Year-end planning ideas to engage clients

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A critical first step is estimating income for the year

1. Identify marginal tax bracket
   – Cost of adding additional income?
   – Benefit of avoiding additional income?

2. How much “room” is available until taxpayer creeps into next bracket

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#1 Timing of income and losses

- Does a Roth conversion make sense before the end of the year?
  - 3.8% surtax applies at $200k/$250k
  - Medicare Part B/D premiums (2 year look-back)
  - Taxation of Social Security benefits
  - FAFSA ("base year" for calculating aid is two years prior)
- Should retired clients consider taking more than the RMD?
  - Or, should clients withdraw from IRA before age 73?
- Opportunities to reduce income – HSA or retirement account contribution?

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Roth conversions can hedge the risk of higher taxes in the future

2023

- **37%**
- $693,750
- **35%**
- $462,500
- **32%**
- $364,200
- **$250,000**
- **24%**
- $190,750
- **22%**
- $89,450
- **12%**
- $22,000
- **10%**

PROJECTED

- **39.6%**
- $553,600
- **35%**
- $490,000
- **33%**
- $274,400
- **28%**
- $180,000
- **25%**
- $89,450
- **15%**
- $22,000
- **10%**

Potential Roth IRA conversion opportunity?

Based on 2023 tax brackets for married couples filing a joint tax return. Projected example is based on tax brackets in place prior to the Tax Cuts and Jobs Act (TCJA) adjusted for inflation through 2023. Current tax brackets are scheduled to expire at the end of 2025 with pre-TCJA tax brackets applying, adjusted for inflation. Note that other tax items are scheduled to change after the sunset provision activates in 2025, including (for example) personal exemptions returning, lower standard deduction, less restrictions on itemized deductions, and lower exemptions applying for Alternative Minimum (AMT) tax purposes.

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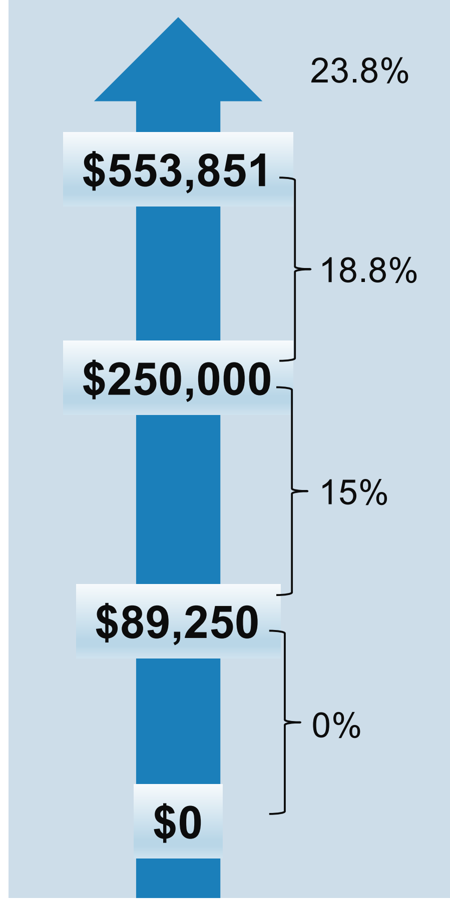
#2 Planning for unrealized gains

- Consider establishing a capital gains budget
- Maximize use of the zero percent rate
- Identify opportunities to harvest losses
  - Tax swap using mutual funds
- Strategies to mitigate capital gains exposure
  - Installment sales
  - Charitable planning
  - 1031 exchanges for real estate

LTCG - MFJ



Source: Internal Revenue Service, visual depicts brackets for long-term capital gain income for married couples filing a joint tax return in 2022. In order to avoid the IRS wash sale rule the securities being exchanged cannot be "substantially identical". In determining whether stock or securities are substantially identical, you must consider all the facts and circumstances in the particular case. For more information consult IRS Publication 550, *Investment Income and Losses*.

