Baker Avenue
Wealth Management

Your Tax Planning Checklist for Year End 2022 and the New Year 2023

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At BakerAvenue, we understand the importance of considering all the options when it comes time to prepare for a new year and a new tax season. That's why we've consolidated some of our tax expertise into this handy checklist guide to assist with your planning. Find valuable insights about:

Individual / Income Tax Planning

- [ ] Retirement Accounts
- [ ] Charitable Contributions
- [ ] Capital Gains
- [ ] Concentrated Stock
- [ ] Positions Medical Expenses
- [ ] Education
- [ ] Permanent life insurance

Estate & Gift Tax Planning

- [ ] Estate and Gift Tax Planning
- [ ] Estate and Gift Tax Planning – Trusts and Partnerships

Business Tax Planning

- [ ] Business Planning – Retirement
- [ ] Contributions Business Planning - Other

Retirement Accounts

Retirement accounts can represent a substantial portion of your savings—so it makes sense to understand actions you can take to help maximize your income when you are ready to retire.

Here are five approaches you might want to consider that may optimize retirement savings:

1. Mega Backdoor Roth Contributions Using Your Company 401(k)
Assuming that full tax-deductible contributions have been maximized, consider making post-tax contributions to your 401(k) account and immediately converting those post-tax contributions to a Roth IRA account where they will grow tax-free forever and won't be subject to RMDs. The maximum contribution to a 401(k) for 2022 is \$61,000 and \$67,500 if over 50 years old. For 2023, the maximums are \$66,000 and \$73,500 if over 50. These maximums take into consideration all pre-tax (deductible) employee contributions, employer match and employee post-tax (non-deductible) contributions to the plan. View Here's a Mega Strategy to Turbo-Charge Your Retirement Savings for more details.

2. Fund Roth IRA Accounts
Roth IRAs can grow tax-free indefinitely and can be accessed free of tax in retirement. Contributions can be made up to \$6,000 for 2022 and \$6,500 for 2023 from earned income (with a \$1,000 catch up contribution if over 50 years old). Roth contributions are subject to income limits (\$129,000 if filing single for 2022 and \$138,000 for 2023; for MFJ, the thresholds are \$204,000 for 2022 and \$218,000 for 2023).

3. Convert Traditional IRA Accounts to Roth IRAs
Convert Traditional IRAs to Roth IRAs accounts where they can grow tax-free indefinitely as no Required Minimum Distributions (RMDs) are required for Roth accounts. Roth conversions work best in years with lower total income. Unlimited amounts can be converted to Roth under this strategy however the conversion is considered a taxable event.

4. "Backdoor" Roth IRA Conversion
Consider a backdoor Roth Conversion where income exceeds the Roth contribution limits. Make contributions to a Traditional IRA on a post-tax (non-deductible) basis, then convert that Traditional IRA to a Roth IRA without tax consequences.

5. Separate pre-tax and post-tax IRAs accounts
Roth conversion strategies may be less effective where there are both pre-tax and post-tax funds within the same IRA account or across different accounts. Contribute the pre-tax portion of IRA account(s) to an "active participant" employer plan, such as a 401(k), and then convert the clean post-tax remainder(s) to a Roth IRA. Both transactions can be achieved on a tax-free basis.

Here are a few additional considerations to help with your 2022/2023 retirement account tax planning:

- [ ] **Traditional IRA contributions are fully deductible regardless of income level**
However, where the taxpayer or the taxpayer's spouse are covered by a qualified plan with an employer, the deductibility of the contribution may be limited or lost entirely. The deduction for the contribution starts to be limited at modest income levels ($68,000 for 2022 if single, $109,000 if MFJ; $73,000 for 2023 if single, $116,000 if MFJ). In such situations consider the "Backdoor" Roth conversion strategy in 4 above.

- [ ] **Married taxpayers each can contribute to their own IRA**
For those filing joint returns, there is no earned income requirement for IRA contributions made by a non-working spouse if the earned income of the couple exceeds the combined IRA contribution amount.

- [ ] **From 2020 onwards, the age limit on IRA contributions is removed**

Charitable Contributions

Charitable contributions are important to many of us as a way to support causes that we care about as well as create a living legacy. Tax benefits can provide an extra incentive for us to do so—you'll want to be sure to take advantage of these to realize maximum benefit. Here are four approaches to consider.

