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Year-End Tax Planning

Thursday, November 29, 2022

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Meet the Presenters

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Today’s Agenda

- Why estate planning should continue
- Charitable planning strategies
- Portfolio allocation for tax efficiency
- Year-end capital gains distributions
- RMDs, Roth Conversions, etc.
- Opportunities to reduce taxable self-employment income
- Employee Benefit Plans
- Inflation Reduction Act Impact

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Estate Planning

Simple Estate Planning Ideas

- Consider gifting
  - $16,000 per person per year tax free
  - $17,000 for 2023
- Evaluate life insurance that you might own
  - Make sure it is owned in a trust and not outright
- Eligible to pay people's health and education expenses if paid directly to the provider
- Accelerate gifts by making 5 years worth of 529 gifts

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Estate / Gift Taxes: Current Situation

- 2022 Exemption is $12.06 million per person ($24.12 mil per couple)
  - 2023: $12.92 million ($25.84 mil per couple)
- Exemption is the aggregate amount that can be given away during lifetime and at death
- Under current law, this exemption will be automatically cut in half in 2026
- For those ready to transfer in 2022, they may wish to confirm cash flow and continue with planning already started

Talk to Your Trusted Advisor

Talk to your trusted advisor who will then pull in experts from various disciplines to make sure your plan is cohesive:

- Attorneys – advise about planning opportunities and draft legal instruments
- Accountants – comply with tax reporting and accounting regulations
- Financial advisors – ensure investment strategy complements charitable structures
- Trustees – administers trusts for the best interests of the charitable and non-charitable beneficiaries

Advisors should be collaborative with each other and with the charitable organization throughout the planning process as well as during the administration of any trusts.

Charitable Planning Strategies

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General Thoughts about Charitable Trusts

- Charitable trusts can be set up as lifetime transfers or by operation of a will
- Income tax for charitable contributions through charitable trusts are limited:
  - The value of the actual interest being conveyed to the charity
  - Deductions limited – only up to 30% of adjusted gross income
- Lifetime transfers usually provide greater tax benefits than testamentary bequests because the donor will receive BOTH an income tax and gift tax charitable deduction

Charitable Planning Strategies

Ranked from basic to most sophisticated, the following is a very broad view of the categories available to prospective donors wishing to make charitable contributions:

a. Annual Cash Donations

b. Donor Advised Funds

c. In Kind Donations of Appreciated Assets

d. QCDs (Qualified Charitable Distribution) from an IRA (for beneficiary over age 70) to charity

e. Testamentary Bequests

f. Charitable Annuities

g. Charitable Trusts

Annual Cash Donations

- Attractive for its simplicity: no valuations, not subject to IRS challenge if substantiated
- Easy to implement: no costs associated with transferring title
- Cash is suitable for any charitable organization
- Deductible up to 60% of Adjusted Gross Income (AGI) through 2025
- Could be missing opportunities for larger income tax deductions and estate planning
- Charitable organizations may not be able to plan for donations and spending on behalf of charitable causes
- Deductible up to 60% of AGI for 2022

Donor Advised Funds

Benefit to Donor of using DAF instead of direct charitable contributions

- Can make large charitable contributions in year when income is much higher than usual
- Spread out charitable grants over time while getting tax deduction in specific year
- Can donate highly appreciated investments or cash (in some cases privately held investments also)
- Donor can leave a legacy for family to continue to make grants after death

Transfers of Low Basis Stock

- Need to have held stock for more than one year and the price has appreciated
  - For ordinary income and short-term capital gain property, the donor’s charitable contribution would be limited to the property’s FMV less amount that would be treated as income – essentially, the donor’s basis
  - Long-term capital gain property (usually stocks but could be other kind of property): the donor can deduct the Fair Market Value (FMV) without recognizing the realized gain
- If the donation exceeds this, you may carry forward the deduction for 5 years
- Receiving charity must have a brokerage account to accept the shares and a Board Approved policy of how to handle investments once received

Qualified Charitable Distributions (QCDs)

- Donor must be 70 ½ or older
- Donation directly from IRA to Charity
- Maximum amount is $100,000
- Can donate cash or stocks from IRA
- Satisfies Required Minimum Distribution amount
- Cannot donate to Foundation or Donor Advised Fund
- Amount of QCD is not included in income for the year
- QCD is not a deductible charitable expense
- Donation is not subject to AGI income limits

Charitable Contributions

- Up to $600 deduction for cash donations even it not itemizing

Type of Contribution	AGI Limitation	Unused Donation
Cash	60% of Adjusted Gross Income	Carries forward and used over next 5 years
Appreciated Stocks	30% of Adjusted Gross Income	Carries forward and used over next 5 years
Cash to Private Foundation	30% of Adjusted Gross Income	Carries forward and used over next 5 years
Appreciated Stock to a Private Foundation	20% of Adjusted Gross Income	Carries forward and used over next 5 years
Cash to Donor Advised Fund	60% of Adjusted Gross Income	Carries forward and used over next 5 years
Appreciated Stock to Donor Advised Fund	30% of Adjusted Gross Income	Carries forward and used over next 5 years

Portfolio Allocation

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Portfolio Allocation for Tax Efficiency

