EQUITABLE

Time is running out on year-end strategies

Year-end 2023 is expected to be another busy one when it comes to retirement, financial, estate and income tax planning strategies. For some, it is a simple, easy, ongoing annual process. For others, it is more involved than ever, given the number of complex strategies that can be selected and how they impact changing financial situations from one year to the next.

Managing wealth in an effective and efficient manner usually requires strategies to be completed and finalized in advance of year end. There are many strategies to consider this year before time runs out. A few of these opportunities must be executed in 2023 or will be lost forever.

Here are some of the more noteworthy year-end strategies

1 Required minimum distributions (RMDs)

Many IRA owners have highly important RMDs due in 2022 that must be taken by December 31, 2022. If these distributions are not taken by this deadline, IRA owners may face an IRS tax penalty on the amount that is due, but not taken out.

Lifetime IRA RMDs

For IRA owners born before July 1, 1949, lifetime RMDs are based on age 70½. For IRA owners born after June 30, 1949 and before 1951, lifetime RMDs are based on age 72. For IRA owners born in 1951 through 1959, RMDs are based on age 73. The first RMD may be taken in the year they attain RMD age, or no later than April 1 following the year they attain RMD age. If the latter, then two RMDs must be taken in the year following RMD age (the first one by April 1 and the second by December 31). Subsequent RMDs would be due by December 31 each year thereafter.

Inherited IRA RMDs

For inherited IRA beneficiaries who were eligible and elected to stretch their RA benefit over their life expectancy, annual distributions are required in the year following the passing of the IRA owner and are due by December 31, 2023.

New life expectancy tables were effective in 2022 and will apply going forward. The new tables will result in smaller RMDs and greater amounts retained in the retirement plan. Decreasing RMDs will create an opportunity to reduce current income taxation. More amounts remaining in the retirement plans will result in larger account balances to capture investment opportunities, along with an increase in tax-deferred growth. Individuals subject to RMDs will have the continued flexibility to take more than the RMD if needed, subject to contract provisions.

2 Qualified charitable distribution (QCD)

IRA owners, including inherited IRA beneficiaries, who have attained 70½, can directly donate up to $100,000 annually and avoid income taxation on what would otherwise be a taxable distribution. The distribution needs to go directly to the charity to be eligible for a QCD, and the IRA owner must be age 70½ or older. Although an RMD may not be currently required due to the RMD age changes, a QCD from an IRA can be completed if the IRA owner has attained age 70½. The QCD deadline date is usually December 31. It is a good idea to allow extra time to process this year-end distribution.

3 Roth conversions

Currently there are no income or age restrictions on Roth conversions. Congress may enact legislation increasing federal income tax rates in the near future, making a good argument to convert in 2023 at lower tax rates. For high-income earners, it is entirely possible legislation could be enacted that would discontinue Roth IRA conversions altogether, depending on income. Given the many attractive benefits to a Roth IRA, a Roth IRA conversion may be a valuable income tax strategy to execute in 2023. This strategy is not always attractive every year. It tends to be most attractive in the year when the individual is in a lower tax rate. If a Roth IRA conversion is desired for 2023, the deadline for executing a conversion is December 31, 2023. A distribution (or actual contract conversion) from the IRA would have to be completed by December 31, 2023. If the conversion is done as a rollover, the 60-day rule applies. Also note, December 31, 2023, is the deadline date for a conversion for the 5-year countdown applicable to qualifying distributions to begin on January 1, 2023.

4 Charitable gifting

Contributions are due by December 31, 2023, for the 2023 tax year. Consider donating an appreciated asset, such as stock, that would otherwise be subject to capital gains tax had you sold it. By donating stock that has appreciated for more than a year, often a higher amount can be gifted than if the stock is sold and cash is gifted. Capital gains tax can be avoided when appreciated assets are gifted. The full fair market value of the asset donated can be tax-deductible, up to the amount allowed by the IRS.

5 Annual $17,000 gift exclusion

Seventeen thousand dollars can be given without having to file a gift tax return. If married, the spouse can also give $17,000 to the same person. For example, a married couple with two children can give up to $68,000 in 2023. These amounts do not count against the current $12,920,000 lifetime gift tax exemption. In order for the annual exclusion gifts to count for 2023, the gift must be made by December 31, 2023. Unused exclusions cannot be carried over to 2024. The annual $17,000 annual exclusion gift is a use it or lose it strategy.

6 Realize tax losses to offset capital gains

Capital gains may have been realized in 2023 by selling appreciated stock or other investments subject to capital gain treatment earlier in the year. Capital gains can also be realized when mutual funds pass through capital gains to shareholders. If there are no losses to offset the capital gains already realized in 2023, capital gains tax could be incurred. Selling losing investments by December 31, 2023 may be an effective strategy to reduce capital gains and the related capital gains tax.

7 Maximize 401(k) or other elective deferral contributions

Participants in 401(k) plans, including elective deferral plans such as 403(b) plans and Simple IRAs, have limited time remaining in the year to make the maximum contribution to minimize current income tax, if they have not already done so. It is important to note the election deadline to have the deferrals count for 2023 is plan-specific. Many participants contribute to 401(k) plans through payroll withholding, so it may take a pay period or two to process changes. Either way, time is running out to have 2023 deferral contributions deducted from paychecks to apply to these plans for the 2023 year. Participants who are self-employed may have longer to make 401(k) contributions based on their net earnings. The maximum 2023 401(k) deferral is $22,500, plus a $7,500 catch-up contribution for individuals 50 and over.

8 Recontribution of coronavirus-related distribution (CRD)

Certain qualified individuals who withdrew money from their retirement plan as a CRD in 2020 may want to recontribute these monies as a rollover contribution to help minimize the income tax they would otherwise incur. These amounts can be rolled over at any time in the 3-year period beginning on the day after the CRD was received. Recontribution of all or a portion of the CRD would reduce their taxable income.

9 Deferring income and acceleration deductions

A traditional income tax strategy for businesses exercised in the past has been to accelerate expenses to the current year and postpone income to the following year. Bunching expenses into 2023 to maximize deductions may be viable depending on future income tax rates. If rates increase, it may be preferable to accelerate income and be taxed at a lower rate, deferring expenses to be used in the future when income tax rates could potentially be higher, in order to reduce taxable income.

Completing timely year-end gifts, contributions and RMD distributions by December 31, 2023, is critically important if the strategy is to be properly counted for in the current year. Financial institutions may have certain procedures and time frames to process transactions for various strategies. Starting the strategy well in advance of the December 31, 2023, deadline will usually be necessary. If not executed and processed timely, the benefits of the strategy may fall into the following year, or even be lost forever, causing unnecessary taxation.

Current or future federal legislation may have an impact, or even eliminate, one or more of the above-mentioned strategies. You should consult with your income tax advisor on these strategies.

EQUITABLE