2022 Year-End Tax Planning Strategies

by Jen Hall, CMA, CPA, CFP®, CRPC® and James Lange, CPA/Attorney

If you haven't already done so, now is a good time to start thinking about cutting this year's taxes and/or considering whether you should make a Roth IRA conversion. Let us look at some tax-planning considerations that can help lower your 2022 tax bill or reduce future taxes beyond 2022.

For 2022 year-end tax planning purposes, once again we highly recommend that taxpayers who have yet to implement Roth conversions in 2022 to consider doing so. In the right situation, strategic Roth conversion planning can utilize incremental tax costs while also providing a tax-free retirement nest egg account. While we do not claim to be market timers, there is a strong argument that it is a good time to do Roth conversions after a market decline which we are experiencing in 2022. If your Roth IRA increases in value over time, you will compensate for any temporary market declines. Please read Chapter 6 of our book, ***The IRA and Retirement Plan Owner's Guide to Beating the New Death Tax***, which describes Roth IRA conversions after the passing of the SECURE Act.

Making Roth conversions used to be an "offensive strategy" meaning you would likely get a great result for your family if you made the appropriate Roth IRA conversions. Today, with the SECURE Act, we are recommending Roth conversions for many clients as a "defensive strategy." That is, you and your family might suffer horrendous consequences by not doing Roth conversions. Some of those draconian consequences could be avoided or at least reduced by doing the appropriate Roth IRA conversion.

Please feel free to watch our recent Roth IRA conversion workshop available at https://PayTaxesLater.com/roth-workshop.

Please also read our article that received over 175,000 views on *Forbes.com* at https://www.forbes.com/sites/jlange/2020/03/30/now-is-the-best-time-in-history-to-do-a-roth-ira-conversion/?sh=3625c242f1ba.

We want to emphasize the importance of the looming sunset of the provisions included in the Tax Cuts and Jobs Act (TCJA) of 2017. The two (2) biggest changes that should be on everyone's radar are (1) the higher individual tax rates that will be coming back in 2026 and (2) the lower estate and gift tax exemption limit returning in 2026.

For individual taxpayers, the top individual, estate, and trust income tax rate increases back up to 39.6% from the current rate of 37%. By making a series of Roth conversions in years 2022-2025, you may position yourself to save significant tax dollars by reducing your required minimum distributions (RMDs) since there are no RMDs required on Roth IRA accounts. Also, there would not be any taxes owed on the portfolio income earned on those RMDs, your capital gains taxes could be reduced, your net investment income taxes could be reduced, your medical expense deduction may be increased, and your IRMAA premium charges may be reduced as a result of a solid Roth conversion plan. We encourage you to consult with your professional tax preparer to see if Roth conversions make sense for you.

For many older taxpayers, the sunset of the current estate and gift tax provision provides the greatest concern. TCJA doubled the estate and gift tax exemption limit. For 2023, the federal and gift tax limit increases to $12.92 million per individual ($25.84 million for married couples). In 2026, when the estate and gift exemption limit reverts back to the pre-TCJA level, we can expect the exemption to be approximately $6.5 million per individual ($13 million for married couples). If your estate is close to the post-TCJA exemption level, we encourage you to consult with your estate attorney to plan for these changes. Some actions you may want to consider taking now include: (1) making gifts now to reduce the size of your overall estate and/or (2) purchasing second-to-die life insurance to cover the estate tax burden that may be assessed in the future while you are healthy now. Gifts made during a 'depressed' market are better than gifts made during a robust market, as the growth in the investment gifted is now done 'outside' of your estate.

There is, of course, the potential of new tax legislation before the sunset of the tax rates and exemption limits in 2026. Since we are big proponents of planning, we encourage you to consult with your advisory team (professional tax preparer and estate attorney) to develop a solid plan to combat these upcoming changes.

What's New for 2022?

What's new for 2022 is the passing of the Inflation Reduction Act (IRA) on August 16, 2022. The purpose of the IRA, not to be confused with your personal IRA, was to help combat inflation through various tax provisions impacting the business tax sector primarily. In addition, an estimated $369 billion in expenditures related to clean energy and energy security is included. The changes to the business tax sector are beyond the scope of this writing and will not be included. Many of the changes made in the IRA are effective in years 2023 and beyond. The changes that are effective in 2022 include: (1) **The Residential Clean Energy Credit** and (2) **Clean Vehicle Credit.**

The Residential Clean Energy Credit (previously named the Residential Energy Efficient Property Credit) increased from 26% to 30% of the cost to install qualifying electric, water heating, or temperature control systems for your home that use solar, wind, geothermal, biomass or fuel cell power. The credit does not apply to biomass furnaces and water heaters anymore, however.

If you are in the market for a new electric vehicle, you may want to consider the Clean Vehicle Credit which provides a maximum credit of $7,500 per vehicle. There are not any limitations on the number of vehicles you can purchase to be eligible for the credit, so if you and your spouse are both looking to purchase a new vehicle, your combined credit could be $15,000. There are (3) tests in order to qualify for the credit. If you make too much, no credit; if the vehicle costs too much, no credit, and if it was manufactured outside of North America, no credit. If you are in the market for a new vehicle and want to qualify for the $7,500 Clean Vehicle Credit, we encourage you to check the https://afdc.energy.gov/laws/inflation-reduction-act website and the https://vpic.nhtsa.dot.gov/decoder/ website to make sure the year/model is eligible for the credit. The Clean Vehicle Credit is disallowed if the manufacturer's suggested retail price is in excess of $80,000 for SUVs, vans, and pickup trucks and $55,000 for all other vehicles. The credit is disallowed if your Modified Adjusted Gross Income (MAGI) for the current or preceding tax year exceeds $300,000 for married filing jointly or surviving spouses, $225,000 for head of household, and $150,000 for all other taxpayers.

One loophole to this rule is if an individual entered into a written binding contract to purchase a qualifying electric vehicle before the date of enactment of the IRA (August 16, 2022) but didn't take possession until after August 16, 2022, the changes in the IRA will not impact the individual's Clean Vehicle Tax Credit. The individual may still claim the credit based upon the rules that were in effect before August 16, 2022.

Beginning in years 2024, taxpayers purchasing eligible vehicles can elect to transfer the Clean Vehicle Tax Credit to the dealer, provided the dealer meets the registration, disclosure, and other requirements. We are not certain how this will shake out in real life but wanted to bring it to your attention for a future vehicle purchase.

In addition to the Clean Energy Credit, the IRA has expanded and created various other tax credits to promote renewable, clean energy. If you recall, previously, there was a lifetime cap of $500 on energy-efficient home improvements. **Beginning in year 2023**, a $1,200 annual tax credit limit will replace the prior $500 lifetime cap. Beginning in year 2023, the tax credit will be equal to 30% of the costs for all eligible home improvements made during the year up to the $1,200 maximum annual credit. So, if you are planning on replacing your windows, purchasing a new furnace or water heater, etc. and can wait until 2023, we would encourage you to do so. Many of our clients have already exhausted their lifetime credit of $500. Beginning in 2023, they will now be eligible to take advantage of this new credit, not only in 2023 but in future years as well.

The TCJA passed in 2017 brought significant tax reform changes for both individuals and businesses that are relevant now. Many of the new changes that took place in 2018 were anything but simple. One change that affected millions of taxpayers was the elimination or drastic reduction of certain itemized deductions on Schedule A.