1. Contribute Highly Appreciated Assets (Stocks)
Contribute to charity to avoid paying capital gains and receive tax deductions. Such contributions also remove assets from the taxable estate.

Tax deduction equal to Market Value even if there is very low, or no, tax basis. The tax deduction may be limited to 30% of AGI, however, any unused deduction in the year may be carried forward for 5 years.

2. Deduct up to 60% of Adjusted Gross Income (AGI)
For 2022 and 2023, 60% of adjusted gross income (AGI) can be deducted if paid in cash to a public charity.

3. Make smaller donations tax effective

Due to the large Standard Deduction of up to $28,700 if both spouses are over 65, MFJ 2022 and $30,700 for 2023, charitable donations claimed as itemized deductions are often not tax effective.

In these circumstances, it is more beneficial to make a Qualifying Charitable Distribution (QCD) from your IRA yearly to a public charity, if you are over 70.5 years old. Such QCDs count towards meeting your Required Minimum Distributions for the year and transfer highly taxed ordinary income to the charity without creating taxable income for you.

4. Consider using Charitable Trusts to sell highly appreciated assets

Achieve capital gains tax deferral when selling appreciated assets; create a long-term income flow for yourself and your heirs; favor selected charities and take advantage of an up-front income tax deduction that you can use over 6 years.

Income Tax Planning - Capital Gains Tax

Capital gains tax can end up impacting your investment portfolio income in big ways. Here are some strategies to consider in order to minimize this impact, maximum your investment returns and share your wealth with heirs and your favorite charities.

- [ ] **Harvest unrealized capital losses**
  Stock sitting at an unrealized loss can be sold, creating a tax loss and be used to off-set realized taxable gains. Such strategies need to consider the Wash Sale rules.

- [ ] **Defer tax on capital gains by investing proceeds into a Qualifying Opportunity Zone Fund**
  Capital gains from any investment can be deferred until April of 2027 if reinvested into a Qualifying Opportunity Fund. Furthermore, gains within the Fund can be 100% eliminated if held for 10 years. Capital gains must be reinvested within 180 days of the date realized.

- [ ] **Establish installment sale agreements**
  Push tax liability further into the future by “stretching” the receipt of proceeds into the future – particularly appropriate for an existing business.

- [ ] **Rollover real estate**
  Gains from rental real estate may be fully deferred by investing the proceeds into a new rental using a Section 1031 Rollover or a 1031 Fund.

- [ ] **Section 83(b) election with pre-IPO options grants**
  Available 30 days from the option grant date, this election taxes the option compensation element at ordinary income tax rates but can allow a higher percentage of the stock appreciation to be taxed at favorable long-term capital gains tax rates.

Concentrated Stock Position

Owning a large portion of one company's stock can put investors in a riskier position over the long term. Here are some tactics to consider with a concentrated stock position.

- [ ] **Use Long-Term Capital Gains preferential rate**
15% capital gains tax bracket up to $517,200 total income for MFJ in 2022 and $553,850 for 2023, 20% where taxable income is above those thresholds.

- [ ] **Manage positions and stock exercises strategically**
With incentive stock options (ISOs), actively manage Alternative Minimum Tax (AMT) generation on stock exercises and plan to re-coup AMT credits as soon as possible.

- [ ] **Out-right gifts to charity of appreciated stock**
Receive an upfront tax deduction equal to Market Value of the stock. Subject to 30% AGI limitation, with 5-year carry-forward of any unused deduction.

- [ ] **Contribute appreciated stock to a Donor Advised Fund**
Receive an upfront tax deduction equal to Market Value of the stock. Subject to 30% AGI limitation, with 5-year carry-forward of any unused deduction.

- [ ] **Transfer appreciated stock to a Charitable Remainder Trust**
Realize gains within the Trust on a tax-free basis. The gross value of transferred assets can be sold and re-invested in a diversified portfolio without up-front capital gains. The diversified portfolio creates an annuity stream for up to 20 years, or for the life of the donor. Remainder interest goes to charity at end of Trust term and attracts a partial up-front income tax deduction. AGI limits apply to the tax deduction, any unused deduction can be carried forward 5 years.

