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DVI
DAVID VAUGHAN INVESTMENTS

YEAR-END TAX AND ESTATE PLANNING

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As the end of 2022 nears, don't overlook the many opportunities available to reduce, defer, or accelerate your tax obligations. Depending on your individual circumstances, one or more of the following strategies (based on current federal laws and policies) may prove extremely valuable.

Retirement Plan Strategies

Where possible, try to contribute the maximum allowable amounts to all your tax-deferred and/or tax-free retirement plans. It's one of the easiest and most effective ways to reduce your current income taxes while saving for the future:

- Contribute to your 401(k) or 403(b) retirement plan
  - The maximum contribution limit for 2022 is $20,500
  - But if you're age 50 or older, 'catch up' provisions allow you to save an additional $6,500
- Contribute to a traditional IRA or Roth IRA
  - The maximum contribution limit for 2022 is $6,000
  - If you're age 50 or older you can also set aside an additional $1,000 catch up contribution
  - There are, however, income limitations that may prevent (or reduce) allowable contributions
- Consider a 'back-door Roth' strategy
  - If your income exceeds $144,000 (single) or $214,000 (married filing jointly), your ability to make Roth IRA contributions phases out
  - One work-around to this limitation is by contributing the maximum allowable amount to a non-deductible IRA, and then converting those assets to a Roth
  - Your balances in other IRA accounts may prohibit you from using this strategy; so make sure to talk with your tax attorney to avoid any unintended consequences
- Explore whether a Roth conversion makes sense for you
  - If you're currently in a low tax bracket, consider converting a portion or all your tax-deferred funds to tax-free funds through a Roth conversion
  - A conversion may potentially help reduce taxes in future years, and unlike traditional IRAs (which mandate annual distributions starting at age 72) Roths have no required distribution requirement
  - For maximum effectiveness, use cash rather than IRA funds to pay the conversion taxes
- Take advantage of small businesses owner plans
  - SEP IRAs allow you to contribute up to 25% of your annual compensation or a maximum of $61,000 (whichever is smaller)
  - SIMPLE IRA plans allow a maximum contribution of $14,000 per employee along with an additional $3,000 catch up contribution for those age 50 or older

Required Minimum Distribution (RMD) Strategies

If you're age 72 or older, you must take annual distributions from your retirement plans. Given the severity of potential penalties (50% of the required amount) for not accurately complying with these distribution rules, make sure you fully understand the requirements:

- RMDs must be calculated based on the total balance of all tax-deferred IRAs (Roth IRAs have no distribution requirement) as of December 31st of the previous year
  - If you own multiple IRA accounts, required distributions can be taken from any single account or combination of accounts to meet your annual RMD requirement
  - If 2022 is your first year for RMDs, you have until April 3rd, 2023 to complete your 2022 withdrawal (You still, however, will be required to take a 2023 distribution)
- 401(k) plans have similar rules with several exceptions
  - RMDs for your 401(k) plan funds must be calculated separately and distributed from the 401(k); they can't be aggregated with IRA funds
  - If you're still working and participating in your employer's plan, you can delay taking any 401(k) plan distributions until retirement – unless you own more than 5% of the company, in which case you aren't allowed to delay RMDs
- Qualified Charitable Distribution (QCD) can be made directly from your traditional IRA
  - From age 70½ onward, you can transfer up to $100,000 annually from your traditional IRA directly to a qualified charity
  - These QCDs can satisfy your annual RMD for the year without subjecting you to income tax on the distribution
  - And since QCDs aren't taxable (and therefore not added to your adjusted gross income), they aren't factored in when calculating your Medicare premium surcharge in a couple years – potentially saving you additional costs

Inherited IRA Requirements

If you are the named beneficiary of an IRA and the primary account holder dies, you have the choice of taking a lump sum distribution or transferring the account assets to an Inherited IRA in your name. But be aware that there are several rules and regulations that govern inherited retirement accounts:

- If the original account owner died after December 31st, 2019, the SECURE Act requires beneficiaries of inherited IRAs to take distribution of all accounts assets within ten years
- Eligible designated beneficiaries (i.e., surviving spouses, minor children, disabled and chronically ill individuals, and anyone who is less than 10 years younger) aren't bound by the 10-year distribution rule
- Proposed regulatory changes may require a minimum amount be distributed each year during the 10-year period if the original account owner had already begun taking RMDs. This could retroactively impact the 2021 and 2022 tax years, so talk with your advisor or tax consultant

Health Care Saving

Take advantage of any opportunity to maximize your contributions to a Health Savings Account (HSA) and/or a Flexible Savings Account (FSA), as these can provide significant tax savings for any future health care expenses.

- An FSA may be available through your employer to cover out-of-pocket health care expenses
  - Contributions are tax deductible, and can be used tax free to cover any qualified health care expenses
  - The maximum annual contribution limit for 2022 is $2,850
  - FSA contributions must be used in the same year as the contributions are made (any unused funds are forfeited); but up to 20% can be rolled over to the next calendar year
- Consider combining an HSA with a high-deductible health plan (HDHP) to allow tax-deductible contributions and tax-free distributions when used for qualified health care expenses
  - Maximum HSA contribution limits for 2022 are $3,650 (single) and $7,300 (married couple)

- If you're age 55 or older, you can make an additional $1,000 'catch up' contribution (For your spouse to contribute the catch up amount, they must have a separate account)
- Medical expenses don't have to be incurred in the same year of the HSA distribution to qualify as tax free. We recommend tracking your medical expenses while the plan is in place and allowing HSA funds to grow tax free. Then, in retirement, you can distribute the funds to cover either current or past medical expenses tax-free.