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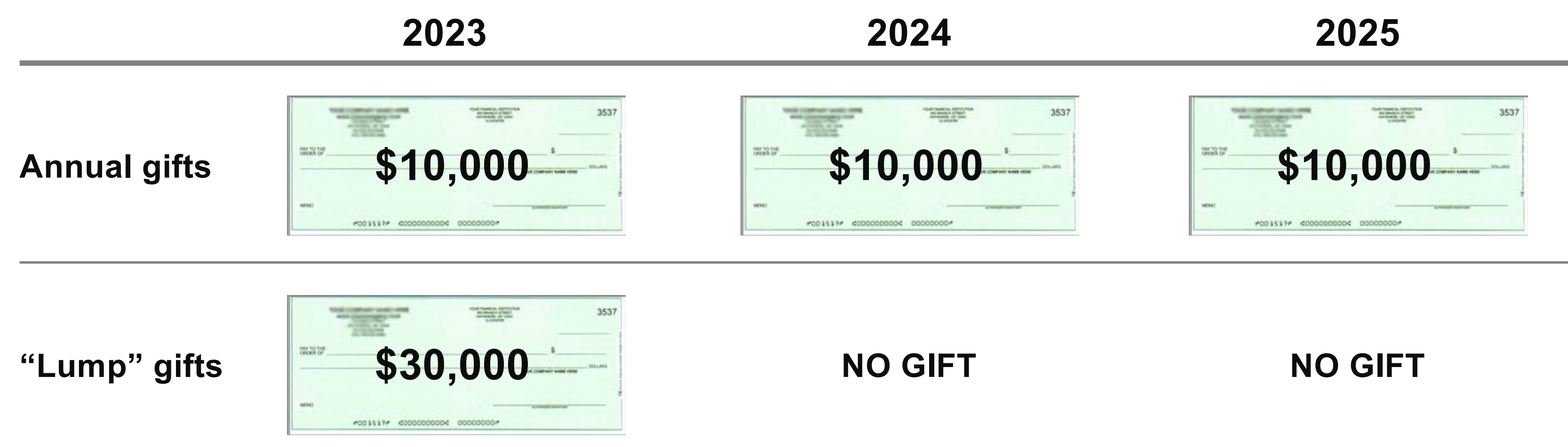
#3 Consider “lumping” charitable gifts

Assumptions: H&W, age 65, who donate $10,000 annually to charity; other deductions include $10,000 for SALT and $8,000 for mortgage interest; their marginal income tax bracket is 22%; their standard deduction is $30,700 since both are age 65+

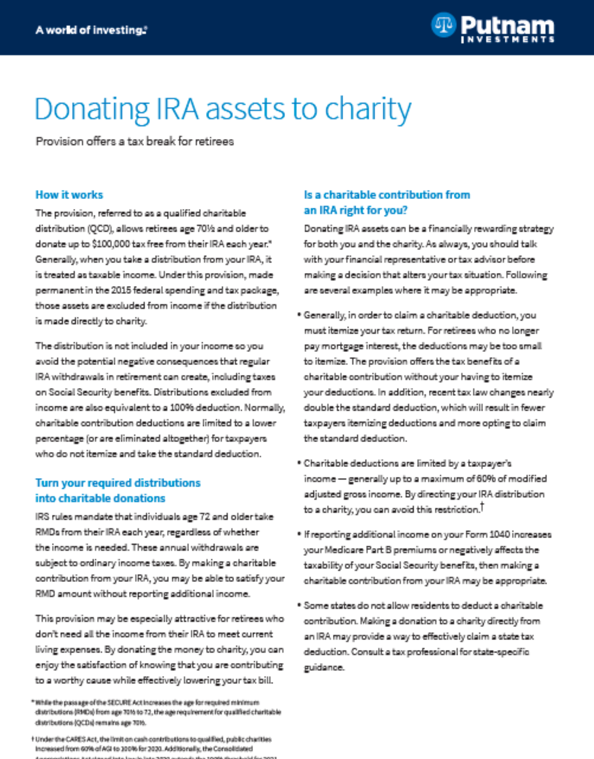


Result: With annual gifting, their total deductions = $92,100 ($30,700 x 3 years); by lumping gifts, their total deductions = $109,400 ($48,000 + $30,700 + $30,700), resulting in a difference of **$17,300** for a tax savings of approximately **$3,800,** assuming a 22% marginal tax bracket.

Example is based on 2023 IRS figures and does not account for higher standard deduction in 2024 and 2025 due to annual inflation adjustments.

#4 Opportunities for charitable giving

- Lumping charitable gifts using a DAF
  - Also a great way to connect with other family members of clients
- Prospect private foundations locally
  - Conversion to DAF in light of administrative burdens?
- Qualified Charitable Distributions (QCDs)
- Gifting of appreciated property



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Donating IRA assets to charity

Provision offers a tax break for retirees

How it works

The provision, referred to as a qualified charitable distribution (QCD), allows retirees age 70½ and older to donate up to $100,000 tax free from their IRA each year.* Generally, when you take a distribution from your IRA, it is treated as taxable income. Under this provision, made permanent in the 2015 federal spending and tax package, those assets are excluded from income if the distribution is made directly to charity.