Medical Expenses

With rising costs of health care, higher premiums and deductibles, it's good to understand ways to reduce the financial impact through these deductions and tax beneficial accounts.

1. **Deduct all possible medical costs and use a Health Savings Account**
Most medical costs often fail to be deducted because of the 7.5% AGI hurdle that applies under Schedule A – Itemized Deductions. Consider a Health Savings Account (HSA), contributions to which are tax deductible, above the line, as an adjustment to income. Can only be used in conjunction with a High Deductible Health Plan.

2. **Medical expenses of a Dependent may be deducted on Schedule A, including medical and LTC expenses of parents, if they are not capable of self-care**

3. **Deduct Long-Term Care (LTC) Insurance**
The LTC premium deduction is up to $5,640 in 2022 if over 70 years old. For 2023, the maximum deduction is $5,960 if over 70. Amounts received under the contract (other than dividends) are excluded in most cases from taxable income when used to fund care (Note: employer paid contracts are taxable). Payments received do not count towards income for Medicare premium purposes.

4. Use Achieving a Better Life Experience (ABLE or Disability) accounts

With a $15,000 annual contribution limit and $12,490 from the beneficiary, these accounts grow tax free. Up to $100,000 value in the account won't be considered for Supplement Security Income or Medicaid. Distributions are tax-free if used for a qualifying purpose, which is interpreted widely.

Education

Education costs typically represent a major expenditure. And with the cost of education continually increasing, understanding ways to utilize available tax benefited accounts and tax credits is important.

Use 529 accounts

With no income restrictions, these accounts allow tax deferred growth with no tax on distributions when used for qualifying purposes including tuition, fees, books, supplies and equipment as well as room and board. They can also be used to pay private school tuition K1 through 12th grade, up to $10,000 per year for the beneficiary, and most student loan debt up to $10,000 lifetime. New York and Connecticut provide state tax deductions of up to $10,000 (MFJ) per year on 529 contributions. There is no deduction in California.

Use American Opportunity Credit (AOC) and Lifetime Learning Credit (LLC) tax credits

Creditable expenses include tuition, books and enrollment fees. Credit available up to $2,500 per student for AOC and $2,000 per return for LLC. The income limit is $160,000 MFJ and $80,000 single.

Deduct student loan interest

Student loan interest is deductible up to a maximum of $2,500 per annum for 2022 and 2023. Income limits apply – for 2022, no deduction may be taken where AGI exceeds $175,000 (MFJ) and $85,000 (Single). For 2023 the limits are $185,000 (MFJ) and $90,000 (Single).

Permanent Life Insurance

You can borrow against your life insurance without any tax consequences during your lifetime. This won't result in an increase in Medicare premiums as borrowing is not taxable. Returns within the policy grow tax-free. Life insurance proceeds are paid free of income tax and are estate tax-free if received by a person other than the decedent's estate.

Estate and Gift Tax Planning

The current estate and gift tax exemption amounts are currently $12.06M per person in 2022 and $12.92M in 2023. However, these amounts are due to be reduced to approximately $6M per person with effect from 1/1/2026.

Strategies that can help to minimize the estate and gift tax include:

- [ ] **Fully utilize the historically high Lifetime Unified Gift/Estate Tax exemption**

- [ ] **Use the Annual Gift Tax Exclusion amount**
  $16,000 per individual recipient of a gift in 2022 and $17,000 in 2023.

- [ ] **Charitable gifts of cash**
  For 2022 and 2023, gifts of cash to public charities would be deductible up to 60% of AGI. The AGI limitation for cash gifts to a Donor Advised Fund remains 60%. All gifts to charity remove the asset permanently from the donor's estate without estate or gift tax consequences.

- [ ] **Charitable gifts of appreciated property**
  Deductible at Market Value for stocks and real estate, subject to 30% AGI limitation.

- [ ] **Direct gifts of tuition and medical expenses**
  Are not taxable gifts – no limit.

- [ ] **Inter-generational loans**
  These can be made free of gift tax. Interest can be funded using annual gift tax exclusion of $16,000 in 2022 and $17,000 in 2023.

