2023 Tax Guide

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Each year the IRS makes inflation adjustments to more than 60 tax provisions. These adjustments are to ensure that an increase in a taxpayer's income taxes is the result of an increase in the taxpayer's real income and not simply due to inflation (referred to as "bracket creep"). This guide provides a summary of the key tax updates for 2023 (which generally apply to tax returns filed in 2024).

Health Savings Account (HSA) and Flexible Spending Account (FSA) Contributions. HSA contribution limits for 2023 are $3,850 for individual coverage and $7,750 for family coverage. Individuals age 55 and older can contribute an additional $1,000 as a catch-up contribution. The FSA contribution limit for 2023 is $3,050. HSA and FSA contributions are typically pre-tax payroll deductions, but HSA contributions may also be taken as an above-the-line deduction (i.e., taken to arrive at adjusted gross income), if not already deducted from payroll. You may be able to contribute to both an HSA and a Limited Purpose FSA to pay for expenses not covered by your health plan, such as dental and vision care.

In addition to the contribution limits, HSAs and FSAs have some other key differences. To contribute to an HSA, you must be enrolled in a qualifying high-deductible health plan (HDHP) while FSAs are available to anyone whose employer offers one. HSA contributions can be made until your tax filing deadline for the year (i.e., April of the following year) while you must elect how much to contribute to an FSA before the start of the year (i.e., December or the prior year). HSA funds can be carried forward and invested while FSA funds must generally be spent during the year contributed or shortly thereafter. For 2023, FSA plans may allow up to $610 of unused funds to be rolled over into the following year. FSA funds can only be used for qualified medical expenses. HSA funds can be used for other purposes but must be used for qualified medical expenses to avoid tax and an additional 20% penalty if withdrawn prior to age 65. The chart below outlines the differences between HSAs and FSAs.

HSAs / FSAs Comparison:

	HSA	FSA
Eligibility requirements	Enrolled in HDHP	Offered by employer
Contribution limits 2023	$3,850 single or $7,750 for family (additional $1,000 if age 55+)	$3,050
Contribution tax treatment	Pre-tax (or above-the-line deduction)	Pre-tax
Contribution deadline	Tax filing deadline for plan year	Start of plan year
Use of funds	Any purpose (subject to tax and potential 20% penalty if not for qualified medical expenses)	Limited to qualified medical expenses
Deadline to spend funds	None	During year of contribution (or shortly thereafter if plan allows)
Investment option	Yes (potentially tax-free)	No
Retirement option	Yes (treated like a traditional 401(k) after age 65)	No

Retirement Plan Contributions. Retirement plan contribution limits and income thresholds have been increased for 2023 except for IRA the catch-up contribution which have never been adjusted for inflation but will be beginning in 2024. As with HSAs and FSAs, retirement plan contributions are typically either pre-tax payroll deductions or above-the-line deductions (i.e., taken to arrive at adjusted gross income). The 2023 contribution limits and income thresholds as well as the deadlines to establish and contribute are listed in the tables below.

Retirement Plan Contribution Limits:

	Individual (Employee): Contribution Limit 2023	Employer: Contribution Limit 2023
IRA-Based:		
IRA	Compensation up to $6,500 ($7,500 if age 50+)	$0
SEP IRA	Plan may permit traditional IRA contributions subject to IRA contribution limits	25% of compensation up to $66,000
SIMPLE IRA	Compensation up to $15,500 ($19,000 if age 50+)	Limited to matching contributions on up to 3% of compensation <u>or</u> nonelective contributions equal to 2% of up to $330,000 compensation for each eligible employee