Nearly 90% of taxpayers utilize the standard deduction in lieu of itemizing their tax deductions since the law change took place. While this change did simplify the tax return filing for many, there are still plenty of tax-savvy ideas to consider. With many taxpayers no longer itemizing deductions, additional focus should shift to Adjusted Gross Income (AGI) tax planning. Reducing your AGI can increase tax deductions, increase certain tax credits, and reduce exposure to other taxes.

Itemized Deductions: We have a higher standard deduction allowance in 2022 ($12,950 for individuals, $14,700 if 65 or over, $25,900 for married filing jointly, $28,700 if 65 or over). There are also significant limitations on what we may include for itemized deductions. For those taxpayers who typically never itemized their deductions, the increase in the standard deduction is welcome. For itemizers, particularly if you pay high real estate taxes and state and local income taxes, the change in itemized deductions generally hurt you.

Gaming the Standard Deduction Allowance Vs. Itemizing Deductions

Bunching Strategy: Bunching your itemized deductions is a technique that involves accumulating deductions, so they are high in one year and low in the following year. You can benefit from the "bunching" strategy. It's very typical for most taxpayers to wait until tax time to add up everything and use the higher of the standard deduction or their itemized deductions. It should be easier for most taxpayers to project their total itemized deductions before the end of 2022 due to the elimination of certain itemized deductions and limitations on others [State and Local Tax (SALT) deduction]. By being proactive, you can time the payments of tax-deductible items to maximize your itemized deductions in one year while using the standard deduction the following year.

Bunching Charitable Donations: Consider bunching charitable donations every other year while taking the standard deduction in the off years.

A popular vehicle for maximizing your charitable donations is the use of a Donor-Advised Fund (DAF). The DAF functions as a conduit. The taxpayer receives an immediate tax deduction up to certain limits when the money is directed into the fund. The donor decides what charities will receive the money and when it shall be paid out. In a high-income year, front loading the fund with a larger contribution can be quite nice. The assets within the fund also enjoy tax-free growth. Please note that the charitable contribution limit for 2022, including donor-advised funds, is 60% of AGI for contributions of cash, and 30% of AGI for contributions for non-cash assets if the assets were held more than one year.

We have found that charities are very active with their solicitations during the holiday season and would be happy to receive gifts near year-end or early in the new year. If it appears that you think you will be itemizing your deductions in 2022, but not next year, consider making last minute cash and non-cash charity donations before year-end. If you do not have the extra cash available today, you can use a credit card before year-end and still qualify for a 2022 tax deduction. If the gift is appreciated stock, the tax benefits are even greater as you qualify for the larger charitable contribution tax deduction and do not have to pay tax on the capital gains of the appreciated stock.

Also, you don't necessarily have to donate cash. You could also consider non-cash contributions of household goods, clothing, and furniture to the appropriate charity.

We often like to recommend a Roth IRA conversion strategy for those taxpayers who have already or are still planning to make a large charitable contribution before year-end.

In one case, a parent was planning a large gift to a child. The child, who is in a much lower bracket, was planning to make a large gift to a charity and would not have received much tax benefit. The father was planning to give to the child a gift. Instead, we had the father make that gift directly to the child's charity. The father got a large tax deduction and with that tax deduction, we did a big Roth IRA conversion for the parents the same year as the contribution. That was fun because in effect we compounded the tax benefit of the charitable contribution potentially saving the family a lot of taxes in the long run.

Recovery Rebate Credit: There are not any recovery rebate credits (stimulus check payments) for the 2022 tax year, so you will not have to be concerned about reviewing your bank statements to make sure you received the proper credits available to you.

Required Minimum Distributions (RMDs) in 2022: Since the IRS updated the tables used to calculate RMDs to account for longer life expectancies beginning in 2022, RMDs may be somewhat smaller starting in 2022 than they were in prior years. This would not be the case if your 2021 ending balances in your IRAs were significantly higher than the balances at the end of 2020. Many of our clients experienced higher market returns in 2021, so a lower RMD in 2022 may not be the case for you.

Changes in 2022 Child Tax Credit: The 2022 Child Tax Credit reverts back to the pre-2021 amount. This means the 2022 credit amount drops back down to $2,000 per child if your MAGI is below $400,000 for married couples ($200,000 for single filers). If you recall, in 2021, as a result of the American Rescue Plan Act, the Child Tax Credit was increased to $3,600 for children 5 years old and younger and $3,000 for children 6 to 17 years of age. Children who are 17 years old do not qualify for the credit this year because the former age limit of 16 years old returns. For some lower-income taxpayers, the 2022 credit is only partially refundable (up to $1,500 per qualifying child), and they must have earned income of at least $2,500 to take advantage of the credit's limited refundability. In addition, there were not any monthly advance payments of the credit in 2022. This change can have an impact on those families with children who reduced their federal withholding because they thought the Child Tax Credit was permanently changed to $3,000 per child ($3,600 for children 5 years old and younger). We encourage you to make sure your withholding and tax estimates are in check, as the child tax credit and dependent care credits revert back to where they were in year 2020.

Changes in 2022 Child and Dependent Care Credit: There is a significant decrease in the amount of the eligible credit in 2022. The maximum credit in 2022 drops from 50% down to 35% of qualified expenses. The cap on qualified expenses is $3,000 for one child and $6,000 for two or more children. This means the maximum credit for one child is $1,050 and $2,100 for two or more children. Unlike 2021, the child and dependent care credit is non-refundable in 2022. In 2021, the maximum credit for one child was $4,000 and $8,000 for two or more children with the credits being refundable. The 2022 changes result in the credit being only 25% of the prior year credit.

Dependent Care Flexible Spending Account Limits: The 2022 limits reverted to $5,000 for individuals or married couples filing jointly. In 2021, the limit was doubled to $10,500 for the 2021 year only.

2021 Lifetime Learning Credits Limits: The maximum credit remains the same as 2021 in the amount of $2,000 and the income levels are unchanged. The income levels are $80,000-$90,000 for single taxpayers and $160,000-$180,000 for married joint filers. The Lifetime Learning Credits are available for undergraduate, graduate and job skill courses, and there is no limit on the number of years you can claim the credit.

60% Limit on Eligible Cash Contributions: The 60% of AGI limit on deductions for cash donation by taxpayers who itemize is back in place. If you recall, in 2020 and 2021, the limit was increased to 100% of AGI. To be fair, it was not a good tax strategy to make charitable contributions up to 100% of your AGI as the taxpayer did not receive any tax benefit from their other Schedule A deductions.

The 'above-the-line' deduction for up to $300 of a charitable cash contribution ($600 for married couples) expired at the end of 2021.

One planning technique that may be more advantageous in 2022 and beyond is the use of Qualified Charitable Distributions (QCDs) for taxpayers who are 70 and ½ or older. See the section titled **Charitable Giving** for details on using this strategy.

A Helpful Tip: If you are currently using QCDs, please make sure you receive acknowledgement letters from the charitable organizations for any single donation of $250 or more before filing your tax return. The IRS requires the letter under the Substantiation and Disclosure requirements for the donation to be tax-deductible.

Alert: If you are subject to 2022 RMD rules and your pension income is entirely from qualified plans such as 403(b)s and 401(k)s, you should consider an IRA rollover or partial rollover before December 31, 2022. This will enable you to take advantage of QCDs as part of your 2023 RMD.

