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2022 Tax Year-End Planning for Individuals

December 15, 2022

AGENDA

- Financial Planning Checklist
- Portfolio Maintenance
- Above the Line & Itemized Deductions
- Pass Through Entity (PTE) Taxation
- Estate and Gift & GRAT Example
- SECURE Act & IRS Notice 2022-53
- Charitable Gifting

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Financial Planning Checklist

Year End Financial Planning Considerations

- Roth IRA
  - Conversion
  - Two Step Contribution
- Review Floating Rate Financing
- Review Financial Plan

Roth IRA

- A Roth IRA is a retirement account that uses after-tax dollars to fund retirement
  - It grows tax-free
  - Qualified distributions are tax-free
- Maximum 2022 contribution - $6,000
- Modified adjusted gross income must be under $144,000 (single) or $214,000 (married filing jointly)

Reasons for a Roth IRA Conversion

- You think your future tax bracket will be higher
  - If you expect your income to keep increasing, a Roth IRA conversion is a way to convert funds at your current tax rate and then withdraw them tax-free in retirement
- Your income is lower this year
  - Conversion dollars are taxes at ordinary rates, so converting in a year where your income is lower could mean less taxes on the conversion
- You want to give a tax-free gift to your heirs
  - Unlike other retirement vehicles, your heirs will not pay taxes when they withdraw from a Roth IRA

Two-Step Roth IRA

- If your annual income would otherwise disqualify you from contributing to a Roth IRA, you may be able to utilize the two-step Roth IRA strategy
- How does the two-step IRA strategy work?
  - Open traditional IRA
  - Make a non-deductible contribution
  - Convert the traditional IRA into a Roth IRA

Portfolio Maintenance

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Year End Portfolio Review Considerations

- Review Risk Tolerance
- Portfolio Rebalance
- Tax Loss Harvesting

How does it work?

- Sell an investment that is underperforming and losing money
- Use the loss to reduce taxable capital gains and potentially offset up to $3,000 of ordinary income, excess capital loss carries forward
- Reinvest the money from the sale into a different security that meets your investment needs and asset allocation strategy
- Given the drop in the market in 2022, this might be a good year to evaluate your portfolio with your investment advisor and capture tax losses

Items to consider

- Tax-loss harvesting is not beneficial in retirement accounts because the losses in a tax-deferred account are not deductible
- Be aware of the wash sale rule which prohibits the deduction of a loss for income tax purposes if the same or a “substantially identical” security is purchased within 30 days before or after the sale

Above the Line & Itemized Deductions

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“Above the line” Deduction

- Qualified Charitable Distribution from an IRA
- IRA owner must be 70 ½ to be eligible
- Limited to amount otherwise taxed as ordinary income, *i.e.*, excludes non-deductible contributions
- Maximum annual contribution is $100,000
- Charity must be IRC Sec. 501(c)(3) organization (private foundations, supporting organizations & donor-advised funds don’t qualify)
- Consider potential state tax savings as well

Itemized Deduction

- Consider if your donation will allow you to itemize deductions
- Standard Deduction for 2022 is $12,950 for single taxpayers ($25,900 for MFJ) – if your total itemized deductions are less than the standard deduction, you take the standard deduction
- Other itemized deductions – state taxes (limited to $10,000 in total), medical expenses (subject to a separate limitation), mortgage & investment interest

Pass Through Entity (PTE) Taxation

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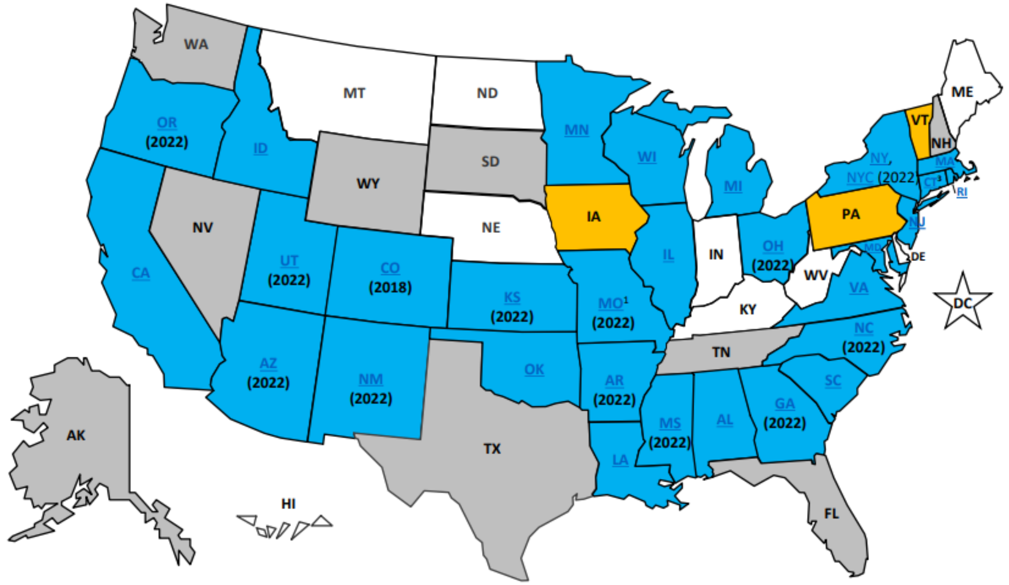
“Pass Through Entity Taxation” or PTE: What is the Big Deal

