Five Year-End Tax Planning Strategies for 2022

December 20, 2022 **|** by Samantha Rocco

As 2022 comes to a close, it is important to know the advantages of certain tax planning strategies.

Following a brief overview of how the federal gift and estate tax system works, this article presents five year-end tax planning strategies for 2022.[1]

Understanding the "Lifetime Exemption" in 2022: The Amount Gifted During Life and At Death That is Exempt from Federal Gift or Estate Tax

In 2022, an individual who is a United States citizen can pass a total of $12,060,000 during life and at death *without incurring a federal gift or estate tax*. This is known as the Lifetime Exemption.

To illustrate, using "Jane" as the individual, an individual is required to pay federal gift tax only after she has actually gifted an amount equal to her entire Lifetime Exemption ($12,060,000 in 2022). Any "taxable" gifts Jane makes during her lifetime reduces the amount that she may give free of federal estate tax at her death.

In 2022, if an estate is worth more than the Lifetime Exemption ($12,060,000 for single individuals; $24,120,000 for married couples), the excess will incur a federal estate tax at a rate of 40%[2].

Note, on January 1, 2023, the Lifetime Exemption increases to $12,920,000 per person – that's $860,000 more per person than in 2022.

It is important to also note that on January 1, 2026, the Lifetime Exemption is scheduled to be reduced to $5,000,000 per person (indexed for inflation). If this happens, many practitioners believe the Lifetime Exemption for tax year 2026 will be between $6,500,000 and $7,000,000 per person.

With that being said, here are five year-end tax planning strategies to consider.

1.

Consider Making “Annual Exclusion Gifts” in 2022

For those who expect to have taxable estates, making Annual Exclusion Gifts (defined below) can be a powerful and tax-efficient method to transfer wealth from generation-to-generation, since Annual Exclusion Gifts do not reduce an individual’s Lifetime Exemption.

To illustrate, imagine that in 2022, Jane gifts $16,000 to her best friend, $16,000 to her niece, and $16,000 to her cousin. Despite the fact that Jane has gifted a total of $48,000 ($16,000 x 3) in 2022 to donees (recipients), her Lifetime Exemption ($12,060,000) is **not** reduced by the value of these gifts, and she can still gift away her entire $12,060,000 without incurring any federal gift tax.

Married couples can make double the amount of gifts without incurring a federal gift tax. In 2022, a married couple can gift a total of $32,000 to an unlimited number of donees.[3]

2.

Establish or Continue Saving for Educational Expenses with a 529 Plan

A 529 plan is a tax-advantaged account that enables individuals to save for future educational expenses (e.g., elementary through high school tuition, college and graduate school tuition; trade school tuition). Once assets are deposited into a 529 plan, the investments in the 529 account grow tax-deferred, and as long as the assets are used for qualified higher education expenses, the withdrawals will not be subject to federal income tax (and in many states, including New Jersey, not subject to state income tax).

Rather than making an Annual Exclusion Gift (again, in 2022, $16,000 per donor/per donee) directly to a beneficiary, one can fund a 529 account for the benefit of such beneficiary.

Even better, the IRS allows individuals to frontload five-years' worth of Annual Exclusion Gifts to a 529 account; so, a single individual, in 2022, can gift up to $80,000 to a 529 account (and for married couples, $160,000).

3.

Maximize the Contributions to your Retirement Plans

Individual Retirement Accounts (IRAs)

For tax year 2022, an individual who has earned income may contribute, in total, to her traditional IRA or her Roth IRA, or some combination thereof, a maximum of $6,000, or $7,000 for those who are over the age of 50.[4]

In order to be considered for tax year 2022, traditional IRA and Roth IRA contributions must be made on or before April 18, 2023.

Certain individuals may deduct the amount of their **traditional** IRA[5] contributions from their adjusted gross income on their federal income tax returns (subject to certain income phase outs).

Individuals may only contribute to a Roth IRA if their modified adjusted gross income is at or below a certain income limit. For those above the income limits for contributions to a Roth IRA, however, all hope is not (necessarily) lost.

High-income earners who cannot contribute directly to a Roth IRA due to the income limits may use the “backdoor” Roth IRA strategy and still be able to maximize retirement savings (assets in the Roth IRAs grow income tax free). In terms of mechanics high-income earners (again, who cannot contribute directly to a Roth IRA) can contribute to a traditional IRA then roll the traditional IRA over into a Roth IRA[6]. Among the benefits of the Roth IRA are: (i) the fact that qualified withdrawals are tax-free and (ii) there are no required minimum distributions, which means the Roth IRA can continue growing tax-free for the taxpayer’s lifetime.

401(k) Savings Plan

In 2022, an individual may contribute $20,500[7] to his or her 401(k) plan. Individuals who are fifty (50) years of age or older may contribute an additional $6,500.

An individual is permitted to maximize their IRA and 401(k).

4.

