Year-end tax planning strategies to consider before 2023

2022 has been an eventful year to say the least. From spiking inflation and rising interest rates to geopolitical uncertainty and unnerving market volatility, this year has presented plenty of financial obstacles.

Yet amidst these uncontrollable events, there are still some valuable planning considerations and opportunities that are within your control, as 2022 draws to a close.

Personal finance is personal

It has been some time since we have had a market environment that's tested even the most disciplined of investors. How are you handling the current financial atmosphere? It may be a good time to revisit your overall risk tolerance and reevaluate your asset allocation. Market volatility provides an opportunity to check in and see if your financial goals are impacted, or if this is just a bump in the road.

As the year nears a close, the upcoming holidays are a great time to host a family meeting and discuss your long-term financial priorities together. How has this past year impacted you? What updates do you need to make to your financial goals to help meet your personal priorities?

Tax-loss harvesting

With a widespread bear market, you may be sitting on some losses in your investment portfolio. And while no one wants to see losses in their portfolio, let alone realize them, losses can be used for a purpose. Consider selling securities in your portfolio that have declined, to offset your earned income. Capital losses can be used to offset capital gains, and in instances where cumulative losses are greater than gains, you can use up to $3,000 of capital losses against your ordinary income, with any additional capital losses carried forward into future tax years. Remember to be mindful of the wash-sale rule when it comes to realized losses and rebalance your portfolio after tax-loss harvesting to stay on track with your investment goals.

Employee Benefits

As open enrollment is happening, if you have access to a high deductible health plan (HDHP), consider utilizing a health savings account (HSA). HSAs are triple tax advantaged (tax deductible contributions, tax deferred growth, and tax-free withdrawals if used for qualified medical expenses), and avoid FICA taxes if contributed via payroll deductions.

For 2022, individuals can contribute up to $3,650 and those with families can contribute up to $7,300. For individuals 55 or older, you can contribute an additional $1,000 "catch-up". It should be noted that if your employer contributes to your HSA on your behalf, this amount counts towards your total contribution.

Be sure to also review your flexible spending accounts (FSA) and dependent care FSA to ensure you spend those balances down before the required deadlines. Typically, FSA balances are forfeited if they're not used within the plan year.

While there is still some uncertainty going into 2023, there's no uncertainty around the need for tax planning. Speak with your wealth advisor and tax advisor about what changes you should be looking at now, to put yourself in the best possible position for 2023.

Retirement planning

Now is a great time to review your contributions to any retirement accounts to see if you can make additional contributions up to the maximum allowed. You not only lower your tax bill by increasing your contribution to tax-deferred accounts, but with markets down double-digits as of this writing, you can purchase more shares per dollar with your savings.

For 2022, employees can contribute up to $20,500 into 401(k)s (and those 50 and older can contribute an additional $6,500 "catch-up"). For traditional and Roth IRAs, the maximum contribution amount is $6,000 with an additional $1,000 catch-up provision for those 50 and older.

Another opportunity to consider with the current market declines is converting some of your traditional IRAs to Roth IRAs. While you are liable for the income tax today, you can convert more shares at depressed values and benefit from future tax-free growth with no required minimum distributions (RMDs) in the future.

Further, to the extent you are subject to Required Minimum Distributions (RMDs) from any of your pre-tax retirement accounts, make sure you have satisfied the withdrawal amount to avoid possible excise taxes on amounts not distributed as required.

Finally, there are income limitations when it comes to contributing to a "deductible" traditional IRA and an after-tax Roth IRA. For taxpayers over the income limits, talk with your tax advisor on whether or not a "Back-Door Roth" strategy might be right for you.

Gifting

In 2022, each taxpayer can gift $16,000 to an unlimited number of recipients tax-free without having to file a gift tax return. A married couple with two children and four grandchildren, for example, could gift $192,000 in 2022 tax-free. For those subject to federal estate taxes, that gift could yield $76,800 in estate tax savings (assuming a 40% federal estate tax). A yearly gifting strategy can transfer a significant amount of assets (and the future growth of those respective assets) out of an estate if done systematically.

Gifts of cash are always easier and faster than gifting securities, which may take longer to process and run the risk of missing the December 31 deadline. And with a cash gift, make sure that the check is deposited in the recipient's account before December 31 in order for it to count for 2022.

Consider utilizing these gifts in tax advantaged ways. Year-end is a great time to beef up 529 accounts to combat the higher cost of tuition. In addition, if a child has earned income from a job, consider gifting to help them open a Roth IRA. Not only does this provide them with tax-free growth but gives you an opportunity to teach them the power of investing.

While asset prices have taken a hit, now is a great chance to "lock in" reduced gift values to an irrevocable trust. This allows you to use less of your federal gift and estate tax exemption today, while getting the future growth out of your taxable estate.

CONSIDERATION *Gifting is likely to become a more important strategy if the federal estate tax exemption drops from today's $12.06 million per taxpayer (or $24.12 million per couple). The exemption is still scheduled to drop at the end of 2025, giving you a maximum of three more years to gift at the higher exemption, pending future legislation.*

Charitable contributions

In order to take a deduction for charitable gifts, it's important that checks are post-marked before Dec. 31 to take the deduction for 2022. If you make your gift by credit card, the donation is official once you make the charge, not when you pay the bill.

Consider donating appreciated capital gains assets rather than cash. By donating appreciated assets, you have the ability to take the tax deduction on the current value of the asset, even though your original investment may have been less.

For example, if you invested $10,000 in a stock five years ago, and today it's worth $25,000, this investment carries a gain of $15,000. By donating that asset, you are able to receive a deduction for the entire $25,000 amount, while avoiding having to pay capital gains tax on the appreciated amount.

If you are at least 70 ½ consider making your donation from an IRA by using a Qualified Charitable Distribution (QCD). You can donate up to $100,000 each year directly to qualified charities. This is an effective strategy since you avoid income taxes completely by making a direct transfer to charity. QCDs can even be used as part of your RMD obligation (up to the $100,000 limit), to reduce your topline taxable income, which may be more favorable than itemizing the same amount as a charitable deduction.

Donor-advised funds (DAFs) make charitable giving simple and allow you to avoid the stress of mailing in checks. You can make gifts to a DAF in 2022 and receive the deduction this year. However, you can wait to direct donations to your favorite charities at a later date when you might have more time to research organizations and formulate a giving plan. It should be noted that a QCD cannot be used to fund a DAF and must be made directly to a charity.

DAFs are a great option to "bunch" several years of charitable contributions into one year, hence making your contributions more tax efficient. If you do not currently have a DAF, leave enough time to set up the account if you intend to contribute for 2022.

CONSIDERATION *If you think you may fall into a higher tax bracket in 2023, it might be more beneficial to defer deductions to next year because the value of your deductions will be greater under a higher tax rate.*

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