Caution: For those seniors still working and doing back door Roth conversions, an IRA rollover would dilute the intended benefit of the back door strategy.

Important Early Thought for 2023: If you are considering using your RMDs from your IRA to make QCDs, try to be proactive. Advanced planning with your tax advisor and investment advisor (if you have one) will ease the process while achieving your charitable giving goal and maximizing the income tax savings.

Medical Expenses: The 2022 threshold for deducting out-of-pocket medical expenses on Schedule A must exceed 7.5% of your AGI. Most taxpayers don't typically incur significant deductible out-of-pocket medical expenses due to medical insurance coverage.

Your net medical expense deduction is linked directly to your AGI. Eligible expenses include health insurance premiums, long-term care premiums (limits apply), prescription drugs, medical, dental and eye care services. If you have incurred higher medical expenses and believe that you will qualify to itemize your deductions in 2022, you should consider paying any last-minute medical expenses before December 31, 2022. If one spouse has larger medical expenses and lower income than the other, analyze if filing separately reduces your overall tax bill.

State and Local Tax Deductions: The overall deductible limit for 2022 remains at $10,000. This was a previous backdoor tax increase for those paying high real estate and/or state and local income taxes. This limit applies to a combined total that will include state and local income taxes, real estate taxes, sales tax, personal property tax, etc. There is not a lot of 'strategy' in this category. A large portion of this deduction is typically filled with a combination of income tax withholdings from employee wages and larger real estate tax costs. If you don't have employee wages but are expecting higher taxable income from other sources of taxable income (i.e., self-employment income, capital gain income/investment income), paying an increased 4th quarter estimate by December 31, 2022, can generate additional tax savings. But, if your state and local deductions are more than $10,000, there is no advantage of paying your estimates early.

Qualified Business Income Deduction for Business Owners: The TCJA introduced a new complicated 20 percent tax deduction (also known as the Section 199A deduction) for eligible business owners such as sole proprietorships, LLCs, S Corporations, Partnerships, and Trusts. The deduction is also available to certain real estate rental property owners. The details of this deduction are beyond the scope of this letter. It is a valuable tax deduction for those who qualify. The businessowner will enjoy an extra reduction of taxable income without additional capital outlay. Certain deduction limits are imposed when taxable income exceeds threshold amounts. Keeping taxable income below these thresholds will preserve more of the qualifying deduction.

New in 2022, third-party payment settlement networks, such as PayPal and Venmo, are now required to send you a Form 1099-K if you are paid over $600 during the year for goods or services, regardless of the number of transactions. Previously the form was only sent if you received over $20,000 in gross payments and participated in more than 200 transactions. The gross amount of a payment doesn't include any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts, or any other amounts. The 1099-K does not apply to payments from family and friends. **Planning Note**: It will be important to have your reported gross receipts be equal to or more than the gross receipts reported on the 1099-K. Otherwise, an IRS notice may be generated for underreporting of the gross receipts reported by your business.

Defer Income and/or Accelerate Expenses: Many taxpayers don't have much control in choosing whether to defer or accelerate income from year to year. However, the new tax law provides businesses and business owners (including pass-through entities), with incentives and deductions to lower their overall tax costs. Smart timing of income and expenses can be fruitful while poor timing may result in paying a larger tax bill. Being able to estimate income for 2023 can help with the decision of either accelerating income before the end of 2022 or deferring the income into 2023. The same is true for deductions. Try and use this flexibility to your advantage. Our goal is to 'manage the tax brackets' between the various years to smooth out your income and deductions in order to pay the overall lowest income tax.

Employee Retention Credits: The details of the Employer Retention Credit (ERC) are beyond the scope of this letter. We highly recommend that all businesses with employees determine if they qualify for these generous payroll related tax credits. There is a 3-year statute of limitations for filing amended quarterly returns from the date of filing the original Form 941 so you still have time to claim the ERC if you are eligible.

Tax Loss Harvesting: This strategy may not be as prevalent in 2022 as in previous years due to the poor performance of the market this year. However, if your capital gains are larger than your losses in 2022, you might want to consider “loss harvesting.” This means selling certain investments that will generate a loss—converting them from unrealized losses to realized losses. You can use an unlimited amount of capital losses to offset capital gains.

For details about tax-loss harvesting, please see Chapter 7, page 103, of ***The IRA and Retirement Plan Owner’s Guide to Beating the New Death Tax*** book which you should have already received.

Large long-term capital gain income has often triggered Alternative Minimum Tax (AMT) in past years. On a good note, for the most part AMT has virtually disappeared. For those higher income taxpayers, lowering current year investment income by loss harvesting will generate even greater savings. These taxpayers can potentially lower the net investment income tax (the additional 3.8% tax) assessed on net investment income above certain levels.

Tax Gain Harvesting: Tax Gain Harvesting is the opposite of Tax Loss Harvesting. If you have any highly appreciated stock that you have been holding onto for many years because you did not want to accelerate additional capital gains, this may be the year you want to sell. By selling your highly appreciated stock and offset the capital losses that you harvested, you can minimize your overall ‘net’ capital gain/loss. Remember, you are limited to a net capital loss of $3,000 annually. Any additional capital losses carry over to the following year indefinitely until they are used. If you should die before the carryforward capital losses are fully utilized, those capital losses are lost. By consulting with both your investment advisor and professional tax preparer, you will be able to determine the best tax strategy for handling your capital gains and losses each year.

Roth IRA Conversions: In general, we like Roth IRA conversions for taxpayers who can make a conversion and stay in the same tax bracket they are currently in and have the funds to pay for the Roth conversion from outside of the IRA. Unfortunately, the qualification “in general” is likely critically important. It is best to run the numbers to determine the most appropriate conversion amount for the current year and to plan for possible future conversions in your situation. We often develop a long-term Roth IRA conversion plan that usually involves multiple years of partial conversions.

When a conversion plan is developed, we often recommend a conversion up to certain income limits to avoid additional Medicare premium cost increases or to avoid high rates of income tax on amounts of Roth conversion income over certain amounts.

But again, in "running the numbers" we have also found that in some circumstances, it may be advantageous to make a Roth conversion that will push the taxpayer into a higher tax bracket.

Likewise, it is part of the Westinghouse retiree's religion to never make a Roth conversion that will increase their Medicare Part B premium. More times than not, that is good thinking. But certainly not always, especially if you are considering the very long-term implications of a Roth IRA conversion. In God We Trust. All Others Bring Data.

Jim was recently on a webinar panel for ***Financial Planning*** magazine and one of the quantitative speakers mentioned to Jim that he himself did Roth conversions that pushed him into paying higher Medicare Part B premiums, but the long-term benefits of the conversion were so powerful, it was worth well more than the short-term pain of the higher premiums. It is important to remember, paying higher Medicare Part B premiums may only be a 1-year sacrifice for many more future gains.

It often makes sense for a parent to gift money to their children or grandchild to either make a Roth IRA contribution or to pay for a Roth IRA conversion.

Sometimes, it goes the other way too. In certain situations, utilizing a parent's IRA and lower tax rates to do Roth conversions can be beneficial. The adult child (eventual beneficiary) having sufficient financial resources can make a monetary gift to the parent to pay the tax on the conversion. Since the parent wouldn't be receiving annual RMDs from the converted portion of the IRA, the child can make annual gifts to replace the lost income distributions to cover living expenses. Without future IRA income, the parent's Social Security income in future years can be received tax-free. **Friendly Caution:** Keep in mind that you are expecting your child to make those monetary gifts to you each year. It also gets trickier if there is a living sibling.