	Individual (Employee): Contribution Limit 2023	Employer: Contribution Limit 2023
Defined Contribution:		
SIMPLE 401(k)	Compensation up to $15,500 ($19,000 if age 50+)	Same as for SIMPLE IRA
Safe-Harbor 401(k)	Compensation up to $22,500 ($30,000 if age 50+)	Compensation up to $66,000 (for both employer and employee contributions with minimum requirement for employer)
401(k)	Compensation up to $22,500 ($30,000 if age 50+)	Compensation up to $66,000 (for both employer and employee contributions)
Solo 401(k)	Compensation up to $22,500 ($30,000 if age 50+)	25% of compensation up to $66,000 (for both employer and employee contributions)
Profit Sharing	$0	Compensation up to $66,000 (for both employer and employee contributions)
Defined Benefit:		
	$0	Compensation up to $265,000

Contribution limits for Roth designated plans are the same as above, provided Roth IRA eligibility begins to phase out when MAGI exceeds $218,000 married filing jointly or $138,000 single.

The employer and employee designations can be confusing. Self-employed business owners are essentially both the employer and employee. However, there can be a distinction for purposes of retirement contributions. A business owner with a Solo 401(k) may elect to defer (i.e., contribute as an employee) up to $22,500 of their compensation in 2023 ($30,000 if age 50 or over). The business can then contribute (as the employer) up to 25% of the business owner's compensation, provided the total employee and employer contributions cannot exceed $66,000 for 2023 ($73,500 if age 50 or over). For single owner businesses earning over $300,000 per year the employee vs. employer contribution distinction doesn't really matter because the maximum contribution could all come from the business (i.e., the employer) since 25% of $300,000 exceeds the $66,000 contribution limit. However, the distinction can be important for single owner businesses making less than this. For example, if a business were to earn $100,000 in 2023 then the business (i.e., the employer) could only contribute $25,000 (25% of $100,000), but the business owner (i.e., employee) could contribute an additional $22,500 ($30,000 if age 50 or over). This is where the deadlines for establishing and contributing to a plan become important.

Retirement Plan Contribution Deadlines:

	Deadline to Set-Up	Employee: Contribution Deadline	Employer: Contribution Deadline
IRA-Based:			
IRA	Individuals must establish by individual tax filing deadline	Individual tax filing deadline	N/A
SEP IRA	Employer must establish by employer's tax filing deadline + extension	Individual tax filing deadline (if contributions permitted)	Employer tax filing deadline + extension
SIMPLE IRA	Employer must establish by October 1st	Within 30 days after the end of the month for which the contributions are to be made (i.e., January 30th of the following year)	Employer tax filing deadline + extension
Defined Contribution:			
SIMPLE 401(k)	Employer must establish by October 1st	Same as for SIMPLE IRA	Employer tax filing deadline + extension
Safe-Harbor 401(k)	Employer must establish by October 1st	December 31st	Employer tax filing deadline + extension
401(k)	Employer must establish by employer's tax filing deadline + extension	December 31st	Employer tax filing deadline + extension
Solo 401(k)	Individual must establish by individual tax filing deadline	Individual tax filing deadline	Employer tax filing deadline + extension
Profit Sharing	Employer must establish by employer's tax filing deadline + extension	N/A	Employer tax filing deadline + extension
Defined Benefit:			
	Employer must establish by employer's tax filing deadline + extension	N/A	Quarterly installment payments of the required contribution are due 15 days after the end of each quarter

The dates in the above chart are for the plan year unless otherwise noted (i.e., a 2023 SIMPLE plan must be set up by October 31st of 2023). However, the tax filing deadlines are for the year following the plan year (i.e., 2023 individual taxes are due April 2024 and the deadline for setting up and funding a 2023 IRA is April 2024).

Standard Deduction. For 2023 the standard deduction increased to $13,850 for individuals who are single filers and to $27,700 for couples who are married filing jointly (MFJ). Taxpayers age 65 and older are eligible for an additional standard deduction of $1,850 for single filers and $1,500 for each spouse that is age 65 or over for couples MFJ. Taxpayers may elect to take either the standard deduction or itemize deductions from their adjusted gross income (AGI) to arrive at their taxable income.

Income Tax Rates. The ordinary income and capital gain rates are unchanged for 2023, but the income limits for each tax bracket have been increased which reduces the effective tax rate. The 2023 rates and income brackets for single filers and couples MFJ are listed in the tables below.

