Certain Property</b>	80%	Unlimited
<b>Annual Gift Tax Exclusion Per Donee</b>	\$ 17,000	\$ 16,000
<b>Health Savings Account</b>		
Maximum Contribution – Individual Coverage	\$ 3,850	\$ 3,650
Maximum Contribution – Family Coverage	\$ 7,750	\$ 7,300
Age 55 and Over Catch Up	- No Change - \$ 1,000	\$ 1,000

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## Tax & Business Alert

DECEMBER 2022

### WHAT'S YOUR TAXPAYER FILING STATUS?

For many people, December 31 means a New Year's Eve celebration. However, from a tax perspective, it means thinking about the filing status you'll use when filing your tax return for the year. The one you use depends partly on whether you're married on that date.

#### THE FIVE STATUSES

When you file your federal tax return, you do so with one of five filing statuses. First, there's "single" status, which is generally used if you're unmarried, divorced or legally separated. A second status, "married filing jointly," is for married couples who file a tax return together. If your spouse passes away, you can usually still file a joint return for that year. A third status, "married filing separately," is for married couples who choose to file separate returns. In some cases, doing so may result in less tax owed.

"Head of household" is a fourth status. Certain unmarried taxpayers qualify to use it and potentially pay less tax. Finally, there's a fifth status: "qualifying widow(er) with a dependent child." It may be used if your spouse died during one of the previous two years and you have a dependent child. (Other conditions apply.)

#### HEAD OF HOUSEHOLD

Let's focus on head-of-household status because it's often misunderstood and can be more favorable than filing as a single taxpayer. To qualify, you must "maintain a household" that, for more than



half the year, is the principal home of a "qualifying child" or other relative that you can claim as a dependent.

A qualifying child is defined as someone who lives in your home for more than half the year and is your child, stepchild, foster child, sibling, stepsibling or a descendant of any of these. A qualifying child must also be under 19 years old (or a full-time student under age 24) and be unable to provide over half of his or her own support for the year.

Different rules may apply if a child's parents are divorced. Also, a child isn't a qualifying child if he or she is married and files jointly or isn't a U.S. citizen or resident.

## CAN YOU BE MARRIED AND A HEAD OF HOUSEHOLD?

You must generally be unmarried to claim head-of-household status. However, if you've lived apart from your spouse for the last six months of the year, you have a qualifying child living with you and you maintain the household, you're typically considered unmarried. In this case, you may be able to qualify as head of household.

For head-of-household filing status, you're considered to maintain a household if you live in it for the tax year and pay more than half the cost of running it. This includes property taxes, mortgage interest, rent, utilities, property insurance, repairs, upkeep and food consumed in the home. Medical care, clothing, education, life insurance and transportation aren't included.

Under a special rule, you can qualify as head of household if you maintain a home for a parent even if you don't live with the parent. To qualify, you must be able to claim the parent as your dependent.

### NOT ALWAYS OBVIOUS

Filing status may seem obvious, but there can be situations when it warrants careful consideration. If you have questions about yours, contact us. ■

## THE PROS AND CONS OF NQDC PLANS

Nonqualified deferred compensation (NQDC) plans allow participants to set aside large amounts of tax-deferred compensation while enjoying the flexibility to schedule distributions to align with their financial goals. However, the plans aren't without risks so before you jump in, consider the pros and the cons.

### WHAT MAKES AN NQDC PLAN DIFFERENT?

NQDC plans differ significantly from qualified defined contribution plans. The latter allows employers to contribute on their employees' behalf and employees to direct a portion of their salaries into segregated accounts held in trust.

In addition, qualified defined contribution plans generally allow participants to direct their investments

among the plan's available options. The plans are subject to the applicable requirements of the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code. This includes annual contribution limits, early withdrawal penalties, required minimum distributions and nondiscrimination rules.

By contrast, an NQDC plan is simply an agreement with your employer to defer a portion of your compensation to a future date or dates. Many NQDC plans provide for matching or other employer contributions, while some permit only employer contributions. Such contributions may be subject to a vesting schedule based on years of service, performance or the occurrence of an event (such as a sale).

To avoid current taxation, NQDC plans must not be "funded," and they can't escape your employer's creditors. The plan is secured only by your employer's promise to pay. It's possible to secure funds in a special trust, but they remain subject to creditors' claims.