Going forward, Roth conversions under the current tax laws may present a better opportunity to do conversions at the lower tax rates. The historical benefits of Roth IRAs and Roth conversions that grow in value have not changed. It is more important than ever to develop a Roth conversion plan considering your unique situation. If you are interested in this strategy, please contact us. Also, we refer you to Chapter 6, page 83 of our book, ***The IRA and Retirement Plan Owner's Guide to Beating the New Death Tax.***

Inherited IRA distributions generally must now be taken within 10 years: Under the terms of the draconian SECURE Act, for IRAs inherited from original owners who have passed away on or after January 1, 2020, the new law requires beneficiaries, subject to exception, to withdraw assets from an inherited IRA or 401(k) plan over 10 years following the death of the account holder.

Exceptions to the 10-year rule include assets left to a surviving spouse, a minor child, a disabled or chronically ill beneficiary, and beneficiaries who are less than 10 years younger than the original IRA owner or 401(k) participant.

Further guidance issued in 2022 clarified that a RMD on an inherited traditional IRA must be taken for the first nine years and then the balance in year ten. This means a taxpayer cannot wait until year ten to take a distribution, with the exception of the Roth IRA.

If you were the beneficiary of an inherited IRA in 2020 or 2021 and did not take any distributions from these IRAs, you will not be imposed with the 50% excise tax on any missed RMDs. No distributions from these IRAs will be due until at least year 2023.

Next step: If you have an IRA that you planned to leave to beneficiaries based on prior rules, consider working with your tax advisor or estate planning attorney, as this change may require you to reevaluate your retirement and estate planning strategies. If you are the beneficiary of an inherited IRA or 401(k) and the original owner died prior to January 1, 2020, you do not need to make any changes. Roth IRA conversions are one of action points to defend yourself and your family from the combination of the SECURE Act as well as the likely future tax increases.

As a comprehensive financial services firm, Lange Financial Group, LLC is committed to helping our clients improve their long-term financial success. Of course, since every situation is different, not all strategies outlined will be appropriate for you. Please discuss all potential tax strategies with your tax preparer or CPA who works with the money manager. We want you to get the benefit of true tax planning, not just receiving good historical reporting of what did occur.

Our entire team at Lange Financial Group, LLC is available to provide you with updated information that can help with all your financial planning needs. If you would like us to mail a print copy of this important report to any of your friends or associates, please call **Erin** at our office at **412-521-2732**.

It should be noted that one of the topics of recent webinars has been transferring money from the taxable environment to the tax-free environment. Roth IRA conversions is one example of this strategy.

What may be even more important for many families is transferring money from the taxable environment to the tax-free environment outside of your estate. This is where you withdraw money from your IRA and gift the net proceeds to an heir who invests in something that is tax-free. We mentioned gifts to children and grandchildren for their Roth IRAs and Roth 401(k)s above.

Here are two more:

1. Section 529 plans (college plans for grandchildren and children). We would recommend Joe Hurley's book, ***Saving for College***, or his website, www.savingforcollege.com.

2. Life insurance.

As always, if you have any questions about your specific situation before our next scheduled meeting, please feel free to call your tax preparer or person who is working with the money manager for assets under management.

Sincerely,

James Lange
Certified Public Accountant
Attorney at Law

P.S. What follows is year-end tax planning advice that we licensed and are providing for you. We covered what we believe are the most important points for most taxpayers, but frankly did not go into as much detail in many areas as the following reprinted materials.

Medicare Tax

Many higher income taxpayers have larger tax bills due to the 3.8% Medicare contribution tax on net investment income. The focus must be on reducing your AGI to help mitigate the additional tax costs. Try and manage your AGI by keeping it as close to the threshold as possible. Going well below the threshold provides no additional benefit as it relates to computing the 3.8% surtax. With a few strategic moves, you may be able to reduce your AGI enough to mitigate the impact of these new taxes.

The Medicare contribution tax is imposed only on "net investment income" and only to the extent that total MAGI exceeds $200,000 for single individuals and $250,000 for taxpayers filing joint returns. The amount subject to the tax is the lesser of:

1. Net investment income; or

2. The excess of MAGI over the applicable threshold amount listed above.

Let's examine ways to reduce your AGI before the end of 2022: Many taxpayers, especially wage earners, have less control over their AGI when compared to self-employed taxpayers or even those in retirement. The following year-end moves can be ideal if any of these situations apply. If you have earned income from self-employment or an employee, one of the best ways to manage AGI is through retirement plan contributions. There are many alternatives to choose from that enable individuals to make retirement plan contributions. Now is an ideal time to make sure you maximize your retirement plan contributions for 2022 and start thinking about your strategy for 2023. Examine your year-to-date elective deferral contributions on your most recent pay stub. While your intentions may have been to maximize current year contributions to your 401(k) or 403(b), you may find out that you have not hit the maximum amounts as anticipated. There is still time to have your employer increase your contributions from your remaining paychecks to reach the maximum level of contributions allowable for 2022.

Higher 401(k)/403(b) Contribution Limits: The elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is $20,500. In 2023, the annual limit amount has been increased to $22,500. The 2022 catch-up contribution limit for participants in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan for employees aged 50 and over is $6,500, but for 2023, the contribution limit has increased to $7,500. This is an increase of $1,000. Since 2008, the increases have been only a modest $500 and we have not seen an increase in every year, but because we experienced much higher inflation in 2022, the catch-up contribution limit increased by $1,000.

Planning Note: We are big proponents of using Roth 401(k) and Roth 403(b) plans for elective deferral contributions. Considering the current increased tax rate structure on certain investment income and the Section 199A for business owners, an increased focus on reducing both adjusted gross and taxable income can be beneficial. **Higher income taxpayers should consider switching back** to making tax-deductible retirement plan contributions instead of funding their Roth accounts. An ideal strategy may be to split your contributions during the year if you're in overlapping tax brackets. For example, consider making tax deductible contributions to reduce your income to the bottom level of your upper tax bracket and contribute the remaining balance into your non-deductible Roth account that is in the lower tax bracket. You have flexibility in making these types of changes during the year if your financial circumstances should change. If you're interested in this strategy, be sure to discuss with your professional tax preparer so any adjustments can be made to your quarterly tax estimates if necessary. A practical approach is to simply hedge against higher future tax rates by splitting your current year 401(k)/403(b) contributions equally into deductible and non-deductible Roth contributions.

Make a Tax-Deductible IRA Contribution: For those taxpayers who qualify, you can make a tax-deductible contribution of $6,000 with a catch-up (for taxpayers 50 or older) of an additional $1,000. The contribution can be made until April 15, 2023, and still be a deduction on your 2022 tax return. There are income limits to this strategy so please check with your tax preparer to make sure you qualify.

Planning Note: Since the IRA contribution can be made after the end of the calendar year, calculating the actual tax savings provides a great advantage and should not be overlooked.

While it Lasts: For those of you who don't qualify for a regular Roth IRA contribution (because your income is too high) and who have **no** traditional IRAs, you can still take advantage of a nice loophole in the code (back door Roth). Consider making a traditional IRA contribution and converting it immediately to a Roth IRA. You will run into complications with this strategy if you have other traditional IRAs. Once again, if this strategy fits your situation, make your 2022 contribution as soon as possible and repeat the process with your 2023 IRA contribution in early January 2023. If you are married with adequate earned compensation, the back door Roth IRA strategy will be applicable to your non-working spouse.

