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2023 Midyear Tax Planning Letter for Individual Clients

Dear Client:

The less hectic summer season is a good time to consider steps to cut your 2023 tax bill. Here are some planning strategies to consider, assuming our current federal tax regime remains in place through 2024.

Consider Adjusting Your Tax Withholding or Estimated Payments

No taxpayer likes to be surprised with a large tax bill (or a smaller-than-anticipated refund) come tax filing season. In many cases, this occurs because individuals didn't adjust their tax withholding or estimated payments to account for changes in income. For those accustomed to receiving refunds every year, an unexpected tax bill can be a real hardship. Fortunately, there's still time to make sure the right amount of federal income tax is being withheld from your paycheck for 2023.

IRS Form W-4 is used to tell your employer how much tax to withhold from each paycheck. Many taxpayers simply don't have the correct amount of tax withheld. The IRS has a tool to assist taxpayers in completing Form W-4. If you haven't reviewed your withholding recently, you should consider using the IRS's "Tax Withholding Estimator," available at **www.irs.gov/individuals/tax-withholding-estimator**. You will need your most recent pay stubs (for both spouses if married filing a joint return), details of other sources of income, and a copy of your most recent tax return. However, keep in mind that the calculator isn't perfect. If you want more precise results, we would be happy to put together a 2023 tax projection for you.

If you make estimated tax payments throughout the year (if you're self-employed, for example), we can take a closer look at your tax situation for 2023 to make sure you're not underpaying or overpaying.

Game the Generous Standard Deduction Allowances

The 2023 standard deduction amounts are $13,850 for singles and those who use married filing separate status, $27,700 for married joint filing couples, and $20,800 for heads of household. If your total annual itemizable deductions for 2023 will be close to your standard deduction amount, consider making enough additional expenditures for itemized deduction items between now and year end to exceed your standard deduction. That will lower this year's tax bill. Next year, you can always claim the standard deduction, which will be increased to account for inflation.

The easiest deductible expense to accelerate is included in the house payment due on January 1. Accelerating that payment into this year will give you 13 months' worth of interest in 2023. Although 2017 tax reform put stricter limits on itemized deductions for home mortgage interest, you are probably unaffected. Check with us if you are uncertain.

Next up are state and local income and property taxes that are due early next year. Prepaying those bills before year end can decrease your 2023 federal income tax bill because your total itemized deductions will be that much higher. However, 2017 tax reform decreased the maximum amount you can deduct for state and local taxes to $10,000 or $5,000 if you use married filing separate status. So beware of this limitation.

Also, consider making bigger charitable donations this year and smaller ones next year to compensate. That could cause your itemized deductions to exceed your standard deduction this year. Next year, you can always claim the standard deduction.

Finally, consider accelerating elective medical procedures, dental work, and vision care. For 2023, medical expenses are deductible to the extent they exceed 7.5% of your Adjusted Gross Income (AGI), assuming you itemize.

Warning: The state and local tax prepayment drill can be a bad idea if you owe Alternative Minimum Tax (AMT) for this year. That's because write-offs for state and local income and property taxes are completely disallowed under the AMT rules. Therefore, prepaying those expenses may do little or no tax-saving good if you are an AMT victim. Thankfully, changes included in the 2017 tax reform bill greatly reduced the odds of individuals owing AMT, but contact us if you are unsure about your exposure to the tax.

Carefully Manage Investment Gains and Losses in Taxable Accounts

If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. The federal income tax rate on long-term capital gains recognized in 2023 is only 15% for most individuals, but it can reach the maximum 20% rate at higher income levels. The 3.8% Net Investment Income Tax (NIIT) also can apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2023 years, selling winners this year will not result in any tax hit. In particular, sheltering net short-term capital gains with capital losses is a sweet deal because net short-term gains would otherwise be taxed at higher ordinary income rates.

What if you have some loser investments that you would like to unload? Biting the bullet and taking the resulting capital losses this year would shelter capital gains, including high-taxed short-term gains, from other sales this year.

If selling a bunch of losers would cause your capital losses to exceed your capital gains, the result would be a net capital loss for the year. That net capital loss can be used to shelter up to $3,000 ($1,500 if you use married filing separate status) of 2023 ordinary income from salaries, bonuses, self-employment income, interest, royalties, etc. Any excess net capital loss from this year is carried forward to next year and beyond.

In fact, having a capital loss carry over into next year and beyond could turn out to be a pretty good deal. The carryover can be used to shelter both short-term gains and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a lower tax rate. And since the top two federal rates on net short-term capital gains recognized in 2024 are expected to remain at 35% and 37% (plus the 3.8% NIIT, if applicable), having a capital loss carry over into next year to shelter short-term gains recognized next year could be a very good thing.

Key Point: If you still have a capital loss carryover after 2024, it could come in very handy if the 2024 general election results in increased tax rates for 2025 and beyond. That could happen!

Take Advantage of 0% Tax Rate on Investment Income

The federal income tax rate on long-term capital gains and qualified dividends from securities held in taxable brokerage firm accounts is still 0% when the gains and dividends fall within the 0% bracket. For 2023, you may qualify for the 0% bracket if your taxable income is $44,625 or less for single filers, $89,250 or less for married couples filing jointly, or $59,750 or less for heads of household.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in the 0% bracket. If so, consider giving them some appreciated stock or mutual fund shares that they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before the recipient sells) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 0% rate bracket, they will be federal-income-tax-free.