States with Enacted or Proposed Pass-Through Entity (PTE) Level Tax

As of August 31, 2022



29 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

AL, AR[1], AZ[1], CA, CO[2], CT[3], GA[1], ID, IL, KS[1], LA, MA, MI, MD, MN, MO[1], MS[1], NC[1], NJ, NM[1], NY, OH[1], OK, OR[1], RI, SC, UT[1], VA, WI, and NYC[1]

[1] Effective in 2022 or later – on map (2022) or (2023)

[2] Retroactive to 2018

[3] Mandatory

3 states with proposed PTE tax bills:

IA - HF 2087, session over, not enacted

PA – HB 1709, in committee

VT - H 0527 , session over, not enacted

9 states with no owner-level personal income tax on PTE income:

AK, FL, NH, NV, SD, TN, TX, WA, WY

10 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:

DE, HI, IN, KY, ME, MT, NE, ND, VT, WV

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[Source: AICPA.org: Downloadable PTE Map]

Estate and Gift Planning

Sunset of Tax Cuts and Jobs Act

- Passed in December 2017, TCJA doubled the basic exclusion amount (BEA) from roughly $5.5 million to just over $11 million
- Inflation adjustments have increased the BEA to $12.06 million for 2022 decedents
- As part of the budget reconciliation process used to pass TCJA, it was required to sunset effective January 1, 2026
- The tax rate will increase to 45%

Chances for a legislative solution

- No changes have been made to date to resolve the pending sunset
- Original Build Back Better Act
  - Accelerated the BEA reduction
  - Removed valuation discounts on family transfers
- Bernie Sanders 2019 proposal
  - Taxability at $3.5 million and top tax rate of 77%

Who is impacted?

- Taxpayers with net worth above the existing BEA (Ultra High Net Worth – "UHNW")
- Taxpayers above the pending BEA (Taxable Estates)

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Capturing benefit of today's exclusion

- To capture the benefit of the "disappearing" exclusion, a taxpayer would need to give away enough assets to increase cumulative gifts to above the pending BEA
- Regulation 20.2010-1(c) was added in November 2019 and clarifies there will be no clawback, so utilization of the TCJA increase will not be taxed due to sunset
- Proposed Regulation issued on April 26, 2022 (REG-118913-21) would alter this position for gifts with potential estate inclusion that were made using the higher BEA (e.g., GRATs, QPRTs, GRITs, gift promissory notes)

UHNW Estates

- Simple plan - Make transfers between now and the end of 2025 to utilize the full value of the “disappearing” exclusion
  - This may be possible for taxpayers with estates much larger than the existing BEA, but consider a family with a $25MM estate
  - Would they be comfortable only retaining $3MM of their net worth to accommodate such a plan?

Estate & Gift Limitations

Lifetime Exemption		
	2022	2023
Form 706 required for estates with combined gross assets & prior taxable gifts exceeding	$12,060,000	$12,920,000

Although estates falling below filing threshold are not required to file, doing so could help estate take advantage of portability, e.g., transferring unused estate exemption amounts between spouses

Annual Gift Tax Exclusion		
	2022	2023
Exclusion per person	$16,000	$17,000

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SLATs – a possible solution for UHNW and Taxable

- Spousal Lifetime Access Trust
  - One spouse gifts separate property to an irrevocable trust for the benefit of children
  - The donee spouse is a permissible beneficiary of the trust
  - The trust is a grantor trust for income tax purposes
  - Beware the reciprocal trust doctrine
    - If both spouses create SLATs for the other, the trusts must be sufficiently different that IRS can't argue that no real change in economic position has occurred for the marital estate

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Intentionally defective grantor trusts

- Trusts with terms that make the donor subject to tax on the income derived therein
  - Common term is a power of substitution (IRS Section 675)
- Contributing property with high income potential (e.g., owner operated business, investment partnership) can generate a drag against the estate over a period of years
- Valuation discounts can be taken when determining gift/sale value

Basis step up

- Movement of property into trusts to shift estate tax burden will remove the date-of-death basis step up
- Consider using power of substitution within existing grantor trusts to pull out low basis assets and replace with high basis assets

GRATs

- Grantor Retained Annuity Trust
  - Donor gifts property to a trust and retains for a period of years an annuity back from the trust
  - Death during the term causes the entire trust to be includible in the donor’s estate
  - The annuity payment is not taxable but the grantor pays tax on the trust’s income during the annuity period
  - After the annuity term, any growth on the original property has been removed from the donor’s estate
  - A tool for “freezing” the estate value

