December 4, 2023

RE: 2023 Year End Tax Letter

Dear Clients and Friends:

We hope you and your family are doing well. As the year draws to a close, it is with mixed emotions that we announce the retirement of Gary M. Locarno, Managing Director of Dakota Tax Services ("DTS"). Although we will miss Gary, after fifty years of exemplary client service he has earned the opportunity to pursue his other interests and spend meaningful time with his family. Gary's retirement was predicated on the fact that his clients would be taken care of properly. To assure this occurs, Gary agreed to assist with the transition of the tax and consulting services to our clients which will now be overseen by Katelyn Ainsworth, our new Managing Director of Dakota Tax Services, who has worked with Gary for fifteen years.

As some of you may have heard, as part of the transition in management Dakota Tax Services will be relocating to Newport County, Rhode Island. Please note our new mailing address as reflected on this letterhead. Along with the move Dakota Tax Services is welcoming a new Office Manager, Cheri Bontrager, Tax Associate, Jack Peterson, and Tax Manager, Peter Dixon, CPA, who have joined the firm in its new location.

The Dakota Tax Services team will continue to offer sophisticated tax compliance, consulting, and estate planning services to its clients. Through use of a continuing consulting and referral relationship with Gary via the law firm of GML Associates, PC, Dakota Tax Services will continue to offer full-service estate planning including document drafting and assistance with wealth transfers to avoid probate and minimize estate tax exposure.

As we approach year end, now is the time for individuals, business owners and family offices to review their 2023 and 2024 tax situations and identify opportunities for reducing, deferring, or accelerating their tax obligations.

Although the majority of taxpayers think of April 15th as their deadline for federal tax purposes over the course of any single year, looking at December 31st as a more important date makes much more sense for many taxpayers. You can always file an extension to avoid the April 15th deadline (though we do not encourage this); but you cannot delay the payment of any taxes due beyond April 15th .

Once December 31st passes, your taxable income, deductions, credits, and tax liability for the year are all "set in concrete" with little, if any, opportunity to change the outcome. As a result, year-end tax planning should form an essential part of your financial strategy.

Effective year-end tax planning for 2023 combines the use of traditional techniques of acceleration and deferral of income/deductions with appropriate responses to a constantly changing tax landscape. As the end of 2023 approaches, several tax planning opportunities may be available to

1816 Main Road, Tiverton, RI 02878
617-262-0700 • www.dakotataxservices.com

help reduce your tax burden. We have set forth below items that you may want to consider before year end that may impact your 2023 and 2024 taxes.

In this regard we always recommend a year-end tax projection may be appropriate to maximize all tax planning opportunities for the 2023 tax year. We at Dakota stand ready to assist you in this regard if you choose to review your 2023 income taxes before year end.

While we have seen some federal tax legislation, the changes have been far more limited than in prior years.

Traditional Planning

Traditional year-end tax planning incorporates a standard set of considerations but is far from a one-size-fits-all process. Every plan must account for the particular needs and circumstances of each individual or business.

Adjust Income Tax Payments: If, after reviewing your 2022 return, you had a balance due, consider adjusting paycheck withholding for the remainder of 2023, and/or make an estimated payment to avoid an estimated tax penalty. An individual may be able to avoid the penalty by paying withholding and/or estimated taxes based on 100% of the tax shown on the 2022 return. However, if an individual's adjusted gross income as shown on the 2022 return exceeds $150,000 ($75,000 in the case of a married individual who files separately), the amount of the required installment generally increases to 110% of the tax shown on the 2022 return.

To adjust income taxes withheld or estimated tax payments one should also review your projected 2023 income taxes before year end. In addition to reviewing your items of income and deduction one should also factor in the 3.8% net investment income tax, alternative minimum tax (AMT), the receipt of taxable unemployment benefits, and distributions from IRAs and 401(k) plans, any of which can impact your 2023 taxes.

With the $10,000 SALT cap (limitation on state tax deductions) in place, the acceleration of the fourth estimated state income tax payment into December 2023 to increase the current year SALT deduction may be less important as you may have already exceeded it.