The distribution is not included in your income so you avoid the potential negative consequences that regular IRA withdrawals in retirement can create, including taxes on Social Security benefits. Distributions excluded from income are also equivalent to a 100% deduction. Normally, charitable contribution deductions are limited to a lower percentage (or are eliminated altogether) for taxpayers who do not itemize and take the standard deduction.

Turn your required distributions into charitable donations

IRS rules mandate that individuals age 72 and older take RMDs from their IRA each year, regardless of whether the income is needed. These annual withdrawals are subject to ordinary income taxes. By making a charitable contribution from your IRA, you may be able to satisfy your RMD amount without reporting additional income.

This provision may be especially attractive for retirees who don't need all the income from their IRA to meet current living expenses. By donating the money to charity, you can enjoy the satisfaction of knowing that you are contributing to a worthy cause while effectively lowering your tax bill.

Is a charitable contribution from an IRA right for you?

Donating IRA assets can be a financially rewarding strategy for both you and the charity. As always, you should talk with your financial representative or tax advisor before making a decision that alters your tax situation. Following are several examples where it may be appropriate.

- Generally, in order to claim a charitable deduction, you must itemize your tax return. For retirees who no longer pay mortgage interest, the deductions may be too small to itemize. The provision offers the tax benefits of a charitable contribution without your having to itemize your deductions. In addition, recent tax law changes nearly double the standard deduction, which will result in fewer taxpayers itemizing deductions and more opting to claim the standard deduction.
- Charitable deductions are limited by a taxpayer's income — generally up to a maximum of 60% of modified adjusted gross income. By directing your IRA distribution to a charity, you can avoid this restriction.†
- If reporting additional income on your Form 1040 increases your Medicare Part B premiums or negatively affects the taxability of your Social Security benefits, then making a charitable contribution from your IRA may be appropriate.
- Some states do not allow residents to deduct a charitable contribution. Making a donation to a charity directly from an IRA may provide a way to effectively claim a state tax deduction. Consult a tax professional for state-specific guidance.

*While the passage of the SECURE Act increases the age for required minimum distributions (RMDs) from age 70½ to 72, the age requirement for qualified charitable distributions (QCDs) remains age 70½.

† Under the CARES Act, the limit on cash contributions to qualified, public charities increased from 60% of AGI to 100% for 2020. Additionally, the Consolidated Appropriations Act signed into law in late 2020 extends the 100% threshold for 2021.

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#5 Make sure you have addressed the impact of the SECURE Act with clients

Account owners

- Review and evaluate beneficiary designations
    - Leave IRA to lower-income heirs, or more heirs in general
    - Review trust arrangements
- Spend down IRA while living
- Roth conversions
- Charitable considerations
    - QCD, CRT as stretch "proxy"
- Permanent life insurance as a means to leave a tax-free legacy

Heirs

- Tax-efficient timing of distributions over the 10-year period
- If inheriting Roth, wait until the end of the 10th year to distribute

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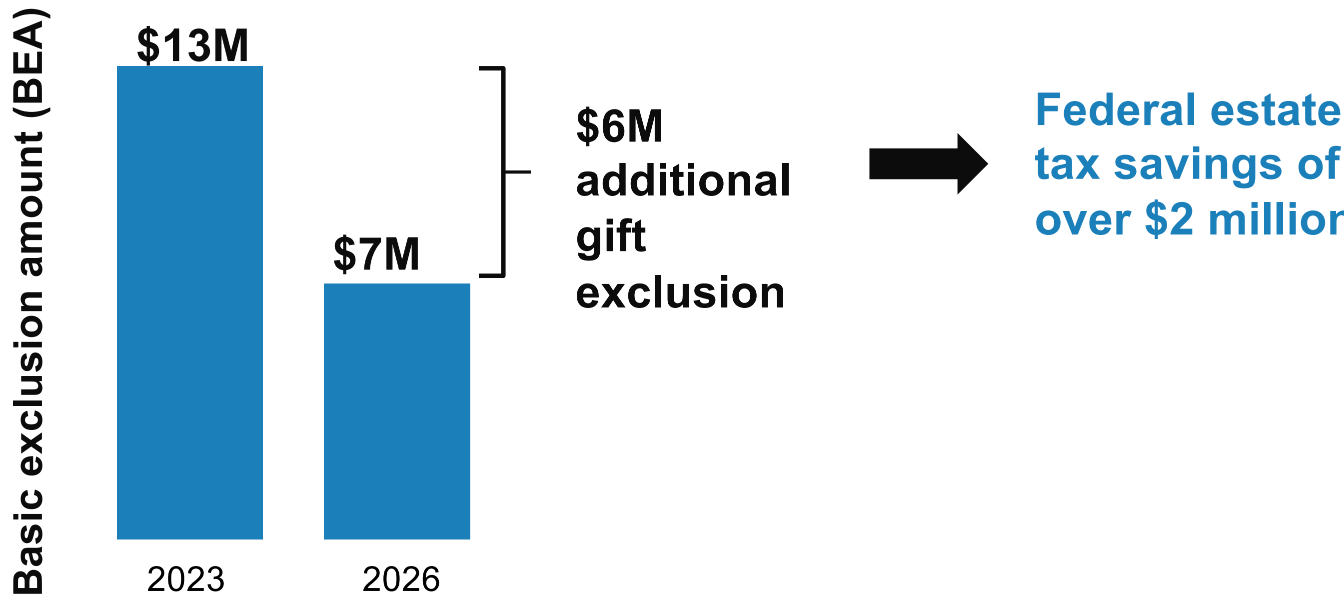
#6 Capitalize on strategies to transfer wealth before potential expiration in the lifetime exclusion amount