Caution: If you are planning to do a rollover from a qualified plan to an IRA account prior to the end of the year, the above strategy will be unsuccessful, and the conversion will result in unexpected taxable income. It will not matter if the IRA contribution and the immediate Roth conversions occurred earlier in the year before the rollover date. If both transactions occurred in the same year, you could trigger taxable income.

For those of you who can afford it, I encourage establishing and funding a Roth IRA for your children or even grandchildren and get a tax-free retirement fund started for their benefit. The longer period of tax-free growth provides a greater benefit. Like any IRA, the child or grandchild must have earned income to qualify for a contribution.

Tax Loss Harvesting: If your capital gains are larger than your losses, you might want to consider "loss harvesting." Loss harvesting occurs by selling securities that convert unrealized paper losses to actual realized losses. You can use an unlimited amount of capital losses to offset capital gains. If you recognize excess losses over your gains, you are permitted to offset other income items, such as interest, dividends, and wages up to $3,000. Any remaining unused capital losses can be carried forward into future years indefinitely. Tax loss harvesting will generate even greater savings for higher income taxpayers that are subject to additional 3.8% net investment income tax on net capital gains. (Don't forget to review your "Trust Investment Accounts" for loss harvesting as the higher tax rates apply at much lower levels of taxable income). Being tax savvy by reviewing your investment portfolio(s) for loss harvesting should be done annually prior to the end of the current tax year.

The Hidden Tax Trap: Larger tax balances due or smaller than expected refunds can often be traced to Capital Gain Distributions. Quite often the bulk of these taxable distributions will not be known until late November and December. These taxable capital gain distributions occur when the mutual fund portfolio managers recognize gains in the managed funds that get passed onto the fund investors. It is very important that you or your investment advisor review your investment portfolio(s) for any “Loss Harvesting” opportunities. You do have until the end of December to sell securities at a loss.

Please note that if you sell an investment with a loss and then buy it right back, the IRS disallows the deduction. The “wash sale” rule says you must wait at least 30 days before buying back the same security to be able to claim the original loss as a deduction. However, you can buy a *similar* security to immediately replace the one you sold—perhaps a stock in the same sector. This strategy allows you to maintain your general market position while capitalizing a tax break.

If you are planning to write-off a non-business bad debt, be sure to establish that it is a bonafide debt and document unsuccessful efforts to collect. Form over substance matters in these instances.

Utilize Installment Sales: If appropriate, reporting taxable gains using an installment sale will allow you to spread the gain over several years rather than recognizing the entire gain in the year of sale. In many instances, this type of gain is also subject to the 3.8% Medicare surtax on “net investment income” thus managing your AGI can save additional taxes. Keep in mind that Medicare Part B premiums are determined by looking at your tax return from two years prior to the current year. An installment sale may enable you to spread the gain over several years while never crossing the threshold that would trigger increased Medicare premiums in any one year. Opting out of installment sale treatment allows you to recognize the entire gain in the year of sale even though payments would be received over multiple tax years. Consider this option if it’s the appropriate tax strategy. **Caution:** Due to the risk of pending tax increases electing installment sale treatment and deferring income into the future comes with some uncertain risk. Also, while the IRS recognizes installment sales, not all states recognize installment sales and require you to report 100% of the gain in the year of sale. Please contact your tax advisor on your state’s rules regarding installment sales before making the decision.

Maximize your HSA Contribution: If you are enrolled in a Health Savings Account (HSA) plan, it is not too late to maximize your 2022 tax deductible contribution to the account. You have until April 15, 2023, to fund your HSA account and still receive a 2022 tax deduction. Like an IRA contribution, the exact amount of tax savings can be calculated. It is the only section in the Internal Revenue Code (the Triple Crown if you will) that allows a tax deduction on the way in, tax-free growth, and tax-free qualifying distributions. For those who can afford it, fully funding the HSA account and never using the funds to pay for current medical expenses (using other monies to pay for medical expenses incurred) can allow for a big pot of tax-free money to accumulate over time to be used for future medical costs. These funds can come in handy during retirement when you normally experience more medical expenses while having less annual income. Also, once you reach age 65, you can use the money for reasons other than medical expenses. These nonqualifying distributions will be penalty free but subject to income taxes. It is analogous to owning an extra IRA account without being subject to RMD rules. **Planning Note**: Currently, there is not a 'timing' requirement for qualifying distributions to occur in the same year as the qualifying expenses were incurred. So if you wanted, while you are still working and under a high deductible health plan, you could pay for your qualified health expenses outside of the HSA, save the receipts, and sometime in the future, so long as the IRS still permits, you could withdraw the funds from your HSA equal to the amount of the qualified health expenses that you have receipts for, and take a distribution income-tax free. The only caveat is the HSA withdrawal cannot be for an expense incurred prior to the date the HSA was established.

What if you do not have enough money to fund your HSA in a given year but have significant money in your IRA? There is a once-in-a-lifetime rollover option from an IRA to fund your HSA account. This technique is called a **Qualified HSA Funding Distribution (QHFD).** Since HSAs have a triple tax benefit, it could be a good tax planning strategy for someone who does not have enough cash to fund their HSA. There are *specific conditions* for utilizing this technique, however, so we encourage you to contact your professional tax preparer before considering this option. Where we see this tax strategy being the most beneficial is for someone under the age of 59 ½ who would not otherwise qualify for penalty-free distributions from their IRA.

Funding Self-Employed Retirement Plans: If you are self-employed, you have other retirement savings options. We will review these alternatives with you when you come in for your appointment. One of my favorites for many one-person self-employed businesses is the one person 401(k) plan.

Most self-employed retirement plans allow for contributions to be made as late as October 15th of the following year. Having this deferred funding benefit allows you to calculate various levels of savings based on various contribution amounts. For taxpayers age 50 and older, the 2022 and 2023 maximum contribution amounts can be as high as $67,500 and $73,500, respectively.

Increase Tax-Favored Income: Converting taxable interest to tax-exempt interest will serve to reduce AGI and MAGI. For example, moving money from CDs or money market accounts will not create any taxable income. Alternatively, selling corporate bonds may produce a taxable gain and reduce or offset the benefits.

Reduce Business or Rental Real Estate Income: Make full use of depreciation including bonus depreciation and Section §179 expensing allowances for property and equipment placed in service before the end of the year. You have more control in attaining the desired profit or loss level if properly analyzed. The 2017 TCJA has increased the annual limits for Section §179 expensing and bonus depreciation. The new tax law permits full expensing of certain improvements to **nonresidential** rental property. Improvements such as a full roof replacement on an existing building is eligible for full write-off under Code Section §179. These type expenditures have historically been subject to much longer depreciation recovery periods. Expensing certain asset purchases under the de minimis expensing rules, while convenient, may end up reducing the Qualified Business Income deduction. **Important Note:** 100% bonus depreciation deduction expires December 31, 2022. In 2023, the first-year bonus depreciation deduction decreases to 80% for property placed in service during 2023, 60% for property placed in service during 2024, 40% for property placed in service during 2025, and 20% for property placed in service during 2026, and then eliminated in future years unless new legislation is enacted. This means any new equipment purchases contemplated for your business should be made sooner rather than later, assuming the proper capital to make the purchase or favorable financing terms exist.