Income shifting: Individuals and businesses alike can benefit from the classic strategy of shifting taxable income and accelerating or deferring deductions between 2023 and 2024 by controlling the receipt of income and payment of expenses. Taxpayers expecting to be in the same or lower tax bracket in 2024 should consider deferring income until next year and accelerating deductible expenses in 2023. Alternatively, if a substantial increase in income is anticipated in 2024 (propelling the taxpayer into a higher tax bracket), income should be accelerated in 2023 and deductions deferred until next year. Such things as delaying billings, and deferring sales of securities and bonuses may be beneficial which should be considered.

If self-employed it could be disadvantageous to accelerate income, even if the individual will be in a higher bracket in 2024, if the acceleration causes the individual to cross a threshold that would result in an offsetting reduction in the 199A qualified business income deduction. The 199A

deduction phase-out thresholds for 2023 are $364,200 for joint filers and $182,100 for all other taxpayers.

Capital losses: The end of the year is the right time to examine your investments (winners and losers over the course of the year) to take the steps necessary to minimize your capital gains income and maximize the benefit of any capital losses. Your portfolio's records for the entire year can make a difference in not only what you might buy or sell in December but what estimated tax you will need to pay (or not pay) for the fourth quarter of 2023.

Long-term capital losses can be used to fully offset long-term capital gains. Losses taken in excess of gains can also be used to offset up to $3,000 in ordinary income (or $1,500 for an individual or a married couple filing separately). Short-term losses can be used to offset short-term gains that are otherwise taxable at your ordinary income tax rate (which can reach as high as 37% percent). Excess capital losses incurred by individuals may only be carried forward.

An additional 3.8% tax is levied on the lesser of net investment income (which includes gross income from interest, dividends, capital gains, etc.) or the amount by which modified AGI exceeds certain dollar amounts ($250,000 for joint returns and $200,000 for single filers).

Retirement planning: Year-end planning for 2023 also involves maximizing annual contributions to your retirement plan accounts, since one year's limit cannot be added to the next year's limit, if not taken in time. While contributions to IRAs may be applied retroactively if made before the filing deadline, an individual's elective deferral contribution made as an employee to a qualified plan must be made before the end of the calendar year. If the maximum §401(k) contribution for 2023 was not selected, a taxpayer may be able to increase contributions for the remainder of 2023 to lower AGI in order to take advantage of some of the tax breaks described below. Additionally, many qualified plans (non-IRA type plans) must be established and in place by year end for contributions to them after year end to be deductible. We can assist you in determining what type of plan may be appropriate for you if you currently do not have one.

Maximizing contributions to your retirement plan (or plans) before year end also allows you to reduce your adjusted gross income in direct proportion to those contributions. This in turn can give you the benefit of increasing the deductibility of medical and other deductions subject to adjusted gross income floors. Certain plans such as SEP-IRA's and 401(k) plans also allow catch up contributions to be made if you are 50 years or older in the current year. In light of the uncertainty in the market turmoil and increased life expectancies, additional retirement savings may also be warranted regardless of tax savings.

Managing a tax-deferred retirement account is not a "set it and forget it" proposition. Although sheltered from tax, a 401(k) or other defined contribution plan also requires careful management of the performance of those investments and re-allocation of assets whenever appropriate. Unfortunately, losses on any 401(k) plan are not tax deductible; nor can they offset capital gains in non-tax-sheltered accounts.

For taxpayers that are over age 59 1/2 that participate in an employer retirement plan or have an IRA, consider taking any taxable withdrawals before 2024. Taxpayers also may also want to

consider making a Roth IRA rollover distribution, as discussed below. A special provision gives taxpayers the ability to distribute tax-free to charity up to $100,000 from a traditional or Roth IRA maintained for an individual who has reached age 70 ½, but you can't claim a charitable contribution deduction.

Traditional IRAs: Individuals who are not active participants in an employer pension plan may make deductible contributions to an IRA. The deadline for 2023 contributions is April 15, 2024. The annual deductible contribution limit for an IRA for 2023 is $6,500. A $1,000 "catch-up" contribution is allowed for taxpayers aged 50 or older by the close of 2023, making the total limit $7,500 for these individuals. Individuals who are active participants in an employer pension plan also may make deductible contributions to an IRA, but their contributions are limited in amount depending on their AGI. For 2023, the AGI phase-out range for deductibility of IRA contributions is between $73,000 and $83,000 of modified AGI for single persons (including heads of households), and between $116,000 and $136,000 of modified AGI for married filing jointly. Above these ranges, no deduction is allowed.