GRAT further Exploration

- Why would you utilize a GRAT?
  - Already utilized a majority of your lifetime exemption
    - Zero’d out GRATs
  - Easy to value asset, with a potential to outpace the market
- To Do:
  - Connect with attorney to draft trust documentation
  - Consider repeatability of the language for ease of use

Example: GRAT

- Example
  - Midterm GRAT, utilize IRS §7520 Rate in February 2021 of 0.6%
  - $4,000,000 asset for a 2 year GRAT
  - 50.45% annuity, results in a $36 gift
  - If growth is even 3% during that period, $120,000 could be transferred

Miscellaneous

- Use annual exclusion gifts to manage post-2025 estate tax exposure
- Remember the exclusion of direct payments to health and educational providers
- Consider possible new surtaxes on high-income taxpayers that hit trusts as lower income thresholds
- Plan for impact of 10-year rule on qualified plan assets under SECURE Act

Secure Act & IRS Notice 2022-53

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SECURE ACT – Highlights & EDBs

- Enacted as part of Further Consolidated Appropriations Act, 2020 on December 20, 2019
- Generally
  - Old: “Beneficiary can withdrawal over life expectancy”
  - New: “over 10 years” – further explanation in following slides.
- Any age can contribute to a traditional IRA (70.5 yrs old rule removed)
- Changed 70.5 yrs old to 72 yrs old - ALMOST everywhere
- Effective if 70.5 yrs old after 12/31/19

How the SECURE Act Changed Beneficiaries

	Prior, Old Law	Secure Act
"Bronze"	• Non-designated beneficiary (estate, charity, or non see-through trust) • 5 year rule if died before RBD; remaining participants life expectancy if after RBD	• NO CHANGE • SECURE Act added §401(a)(9)(H) which begins "<u>except</u> in the case of a beneficiary who is <u>not</u> a designated beneficiary"
"Silver"	• Non-spouse designated beneficiary • Life expectancy or "Bronze"	• Designated beneficiary – unchanged definition! §401(a)(9)(E) • 10 years
"Gold"	• Surviving Spouse • Life expectancy or "Bronze"	• Eligible Designated Beneficiaries "EDB" • A new term - They are special!

What are EDBs?

Eligible Designated Beneficiary	Payout
1. The surviving spouse ("SS") of the participant	• Life expectancy payout; 10 year on SS death • §401(a)(9)(E)(ii)(I)
2. Minor child of the participant	• Child of participant (not grand) – until age of "majority" – "until specified course of education is completed, up to 26 yrs old" – then 10 years. • 10 year on death on minor child • §401(a)(9)(E)(ii)(II); § 1.401(a)(9)-6, A-15
3. Disabled beneficiaries	• Life expectancy payout; 10 year on death of disabled beneficiary. • a child who is disabled within the meaning of section §72(m)(7) when the child reaches the age of majority may be treated as having not reached the age of majority so long as the child continues to be disabled
4. Chronically ill individual	• Life expectancy payout; Meets the definition of chronically ill under § 7702B(c)(2) • 10 year on death of chronically ill
5. Less than 10 years younger beneficiary	• Life expectancy payout; 10 year on death

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IRS Notice 2022-53: What does it mean?

- RMDs & Inherited IRAs
  - Only Inherited IRA's after January 1, 2020
  - Should RMDs have been required all along?
  - No penalties till 2023
  - Form 5329, required?

Charitable Gifting

Charitable Gifting Considerations

- First – consider your charitable intent
- Second – consider the most tax efficient way to structure your gift.

"To give away money is an easy matter and in any man's power. But to decide to whom to give it and how large and when, and for what purpose and how, is neither in every man's power nor an easy matter."

- Aristotle

Different Ways to Gift

For itemized gifts, there are different ways to give assets- each way comes with a different set of rules

- **Gifts of Cash**
  - Deduction limited to 60% of AGI (reverts for 2022 after CARES Act)
  - Need to have charitable gift acknowledgement letter
- **Gifts of appreciated securities**
  - Deduction limited to 30% of AGI
  - Avoid having to recognize gain
  - Deduction is valued at FMV on date of gift
- **Gifts of non-cash assets (i.e. property)**
  - Deduction limited to 30% of AGI
  - Valuation considerations – over $5,000 value requires a signed appraisal attached to the return. Consider pictures to document condition of items that may not require appraisal.
  - Avoid having to recognize gain on sale
  - Deduction is valued at FMV on date of gift

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Gifts to Family Members

Gifts which control your net taxable estate.

- Annual Exclusion Gifts
  - $16,000 per person in 2022
  - $17,000 per person in 2023
- Lifetime Gift Exemption
  - $12,060,000 in 2022
  - Set to be increased by inflation adjustment through 2025.
  - After 2025, the sunset of the TCJA will take the exemption back to a pre-2019 amount adjusted for inflation (around $6 million per person)
- Direct payments of medical expenses
- Direct payments of education expenses
- Gifts to spouse/creation of trusts

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