Trust and Partnerships

- [ ] **Qualified Personal Residence Trust**
  Compresses the Gift Tax transfer valuation due to carve-out of the right to reside in the property. The donor must survive the trust term to be effective. Gift tax efficient.

- [ ] **Grantor Retained Annuity Trust**
  For those who want asset growth to pass to next generation free of gift/estate tax. Donor transfers assets likely to appreciate to a GRAT but retains an annuity from the assets. The appreciation of the assets while in the Trust goes to donor's heirs after the Trust term free of Gift/Estate Tax. Gift tax efficient.

- [ ] **Charitable Remainder Trust (Split Interest)**
  Effective vehicles for recognizing gains on appreciated assets tax efficiently. Defers capital gains tax over Trust term, creates an annuity for the donor from Trust assets and allows an up-front tax deduction for the remainder interest going to charity.

- [ ] **Charitable Lead Trust (Split Interest)**
  Charity receives an annuity from Trust during the Trust term. The growth in the trust assets during the life of the Trust can pass to heirs/beneficiaries free of gift tax.

- [ ] **Family Limited Partnership (FLP)**
  For those who wish to transfer business assets to the next generation, FLPs allow a discounted transfer value for Gift tax purposes while still retaining substantial operating control for the donor.

- [ ] **Irrevocable Life Insurance Trust**
  Life insurance proceeds add to the insured's estate (and estate tax) if owned directly by the decedent. Life insurance contracts should rather be held by a Life Insurance Trust with the insured's family as beneficiary.

Business Planning

Businesses large and small have unique considerations when it comes to retirement planning and tax planning.

Retirement Contributions

Solo 401(k) plan
Allows for a tax-deductible pension contribution for business owners of up to $67,500 for those over 50 and $61,000 for those under. Applies to 1099s, S-Corps, LLCs, Schedule C businesses. No employees.

SEP (Simplified Employee Pension Plan) IRA
Up to $67,500 (over 50), $61,000 (if under) may be contributed. Only the employer contributes up to the lesser of 25% of each eligible employee compensation and $61,000. Must include all eligible employees.

Defined Benefit/Cash Balance Plan
100% of taxable income may be contributed up to $230,000 per year. Must cover all eligible employees working >1 year. The owner usually captures approximately 80% of contribution benefits. Profit-share requirements can be modest. Defined Benefit plans are complex trust-based vehicles, annual costs ($5K), and require actuarial valuations.

- [ ] **Depreciation - Plant and equipment expenditures**
The 2017 TCJA significantly expanded tax write-offs for qualifying expenditures on plant and equipment through first year Special Depreciation (Section 179) and Bonus Depreciation (Section 168).

- [ ] **Net Operating Losses (NOLs)**
The CARES Act of 2020 introduced a five-year carry-back for Net Operating Losses (NOLs) generated in years 2018 through 2020. This NOL carry-back ability, combined with the removal of the Excess Business Loss provisions for tax years beginning before 2021, presents planning opportunities for those with NOLs or who may be able to generate losses due to depreciation write-offs.

Qualifying Business Income (QBI) deduction
Pension contributions and charitable donations are not only tax deductible in themselves but can bring in a secondary benefit by lowering taxable income for business owners who are above the Qualified Business Income (QBI) deduction thresholds. When business income is lowered through pension and charitable contributions, the QBI 20% deduction may get turned on – effectively one tax deduction can lead to a secondary deduction. This addi-tional benefit is particularly in point where the business is a Specified Service such as in health and legal practices.

The new year brings new opportunities for implementing tax strategies. This checklist can give you a starting point for what to consider. We at BakerAvenue can help you navigate through the complexities of tax planning and are committed to helping you through life’s transitions. Contact us to start the conversation.

Helping You Embrace Life's Transitions.

Since 2004, BakerAvenue has guided clients through personal and professional life transitions. Our firm provides comprehensive wealth management and investment expertise for high-net-worth individuals, families, trusts, foundations and endowments. Driven by our purpose, we strive to make a positive impact on society alongside financial return. We're headquartered in San Francisco with offices in New York, Dallas, Seattle, San Diego, and Sun Valley.

For more information, please contact us or visit us at bakerave.com.

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