In addition, an individual will not be considered an "active participant" in an employer plan simply because the individual's spouse is an active participant for part of a plan year. The taxpayer may be able to take the full deduction for an IRA contribution regardless of whether their spouse is covered by a plan at work, subject to a phase-out if their joint modified AGI is $218,000 to $228,000 ($0 – $10,000 if married filing separately) for 2023. Above this range, no deduction is allowed.

IRA Rollovers: For 2023, taxpayers may make only one IRA-to-IRA rollover per year. (Direct trustee to trustee rollovers are not affected.) A second attempted rollover will be treated as a withdrawal and taxed at regular rates, plus a possible 10% early withdrawal penalty.

Spousal IRA: If an individual files a joint return and has less compensation than his or her spouse, the IRA contribution is limited to the lesser of $6,500 for 2023 plus age 50 catch-up contributions ($1,000 for 2023), or the total compensation of both spouses reduced by the other spouse's IRA contributions (traditional and Roth).

Roth IRA: This type of IRA permits nondeductible contributions of up to $6,500 ($7,500 if making eligible catch-up contribution) for 2023, but no more than an individual's compensation. Earnings grow tax-free, and distributions are tax-free provided no distributions are made until more than five years after the first contribution and the individual has reached age 59 1/2. Distributions may be made earlier on account of the individual's disability or death. The maximum contribution is phased out in 2023 for persons with an AGI above $218,000 to $228,000 for those taxpayers that are married filing jointly, $138,000 to $153,000 for single taxpayers (including heads of households), and between $0 and $10,000 for married filing separately who lived with the spouse during the year. A Roth IRA must be established by April 15, 2024 and funded for a 2023 contribution.

Roth IRA Conversion Rule: Funds in a traditional IRA (including SEPs and SIMPLE IRAs), §401(a) qualified retirement plan, §403(b) tax-sheltered annuity, or §457 government plan may be rolled over into a Roth IRA. Such a rollover, however, is treated as a taxable event, and the

taxpayer will pay tax on the amount converted. No penalties will apply if all the requirements for such a transfer are satisfied.

Section 401(K) Contribution: The §401(k) elective deferral limit is $22,500 for 2023. If the taxpayer's §401(k) plan has been amended to allow for catch-up contributions for 2023 and the taxpayer reaches age 50 by December 31, 2023, an additional $7,500 may be contributed to the §401(k) account, for a total maximum contribution of $30,000 ($22,500 in regular contributions plus $7,500 in catch-up contributions).

SIMPLE Plan Contribution: The SIMPLE plan deferral limit is $15,500 for 2023. If the taxpayer's SIMPLE plan has been amended to allow for catch-up contributions for 2023 and the taxpayer will be 50 years old by December 31, 2023, an additional $3,500 may be contributed for a total maximum contribution of $19,000 ($20,500 in regular contributions plus $6,500 in catch-up contributions).

Catch-Up Contributions for Other Plans: If the taxpayer will be 50 years old by December 31, 2023, an additional $7,500 can be contributed to a §403(b) plan, SEP, or eligible §457 government plan.

Required Minimum Distributions (RMD): If you turned 72 in 2022, you'll need to take your first RMD by April 1, 2023, and another one by the end of 2023. Due to a change to the age that you have to start taking RMDs, if you turn 72 in 2023, you won't have to take an RMD until 2024 (when you turn 73), and the first must be taken by April 1, 2025. If a portion of your retirement account includes an annuity, you may be able to decrease the amount of your required distribution by aggregating distributions from the IRA and the annuity.

Itemized Deduction Planning: Deduction timing is an important element of year-end tax planning. However, deduction planning is complex, due to factors such as AGI levels, AMT, filing status, and the increased standard deduction. An expense is only deductible in the year in which it is actually paid. Under this rule, if the taxpayer's tax rate is going to increase in 2024, it is a good strategy to postpone spending until after 2023 to take the deduction in 2024.

