GEHRING &
FARRWOOD

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Greetings!

We hope you had a great year! As we are gearing up for our busy time of year, we wanted to provide some information for the upcoming tax season. We'll provide some guidance surrounding tax law changes since our last newsletter, give some general reminders, and provide some tax savings strategies.

2022 was slower on the legislative front for tax law. The Inflation Reduction Act was passed this fall, and its tax provisions mainly focus on energy credits. There are also some updates to some of the Washington State tax laws we discussed in our last newsletter.

Changes to Our Firm

We have some excellent new team members, and we hope you get to meet them! Natalie Carrey started in November as a full-time bookkeeper and payroll specialist. We also had Kristyn Grayson join us this January as a full-time administrative assistant. We hope you become acquainted with everyone!

We switched tax software for the coming tax season. Most of your tax data was converted from the old software to the new software, but there are some limitations and rollover errors on certain types of data. Don't worry, your 2022 tax returns will be accurate as usual. However, your 2022 tax organizer might be missing some information you're used to seeing. Specifically, information for rental properties and sole proprietorships did not transfer 2021 information properly, so you might not see your 2021 figures in your 2022 organizer. We've found that most of the basic information such as names and addresses carried over, but we ask that you please review that information when you fill out your organizer. Your CPA will make sure that all of the important information from prior years is complete, such as depreciation and loss carryovers.

Please note the following dates and deadlines

January 2023:	In this packet you'll find your 2022 tax organizer. We've split it into two packets this year. One packet is mandatory, and includes an engagement letter, questionnaire, basic information page, and dependents page. The second packet is optional and includes a page for each income type you reported on your 2021 tax return.
January 31, 2023:	Form 1099-MISC and 1099-NEC
March 15, 2023:	Form 1065 (Partnerships) and Form 1120S (S Corporations)
April 18, 2023:	Form 1040, Form 1041 (Estates and Trusts), Form 1120 (Corporations), IRA contributions, HSA contributions, and foreign asset reporting.

Sincerely,

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Tim Gehring　　　　Bo Farrwood

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UPDATES, REMINDERS, STRATEGIES – FOR INDIVIDUALS

Key Changes & General Reminders

- Correspondence with the IRS remains a challenge. Many issues require correspondence via the mail, which generally takes a month or two. Since April 2020, however, most issues take more than two months to resolve via mail. Issues that can be handled over the phone remain difficult to resolve as well, as the IRS phone lines are often down due to understaffing. If you receive a notice from the IRS that requires telephone or mail correspondence, please be patient.
- The IRS budget was expanded by $80 billion over the next 10 years, which accounts for a roughly 66% per year budget increase. Some of those additional funds will go toward improving service, such as hiring additional staff and improving existing technology. Most of the budget expansion will go toward enforcement and compliance, which will impact high earners more than low earners. With that said, IRS audits are at a historic low, so even with additional funds going toward enforcement and compliance, your chances of an audit are still incredibly low compared to historical audit rates.
- The $300 and $600 special deductions for charitable contributions available in 2020 and 2021 are no more. These tax provisions were a temporary measure to help encourage giving during the pandemic. You can still deduct charitable contributions as an itemized deduction.
- Fill out a new W-4 with your employer if your tax situation has changed, such as a change in income, marital status, or dependents.
- The new overtime exempt salary threshold for qualified Washington employees is $54,132 for small employers and $61,828 for large employers. Qualified employees include those in administrative, executive, professional, computer-related (such as a systems analyst or software engineer), and outside sales.
- Washington agricultural workers are no longer exempt from overtime. Beginning in 2022, overtime must be paid after 55 hours per week. In 2023 the limit drops to 48 hours, and in 2024 the limit will be 40 hours.
- The deadline for contributing to your HSA for the 2022 tax year is April 18, 2023. HSA contributions lower your taxable income, and distributions are not taxable if used for qualified medical expenses. Even better, if you contribute via a payroll deduction you also save an additional 7.65% on FICA taxes.
- Forgiven student loans are not included in federal taxable income but may be taxable for state purposes depending on which state you reside in at the time of forgiveness. The status of the $20,000 forgiveness under executive order remains unclear as it is going through the courts.
- The annual gifting limit is increased from $16,000 to $17,000 per individual or trust in 2023. The amount gifted to an individual or trust in excess of this amount is required to be reported on an annual gift tax return.
- The IRS is delaying the requirement for platforms such as Venmo and Cash App to report payments on Form 1099-K. The annual threshold for 1099-K reporting was reduced from $20,000 to $600 in 2021. Beginning in 2022, platforms such as Venmo and Cash App also begin reporting under these requirements. However, the IRS recently deemed 2022 to be a transition year and lifted the requirement for platforms to issue 1099-Ks for under $20,000. This announcement from the IRS came very near the end of the year, and companies might have already had the new $600 reporting threshold planned for issuing 1099-Ks in January, so don't be surprised if you see a 1099-K for less than $20,000. Only payment for goods and services are to be reported, though there was concern that errors would occur and payments for personal items would be reported on a 1099-K, which likely was the reason for the IRS delaying this requirement one more year.
- The Paid Family & Medical Leave tax in Washington has increased to 0.8%, up from 0.6% under the prior law. Employees will pay 72.76% of this amount, and employers must pay the other 27.24%, unless they average less than 50 full time employers per year.
- The Washington State long term capital gains tax was successfully challenged in Douglas County on the basis of constitutionality. The state has appealed the decision to its supreme court to determine its constitutional validity. In the meantime, the state is proceeding under the assumption the tax is valid. A filing system will open in 2023 to file and pay. If the tax is struck down by the Washington Supreme Court, any payments will be refunded with interest. For more information on the Washington long-term capital gains tax, please see our newsletter from last year, available on our website.
- The increases to the Child Tax Credit and Dependent Care Credit in 2021 are not available for 2022 and future years. The child tax credit once again has a $2,000 maximum, and the Dependent Care Credit falls back to the $6,000 maximum under the old rules.
- The interest rate set by the IRS is at the highest it's been in recent years. This rate is applied to balances due and determines the penalty rate for not paying quarterly estimated taxes for certain individuals. The average rate has been between 3%-4% for the last few years but is currently set at 7%. For those of you who don't have enough withholding to cover your tax liability, we strongly recommend that you pay in your expected balance due via quarterly estimates to avoid paying 7% penalties on your balance due.

