YEAR-END STRATEGIES

FINANCIAL CONSIDERATIONS BEFORE DECEMBER 31

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As year-end approaches, the clock is ticking on planning strategies to take advantage of before December 31. Review the details on each strategy below to see which ones may be applicable.

CHARITABLE GIFTS

For those who are charitably inclined, there are a couple of general rules to be aware of when making charitable gifts (see chart).

- The amount of the deduction is based on the nature of the assets gifted and the status of the charity receiving the gift.
- When a donor gifts appreciated long-term capital gains assets to charity, the donor is usually able to avoid paying any capital gains taxes on those gains.

DEDUCTION LIMIT FOR 2023 (% OF AGI*)

Charity	Public	Private
Cash	60%	30%
Long-Term Capital Gains	30%	20%

* Adjusted gross income

For more information, consult IRS Publication 526, Charitable Contributions.

Because the decision requires careful consideration of personal circumstances and goals, addressing this issue prior to year-end makes sense.

Qualified Charitable Distributions: A qualified charitable distribution (QCD) can be a tax-efficient way to make a gift to charity. A QCD is a distribution of assets from an IRA directly to a qualified charitable organization. QCDs are only available to traditional IRA owners age 70½ or older and are currently limited to $100,000 per year. The advantage of a QCD is that the distribution counts toward the owner's RMD for the year, but it is not included in income.[1] Note that after 2023 the QCD limit will be indexed for inflation.

For additional information on QCDs, consult IRS Publication 590-B, Distributions from Individual Retirement Arrangements.

SMALL BUSINESS RETIREMENT PLANS

For sole proprietors or small business owners who are concerned about their 2023 tax liability, there are two qualified retirement plans that can help reduce their tax bill and build their retirement nest egg.

401(k) PROFIT-SHARING PLANS

- A profit-sharing plan may offer advantages over a SEP or SIMPLE by allowing increased flexibility in designing plans and increased contribution and deduction limits in some cases.[2]
- Employees may defer up to $22,500 with a $7,500 catch-up contribution if they are age 50 or older.
- The employer may make deductible contributions of 25% of compensation (total contribution to an employee's plan is the lesser of 100% of employee's compensation or $66,000 plus catch-up).[3]

DEFINED BENEFIT PLANS

These plans are often overlooked because of the perceived complexity and recordkeeping requirements. For sole proprietors and small partnerships, however, these plans can offer a substantial tax-deferral opportunity.

- Contribution limits are determined by an actuarial calculation based on a retirement benefit as high as $265,000 per year in retirement.[3]
- Defined benefit plans have required minimum funding rules.[2]

Single participant (Solo) plans are available to self-employed individuals and their spouses. Those considering 401(k) profit-sharing plans or defined benefit plans should generally seek the assistance of a professional plan administrator. Selecting and designing the right type of plan can take time, so it's important to address this issue well before year-end.

The rules have changed for plan implementation and funding deadlines depending on the type of plan and business organization. Consult your tax professional for more details.

TAX-LOSS HARVESTING

For those with assets in taxable investment accounts, the ups and downs of the financial markets can provide an opportunity to diversify or rebalance in a tax-efficient manner; this is because capital gains and losses can be used to offset each other. Some basic rules to keep in mind include:

- Capital losses that are not used in the same tax year in which they are incurred can be carried forward into a future tax year.
- Capital losses can also offset ordinary income, but only up to $3,000 per year for single and joint filers ($1,500 married filing separately).[4]
- A loss will be disregarded as a so-called "wash sale" if the seller buys the same or a "substantially identical" security within 30 days before and after the sale.[4]

For additional information, consult IRS Publication 17, Your Federal Income Tax.

REVIEW FLEXIBLE SPENDING ACCOUNTS

- Grace period provision: Some plans will allow a grace period of up to two-and-a-half months after the end of the year to use funds.
- Carryover provision: Some plans have a carryover provision that allows up to $610 to be carried over from 2023 to 2024.
- No provision: All funds will be forfeited at year-end.

A PLAN CAN ALLOW EITHER A GRACE PERIOD OR CARRYOVER, BUT NOT BOTH.