Assumes an estate tax rate of 40%. For 2023 the Basic Exclusion Amount (BEA) is $13,000,000. The 2026 projected figure of $7 million is based on the sunset provision effective at the end of 2025, which will reduce the BEA to $5 million adjusted for inflation. On 11/23/18, the Treasury Department issued proposed regulations (REG-106706-18) stating that, upon sunset of the federal estate gift and estate tax provisions under the TCJA in 2026, there would be no “claw-back” provision applied on large gifts made during the temporary increase in the exclusion amount. On April 26, 2022 the Treasury Department issued proposed regulations that would apply a clawback on certain gifts (GRATs, QPRTs) where the donor has reserved a way of accessing the funds directly in the future.

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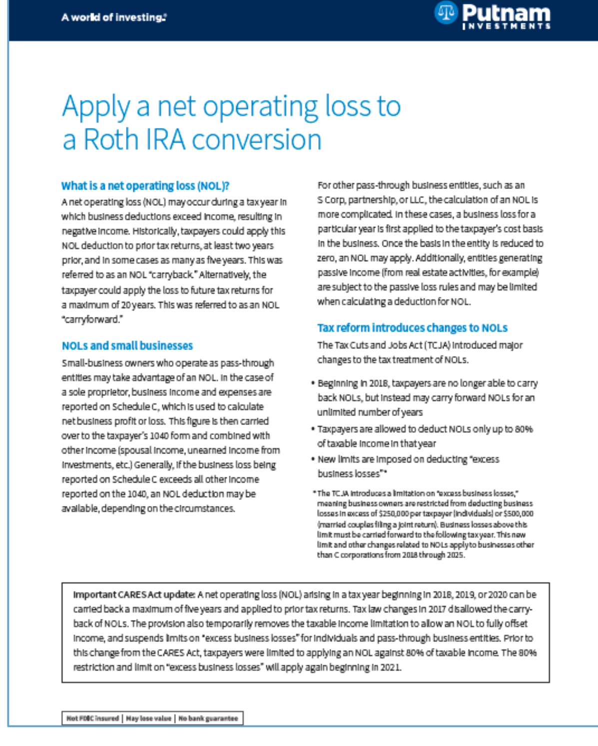
#7 Key conversations for business owners

- Net operating loss (NOL) carryforward and Roth conversion opportunity
- SALT workaround option
- Retirement plan review / upgrade



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Apply a net operating loss to a Roth IRA conversion

What is a net operating loss (NOL)?

A net operating loss (NOL) may occur during a tax year in which business deductions exceed income, resulting in negative income. Historically, taxpayers could apply this NOL deduction to prior tax returns, at least two years prior, and in some cases as many as five years. This was referred to as an NOL "carryback." Alternatively, the taxpayer could apply the loss to future tax returns for a maximum of 20 years. This was referred to as an NOL "carryforward."

NOLs and small businesses

Small-business owners who operate as pass-through entities may take advantage of an NOL. In the case of a sole proprietor, business income and expenses are reported on Schedule C, which is used to calculate net business profit or loss. This figure is then carried over to the taxpayer's 1040 form and combined with other income (spousal income, unearned income from investments, etc.) Generally, if the business loss being reported on Schedule C exceeds all other income reported on the 1040, an NOL deduction may be available, depending on the circumstances.