Capital Gains and Losses: Looking at your investment portfolio can reveal several different tax-saving opportunities. Review your year-to-date sales of stocks, bonds, and other investments. This allows you to determine the net amount of capital gains or losses you have realized to date. Also, review the unsold investments in your portfolio to determine whether these investments have an unrealized gains or losses. (***Unrealized*** means you still own the investment while ***realized*** means you've sold the investment.)

Most taxpayers can obtain the tax basis of their investments. In most instances, basis refers to the price that you paid to acquire the investment. Some investments allow you to reinvest your dividends and/or capital gains to purchase additional shares. These additional shares add to the cost basis of the original purchase.

Generally, it is best to offset short-term gains with long-term losses rather than the opposite of offsetting long-term gains with short-term losses. If your capital gains are larger than your losses, you can begin looking for tax-loss selling candidates. See **Tax Loss Harvesting**. Tax loss harvesting and portfolio rebalancing are a natural fit.

Please note that if you sell an investment with a loss and then buy it right back, the IRS disallows the deduction. The "wash sale" rule says you must wait at least 30 days before buying back the same security to preserve the original loss as a deduction. However, you can buy a *similar* security to immediately replace the one you sold—perhaps a stock in the same sector. This strategy allows you to maintain your general market position while utilizing a tax break.

Dealing with Stock Loss Carryovers in the Year of Death for a Surviving Spouse: From a tax point of view, it is important for the surviving spouse to consult with his/her tax advisor on strategies that would use the deceased spouse's loss carryovers on the final joint tax return. The surviving spouse could sell their own securities or other capital assets at a gain to use the deceased spouse's expiring capital loss carryover. If there is time, evaluating the ill spouse's portfolio before the date of death may also be helpful.

Zero Percent Tax on Long-Term Capital Gains: If you are in the 10% or 12% tax bracket, the tax rate for long-term capital gains is zero percent! To qualify for the zero-tax rate, your 2022 taxable income cannot exceed $41,675 for singles and $83,350 for married joint filers.

Please note that the 0% tax rate only applies until your taxable income reaches the end of the 12% tax bracket. For example, let us assume that a married couple with wages of $70,000, long-term capital gains of $45,000 a standard deduction of $25,900 leaving them with $89,100 of taxable income. The first $39,250 of long-term capital gain is tax-free, but once the taxable income passes the $83,350 limit, the remaining long-term capital gain of $5,750 is taxed at 15%.

If you are eligible for the 0% capital gains tax rate, here is a cool maneuver to take advantage of the federal tax-free rate. Sell some appreciated stocks recognizing just enough gain to push your income to the top of the 12% tax bracket. If you want to continue owning these investments, use the sales proceeds to purchase new shares in the same company or companies. The newly purchased shares will now have a higher cost basis than the shares you sold. If you eventually decide to sell the new shares, the capital gains will be smaller due to the higher cost basis. Please also note that **you do not have to wait 30 days** before you can buy the stock back when there is a taxable gain. This technique is referred to as "gains-harvesting." The 30-day period only applies to securities sold at a loss.

Consider this strategy: If you're ineligible for the 0% capital gains tax rate, but you have adult children (not subject to the Kiddie tax rules) in the 0% bracket, consider gifting appreciated stock to them. Your adult children will pay a lot less in capital gains tax than if you sold the stock yourself and gifted the cash to them. This is especially true if you are subject to both the Medicare surtax on net investment income, and you're in the 37% tax bracket. In this scenario, you are paying 23.8% on your long-term capital gains. Modest amounts of low basis stocks can still be gifted and sold by younger children while avoiding the new Kiddie tax rules in effect.

But be careful—you cannot "go back in time" if you subsequently discover you would have fared better had you identified different shares before you made a particular sale. If you don't specify which shares you are selling at the time of the sale, the tax law treats the shares you acquired first as the first ones sold. In other words, it uses a First-In, First-Out **(FIFO)** method. This may not produce the optimal result that you had wished for.

Hidden Gem: When a parent's income is too large to claim education tax credits (the American Opportunity and Lifetime Learning), shifting income to the kid's return can generate tax savings. In this tax-planning strategy, the parent is eligible to claim the child as a dependent but chooses not to do so. The child indicates that he or she can be claimed as a dependent on someone else's tax return thus by default not claiming a personal exemption. Due to income limitations, the parent(s) do not qualify for the education tax credit on their tax return. Also, since the personal exemption deduction is currently suspended, no tax benefits associated with the child are lost. The child utilizes the education credit up to $2,500 on their own tax return depending on which education credit they qualify for. This holds true even if the parent pays for the college tuition and qualified expenses. Ideally you would shift enough income from the parent to the child to be offset by the education tax credit. **Caution:** Consider the changes to the Kiddie Tax rules when calculating the optimal amount of income to shift.

Step-Up-In-Basis Rules: Another very important but often overlooked item is a step-up-in-basis which occurs when a taxpayer inherits certain assets. The new cost basis is the fair market value as of the date of death, which is often much greater than the original basis that the decedent had in this investment. However, the step-up-in-basis rule does not apply to certain investments, such as IRAs and other tax-deferred accounts.

Remember that if someone gifts you an appreciated asset while they are alive, tax basis of the giver becomes your tax basis.

Taxes on Social Security Income: Social Security income may be taxable, depending on the amount of other income a taxpayer receives. If a taxpayer only receives Social Security income, the benefits are generally not taxable, and it is possible that the taxpayer may not even need to file a federal income tax return.

If a taxpayer receives other income in addition to Social Security income, and one-half of the Social Security income plus the other income exceeds a base amount up to 85% of the Social Security income may be taxable. The base amount is $25,000 for a single filer and $34,000 for married taxpayers filing a joint return.

A complicated formula is necessary to determine the amount of Social Security income that is subject to income tax. IRS publication 915 contains a worksheet that is helpful in making this determination.

Social Security income is included in the calculation of MAGI for purposes of calculating the Medicare contribution tax, as discussed earlier. Therefore, taxpayers having significant net-investment income will have a reason to delay receiving Social Security benefits.

Assuming a reasonable or long-life expectancy, it is generally beneficial for an individual who is eligible to receive Social Security on or after age 62 to delay payments until full retirement age. Assuming a full retirement age of 66, an individual who elects to receive Social Security benefits at age 62 will see benefits reduced by 25%. However, if the same individual delays receiving Social Security benefits until after full retirement age, a delayed retirement credit may be available. The chart below shows the percentage increases when an individual delays receipt of retirement benefits.

Increase in Social Security Benefits for Delayed Retirement		
Year of Birth	**Yearly Rate of Increase**	**Monthly Rate of Increase**
1933-1934	5.5%	11/24 of 1%
1935-1936	6.0%	1/2 of 1%
1937-1938	6.5%	13/24 of 1%
1939-1940	7.0%	7/12 of 1%
1941-1942	7.5%	5/8 of 1%
1943 or later	8.0%	2/3 of 1%
Source: The Essential Planning Guide to The Income & Estate Tax Increases, page 38		

An interesting wrinkle in long-term planning related to the taxation of Social Security is the synergy of developing a good long-term Social Security maximization plan and a good long-term Roth IRA conversion plan. We often enjoy tremendous benefits using the following combination strategy under the right circumstances.