Washington Long-Term Care (LTC)

- In our last newsletter, we explained the new Washington Long-Term Care program, which was set to begin in 2022. The state postponed the program until July 1, 2023, to hear feedback for a variety of issues, and two implement to online systems to administer the program.
- Payroll tax deductions will begin on July 1, 2023. Employees will have 0.58% deducted from their gross earnings.
- Benefits will be available beginning July 1, 2026.
- Out of state workers can now opt out, as well as certain veterans, and spouses of active-duty military. The exemption application for these new categories will be available on January 1, 2023.
- For more information on this program, please refer to our last newsletter, available on our website.

Retirement

- 2022 Traditional and Roth IRA contribution limits remain at $6,000 plus a $1,000 catch-up for those 50 and older. The deadline for contributing for the 2022 tax year is April 18, 2023.
- 2023 Traditional and Roth IRA contribution limits will increase to $6,500 plus a $1,000 catch-up.
- The requirement to take minimum distributions from retirement accounts is now 72 years old, and is expected to increase to 75 years old in an upcoming bill.
- Recipients of Coronavirus-related distributions in 2020 must include 1/3 of the distribution in their incomes in 2021 and 2022, assuming an election was made to split the income over three years.
- Recipients of Coronavirus-related distributions could have paid back up to the entire amount of the distribution before December 31, 2022. Repayments are split equally between all three years, so an amended income tax return for prior years should be filed if any repayment is made after the original return was filed.

Inflation Reduction Act – Residential Energy Credit

- There are two Residential Energy Credits available – one for building components such as windows, doors, and insulation, and one for Qualified Energy Property, discussed below. Each credit has separate limitations.
- Prior to 2023, there was a $500 lifetime credit available for purchasing energy efficient building components for your personal residence. The credit rate was 10%, so you'd need to spend $5,000 to max out your lifetime credit.
- Beginning in 2023, the residential energy credit for building components now has a $1,200 annual maximum, and the credit rate is increased to 30% of qualifying expenses.
- There are limitations on the credit for building components based on which type of improvement is made. Windows are limited to a $600 annual credit, and doors are limited to a $500 total annual credit and $250 per door. Additionally, if you hire an energy efficiency auditor to inspect your home, you can claim a credit of up to $150 per year.
- Qualified Energy Property also qualifies for a 30% credit, with a max of $2,000 annually. Qualifying property includes heat pumps, boilers, and central air.
- In order to qualify, property generally needs to meet Energy Star 6.0 requirements. It's a good idea to look up the type of property you're purchasing ahead of time to see if it qualifies.
- The previously available 30% credit for solar property was extended under this act.

Inflation Reduction Act – Electric Vehicle Credit

- The electric vehicle credit will be calculated differently starting in 2023. Vehicles can now qualify if purchased new or used.
- The max credit for new vehicles is still $7,500. There are a number of specifications that a vehicle must meet in order to qualify, so we recommend you check ahead of your purchase to see if the vehicle qualifies.
- The credit for new vehicles is now available even after 200,000 units have been sold per model. This was a major limitation under the old electric vehicle credit rules that disallowed the credit for later purchasers of each electric vehicle model.
- The max credit for used vehicles is $4,000. The credit rate is 30%, so any purchase price up to $13,333 will get a 30% credit up to $4,000, and any purchase price between $13,333 and $25,000 will be limited to $4,000. Used electric vehicle credits can only be claimed once every three years.
- The new credits are limited based on your tax return income. For new vehicles, the credit will not be allowed if Adjusted Gross Income is over $300,000 for joint filers, $225,000 for Head of Household Filers, and $150,000 for Single and Married Filing Separate filers. For used vehicles, the credit will not be allowed if Adjusted Gross Income is over $150,000 for joint filers, $112,500 for Head of Household Filers, and $75,000 for Single and Married Filing Separate filers. You may use your income from the year of purchase, or the prior year, to determine your eligibility.
- No credit is allowed for new vehicles if the vehicle's Manufacturer Suggested Retail price is over $80,000 for larger new vehicles and $55,000 for smaller new vehicles. For used vehicles the maximum purchase price cannot exceed $25,000 to qualify.
- Credits can now be transferred to the dealer to obtain a discount on the purchase price instead of claiming a tax credit on your tax return. The credit is still subject to the above limits though, so high income earners cannot get around the income limitation by transferring the credit to the dealer.
- There is also a credit available for electric vehicle charging stations. For depreciable business property, the credit is 30% up to $100,000. For non-business property, such as a charging station in your personal garage, the max credit is $1,000, and is also a 30% credit rate.

