PALLAS
CAPITAL ADVISORS

It's Year End! Time to Plan Ahead

As we approach year-end, taxpayers should consider proactive measures to optimize their current tax situation and mitigate the risk of potential future tax increases. It is especially timely since, for taxpayers, time is running out to act before the end of 2023.

Check with your tax Advisor

Of course, with any of these strategies, it is important to consult with a qualified tax professional who can determine if they make sense for your situation.

Estimate 2023 Income:

Projecting income is fundamental to determine whether a range of tax-related strategies may or may not make sense. Doing this can provide clarity on several key areas, including:

- What is the (tax) cost of realizing additional income before the end of the year?
- What is the (tax) benefit of reducing income before the end of the year?
- Is it feasible to defer income into the next tax year?
- How much income can I potentially realize before creeping into the next tax bracket?

Tax withholding and estimated taxes:

The penalty on tax underpayments rose and is now 8%, so it's important to review your paycheck withholding or quarterly estimated taxes—especially if your income has been uneven or included a windfall like a bonus.

To avoid underpayment penalties, most filers must pay 90% of their taxes. The due date is Dec. 31, 2023, for W2 employees and Jan. 16, 2024 for those making quarterly payments. The IRS has posted a calculator to help individuals figure the right amounts.

Taxpayers can also bypass penalties by paying on time an amount equal to either 100% or 110% of their 2022 taxes. In most cases, the 100% threshold applies to filers with adjusted gross income of $150,000 or less, while the 110% threshold applies to those with more.

In cases where you think you have under-withheld thus far in the year, try to fill the gap by withholding either from your paycheck or your taxable IRA payout. These moves can reduce or even eliminate underpayment penalties, even if the catch-up payment is made late in the year.

Harvesting Tax Losses:

Investors should review portfolios for opportunities to strategically generate tax losses throughout the year, by selling certain securities to offset capital gains. For example, using a tax-swap strategy for certain holdings may allow a taxpayer to realize a tax loss while retaining equivalent market exposure. Just be sure to consider the IRS wash sale rule, which prevents investors from deducting losses.

A wash sale occurs when you sell or trade stock or securities at a loss and within 30 days before or after the sale you:

1. Buy substantially identical stock or securities,
2. Acquire substantially identical stock or securities in a fully taxable trade,
3. Acquire a contract or option to buy substantially identical stock or securities, or
4. Acquire substantially identical stock for your individual retirement arrangement (IRA) or Roth.

large Mutal-fund payouts:
Be aware of potential capital gains payouts from mutual funds. Investors holding mutual funds in taxable accounts should check whether their funds will make large capital-gains payouts for 2023. Once an investor has been made aware of an upcoming mutual fund distribution, they should consider ways to offset that taxable event. Strategies may include harvesting losses elsewhere to offset the gains or donating the holding to charity for a deduction.

Roth Strategies:
Consider using Roth conversion strategies to hedge against potential future tax hikes. For example, it's worth reviewing how much additional income can be realized within the current tax bracket before "creeping" to the next tax bracket as a basis for how much in traditional retirement funds to convert to a Roth.

A higher-income taxpayer may also consider a "backdoor" Roth IRA contribution by contributing to a non-deductible, traditional IRA, and then immediately converting those funds to a Roth IRA. This could allow the taxpayer to fund a Roth IRA even if their income level prohibits them from making a direct contribution to a Roth IRA.

Maximize Zero Percent Tax Bracket:
Taxpayers (e.g., young adult children) in lower income tax brackets may be able to avoid taxation on long-term capital gains and qualified dividends. In 2023, a single taxpayer with income between $0 and $44,625 has a zero percent federal long-term capital gains rate. For joint filers, the income range is even higher – between $0 and $89,250.

If income levels are low enough, a taxpayer could sell a security, realize a capital gain, and not owe any tax on that capital gain. (Keep in mind, that capital gains, when realized, will increase a taxpayer's adjusted gross income – potentially catapulting them into a taxable situation.)

Standard Deducation vs Itemized:
The standard deduction is $27,700 for married joint filers and $13,850 for single filers this year, and in 2024 that rises to $29,200 and $14,600 respectively. Filers age 65 and older each get between $1,500 and $1,850 more.

Some taxpayers will want to switch from standard to itemized to maximize overall deductions. If so, it can make sense to "bunch" deductions either by accelerating or delaying them into years when you'll itemize. More on that topic in the next strategy discussion.

Timing Certain Deductions:

Just like it may be possible to time certain amounts of income before the end of the year, taxpayers may also be able to time certain deductions.

For example, consider unreimbursed medical expenses, which can only be deducted from income once qualified expenses exceed 7.5% of adjusted gross income (AGI). Assuming AGI of $100,000, this means that no deduction is available until qualified, unreimbursed medical expenses exceed $7,500. A taxpayer who has already met this threshold for 2023 may be able to generate additional medical expenses before the end of the year.

Another possible timing choice – Instead of (or in addition to) making consistent charitable gifts each year, consider making a large gift in one year by funding a donor-advised fund if that allows you to itemize deductions on your tax return. In other years, claim the expanded standard deduction. Depending on the situation, this may result in tax savings.