Standard Deduction versus Itemized Deduction Planning: Deduction planning is also affected by the standard deduction. For 2023 returns, the standard deduction is $13,850 for single filers and married couples filing separately, $27,700 for married couples filing jointly and surviving spouses, and $20,800 for head of household. As can be seen from the numbers, for 2023, the standard deduction for married taxpayers is twice the amount as that for single taxpayers. If itemized deductions are relatively constant and are close to the standard deduction amount, little or no benefit will be gained from itemizing deductions each year. But simply taking the standard deduction each year means the loss of the benefit of itemized deductions that exceed the standard deduction. To maximize the benefits of both the standard deduction and itemized deductions, consider adjusting the timing of deductible expenses, i.e., “bunching,” so that they are higher in one year and lower the following year. This can be accomplished by paying deductible expenses in 2023, such as mortgage interest due in January 2024, state estimated tax payments due in early 2024, or doubling up on charitable contributions every other year.

Medical Expenses: For 2023, medical expenses, including amounts paid as health insurance premiums, are deductible only to the extent that they exceed 7.5% of AGI for all taxpayers. Bunching medical expenses in one calendar year can help maximize the allowable deduction.

State and Local Income Taxes and General Sales Taxes (SALT): If you anticipate a state income tax liability for 2023 and plan to make an estimated payment typically due in January 2024, consider making the payment before the end of 2023. But recognize that the current $10,000 cap on deducting state and local taxes ($5,000 if married filing separately) may significantly impact this type of deduction planning.

Charitable Contributions: Consider making charitable contributions by the end of 2023 using a credit card if the bill will not have to be paid until 2024. A mere pledge to make a donation is not deductible, however, unless it is paid by the end of the year.

Benefits for Taxpayers with Children. There are several valuable deductions and credits available for parents with children, as outlined below.

Child Tax Credit: Child Tax Credit. For 2023, families claiming the Child Tax Credit (CTC) may receive up to $2,000 per qualifying child under the age of 17 at the end of 2023. The maximum amount of the credit that is refundable is $1,600 per qualifying child even if no tax is owed. You must have earned income of at least $2,500 to take advantage of the credit's refundability. The credit phases out for taxpayers with adjusted gross incomes above $400,000 for married filing joint returns and $200,000 for all other returns.

Credit for Adoption Expenses: For 2023, the adoption credit limitation is $15,950 of aggregate expenditures for each child, except that the credit for an adoption of a child with special needs is deemed to be $15,950 regardless of the amount of expenses. The credit phases out ratably for taxpayers whose income is between $239,230 and $279,230.

Education Credits: The American Opportunity Tax Credit (AOTC) is available for qualified tuition and fees paid on behalf of a student (i.e., the taxpayer, the taxpayer's spouse, or a dependent) who is enrolled on at least a half-time basis. The maximum credit is $2,500 (100% on the first $2,000, plus 25% of the next $2,000). The credit is available for the first four years of the student's post-secondary education. The credit is phased out at modified AGI levels between $160,000 and $180,000 for joint filers, and between $80,000 and $90,000 for other taxpayers. Forty percent of the credit is refundable, which means that a taxpayer can receive up to $1,000 even if no taxes are owed.

“Qualified tuition and related expenses” include expenditures for “course materials” (i.e., books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance). One way to take advantage of the AOTC for 2023 is to prepay spring 2024 tuition. In addition, if it is known what books the student will need for the spring 2024 semester, those can be bought in 2023 and the costs qualify for the credit for 2023.

<u>The Lifetime Learning Credit (LLC):</u> The credit is available for qualified tuition and related expenses paid for eligible students enrolled in an eligible educational institution. This credit can help pay for undergraduate, graduate, and professional degree courses — including courses to acquire or improve job skills. There is no limit on the number of years you can claim the credit. For 2023, the maximum credit is $2,000 (20% of qualified tuition and fees up to $10,000). A student need not be enrolled on at least a half-time basis so long as he or she is taking post-secondary classes to acquire or improve job skills. As with the AOTC, eligible students include the taxpayer, the taxpayer's spouse, or a dependent. For 2023, the LLC begins to phase out at modified AGI levels of $80,000 for single taxpayers and $160,000 for joint filers similar to the AOTC. The LLC is not a refundable credit.