- Qualified Accounts vs Nonqualified Accounts
- Bond Income and REIT income is taxed at Ordinary Rates
- Qualified Dividends are your friend
- Municipal Bonds vs Taxable Bonds
  - Tax Equivalent Yield = Municipal Bond Yield / (1-Tax Rate)
  - Example – Muni Bond pays 6% and you are in the 37% tax bracket
    - 6% / (1-.37) = 9.52% Tax Equivalent Yield

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Year-End Capital Gains Distributions

- Payment by a mutual fund company from the proceeds of the fund's sale of stocks throughout the year
- Consider Tax-Managed Funds
- Consider Exchange traded Funds (ETFs)

Tax Loss and Gain? Harvesting

- Tax Loss Harvesting
  - Opportunity to sell positions in a loss and generate tax benefit
  - Use loss positions to offset positions in gains
  - Carryforward losses to future years
- Tax Gain Harvesting
  - Opportunity to sell positions at long term capital gains
  - Utilize current tax laws of 20% long term capital gains
  - 0% Long Term Capital Gains rates if income less than $41,675 Single / $83,350 Married
  - Spread future tax burden over multiple periods

IRA Strategies

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IRA Accounts

- Requirement Minimum Distribution (RMD) before December 31st
  - If this is your first year subject to RMD, you have until April 1st
  - Penalty is 50% of the RMD if not taken on time
- COVID distributions from IRA
  - Look at paying this back

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Roth Conversions

- Take money from Traditional IRA and move into Roth IRA
- Pay tax on the amount converted at current tax rates
- No limit on amount that can be converted
- Benefits:
    - Reduces future RMD
    - Pay tax now at lower tax rates than in the future with higher taxes
    - Heirs inherit tax free money

Self-Employed

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Self-Employed Strategies

- Business Formation – LLC, S Corp, C Corp, Partnership
- Timing of Income and Expenses
- Home Office
- Augusta Rule
- Automobile Expenses
- Paying your kids over 7 years old
- MERP
- Retirement Plans

Employee Benefit Plans

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Employee Benefit Plans - Plan Selection

- IRA
- Roth IRA
- SEP IRA
- Solo 401k
- 401k/ PSP
- DB Plans

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IRA

- Self employed individual or employee that is not eligible to participate in a plan
- Easy to set up and maintain. Can be set up after year end. Do not have to contribute every year
- Low contribution amounts and deductibility is limited if covered by a plan or MAGI is too high
- $6,500 per year with $1,000 catch up if over 50 years old
- No tax filings and receive a deduction for the contribution
- Withdraw at any time but 10% penalty if under 59.5 years old

Roth IRA

- Self employed individual or employee
- Easy to set up and maintain. Can be set up after year end. Do not have to contribute every year
- Low contribution amounts and limited if MAGI is too high - $138,000 if single and $218,000 if married
- $6,500 per year with $1,000 catch up if over 50 yrs.
- No tax filings and distributions are tax free
- Withdraw at any time but 10% penalty if under 59.5 yrs.
- Need to track five year aging for distributions

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SEP IRA

- Self employed individual or small business owner, including those with few employees
- Easy set up and maintenance – can be established after year end as long as by tax filing deadline
- Flexible annual funding requirements, but same amounts to everyone
- Funded solely by the employer – up to 25% of compensation up to a maximum of $66,000 in 2023
- No employer tax filings
- Withdraw funds at any time, subject to 10% penalty if under 59.5 yrs.

Solo 401k

- Self employed individuals or business owner with no employees other than spouse – NO Employees
- 401k with potential higher contribution than SEP IRA
- Less administration and no filings until assets above $250,000
- $22,500 of deferrals + catch up if over 50 as well as up to 25% of compensation up to maximum of $66,000 (2023)
- Withdrawals can only be taken if 59.5 years, disability and or plan termination
- Must be set up by year end

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401k/Profit Sharing Plan

- Generally for companies with more than 10 employees
- Flexibility in Plan design – but requires administration, investment advisor and education
- More expensive and burdensome
- Salary deferrals up to $22,500 + catch up and employer can be discretionary – matching, safe harbor, PSP up to 25% of compensation up to $66,000
- Must file form 5500 and have plan testing prepared
- Loans and hardship withdrawals can be available
- Safe harbor deadline is October 1st

Defined Benefit Plans

- Appropriate for consistently profitable companies with 10 or fewer employees and older owner
- Flexibility in Plan design – but requires administration and investment advisor
- More expensive and administratively burdensome
- Annual funding requirements – need consistent cash flow
- Funded solely by the employer – up to $265,000
- 5500 filing required and testing of Plan by Actuary
- Withdrawals can only be taken if 59.5 years, disability and or plan termination
- Must be set up by year end

Real World Example

- Safe Harbor 401k Plan with PSP and Cash Balance Option
- Approximately 12 employers and 3 owners
- Total Employer Contribution to plan was $265,700
- Tax Savings = $120,000
- Contributions to staff = $79,100

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Inflation Reduction Act

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Inflation Reduction Act

- EV Credit up to $7,500
  - Stops when 200,000 units of a vehicle is sold
- Premium Subsidies for Healthcare extended to 2024
- Lower RX costs beginning in 2025
  - $2,000 annual maximum out of pocket for prescriptions
- Raise C Corp Minimum taxes
- Residential Clean Energy Credit
  - 30% credit for solar panels
- Energy Efficient Home Credit
  - $1,200/year credit for energy efficient windows, doors, insulation
  - $2,000 credit for heat pumps

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Thank You!
Questions and Answers

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Contact Us

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