Year-End Planning Tips

A few adjustments could make a difference in your tax rate.

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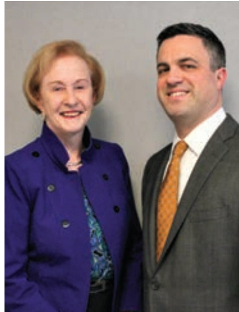

While December often lends itself to thoughts of family and the holidays, it's important to consider practical matters as well. It may not be the most warm and fuzzy topic, but we recommend you look at your tax situation now before you get too caught up in the holidays. Better now than next year at tax time when it is too late to make changes or implement new strategies.

UNDERSTANDING THE DIFFERENCE BETWEEN MARGINAL AND EFFECTIVE TAX RATES

At right you can see the tax brackets for 2023. If you're married filing a joint return, and you estimate your taxable income after all deductions is $100,000, your federal income tax will be $12,615 (**$10,294 + 22% of $10,550 = $12,615**). Every additional dollar of taxable income will be taxed at 22%, until you reach $190,751. Thus 22% is your marginal tax rate.

This differs from your effective tax rate, which is the average tax rate paid on your total taxable income. In the example at right, total tax of $12,615 divided by $100,000 of taxable income gives us an effective tax rate of 12.6%.

LONG-TERM AND SHORT-TERM CAPITAL GAINS TAX RATES

Long-term capital gains on securities (those held for more than one year) are currently taxed at a lower rate of between 0% and 20%. (*See chart on next page.*)

Tax payers who make less than $44,625 (single) or $89,250 (married filing joint) will not be taxed on their long-term gains. Filers with income above those thresholds, but below $492,300 (single) or $553,850 (married filing joint) will pay 15% on long-term capital gains.

MEDICARE SURTAX

In addition, there is a separate Medicare surtax of 3.8% on net investment income (income received from investment assets) applied using a third set of income thresholds. Single taxpayers who make above $200,000 and married couples who make more than $250,000 will be subject to this 3.8% surtax on net investment income, in addition to the capital gains tax noted. If you are close to this threshold it pays to do what you can to avoid the surtax.

Single Taxpayers

Single	Pay	Plus	Of the amount over
Up to $11,000	$ 0	10%	$ 0
$11,001–44,725	1,100	12	11,000
$44,726–95,375	5,147	22	44,725
$95,376–182,100	16,290	24	95,375
$182,101–231,250	37,104	32	182,100
$231,251–578,125	52,832	35	231,250
$578,126+	174,238.25	37	578,125

Married Taxpayers, Filing Joint

Married Filing Joint	Pay	Plus	Of the amount over
Up to $22,000	$ 0	10%	$ 0
$22,001–89,450	2,200	12	22,000
$89,451–190,750	10,294	22	89,450
$190,751–364,200	32,580	24	190,750
$364,201–462,500	74,208	32	364,200
$462,501–693,750	105,664	35	462,500
$693,751+	186,601.50	37	693,750

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CAPITAL GAINS TAXES

Note that the capital gains rates in the chart at right apply to long-term gains, which are gains on sales of assets held for longer than one year. Gains from the sale of short-term holdings will be taxed as ordinary income — at a federal rate as high as 37% depending on your other sources of income.

If you have losses on investment sales, these are first used to offset your capital gains. If your total capital losses exceed your total capital gains, you can deduct up to $3,000 of the excess loss each year against ordinary income. The unused capital losses above that amount can be carried forward indefinitely to be used in future years.

While markets have rebounded in 2023, you may have investments that are currently showing a loss. If so, you should consider selling the shares to realize the loss and reduce your taxes.

If you believe the holding is still a good long-term investment, there are a couple of strategies you can use to capture the loss and ultimately remain invested.

First, you can sell the stock for a loss and repurchase it in 31 days (the Internal Revenue Service requires you to wait 30 days to do so to avoid erasing the tax loss, the so-called "wash rule").

However, you may be concerned about the stock moving up during the 30-day waiting period. One way to mitigate this risk is to double up on your position, wait 30 days and then sell the top-costing shares assuming they're still at a loss. You need to make the purchase before the end of November, in order to wait the 31 days and still take the loss in the 2023 tax year.

Another approach is to invest the proceeds from the sale into a similar (though not "substantially equivalent") security within the same asset class as the one you sold. After 31 days you then sell the placeholder investment and repurchase your original holding.

The Capital Gains Tax

Single	Married filing joint	Cap. gains tax rate
Up to $44,625	Up to $89,250	0%
$44,626 – 492,300	$89,251 – 553,850	15
Over $492,300	Over $553,850	20

CHARITABLE CONTRIBUTION DEDUCTIONS

Whether you contribute cash, stock or other assets, it's important to adhere to the year-end deadlines for 2023 charitable contributions. First, in order to get tax benefits for charitable contributions you generally must itemize deductions.