<u>Coverdell Education Savings Account:</u> The aggregate annual contribution limit to a Coverdell education savings account is $2,000 per designated beneficiary of the account. The limit is phased out for individual contributors with modified AGI between $95,000 and $110,000 and joint filers with modified AGI between $190,000 and $220,000. The AGI amounts are not indexed for inflation. The contributions to the account are nondeductible but the earnings grow tax-free. Coverdell account holdings can be distributed tax-free if used for qualifying expenses (higher education expenses, along with elementary and secondary education expenses).

Taxpayers may be eligible for an above-the-line deduction for student loan interest paid on any "qualified education loan." The maximum deduction is $2,500. The deduction for 2023 is phased out at a modified AGI level between $155,000 and $185,000 for joint filers, and between $75,000 and $90,000 for individual taxpayers.

<u>Kiddie Tax:</u> For 2023, the amount that is used to reduce the net unearned income reported on the child's return that is subject to the "kiddie tax," is $1,250. The same $1,250 amount is used to determine whether a parent may elect to include a child's gross income in the parent's gross income and to calculate the "kiddie tax". For example, one of the requirements for the parental election is that a child's gross income is more than $1,250 but less than $12,950. The kiddie tax applies to: (1) children under 18 who do not file a joint return; (2) 18-year-old children who have unearned income in excess of the threshold amount, do not file a joint return, and who have earned income, if any, that does not exceed one-half of the amount of the child's support; and (3) children between the ages of 19 and 23 if, in addition to the above rules, they are full-time students.

<u>Residential energy property</u>: For 2023, a tax credit is available to homeowners and tenants who install certain energy-efficient property on their residence, such as solar panels, solar water heaters, geothermal heat pumps, wind turbines, fuel cells, and battery storage technology with a capacity of at least 3 kilowatt hours. The amount of the credit is 30% of the cost of qualifying property installed in 2023.

<u>Clean Vehicle Credit</u>: A tax credit – the "clean vehicle credit" – may be available if you purchase a plug-in electric motor vehicle or a fuel cell motor vehicle, and it is delivered to you in 2023. The maximum credit allowed per vehicle is $7,500. The credit is available to individuals and their businesses. Vehicles are not limited to passenger automobiles. They also include, for example, vans, sport utility vehicles, and pickup trucks. It is important to note that in order to be eligible to

take the credit, there are many other factors that must be met. For a full run down please contact our office prior to purchasing an electric vehicle.

Health Savings Accounts: A health savings account (HSA) is a trust or custodial account exclusively created for the benefit of the account holder and his or her spouse and dependents and is subject to rules similar to those applicable to individual retirement arrangements (IRAs). Contributions to an HSA are deductible, within limits. For 2023, the annual limitation on deductions for an individual with self-only coverage under a high deductible health plan is $3,850; for an individual with family coverage under a high deductible health plan is $7,750. For 2023, a "high deductible health plan" is a health plan with an annual deductible that is not less than $1,500 for self-only coverage or $3,000 for family coverage, and the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) do not exceed $7,500 for self-only coverage or $15,000 for family coverage. In computing the annual HSA contribution amount, an individual who is eligible during the last month of a taxable year (December) is treated as having been eligible for all prior months during the taxable year and, thus, is allowed to make contributions for months before the individual was enrolled in a high deductible health plan.

Alternative Minimum Tax: The AMT is another aspect of your tax return that can be triggered by certain items. The goal is to avoid this tax whenever possible. For 2023, the AMT exemption amounts are $126,500 for joint returns or surviving spouses; $81,300 for unmarried individuals; and $63,250 for married filing separately. The exemption phase-out range for 2023 begins at $578,150 for unmarried individuals and $1,156,300 for married filing joint. Also, for 2023, nonrefundable personal credits can offset an individual's regular and alternative minimum tax, and capital gains will be taxed at lower favorable rates for AMT. For 2023, the amount of AMTI above which the 28% rate applies is $110,350 for married individuals filing separate returns and $220,700, for all other taxpayers.

If a taxpayer has stock holding due to the exercise of an incentive stock option (ISO) during 2023 that is now below the value at the exercise date (i.e., "underwater"), consider selling the shares before the end of the year to avoid the AMT tax due on the original exercise of the option. Some of the standard year-end planning ideas will not reduce tax liability if the taxpayer is subject to the AMT because different rules apply. For example, state income and property tax deductions are disallowed in calculating AMT.

