10 Things to Consider Before Year-End 2022

HIRTLE CALLAGHAN & CO
Chief Investment Officers

What a difference a year makes! Inflation, rising interest rates, the Ukraine War, and a struggling financial market have been front and center this year. These events have made 2022 feel very different than 2021, especially as it relates to tax planning. The most recent mid-term elections have also created some uncertainty with regards to future tax legislation.

As we approach the end of 2022, there are various planning strategies you can employ to take full advantage of the existing environment and prepare for what is most likely to occur. As you will notice, high inflation is generally a negative economic factor unless you are discussing taxes. High inflation produces significant increases to tax threshold amounts which are discussed throughout. Below is a list of ten things you may want to consider before year-end or, in some cases, early 2023.

1. **Harvest Tax Losses.** You can reduce your tax bill from capital gains by actively selling certain investments at a loss to offset any taxable gains from the sale of appreciated securities. This practice of actively "harvesting" tax losses is one that we do every year in our clients' accounts. For the first time in decades, we have been actively recognizing losses in fixed-income (bond) investments in addition to equity (stock) investments. You may want to review any other accounts and assets you may have to assess whether other losses should be recognized before year-end. To the extent you have more losses than gains, you can use tax-loss harvesting to offset up to $3,000 of non-investment income this year. Capital losses in excess of $3,000 can be carried forward indefinitely until the amount is exhausted.

   It is important to be mindful of the 30-day wash sale rule, which could disqualify a capital loss if the same or "substantially identical" security is purchased within 30 days before or after the sale. This is intended to prevent the creation of "artificial" losses that are taken just for tax purposes. Currently, the wash sale rule does not apply to cryptocurrencies.

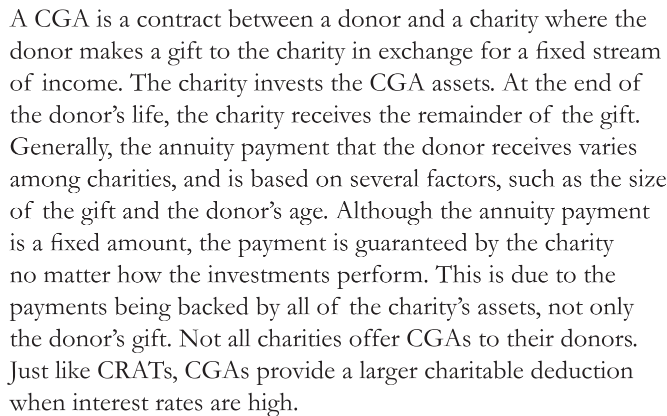
2. **Evaluate Planning Strategies That Benefit When Rates Rise.** There are a number of income and estate planning strategies that are effective in helping to reduce your tax bill (income and/or estate and gift tax) as well as transferring assets to your beneficiaries (family and/or charity). Some of the most popular planning strategies in recent years, such as an intra-family loan (or refinancing an existing intra-family loan), a Grantor Retained Annuity Trust ("GRAT"), a sale to an Intentionally Defective Grantor Trust ("IDGT") or a Charitable Lead Annuity Trust ("CLAT")[1] tend to produce greater tax benefits in low interest rate environments.

   On the other hand, there are a number of planning strategies that are more effective in higher interest rate environments. Three of these strategies include a Qualified Personal Residence Trust ("QPRT"), a Charitable Remainder Annuity Trust ("CRAT"), and a Charitable Gift Annuity ("CGA"). These strategies will likely become more popular as interest rates are higher than in the recent past.

   A QPRT is a trust used to transfer a personal residence to beneficiaries over a period of years. During the term of the QPRT, the grantor may continue to use the residence as if it is his or her own. After the term ends, the residence becomes the property of the beneficiaries. However, the beneficiaries may rent the property back to the grantor for fair-market-value rent. At the time of contribution to the QPRT, the value of property transferred is calculated using an IRS determined interest rate and the remainder interest is taxable as a gift. As interest rates increase, the value of the QPRT term (which is the value of the grantor's right to use the residence during the term of years) also increases and the future remainder interest decreases, reducing the taxable gift.