### WHAT ARE THE PROS?

Like qualified plans, NQDC plans allow you to defer income taxes on compensation until you receive it — although you may have to pay FICA taxes in the year the compensation is earned. NQDC plans also



offer some advantages over qualified plans. That is, they may have no contribution limits. Participants may enjoy greater flexibility to schedule distributions to fund financial goals such as retirement, without penalty for distributions before age 59½ or required distributions at a certain age.

From an employer's perspective, NQDC plans are attractive because they can be limited to highly compensated employees and they don't require compliance with ERISA's reporting and administrative specifications. However, unlike contributions to qualified plans, deferred compensation isn't deductible by the employer until it's paid.

### AND THE CONS?

The biggest disadvantage of NQDC plans for participants is that deferred compensation isn't shielded from the claims of the employer's creditors, possible bankruptcy or insolvency. Also, you may not be able to take loans from the plan and can't roll over distributions into an IRA, qualified plan or other retirement account. What's more, there are limitations on the timing of deferral elections.

### IS IT RIGHT FOR YOU?

An NQDC plan offers attractive benefits, but it can be risky. Contact our firm to discuss how such a plan might affect your financial situation or whether it's right for your company. ■

## HAVE YOU CONSIDERED A COST SEGREGATION STUDY? —

**B**ecause of the economic impact of inflation, many companies may need to conserve cash and not buy much equipment this year. As a result, you may not be able to claim as many depreciation tax deductions as in the past. However, if your company owns real property, there may be another approach to depreciation to consider: a cost segregation study.



### DEPRECIATION BASICS

Business buildings generally have a 39-year depreciation period (27.5 years for residential rental properties). Typically, companies depreciate a building's structural components — including walls, windows, HVAC systems, plumbing and wiring — along with the building. Personal property (such as equipment, machinery, furniture and fixtures) is eligible for

accelerated depreciation, usually over five or seven years. And land improvements, such as fences, outdoor lighting and parking lots, are depreciable over 15 years.

Often, businesses allocate all or most of their buildings' acquisition or construction costs to real property, overlooking opportunities to allocate costs to shorter-lived personal property or land improvements. Items that appear to be "part of a building" may in fact be personal property. Examples include removable wall and floor coverings, removable partitions, awnings, canopies, window treatments, signs and decorative lighting.

### PINPOINTING COSTS

A cost segregation study combines accounting and engineering techniques to identify building costs that are properly allocable to tangible personal property rather than real property. Although the relative costs and benefits of a cost segregation study will depend on your particular facts and circumstances, it can be a valuable investment.

It may allow you to accelerate depreciation deductions on certain items, thereby reducing taxes and boosting cash flow. And, thanks to the Tax Cuts and Jobs Act, the potential benefits of a cost segregation study are even greater than they were years ago because of enhancements to certain depreciation-related tax breaks.

### WORTH A LOOK

Cost segregation studies have costs all their own, but the potential long-term tax benefits may make it worth your while to undertake the process. Contact our firm for further details. ■

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## TWO ESSENTIAL DOCUMENTS TO PROTECT YOUR ESTATE

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Estate planning isn't just about what happens to your assets after you die. It's also about protecting yourself and your loved ones during your lifetime. To spare your family from guessing what you want done, and to ensure that your wishes are carried out, put your wishes in writing. Generally, that means executing two documents:

**1. A living will.** This document expresses your preferences for the use of life-sustaining medical procedures, such as artificial feeding and breathing, surgery, invasive diagnostic tests and pain medication. It also specifies the situations in which these procedures should be used or withheld.

A living will may contain a “do not resuscitate” order, which instructs medical personnel not to perform CPR in the event of cardiac arrest.

**2. A health care power of attorney (HCPA).** This document authorizes a surrogate — your spouse, child or another trusted representative — to make medical decisions on your behalf if you're unable to do so. An HCPA is generally broader than a living will, though there may be some overlap.



An HCPA might authorize your surrogate to make medical decisions that don't conflict with your living will. These might include consent for medical treatment, placement in a nursing home or other facility, or authorization to employ or discontinue life-prolonging measures.

It's a good idea to have both a living will and an HCPA or, if allowed by state law, a single document that combines the two. Contact us with your questions regarding these or other aspects of the estate planning process. ■