Ordinary Income Tax Rates:

Rate	Single	MFJ
10%	$0 - $11,000	$0 - $22,000
12%	$11,000 - $44,725	$22,000 - $89,450
22%	$44,725 - $95,375	$89,450 - $190,750
24%	$95,375 - $182,100	$190,750 - $364,200
32%	$182,100 - $231,250	$364,200 - $462,500
35%	$231,250 - $578,125	$462,500 - $693,750
37%	Over $578,125	Over $693,750

Long-Term Capital Gain and Qualified Dividend Tax Rates:

Rate	Single	MFJ
0%	$0 - $44,625	$0 - $89,250
15%	$44,625 - $492,300	$89,250 - $553,850
20%	Over $492,300	Over $553,850

These are marginal tax rates, and each rate applies only to income within its respective bracket. The marginal tax rate is the rate that would apply to the next dollar of income. Alternatively, the effective tax rate (or average tax rate) is a person's tax as a percentage of income. For example, a couple MFJ with $50,000 of ordinary income would pay 10% on the first $22,000 and 12% on the next $28,000. The couple would owe $5,560 in tax ($22,000 x 10% + $28,000 x 12%). Their marginal tax rate would be 12%, but their effective tax rate would be just over 11% ($5,560 / $50,000).

The tax bracket for long-term capital gains and qualified dividends is determined based on all taxable income. Net long-term capital gains and qualified dividends are "stacked" on top of ordinary income to determine the relevant tax rate. For example, assuming the couple in the prior example had $50,000 of net long-term capital gains in addition to $50,000 of ordinary income, they would pay 0% on the first $39,250 of net long-term capital gains and 15% on the next $10,750 of net long-term capital gains.

Most income that is not tax exempt (i.e., interest on municipal bonds) is taxed as ordinary income unless it is long-term capital gain or qualified dividend income. Gains recognized on the disposition of an asset that has been held for more than a year are generally treated as long-term capital gains. Most dividends are qualified dividends which in general are dividends from shares of domestic and qualified foreign corporations that meet certain minimum holding requirements.

Net Investment Income and Additional Medicare Tax. In addition to the income taxes discussed above, single filers with AGI over $200,000 and couples MFJ with AGI over $250,000 are subject to a 3.8% tax on any net investment income above these thresholds. Net Investment Income includes interest, dividends, capital gains, rents, royalties, and certain other types of passive income. A 0.9% Additional Medicare Tax also applies to any wages exceeding $200,000 for single filers and $250,000 for couples MFJ. A person may be subject to both taxes, but not on the same income. The 0.9% Additional Medicare Tax applies to wages, compensation, and self-employment income over certain thresholds, but it does not apply to Net Investment Income. The tax rates and AGI thresholds for the Net Investment Income Tax and Additional Medicare Tax are not adjusted for inflation and have been unchanged since they went into effect at the beginning of 2013.

Estate and Gift Exemption. As part of the 2017 Tax Cuts and Jobs Act (TCJA), Congress essentially doubled the lifetime estate tax exclusion beginning in 2018. This amount is adjusted for inflation and is $12.92 million per individual in 2023. The annual gift exclusion has also risen to $17,000 per donor/recipient for

2023. Note that the TCJA is scheduled to sunset at the end of 2025 and if Congress does not act the estate tax exemption will essentially be cut in half beginning in 2026.

Tax Provisions not Adjusted for Inflation. This piece mainly covers the key tax provisions that are adjusted for inflation annually. There are other provisions that are not inflation adjusted. The credit amount and income threshold for the child and dependent tax credit and for educational tax credits (Lifetime Learning and the American Opportunity) are not adjusted for inflation.

As you plan around the 2023 tax numbers, it is important to discuss with your financial advisor to determine how they may impact your personal plan.

If you have any questions or would like to discuss further, please reach out to your client service team or call 404.264.1400. You can also visit us on the web at **HomrichBerg.com.**

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