If you donate cash to a charitable organization, you can deduct your donation in 2023 as long as you mail your check by Dec. 31. This is true even if the organization doesn't cash your check until 2024. If you charge your donation to your credit card, your donation is treated as occurring on the date the charge occurs.

If you donate stock or other securities by mailing certificates, the date of mailing is the date of the donation. If you have the shares donated electronically, the date your brokerage statement shows it leaving the account is the date of the gift. The value of your donation equals the average of the highest and lowest selling prices on that date.

Donations of clothing, household items and other goods can be deducted based on the fair market value of the goods. We recommend you make an itemized list and take pictures of your donated items in case your tax return is audited. We also suggest you "low ball" your estimates to be on the safe side.

For 2023, the deduction for charitable cash contributions is limited to 60% of your adjusted gross income (AGI). For non-cash contributions, the deduction is limited to 30% of AGI. Contribution amounts over those limits can be carried forward for up to five years. Note that this is a return to pre-2020 rules, after these limits were temporarily removed to encourage giving during the height of the pandemic.

CONSIDER A QUALIFIED CHARITABLE DISTRIBUTION

If you're over age 70.5, you have the ability to contribute directly to a charity using a distribution from your individual retirement account (IRA), better known as a qualified charitable deduction (QCD). For those over age 73, this distribution counts towards satisfying your required minimum distribution (RMD), but it does not count as taxable income. This is particularly powerful for those who don't itemize deductions on their returns and otherwise wouldn't be able to claim a deduction for their charitable gifts.

CONTRIBUTE THE MAXIMUM YOU CAN TO A QUALIFIED RETIREMENT PLAN OR IRA

In 2023, you can contribute the lower of $22,500 or whatever you earned to your 401(k) or 403(b) plan. If you're age 50 or older, you can add another $7,500 to that number. If these are not contributions to your Roth 401(k), any dollar you set aside will lower your taxable income. These contributions must be made in the form of payroll deductions before year-end.

If your AGI is below $116,000 as a married person filing jointly or $73,000 as a single filer, you also can make a tax-deductible contribution of $6,500 (or $7,500 if you are age 50 or older) to an IRA, even if you are covered by a 401(k) plan at work.

In addition, if one spouse does not work, that person is still eligible to contribute to an IRA. For those married filing jointly, this spousal IRA contribution is fully deductible until your AGI reaches $218,000.

Contributions to an IRA for 2023 can be made any time before the normal filing deadline of April 15, 2024, or when you file your 2024 tax return on extension, whichever date comes first. This is one area where you have time after year-end to decide.

DEADLINES ARE DIFFERENT FOR THOSE WITH SELF-EMPLOYMENT INCOME

While IRA contributions must be made by April 15, that is not true for those with SEP IRAs, SIMPLE IRAs or solo 401(k) plans. The deadline for those plans is the date that you file your taxes. Thus if you file for an extension, you have until Oct. 15 to make your contribution.

TAKE ADVANTAGE OF IRS DELAYS

In 2019 with the Secure Act, and again in late 2022 with Secure Act 2.0, Congress made extensive changes to the tax system. However, because of the complexity of the changes, the Internal Revenue Service has delayed several provisions.

The original Secure Act changed the way inherited IRAs are treated. Under new rules, starting in 2020 if you inherited an IRA from someone who is not your spouse, you are required to distribute the entire account within 10 years of the IRA owner's date of death (subject to some exclusions).

What was not originally clear was whether this could be done all at once at the end of the 10th year, or if distributions had to be taken regularly during the period. The IRS has since clarified that regular age-based required minimum distributions (RMDs) must be taken each year and the IRA account must be empty by year 10. However, the IRS has delayed issuing the final rules, and as a result, has waived any penalties for those not taking an RMD from an inherited IRA in 2023. Therefore you should consider skipping the distribution year and avoid taking on additional taxable income, given there is no penalty.

On the 401(k) front, a pending change to catch-up contributions has been delayed. Under the Secure Act, taxpayers making more than $145,000 will be required to make any catch-up contributions to their 401(k) plans as Roth contributions, which means a tax will be due on those contributions. However, the IRS recently delayed the start of this provision to 2025, so you have two years to take advantage of additional tax savings on these catch-up contributions.

Lastly, if you live in an area affected by natural disaster, the IRS (and your state) often extend the deadlines to file returns or make payments. There are currently extensions in effect for parts of Hawaii due to the wildfires and parts of several Southern states affected by Hurricane Idalia.

CONSULTING YOUR TAX ADVISER

This time of year is an excellent time for you to check in with your accountant about your situation (the earlier the better!). Your accountant can advise you as to whether you should be making estimated federal or state tax payments by year-end or in January based on the information you provide. By taking some action now, you should be able to reduce your tax bill somewhat. Good luck!

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