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UPDATES, REMINDERS, STRATEGIES – FOR BUSINESS OWNERS & EMPLOYERS

Reminders & Key Changes

- Minimum Wage is now $15.74 in Washington state. This affects all wages earned after December 31, 2022.
- Keep a mileage log for all business automobile use. Your log should include dates, locations, and a description of the business purpose for each trip. Logs should be kept for each vehicle used.
- We recommend that you take a picture of the odometer on January 1 each year for all vehicles in which an automobile expense deduction is taken. This helps substantiate business mileage upon audit.
- 2022 SEP IRA contributions are due on March 15, 2023 for businesses and April 18, 2023 for individuals. Your contribution deadline can be extended by six months by filing a federal income tax extension.
- The deduction for business meals from restaurants in 2022 is still 100%. The deduction will go back to a 50% limitation beginning in 2023.
- Your business must register with the Washington Department of Revenue if you collect sales tax, owe use tax, or collect more than $12,000 in gross revenue per year. Other jurisdictions have similar licensing and registration requirements, so check with your local authority.
- The Employee Retention Credit ended on September 30, 2021. Qualifying businesses can amend to receive the credit as a payroll tax refund for up to three years after the due date of their payroll tax return.
- 100% bonus depreciation is no more after 2022. The rate decreases to 80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026, and will be unavailable in years afterward. Bonus depreciation can be claimed on most business assets except real estate and smaller passenger vehicles. It is generally preferable to Section 179 Depreciation because it is allowed on more types of assets and doesn't have income limitations.
- Section 179 Depreciation is still available, which allows up to 100% expensing in the year of purchase for certain business equipment. As mentioned above, there are limitations on Section 179 Depreciation that makes it less useful than bonus depreciation. Beginning in 2023, we'll likely see the use of Section 179 Deprecation increase due to the bonus depreciation rate decreasing.
- Businesses can also qualify for electric vehicle credits for business vehicles referred in the previous section.
- Washington employers must now list a pay range and description of benefits for all job listings starting in 2023. Employers who have under 15 total employees in the company are exempt from this requirement.

State Nexus

- Nexus is a term commonly used in tax law that determines your connection to a state, and a state's ability to tax you. With remote work on the rise, we think it would be beneficial to discuss situations where you might have to report income to a state different from where your business is located.
- We'll start with some basics, but keep in mind that each state writes their own tax code and may have varying rules. Sales are generally taxable based on the location of the benefit received. For shipped goods, sales are taxable based on the shipping destination. You may have noticed a few years ago that large companies like Amazon and eBay started collecting sales tax based on your location.
- Nexus is usually established in two ways. Physical presence nexus generally means you performed work, had a business location, or had employees working in a particular state. Economic nexus is generally established when no physical presence nexus exists, but your business meets certain economic thresholds in a state, discussed below.
- Remote sellers establish economic nexus when their sales in a state exceed $100,000, or they exceed 200 transactions with customers in that state. These are the lowest thresholds we've seen for any state, and some states have set higher thresholds.
- Remote sellers include out of state shippers of goods, and in some states, out of state service providers who work remotely. For example, under Washington and California law, consultants who provide work to customers in these states are subject to the tax laws of those state if economic nexus is established,
- With the above in mind, here are some examples.
- A Washington construction company builds a house in Idaho for an Idaho customer. There is a physical presence nexus here, so the revenue from this transaction is taxable to Idaho.
- A California furniture company produced and shipped to customers in California, Washington, Idaho, and Colorado. The company has no employees in other states and uses a third-party delivery service. California sales were $50,000, Washington sales were $120,000, Idaho sales were $75,000, and Colorado sales were $200,000. Physical presence nexus is established in California, and Economic nexus is established in Washington and Colorado. The company will report these out of state sales to Washington and Colorado and must collect and remit sales tax based on the sales tax rules of the shipping destination. Additionally, the company must file an income tax return in these states.
- An Idaho potato consulting company performs a $50,000 job for its sole Washington customer. The business has no out of state employees. There is no Washington nexus in this case because there is no physical presence, and economic nexus is not met because total remote Washington sales do not exceed $100,000.
- Assume the same facts as above, except now the business has one employee who works remotely in Washington. The physical presence nexus is established, and the company is subject to Washington's tax laws on the $50,000 of sales.