   A CRAT is a trust created for the ultimate benefit of a charity at the end of the trust term but which pays out an annuity to the grantor over a pre-determined number of years (often the life of the grantor.) After the annuity term runs out, the charitable beneficiary selected by the grantor receives the remainder of the trust. The value of the remainder is calculated using specific IRS determined interest rates as of the date of the funding of the trust. This results in a charitable deduction for income tax purposes; the higher the IRS rate, the greater the charitable deduction.

[1] *For more information on intrafamily loans, GRATs, IDGTs and CLATs, please read our paper entitled Add Value Today – Estate Planning in the Current Environment.*



A CGA is a contract between a donor and a charity where the donor makes a gift to the charity in exchange for a fixed stream of income. The charity invests the CGA assets. At the end of the donor's life, the charity receives the remainder of the gift. Generally, the annuity payment that the donor receives varies among charities, and is based on several factors, such as the size of the gift and the donor's age. Although the annuity payment is a fixed amount, the payment is guaranteed by the charity no matter how the investments perform. This is due to the payments being backed by all of the charity's assets, not only the donor's gift. Not all charities offer CGAs to their donors. Just like CRATs, CGAs provide a larger charitable deduction when interest rates are high.

3. **Maximize Your Lifetime Estate and Gift Tax Exemption.** For 2022, the lifetime estate and gift tax exemption is at an all-time high of $12.06 million per individual ($24.12 million for a married couple). The exemption amount will increase (due to the inflation adjustment) on January 1, 2023 to $12.92 million per individual ($25.84 million for a married couple). Such exceptionally high exemption levels provide significant wealth transfer opportunities, but the window is narrowing. Under the existing law, the exemption amount will be reduced on December 31, 2025 to approximately half of the current level.

   If you have not already used your lifetime exemption, you should consider transferring assets and using your remaining exemption in the near future. If you have already used your lifetime exemption before year-end, you should consider "topping it off" early in 2023 when you can transfer an additional $860,000 per individual ($1,720,000 for a married couple).

4. **Make Annual Exclusion Gifts.** In addition to the estate and gift tax exemption (discussed above), you may make an annual gift to an unlimited number of individuals gift-tax free each year. The annual gift tax exclusion is $16,000 per individual for 2022 ($32,000 for a married couple). The annual exclusion amount will increase to $17,000 per individual on January 1, 2023 ($34,000 for a married couple). This is a powerful way to reduce your estate. Not only are the assets removed from your estate but the assets' future appreciation also avoids gift and estate taxes. We recommend giving cash or assets with a high tax basis so your beneficiaries are not burdened with additional taxes.[2]

   It is worth noting that you can also pay directly for another person's educational and medical expenses without those payments counting against your annual exclusion gift amount or lifetime exemption. For example, a grandparent could pay their grandchild's tuition (if such payment is made directly to the educational institution and not to the student) and still gift $16,000 (at 2022 levels) to the grandchild with no gift tax implications.

[2] *A gift must be deposited by the beneficiary before the end of 2022 to qualify as a 2022 gift. A check written in 2022 but deposited on January 2, 2023 will be considered a 2023 gift.*

5. **Consider Making Charitable Contributions.** Charitable contributions not only benefit the organizations and causes you care about, they also are tax-deductible expenses that can reduce your taxable income if you itemize your deductions and do not take the standard deduction ($12,950 for single filers and $25,900 for married couples in 2022). If you are charitably inclined, you can consider "prepaying" next year's charitable contributions to take an income tax deduction this year. If you normally take the standard deduction, bunching together this year's charitable gifts with next year's gifts may allow you to itemize your deductions and not have to take the standard deduction (effectively reducing your tax bill).

   If you want to defer the receipt of your gift by the charity but still receive a charitable deduction in 2022, there are several ways to structure your giving. You can contribute to a donor-advised fund, a private foundation, a charitable lead trust, a charitable remainder trust or purchase a charitable gift annuity.

   If you are making a gift directly to a charity, we generally recommend gifting long-term, highly appreciated securities as charitable gifts to maximize the impact of your gift and to avoid paying tax on the gain. However, there are limits on the deductibility of charitable gifts subject to your Adjusted Gross Income (AGI) depending on the type of gift (cash vs. other assets such as securities) and the charitable beneficiary (public charity vs. private foundation).