NOL Carryfoward and Carryback: If the taxpayer expects to suffer a net operating loss for 2023, it may generally carry the loss forward indefinitely, but may not carry back the loss. A farming loss may be carried back two years or forward indefinitely. Non-life insurance companies with a net operating loss in 2023 may carry the loss back two years but may only carry the loss forward 20 years. Taxpayers may elect to waive the carryback period and instead choose only to carry forward losses. If the taxpayer has any net operating loss carryforwards from prior tax years, deductions for losses arising before 2018 are deductible up to 100% of the taxpayer's taxable income, while deductions for losses arising after 2017 are limited to 80% of taxable income.

Bonus depreciation: Property placed in service in 2023, including used property, may be eligible for 80% bonus depreciation deduction (separate from 179 expensing). Taxpayers engaged in a business may want to consider accelerating the placing in service of property, or the decision to

purchase assets for use in the business, in order to take advantage of this deduction. In 2024, bonus depreciation is reduced to 60%. Taxpayers may want to accelerate purchases into 2023 in order to take the benefit of the 80% bonus depreciation deduction.

Section 179: If the taxpayer is in business and purchases equipment, he/she may depreciate such equipment or make a 179 election, which allows the taxpayer to expense otherwise depreciable business property. For 2023 the allowable deduction is $1,160,000 (with a phase-out beginning once total expenditures exceed $2,890,00). Certain improvements to nonresidential real property (roofs, heating, ventilation, air-conditioning property, fire protection and alarm systems, and security systems), that may not be eligible for bonus depreciation are eligible under 179. Generally, bonus depreciation is preferable over Section 179 depreciation if one wants to maximize depreciation deductions.

Home Office Deductions: Expenses attributable to using the home office as a business office are deductible if the home office is used regularly and exclusively: (1) as a taxpayer's principal place of business for any trade or business; (2) as a place where patients, clients, or customers regularly meet or deal with the taxpayer in the normal course of business; or (3) in the case of a separate structure not attached to the residence, in connection with a trade or business. If a taxpayer uses part of the home as a business office, determining the amount of any deduction available can be tricky, but an IRS-provided safe harbor could be used to minimize audit risk. The home office deduction unfortunately is not available for employees (W-2 wage earners), even if required to work from home.

Self-Employed Health Insurance Premiums: Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and their dependents as an above-the-line deduction, without regard to the general 7.5% of AGI floor.

Gift-giving: Slow and steady estate planning can yield dramatic results. Nowhere is that more apparent than devising an annual gift giving plan to family members. Before year-end 2023, you can transfer up to $17,000 per person, per year, without paying gift tax on the amounts transferred. Married couples can gift $34,000 per person by “splitting” their gifts. In 2024, the annual exclusion rises to $18,000 ($36,000 for couples). This strategy not only avoids the possibility of paying an estate tax later, but it removes earnings from those gifts from your taxable income bracket into that of the lower-bracket gift recipient. Also keep in mind that the increased lifetime estate (GST) and gift tax exemption (currently $12,920,000) expires at the end of 2025 and could be legislatively changed before that. Gifts made prior to 2026, or a sooner legislatively changed date, that exceed the pre-2018 exemption amount (adjusted for inflation of $7,000,000) will however continue to escape future estate taxation and should be considered if appropriate. It is also unlikely we will see any significant changes in the estate planning area with a divided congress.

Life events: A birth of a child, a marriage, divorce, death, new job, loss of a job, new home, foreclosed home, and other “major life changes” also typically have significant tax implications. Many of the applicable tax rules are tied to the calendar year in which they occur.

Because of the complexity of the tax law, understanding what planning provisions to incorporate into your year-end tax planning strategy can be a daunting task. While this letter hopefully gives you a heads-up on at least several tax opportunities on which you might follow through before year end, there are other techniques that can be used depending upon your individual circumstances. Through our experience in year-end tax planning and our tax projection software we can efficiently evaluate your estimated year-end tax results under one or multiple scenarios to assure that you take advantage of options that are available, know the expected results in advance and can plan for them. **For a detailed projection plan that can be customized to your particular circumstances, please do not hesitate to give our office a call.**

Very truly yours,

Dakota Tax Services Managing Director
Katelyn L. Ainsworth, Esq, CPA.