Business Owners and Net Operating Losses (NOLs):

Business owners recording a net operating loss (NOL) this year may be able to use it to their advantage. Unlike net capital losses, where taxpayers are limited to using only $3,000 annually to offset ordinary income, NOLs can generally be applied against 80% of ordinary income. Some taxpayers carrying forward large NOLs can use those losses to offset the additional income from a Roth IRA conversion. As with most income tax areas, it is critical for an individual to consult with a qualified tax professional.

Electric-Vehicle Purchases:

Starting in 2024, EV buyers get up to $7,500 off the purchase right at the dealership, rather than wait months until filing their tax return to get the credit. If you buy an EV this year, you can't claim the credit until you file 2023 tax returns.

However, the list of eligible vehicles could shrink in 2024. Income limits of $150,000 for singles and $300,000 for couples filing jointly could also matter, so check the details if you're close to the limits, or certainly if you think your income will be considerably different in 2024.

Ensure compliance with required IRA distributions:

Owners of most retirement accounts (e.g., IRAs, SIMPLE IRAs, SEP IRAs, but <u>not</u> Roth IRAs) born in 1950 or earlier typically must take required minimum distributions (RMDs). The first RMD must be taken by April 1st of the year after you turn 73. Subsequent RMDs must be taken by 12/31 of each year.

Many heirs of traditional IRAs whose owners died in 2020 or later would normally have to take a required withdrawal this year. However, the IRS is allowing these heirs to skip it for 2023. While those IRAs must be distributed within 10 years of the owner's death, it's still not clear if the IRS will require RMDs beginning in 2024, and until the IRA is fully distributed.

NEWS YOU CAN USE

Key year-end tax planning strategies to consider:

In addition to the topics listed above, Putnam Wealth Management's Bill Cass, CFP®, CPWA® has provided a helpful year-end planning checklist that you can access here.

IRS announces 2024 increased retirement account contribution limits.

The IRS has announced new 2024 investor contribution limits for 401(k) plans, individual retirement accounts and other retirement accounts.

- The employee contribution limit for 401(k) plans is increasing to $23,000 in 2024, up from $22,500 in 2023, and catch-up contributions for savers age 50 and older will remain unchanged at $7,500. The new amounts also apply to 403(b) plans, most 457 plans, and Thrift Savings Plans.

- The agency also boosted contribution limits for IRAs, allowing investors to save $7,000 in 2024, up from $6,500 in 2023. Catch-up contributions will remain unchanged at $1,000.

- In 2024, more Americans may qualify for Roth IRA contributions, with the adjusted gross income phaseout range rising to between $146,000 and $161,000 for single individuals and heads of households, up from between $138,000 and $153,000 in 2023.

- The Roth IRA contribution phaseout for married couples filing together will rise to between $230,000 and $240,000 in 2024, up from between $218,000 and $228,000.

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Inflation Causes IRS to Raise Tax Brackets, Standard Deduction by 5.4%

On November 9, the IRS released its annual inflation adjustments to federal income-tax brackets for 2024. These adjustments, determined by formulas within the tax code, aim to prevent tax increases resulting from inflation. Notably, the standard deduction and tax bracket thresholds have increased by 5.4%, marking the second-largest adjustment in the past three decades, following last year's 7.1% increase.

The updated tax brackets for 2024 reveal a nearly $40,000 climb in the threshold for the top federal income-tax bracket for married couples, where the 37% income-tax rate applies to income surpassing $731,200. For individuals, the top tax bracket begins at $609,350.

However, not all tax rates undergo inflation adjustments. The 3.8% tax on investments, triggered at $200,000 for individuals and $250,000 for married couples, remains unaffected, potentially impacting more taxpayers due to inflation. The $10,000 cap for deducting state and local taxes (SALT) and the $3,000 limit on deductible capital losses are other items not indexed for inflation.

The standard deduction sees an increase to $14,600 for individuals in 2024, up from $13,850 in the current year. Married couples can claim $29,200, compared to $27,700 in 2023.

The income thresholds for capital gains tax rates are also adjusted for inflation. Taxpayers may consider selling appreciated stock to benefit from the 0% capital-gains tax rate. For 2024, this rate applies to single filers with taxable incomes up to $47,025 and joint-filing couples with incomes up to $94,050.

In terms of estate and gift taxes, the federal gift and estate tax exclusion amount increases to **$13.61 million for 2024**, up from $12.92 million in the current year. Individuals can make tax-free lifetime gifts, up to this amount, without incurring federal estate or gift tax, with tax obligations only arising if the amount surpasses the threshold.

Additionally, the annual exclusion limit on tax-free gifts rises to **$18,000 for 2024**, up from $17,000 this year, and does not contribute to the lifetime maximum, with no tax implications for the giver or receiver.

IRS Ends Unannounced Revenue Office Visits to Taxpayers

Earlier this year, the IRS announced a major policy change that will end unannounced visits to taxpayers by agency revenue officers to reduce public confusion and increase overall safety. The change reverses a decades-long practice by IRS Revenue Officers, the unarmed agency employees whose duties included visiting households and businesses to collect unpaid taxes.

"These visits created extra anxiety for taxpayers already wary of potential scam artists," IRS Commissioner Danny Werfel said. "At the same time, the uncertainty around what IRS employees faced when visiting these homes created stress for them as well. This is the right thing to do and the right time to end it."

And it's time to end this newsletter as well. Happy Thanksgiving!