Depending on Your Age, Remember to Take your Required Minimum Distributions (or “RMD") on Certain Retirement Plans

Certain types of retirement plans require that minimum distributions (e.g., 401(k)s, traditional IRAs) be taken upon the owner reaching a specific age. Specifically, those individuals turning 72 years of age in 2022 will have until April 1, 2023, to take their first required minimum distribution (“RMD”). For each subsequent year, the RMD must be taken by December 31st.

There is one caveat: if you take your first RMD in 2023, then you will take two (2) RMDs in 2023 (one that you must take by April 31st and one that you must take by December 31st). This may result in you having a greater tax liability in 2023 than if you took your first RMD by December 31, 2022 (and not in 2023).

5.

Donating Appreciated Securities

Donating appreciated securities, rather than by writing a check, giving cash or donating via credit card, is one of the most tax-efficient ways to donate; doing so may benefit both the donor and the charity.

This is best explained with an illustration:

- Jane purchased 10 shares of ABC Corporation five years ago for $5 per share. This means that Jane's "basis" in the shares is $50 (10 shares x $5 per share). Today, ABC Corporation is valued at $15 per share, so Jane's 10 shares are worth $150 ($15 per share x 10 shares).
- Jane wants to donate to XYZ Charity, so she liquidates all of her ABC Corporation shares. As a result, Jane will be required to pay capital gains tax on the difference between what she sold the shares for ($150) and what she purchased the shares for ($50).
- Assuming Jane is subject to a federal long-term capital gains rate of 20%, a New Jersey capital gains rate of 10.75%, and a net investment income tax of 3.8%, Jane will owe $34.55 in taxes as a result of this sale (the fair market value of the 10 shares Jane sold, $150, minus her basis of $50 = $100 will be subject to capital gains and net investment income taxes; $100 x 0.3455= $34.55 due in capital gains).
- After paying the capital gains tax and net investment income tax, Jane now has $115.45 to donate to charity (she sold the stock for $150 and incurred $34.55 in taxes as a result of the sale). Since Jane itemizes her deductions on her federal income tax return, she takes a $115.45 charitable deduction.
- Now, let's say Jane does not sell her ABC Corporation shares, and instead, Jane transfers the 100 shares, which have a fair market value of $150, to XYZ Charity. The result? Jane pays **no capital gains tax** This means that the charity receives a larger donation ($150, instead of $115.45); and Jane has a larger charitable deduction on her federal income tax return ($150, instead of $115.45).

Donating appreciated stock, rather than liquidating securities and donating after-tax proceeds, to charity is a win-win: the charity receives a larger donation and the donor receives a larger charitable deduction.[8]

Establishing / Funding a Donor Advised Fund

A donor-advised fund ("DAF") is essentially an investment account dedicated solely to supporting charities.

When an individual contributes to a donor-advised fund at a public charity, the individual is generally permitted to take a charitable deduction in the year in which the contribution was made.

The contribution can then be invested, and the donor can make recommendations to the DAF as to which charities the donor wishes to benefit.

A donor can frontload his or her charitable donations and obtain a large charitable deduction in the year he or she transfers assets to the donor-advised fund. The charitable donation in the donor-advised fund can then be distributed out over time but enables the taxpayer to actually receive a tax benefit in the year of the contribution.

Donating Required Minimum Distributions to Charity

For those that are charitably inclined and are currently required to take RMDs, they may wish to consider transferring the RMD directly to a 501(c)(3) charitable organization. This may be tax-advantageous, because subject to certain limitations, the RMD will **not** be included in the donor's taxable income. When the RMD is transferred directly to a charitable organization, the donor cannot claim that RMD as a charitable deduction on her federal income tax return.

In summary, proper tax planning with a trusted advisor may provide strategic advantages that offer significant tax savings. Failure to do such estate and tax planning can result in costs that could have otherwise been avoided. If you would like to review your year-end plan or if you are just starting at the beginning of your planning process, the tax and estate planning team at Einhorn Barbarito is available to speak with you about your particular planning needs.

Endnotes:

[1] This article assumes that all parties involved in a transfer are United States citizens and does not address the gift, estate and income tax implications for non-residents and non-United States citizens.

[2] Assets passing to qualifying charitable organizations will not incur a federal estate tax.

[3] Married couples "splitting" gifts are required to file an Internal Revenue Service Form 709, even if no gift tax will be due.

[4] The limit on IRA contributions is scheduled to increase to $6,500 per person for 2023 (and for those over 50 years of age, $7,500).

[5] Roth IRA contributions are never deductible for federal income tax purposes.

[6] The taxpayer will be required to pay taxes on any assets in the traditional IRA that have not previously been taxed. However, if the taxpayer contributed after-tax funds to the traditional IRA, then those funds will not be taxed when rolled over into the Roth IRA.

[7] The contribution limit for 401(k)s is scheduled to increase to $22,500 for 2023.

[8] There are limits on the size of the charitable deduction one may take in a given year.