Warning: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the parent's higher marginal federal income tax rate. That would defeat the purpose. Please contact us if you have questions about exposure to the Kiddie Tax.

One can be doing pretty well income-wise and still be within the 0% rate bracket for long-term capital gains and qualified dividends. For example, say your married adult daughter files jointly and claims the $27,700 standard deduction for 2023. She could have up to $116,950 of AGI (including long-term capital gains and dividends) and still be within the 0% rate bracket. Her taxable income would be $89,250, which is the top of the 0% bracket for joint filers. Needless to say, having AGI of $116,950 means you're not doing too bad!

Explore Gifting Strategies

If you want to make gifts to some favorite relatives, other loved ones, and/or charities, they can be made in conjunction with an overall revamping of your taxable account stock and equity mutual fund portfolios. Gifts should be made the according to the following tax-smart principles.

Gifts to Relatives and Other Loved Ones. Don't give away loser shares (currently worth less than what you paid for them). Instead, you should sell the shares and book the resulting tax-saving capital loss. Then, give the cash sales proceeds to your loved one.

On the other hand, you should give away winner shares. Most likely, your gift recipient will pay lower tax rates than you would pay if you sold the same shares. As explained earlier, loved ones in the 0% federal income tax bracket for long-term capital gains and qualified dividends will pay a 0% federal tax rate on gains from shares that were held for over a year before being sold. For purposes of meeting the more-than-one-year rule for gifted shares, count your ownership period plus the gift recipient's ownership period. Even if the winner shares have been held for a year or less before being sold, your loved one will probably pay a lower tax rate on the gain than you would.

Gifts to Charities. The principles for tax-smart gifts to relatives and other loved ones also apply to donations to IRS-approved charities. You should sell loser shares and collect the resulting tax-saving capital losses. Then, you can give the cash sales proceeds to favored charities and claim the resulting tax-saving charitable deduction (assuming you itemize). Following this strategy delivers a double tax benefit: tax-saving capital losses plus a deductible charitable donation.

On the other hand, you should donate winner shares instead of giving away cash. Why? Because donations of publicly traded shares that you have owned over a year result in charitable deductions equal to the full current market value of the shares at the time of the gift (assuming you itemize). Plus, when you donate winner shares, you escape any capital gains taxes on those shares. So this idea is another double tax-saver: you avoid capital gains taxes while getting a tax-saving donation deduction (assuming you itemize). Meanwhile, the tax-exempt charitable organization can sell the donated shares without owing anything to the IRS.

Convert Traditional IRAs into Roth Accounts

The best profile for the Roth conversion strategy is when you expect to be in the same or higher tax bracket during your retirement years. If that turns out to be true, the current tax hit from a conversion done this year could be a relatively small price to pay for completely avoiding potentially higher future tax rates on the account's earnings. In effect, a Roth IRA can insure part or all of your retirement savings against future tax rate increases.

Defer Income into Next Year

Depending on your situation, you might be able to defer some taxable income from this year into next year and put off the related income tax hit. Because the thresholds for next year's federal income tax brackets will almost certainly be significantly higher thanks to inflation adjustments, the deferred income might be taxed at a lower rate. Contact us if you want to explore this possibility.

Take Advantage of Principal Residence Gain Exclusion Break

Home prices have cooled off in many areas, but many homeowners are still sitting on substantial unrealized gains. Gains of up to $500,000 from the sale of a principal residence are completely federal-income-tax-free for qualifying married couples who file joint returns. $250,000 is the gain exclusion limit for qualifying unmarried individuals and married individuals who file separate

returns. To qualify for the gain exclusion break, you normally must have owned and used the home as your principal residence for a total of at least two years during the five-year period ending on the sale date. You'll definitely want to take these rules into consideration if you're planning on selling your home in today's real estate environment. Contact us for details.

Watch Out for the AMT

2017 tax reform significantly reduced the odds that you will owe AMT by significantly increasing the AMT exemption amounts and the income levels at which those exemptions are phased out. Even if you still owe AMT, you will probably owe considerably less than before the 2017 tax reform bill. Nevertheless, it's still critical to evaluate year-end tax planning strategies in light of the AMT rules. Because the AMT rules are complicated, you may want some assistance. We stand ready to help.

Don't Overlook Estate Planning

The unified federal estate and gift tax exemption for 2023 is a historically huge $12.92 million, or effectively $25.84 million for married couples. Even though these exemptions probably mean you are not currently close to being exposed to the federal estate tax, your estate plan may need updating to reflect the current tax regime. Also, you may need to make some changes for reasons that have nothing to do with taxes, such as various life changes.

Finally, be aware that in 2026, the unified federal estate and gift tax exemption is scheduled to fall back to what it was before 2017 tax reform with a cumulative inflation adjustment for 2018–2025. That might put it in the $7 million to $8 million range, depending on what inflation turns out to be through 2025. Depending on political developments, the exemption cutback could happen before 2026.

Bottom Line: Estate planning can be a moving target. Personal and tax changes happen. Contact us if you would like to discuss conducting an estate planning update. The slower summer season would be a good time for that.

Other Tax-saving Opportunities

What we have covered here is only part of the story. There are tax breaks for Section 529 college savings accounts, Coverdell education savings accounts, and health savings accounts; tax-saving moves you can make at your job; tax credits for qualifying energy-efficient home improvements; tax credits for qualifying hybrid and electric vehicles; and more. Contact us for details and other ideas.

Best Regards,

Brian Crelin, CPA

July 20, 2023