One effective strategy is holding off on Social Security and making Roth IRA conversions in the years after you retire and you don't have wages, but before age 70 when you will have full Social Security and before age 72 when you begin receiving taxable RMDs. Make those Roth IRA conversions while your marginal income tax bracket is at an all-time low. Please note a Roth IRA conversion increases income which could increase Social Security taxes.

Estate and Gift Tax Opportunities: The game of estate planning for most clients has changed from trying to reduce gift or estate tax to trying to reduce income taxes. For 2022, each taxpayer can pass $12,060,000 (minus past taxable gifts that he/she has made) to children or other beneficiaries without having to pay gift or estate taxes. If you are married, you will be able to pass $24,120,000 without any federal gift or estate taxes. The top tax rate for estates is 40% on gifts or estates of deceased persons exceeding the limits. This is the exemption amount for *federal estate* tax, not for PA *inheritance* tax, which is a flat 4.5% to lineal heirs (children and grandchildren).

Many people believe that with the estate tax exemption set at over $12,000,000 per person, they don't need to worry about shrewd, tax-wise ways to give wealth. However, these people might want to rethink their strategy. Congress can change the law (and has changed the law in the past), and your wealth could grow faster than expected, thereby subjecting you to estate tax. Nevertheless, before you gift something away, you need to consider the *income tax* effects of making certain gifts. **Giving away the wrong asset can cost your family some unnecessary taxes. However, if you have an estate that is worth less than $3,000,000, I recommend focusing on long-term planning to reduce income taxes, not estate taxes. Planning appropriately for your IRA, Roth IRA, Roth IRA conversions, and your retirement plan should be your biggest concern**.

In 2022, you and your spouse can each give $16,000 per calendar year ($32,000 for couples) to as many individuals as you would like without reducing your lifetime gift tax exemptions. Depending on your circumstances, it may be smart to make a gift before the end of this year. Gifts to medical or educational providers are not included in the $16,000 limit. In fact, there is no limit on qualified gifts if the checks are made directly to a school or medical facility. For 2023, the annual gift tax exclusion increases to $17,000 per calendar year ($34,000 for couples).

If you are going to make a gift, it is important to determine which asset is the best one to gift. It is usually best to gift high-basis assets or cash, especially if the taxpayer is in poor health. In most cases, it is best not to give low-basis assets because the basis of gifted assets is the same for the recipient as it is for the donor, and the gifted assets will not usually receive a step-up-in-basis when a taxpayer passes.

Before making sizable gifts to children or other family members, keep in mind that in some cases, these gifts may unfortunately backfire. For example, a gift might make a student ineligible for college financial aid, or the earnings from the gift might trigger tax on a senior's Social Security benefits.

Congress has created several tax breaks over the last few years to help pay for education. One of the most popular types of savings plans is the Section 529 plan. Withdrawals (including earnings) used for qualified education expenses (tuition, books, and computers) are income-tax free.

The amount you can contribute to a Section 529 plan on behalf of a beneficiary qualifies for the annual gift-tax exclusion. However, the tax law allows you to give the equivalent of five years' worth of contributions up front with no gift-tax consequences. The gift is treated as if it were spread out over the 5-year period. For instance, you and your spouse might together contribute the maximum of $160,000 (5 x $32,000) on behalf of a grandchild this year without paying any gift tax.

Miscellaneous Year-End and Other Tax Reduction Strategies: Most taxpayers cannot control the timing of received income, but many of us can determine when to pay or not pay deductible expenses. Prepare tax projections for 2022 and possibly 2023 to determine which tax bracket you are in and where you can get the most bang for your buck.

Let's say for example, your deductions are greater than your income, and you will have a negative taxable income, with a tax liability of zero. This is often the case with seniors who receive tax-free Social Security income. In this case, it would be a good strategy to increase your income from negative taxable income to zero taxable income, because the tax on zero taxable income is still zero! One of the best ways to do this is to do a partial Roth IRA conversion up to the amount that brings your negative taxable income up to zero. Depending on your tax bracket, you may wish to convert even more, especially if you expect to be in a higher income tax bracket in the future. If a Roth conversion is not appropriate or desirable, taking additional retirement account distributions in one year while lowering the amount in the following year may save tax dollars. This strategy is comparable to bunching itemized deductions while using income instead of expenses.

Try to avoid paying unnecessary penalties. If you face an estimated tax shortfall for 2022, consider having the extra tax withheld from sources such as wages, non-suspended regular IRA, and pension distributions. Withheld taxes are treated as if you paid them evenly to the IRS throughout the year. This can make up for any previous underpayments, which could save you penalties.

IRA Contributions: Many Americans are living to older ages and an increasing number are continually working past the normal retirement age. Under the SECURE Act, you can contribute to your traditional IRA past age 72 if you are still working. Essentially, the new rules for Traditional IRAs are lining more closely to Roth IRAs and 401(k) and 403(b) plans.

Heath Savings Account (HSA) Contributions: We love the triple tax benefit of HSA contributions so after funding your deductible IRA, if you qualify, we highly recommend you consider funding your HSA if you have a high-deductible health plan. The $3,650 for self-only or $7,300 family contribution limit is due no later than the tax filing deadline of April 15th, whether you extend your tax return or not. Making contributions to your HSA account reduces your overall AGI.

Harvesting Ordinary Income: Harvesting ordinary income is another part of an overall successful year-end plan. Many older taxpayers incur extra-ordinary high medical expenses. Without proper planning, thousands of dollars of medical expenses can be incurred with no tax benefit. Harvesting ordinary income should at least equal itemized deductions or the standard deduction; and the targeted tax liability at least equals tax credits available. Furthermore, harvesting ordinary income can be considered when "filling up" your marginal tax bracket.

Making Trust Distributions: Net investment income tax also applies to trusts and estates. With compressed tax brackets for trusts compared to individual tax brackets, making permitted discretionary distributions to beneficiaries can reduce overall taxes. By making the proper election, trusts can distribute current year income up to 65 days into the following year and still have the income taxed to the beneficiary in the current tax year. This is known as the 65-day rule. With the highest trust income tax rate being 37% for taxable income over $13,451, proper planning can go a long way to reduce the overall income taxes paid in a given year.

Pennsylvania 529 Plan Contribution Deduction: Don't miss out on the state tax deduction for contributions to a Section 529 College Saving Program. A taxpayer can reduce their PA taxable income up to $16,000 per plan beneficiary (kids, grandkids, nieces, nephews, etc.). Married couples can deduct up to $32,000 per beneficiary per year, provided each spouse has taxable income of at least $16,000. If your child is currently in college and you are writing checks to the college for tuition or qualified expenses, you should open the 529 plan immediately. You can deposit the college expense money into the account and immediately write the check to the college. You have just generated an immediate 3.07% rate of return on the deposit, assuming you file a Pennsylvania state income tax return. Now that's a winner.

Grandparents: Consider the State tax savings available before proceeding to establish and fund a 529 education plan for your grandchildren. If the parents live in a high-income tax state that allows a tax deduction for 529 plan contributions, consider gifting the money directly to the parents and let them establish and fund the 529 plan.

529 Plan Changes: The 2017 TCJA provides that distributions up to $10,000 used for tuition at an elementary or secondary public, private or religious school, K-12 are permitted. Prior law limited 529 money to be used to pay college and/or graduate school costs. Make sure the specific State plan has been amended to allow distributions to elementary and high school tuition. The Further Consolidated Appropriations Act made permanent the $10,000 tax-free withdraw to repay the beneficiary's (and any of the beneficiary's siblings') qualifying student loan debt. This $10,000 limit is an aggregate lifetime limit per borrower. Of course, the interest paid with tax-free withdrawals are not eligible for the student loan interest deduction.