Capital Gains and Losses

Although long-term capital gains are taxed at a preferred rate, given recent market volatility, there may be certain investment taxation pitfalls and opportunities that present themselves. Thoughtful planning may help to mitigate your current and future tax liability:

- Holding investments for at least one year favorably impacts the tax status of any realized gains – from a short-term gain (taxed at your highest ordinary income rate) to a long-term gain (taxed at either 15% or 20% depending on your income level)
- If any investments have lost money and are below their cost basis (the purchase price paid), consider selling them for a loss to offset current or future capital gains
  - Capital losses offset capital gains
  - If the capital losses exceed the capital gains in the tax year, up to $3,000 of the losses can be used to offset ordinary income, with the remainder carried forward to use in future years
  - Make sure to avoid the wash sale rule which removes a capital loss if you turn around and purchase a substantially identical investment within 30 days before or after the sale
- If your income exceeds $200,000 (single) or $250,000 (married couple) you'll also be subject to an additional 3.8% surtax on net investment income
  - Allocating investments with higher income payouts to your retirement account(s) can help mitigate its impact
  - Investing in tax-free municipal bonds can also help avoid the surtax
- If you're charitably inclined, consider gifting highly appreciated securities to a charity to avoid any capital gains taxes while still getting a tax deduction for their full market value
- If you own mutual funds in your taxable accounts, consider the potential for year-end capital gain distributions
  - Most mutual funds publish expected capital gain and income distributions on their websites
  - When distributions are paid, the share price of the funds will decrease by the amount of the distribution
  - Gains from distributions are recognized in the year you receive them. If you're reinvesting fund proceeds, your cost basis in the fund will increase by the amount of the distribution
  - Understanding your cost basis in the mutual fund can provide some flexibility in managing the tax impact of any capital gains distributions

Timing of Income and Deductions

Remember that you may be able to minimize your tax bill by shifting income or deductions between 2022 and 2023. The goal is to recognize income in years where the marginal income tax rate is lower, and maximize deductions in years where marginal rates are higher. If tax rates remain constant, deferring income to the next year provides another year of tax deferral. Consider:

- Deferring income into a deferred compensation plan (if available) to postpone taxes to a future time where marginal rates may be lower
- Paying your January 2023 mortgage bill before year-end so you can deduct the interest portion in 2022 if you itemize deductions
- Combining multiple years of charitable gifts into the current year to maximize your deduction
  - With the increased standard deduction of $12,950 (single) or $25,900 (married filing jointly), many filers no longer itemize deductions
  - Donating to a donor advised fund allows you to pool contributions for multiple years, while deducting the entire contribution value this year

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- Consider using appreciated securities to not only enjoy a tax deduction but also to avoid any capital gains on the contributed assets
- If you are near or over the 7.5% of adjusted gross income threshold for deducting medical expenses, think about booking any necessary medical procedures before year end to incur those expenses now

Tax Withholding

Understanding your tax withholding and payment obligations can help avoid a tax penalty at filing time:

- No penalties will be assessed as long as you prepay your taxes with quarterly tax payments, or have at least 90% of your total tax bill withheld from your income (or 100% of what you owed for 2021)[1]
- Distributions from your traditional IRA can be used to withhold taxes
  - Tax withheld at any point in the year is treated as if it was paid evenly throughout the year
  - This is a great strategy if you're over age 72 – allowing you to use all or a portion of RMDs to satisfy your tax obligation and avoid having to make quarterly estimated payments

[1] 110% if your 2021 AGI exceeded $150,000

Estate and Gift Tax Strategies

Concerned about future estate or inheritance taxes for your family? Take advantage of current opportunities to mitigate estate-related taxes and costs. Moving income across generations may also offer other tax benefits to your family now and down the line. Understand your options regarding:

- Making annual exclusion gifts to your children and/or grandchildren.
  - The annual gift tax exclusion for 2022 is $16,000 per individual recipient
  - A married couple can elect gift splitting which allows each spouse to give from the assets of one spouse the maximum annual exclusion amount ($32,000 per couple per recipient)
- Note that until age 18 (or age 24 if a full-time student) a child's unearned income is taxed at the parent's tax rate if higher
- Contributing to your children's or grandchildren's 529 education plans
  - For 2022, you can contribute up to $16,000 ($32,000 for a couple) to each child and grandchild without incurring any gift taxes
  - There's also a 5-year accelerated gift option where you can contribute up to $80,000 ($160,000 for a couple) to each child in a single year. A gift tax return will need to be filed, but the gift is treated as equal $16,000 gifts for each of the next five years for tax purposes
- You can make unlimited gifts to pay for medical and/or tuition, as long as the payments are made directly to the institution
  - This does not lower the $16,000 annual gift exclusion amount, and it can help lower the overall value of your estate
- Consider making larger gifts to the next generation either outright or in trust
  - The unified estate exemption amount is $12,060,000 in 2022 and can be used at death or during life
- Additional estate strategies to consider include spousal lifetime access trusts (SLATs), grantor retained annuity trusts (GRATs), and selling assets to an intentionally defective grantor trust (IDGT).

As with all planning and tax considerations, the sooner you address them the more options you may have available to you. Talk to both your tax attorney and your DVI Relationship Manager about any tax concerns and expectations for both 2022 and 2023. We may be able to suggest several strategies that could improve your overall wealth picture, while in the process helping to lessen your tax burden.