6. **Confirm All Required Minimum Distributions (RMDs) From IRAs Have Been Made.** You are required to take a minimum distribution for 2022 from all of your IRA and retirement plans (except Roth IRAs) if you have reached your required beginning date (either 70 ½ or 72 depending on the year that you were born) or if you own an inherited IRA account. Failing to take these required distributions may result in a 50% excise tax on the amount not distributed. Therefore, it is important to confirm that you have taken all your required minimum distributions for 2022.

   If you are 70 ½ or older, you may make a Qualified Charitable Deduction ("QCD") to satisfy part or all of your RMD. Using a QCD, you may transfer up to $100,000 from your own IRA (not an inherited IRA) directly to a public charity (which does not include a donor-advised fund or private foundation), thus reducing the tax burden of your RMDs, which are taxed at ordinary income tax rates.

7. **Evaluate Converting Your Traditional IRA to a Roth IRA.** If you anticipate that you will be in a higher income tax bracket in future years or have excess tax deductions that may be lost or cannot be used without additional income, you may want to consider converting your traditional IRA into a Roth IRA. When you convert from a traditional IRA to a Roth IRA, you will pay taxes on the money that you convert today but you will be able to make tax-free withdrawals from the Roth account in the future. This may be a good time to consider a Roth conversion as portfolios are generally lower than last year.

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8. **Establish a Qualified Retirement Plan.** If you are a business owner and are considering a new qualified retirement plan, you must establish the plan before the end of the year. However, you can defer your decision on the funding amount (or contribution amount) until later in 2023 (generally until at least September 15). The tax-deductible contribution limit for 2022 for defined contribution plans is $61,000 per participant or $67,500 if the participant is age 50 or older.

9. **Get Ahead of Trust Income Tax Planning.** Many irrevocable trusts give trustees unfettered discretion to either distribute the income to the beneficiaries each year or accumulate the income. Trustees should consider whether an income distribution should be made and, if so, if it can be made in a tax-efficient manner. Trusts are subject to the highest tax rates [37% ordinary income tax rate, 20% long term capital gains rate and the 3.8% Net Investment Income Tax ("NIIT") on income over $13,450.] Whereas married couples are not taxed at these levels until their income reaches $647,850 ($539,900 for a single taxpayer.

   The lower threshold for taxing trusts at the higher rates may make it more advantageous to transfer income to the beneficiary rather than accumulate income in the trust. Income distributions make more sense when a beneficiary's marginal tax rate is lower than the trust's marginal tax rate as the distribution will be taxed at the lower rate and avoid the imposition of the additional 3.8% NIIT. Although trustees have 65 days after the end of the tax year to shift trust taxable income to a beneficiary, it is a good idea to start considering this planning technique now.

10. **Maximize Your Health Savings Accounts ("HSA").** An HSA is a tax-advantaged way to save and pay for medical expenses if you have a high deductible medical plan. The IRS defines a "high deductible" as any plan with a deductible of at least $1,400 for an individual and $2,800 for a family. Contributions to an HSA are tax deductible, and distributions to pay for qualified medical expenses are tax-free. The maximum family contribution in 2022 for an HSA is $7,300 (or $3,650 for individuals) with an extra $1,000 for those who have reached age 55. The maximum family contribution limits for 2023 for an HSA will increase to $7,750 (or $3,850 for individuals).

    You technically have until April 15, 2023 to fund your HSA for 2022, but you should start planning now to ensure that you maximize your 2022 contribution to your HSA.

Tax planning can be incredibly complex. Although we have provided you with some strategies for tax and philanthropic planning, there is "no-one-size-fits-all" solution. Everyone's tax situation, estate plans and family dynamics are unique. We recommend that you conduct a thorough review of your estate plan (including a review of your retirement plan and life insurance beneficiary designations) at least every three years, and year-end is a good time to take stock. As your trusted investment partner, we are here to help you do this and evaluate your taxes in the context of your overall portfolio and goals for your estate and charitable contributions. For more information, please reach out to your Investment Officer and/or Portfolio Manager.

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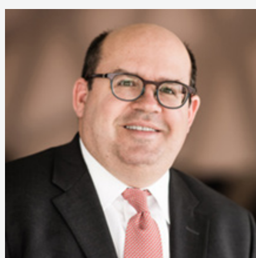

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