TAKE ADVANTAGE OF A LOW-INCOME YEAR

Whether it is something like retirement, a pandemic, or the loss of a job, a low-income year creates opportunity.

A married couple filing jointly can have up to $89,250 of AGI and still qualify for a 0% capital gains rate and a 12% marginal income tax rate.[5]

Those faced with a reduction in their usual income may want to take advantage of lower tax rates. Taking capital gains at a 0% tax rate can be a good opportunity to rebalance or reposition investments. Similarly, pulling money out of an IRA at a low marginal tax rate may not only make sense now, but by reducing the balance in the account, it can help reduce future RMDs. This can potentially provide greater tax flexibility later in retirement.

ROTH OPPORTUNITIES

Not all tax planning is about tax reduction. Tax diversification in retirement can be another objective. Year-end can be a good time to get more money into a potentially tax-free Roth account.

Some may have an opportunity to get money into a Roth IRA while minimizing the tax liability of a Roth conversion.

- Those with pass-through business losses or large excess deductions may have an opportunity to offset the tax liability that would otherwise result from a Roth conversion.
- Examples: A sole proprietor with a loss on Schedule C (Form 1040) or seniors with deductible medical expenses in excess of their income may want to consider a Roth conversion.
- Business owners may want to consider whether their 401(k) plan will allow them to convert some of this year's pretax 401(k) contributions to after-tax Roth 401(k) contributions.
- Those who are rolling assets out of a 401(k) may want to take advantage of IRS guidance clarifying the method of allocating after-tax contributions to a Roth IRA via a rollover (IRS Notice 2014-54).

PLANNING FOR UNCERTAINTY

Since no one can say for certain what taxes will look like in the future, employing strategies that enable flexibility should be a primary focus. Moreover, the impact of taxation should be taken into consideration during both the accumulation stage and the distribution stage. The manner in which a portfolio is situated plays a major role in determining the taxes to which one is subject. One strategy to combat uncertainty is to diversify holdings across different types of accounts, also known as tax diversification.

TAX DIVERSIFICATION

- Tax diversification is the practice of diversifying assets across different account types with varying tax characteristics. In a changing tax policy environment, tax diversification can help investors draw assets from optimal sources and can provide flexibility. It may be a good time to review the current location of assets (ex. taxable, tax-deferred, and tax-free) and determine if any changes should be made. The table below can be used to get a quick idea of how assets are held.

ROTH CONVERSIONS

- If someone is of the belief that tax rates will be higher in the future, it may make sense to convert some pretax retirement accounts to Roth. The idea being to convert at lower tax rates now to increase tax-free sources of income in the future when tax rates could be higher. Roth conversions need to be carefully considered, and it is always recommended to speak with a financial professional and tax professional.

ASSESS-TAKE INVENTORY

GET A COMPLETE VIEW

- Worksheets, fact finders, and software can help

DETERMINE WHERE THE BULK OF ASSETS ARE HELD

- Look at both total amount and the percentage

DEVELOP A STRATEGY AND IDENTIFY DEFICIENCIES

- Consider how your mix may change over time

CURRENTLY TAXABLE	TAX-DEFERRED	TAX-FREE
Savings account and CDs	Traditional IRAs	Roth IRA and Roth 401(k)
$	$	$
Brokerage account	Retirement Plans (e.g., 401(k), 403(b))	Municipal bonds
$	$	$
Mutual funds	Annuities	College savings account (e.g., 529)
$	$	$
% ______	% ______	% ______
Total	Total	Total
$	$	$

When it comes to preparing for your future, there's no time like the present.

[1] IRS Publication 590-B (2021), p.13; IRC Sec. 408(d)(8)
[2] IRS Publication 560 (2021), pp. 2 – 5, 12 – 15
[3] IRS Notice 2020-79 (2020)
[4] IRS 2021 Instructions for Schedule D (2021)
[5] IRS Rev. 2020-45 (2020)

Withdrawals of taxable amounts are subject to ordinary income tax and, if taken prior to age 59½, a 10% federal tax penalty may apply.

The tax costs of a Roth IRA conversion can be significant. Contributions are subject to taxes that were previously deducted, including any accumulated earnings. You may also be pushed into a higher tax bracket, especially if converting a large amount of money.

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