Delaying Income and Accelerating Expenses

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By: Crystal Edwards, Joseph Dolan, John Elias, Charles Falk, I. Richard Ploss, Philip Siana, Deirdre Wheatley-Liss

Historically, one of the most traditional year-end income tax planning strategies has been for taxpayers to defer taxable income from the current tax year to the subsequent tax year and to accelerate income tax deductions so that the taxpayer may claim the same in the current tax year. However, before implementing such a strategy, taxpayers should consider the following:

1. No plan should be implemented without first having one's income tax advisor prepare a proforma draft of the taxpayer's 2022 income tax return to determine how the actions will affect the taxpayer's 2022 income tax liability. Taxpayers should never guess how a tax strategy will impact his/her/their federal, state, and local income tax liability. For example, a change in a taxpayer's gross income or an increase in a taxpayer's income tax deductions can adversely impact his/her/their regular income tax liability, alternative minimum tax liability, other deductions, etc.
2. Deferring W-2 income is difficult and may not be possible. Most individual taxpayers are on the “cash” method of tax accounting, which essentially signifies that income is recognized when cash is received. Before 2005, an employee could request that his/her/their employer defer paying him/her/them salary until after the new year. Unfortunately, this strategy is no longer effective unless the employee requests the deferral of a bonus that was just granted.
3. If a taxpayer is considering selling an asset or a business, properly deferring the sale until next year can be an effective strategy to defer income. Taxpayers can sell certain assets (such as real property and an interest in a closely held business), using the installment sale method, and the taxpayer will not recognize taxable gain until the taxpayer actually receives cash payments. Unfortunately, taxpayers cannot utilize the installment sale method on the sale of marketable securities.
4. If the taxpayer is the owner of a closely owned business with few employees and does not have a qualified retirement plan (e.g., 401k plan), adopting and funding such a plan in 2022 could produce income tax savings by providing the taxpayer with a substantial deduction.
5. If the taxpayer is an employee, who also has earned income from an outside "side hustle" business, the "side hustle" income can often be reduced through the creation and funding of a Simplified Employee Pension Plan ("SEP"), IRA, 401(k), or another retirement plan. Taxpayers should note that 2022 tax year contributions to a SEP may be made in the 2023 tax year before the due date that the taxpayer files his/her/their 2022 individual income tax return.
6. Prepaying deductions may result in reducing a taxpayer's 2022 taxable income if the taxpayer uses the cash method of accounting and prepays an otherwise deductible expense that the taxpayer will incur in the 12 months after payment. For example, if you own your own business and plan to travel on business in 2023, purchasing the airline tickets in 2022 for travel that you will make within 12 months will generally result in a deduction in 2022. Also, the purchase of an airline ticket now may result in a lower ticket price.

7. Prepaying one's January 2023 mortgage payment may not result in the income tax deduction that the taxpayer may expect.
8. If you have a Flexible Spending Account, utilize your funds in the account in 2022 by making medical appointments and purchasing approved items.