Kiddie Tax Planning: Considering hiring your child as an employee. It is prudent to review the child labor laws in your state and the Fair Labor Standards Act. Maintain good records that substantiate wage payments. A child can use their standard deduction to shelter up to $12,950 of wages from federal income tax. There is also Social Security tax savings in certain situations. The child becomes eligible to contribute up to $6,000 to a Roth IRA in 2022 and $6,500 in 2023. The wage income may enable the child to escape the kiddie tax rules that would otherwise be imposed on unearned income.

In prior years, shifting income to children was a popular strategy to reduce overall family tax costs. The new kiddie tax rules can often create more tax than what the parent would have paid on their own tax return.

Utilize Your Home Office: It may be the right year to switch back to deducting the actual cost of home office expenses as opposed to using the simplified method. If you are one of the many who will be using the standard deduction in 2022, enjoying some tax benefits of deducting a portion of your real estate and mortgage interest as a home office deduction can help ease the pain. **Caution:** If you sell your home in the future that had a 'home office' deduction using the actual cost method, you could be required to recapture depreciation on your home office if you are required to report and pay capital gains taxes on the sale of your home. Please consult your tax professional on this provision before electing the actual cost method.

Modifications to Depreciation Limits on Automobiles: The annual depreciation limits have been expanded very generously for these business assets. Generous depreciation deductions will lower overall taxable business income and while reducing AGI. As stated earlier, many tax benefits are tied directly to reducing your AGI.

Employee Business Expenses: With the elimination of deductions formerly reported on Form 2106 Employee Business Expense, encourage your employer for reimbursement of the substantiated expenses that are no longer tax-deductible.

Charitable Giving: Under the current tax system, a focus on controlling AGI can provide tax savings. The Path Act of 2015 made permanent the popular Qualified Charitable Distribution (QCD) rules for making charitable contributions from an IRA. Taxpayers age 70 ½ and older can transfer up to $100,000 directly from their IRA over to a charity, satisfying all or part of the RMD with the IRA-to-charity maneuver. For married couples, the limit is $200,000. It can be viewed as making a charitable donation with pre-tax dollars. This is especially fruitful when the alternative of using the after-tax dollars to fund the donations does not reduce your taxable income due to the higher standard deduction.

Caution: If you are over age 70 ½ and make a current year tax-deductible IRA contribution while also planning a current year QCD from your RMD, your plan becomes more complicated due to the "anti-abuse" provisions. The provision was enacted to prevent individuals from deducting the IRA contribution and subsequently using a QCD vehicle as a pre-tax charitable donation with the same dollars. Married couples with separate IRA accounts have additional flexibility in bypassing the rules.

This is a great time of the year to clean out your basement and garage. However, please remember that you can only write off these non-cash charitable donations to a charitable organization if you itemize your deductions. Please do yourself a favor and follow the substantiation rules to tilt the scale in your direction if the deduction is questioned by the IRS. Determining the value of non-cash donations can sometimes be challenging. It can never hurt to have pictures of the donated items (cell phone cameras make this much easier). The more detailed the receipt, the better. Please send cash donations to your favorite charity no later than December 31, 2022. Be sure to hold on to your cancelled check or credit card receipt as proof of your donation. If you contribute $250 or more, you also need an acknowledgement from the charity. Many taxpayers kindly help various charities by making non-cash donations.

Tax Tip for Coaches who Still Itemize their Charitable Deductions: Many taxpayers have children who participate in youth, intermediate or even high school level sports. If dad or mom volunteer their time as coaches, assistant coaches, timekeepers, etc., they can be eligible for an income tax deduction for various out-of-pocket expenses incurred. For example, miles driven on their cars while performing their role as coach are deductible charity miles. Many teams travel out of town to compete. You are entitled to deduct certain travel expenses as a charitable deduction. See the IRS website Newsroom for "Tips for Taxpayers Who Travel for Charity Work" for a list of qualifying deductions. Of course, you have to be a taxpayer who itemizes their deductions vs. taking the standard deduction to benefit from this strategy.

My favorite substantial charitable gift is leaving a portion of your IRA or retirement plan to a charity of your choice after you and your spouse die.

If you want to give money to a charity and get the deduction this year, but don't know which charity you want to benefit, you should consider donor directed funds that could be set up by a group like The Pittsburgh Foundation or a donor advised fund as discussed earlier.

As mentioned earlier, if you plan to make a significant gift to charity this year, consider gifting appreciated stocks that you have owned for more than one year rather than cash. Review your tax brackets to help determine how you can maximize the deduction. Doing so boosts the savings on your tax returns. Your charitable contribution deduction is the fair market value of the securities on the date of the gift, not the amount you paid for the asset, and therefore, you never have to pay taxes on the profit! If you really like the appreciated stock that you donated, use the non-donated cash to repurchase the donated securities. Essentially, you still own the same stock except with a higher tax basis in the newly acquired shares.

Do not donate stocks that have lost value. If you do, you can't claim a loss. In this case, it is best to sell the stock with the loss first and then donate the proceeds, allowing you to take both the charitable contribution deduction and the capital loss.

Inherited IRAs: Be careful if you inherit a retirement account. In many cases, a decedent's largest asset is his or her retirement account. When a beneficiary receives this distribution, it is often a very large sum of money, and there is no step-up-in-basis on retirement accounts. If you inherit a retirement account, such as an IRA or other qualified plan, the money is usually taxable upon receipt. In addition to this immediate taxation, the extra money could push you up into a higher tax bracket, causing you to pay more taxes than you might have if this taxable income were spread over several years.

The solution to this problem is to establish an Inherited IRA. With an inherited IRA, distributions can be spread over several years allowing you to defer the income taxes and be more selective in controlling your taxable income. Sounds easy, right? Unfortunately, the tax laws regarding the inheritance of retirement accounts are very complicated. Be sure to take the necessary steps to avoid any unnecessary income taxes.

Helpful Tip: Inherited IRAs for non-spouse beneficiaries can never be converted to a Roth IRA. Inherited employer plan assets (401(k), 403(b), etc.) can be directly transferred to a properly titled, Inherited Roth IRA. Income tax will be due on the conversion of an inherited 401(k) and paid by the beneficiary. Required distributions will also occur. If the child beneficiary is in a lower tax bracket at the time of inheritance, what a wonderful way to get a Roth IRA started at a lower tax cost while enjoying future tax-free growth. You may want to help direct mom and/or dad after they retire to keep some of their retirement plan dollars in a qualified plan rather than rolling everything into a traditional IRA.

Identity Theft Affidavit: Consider filing **IRS Form 14039** (available on the IRS website) before the 2022 tax filing season arrives. Identity theft has been steadily on the rise. The IRS will provide you a 6-digit PIN number to use when filing your income tax return. The PIN will help the IRS verify a taxpayer's identity and accept their electronic or paper tax return. The PIN will prevent someone else from filing a tax return with your SSN as the primary or secondary taxpayer (spouse).

Final Thoughts: When it comes to tax planning and paying income taxes, it's usually not what *you know, but rather what you don't know* that can leave you with unhappy tax results. We are here to help close that knowledge gap. We look forward to seeing you soon.

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If you can help us, please call Erin at (412) 521-2732.