For other pass-through business entities, such as an S Corp, partnership, or LLC, the calculation of an NOL is more complicated. In these cases, a business loss for a particular year is first applied to the taxpayer's cost basis in the business. Once the basis in the entity is reduced to zero, an NOL may apply. Additionally, entities generating passive income (from real estate activities, for example) are subject to the passive loss rules and may be limited when calculating a deduction for NOL.

Tax reform introduces changes to NOLs

The Tax Cuts and Jobs Act (TCJA) introduced major changes to the tax treatment of NOLs.

- Beginning in 2018, taxpayers are no longer able to carry back NOLs, but instead may carry forward NOLs for an unlimited number of years
- Taxpayers are allowed to deduct NOLs only up to 80% of taxable income in that year
- New limits are imposed on deducting "excess business losses"*

*The TCJA introduces a limitation on "excess business losses," meaning business owners are restricted from deducting business losses in excess of $250,000 per taxpayer (individuals) or $500,000 (married couples filing a joint return). Business losses above this limit must be carried forward to the following tax year. This new limit and other changes related to NOLs apply to businesses other than C corporations from 2018 through 2025.

Important CARES Act update: A net operating loss (NOL) arising in a tax year beginning in 2018, 2019, or 2020 can be carried back a maximum of five years and applied to prior tax returns. Tax law changes in 2017 disallowed the carry-back of NOLs. The provision also temporarily removes the taxable income limitation to allow an NOL to fully offset income, and suspends limits on "excess business losses" for individuals and pass-through business entities. Prior to this change from the CARES Act, taxpayers were limited to applying an NOL against 80% of taxable income. The 80% restriction and limit on "excess business losses" will apply again beginning in 2021.

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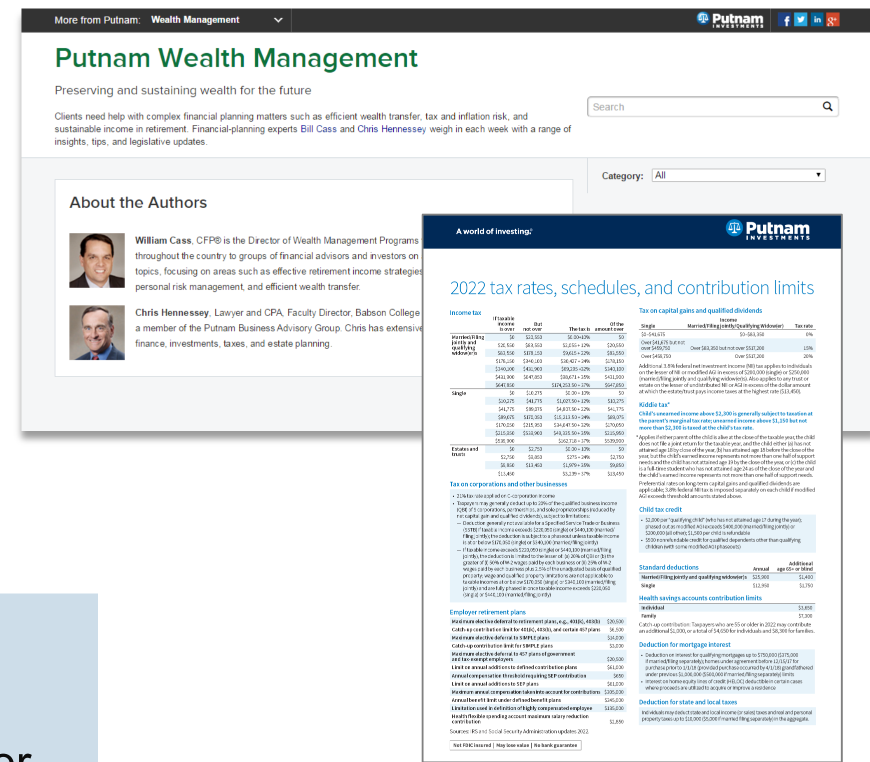
#8 Look for opportunities to engage other family members during the holidays

- As family members gather during the holidays, this presents an opportunity for advisors to deepen or develop relationships
- Make sure key documents are in place
  - For example, are healthcare directives and proxies — especially for older children before they head back to college — in place?
- Family meetings, zoom calls, or social events?
- Do clients have a “road map” document for family members that outlines wishes, lists account details, passwords, etc.
- Fund Roth accounts for younger family members
- Holiday gift giving in 529 plans

Resources designed to help you engage clients and prospects

- Client seminar and investor education pieces on the tax landscape and planning ideas
- Wealth Management Center blog articles and resources
  - Putnamwealthmanagement.com
- Video commentary and podcasts



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