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Capital Management, LLC

End of Year Tax Planning

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There is still time to take control of your 2022 tax bill.

It's that time of year again. The 4th quarter holds a special place in my heart. It's filled with holiday cheer, pumpkin spiced everything, bright lights and décor on every corner, and special moments with family. The fourth quarter also carries a December 31st deadline to take advantage of tax strategies to reduce your 2022 tax bill. For those of you who do not know me, I'm admittedly a tax geek and leverage my past experience preparing tax returns to help clients understand and take actions to maximize their tax situation. Although tax planning should be done throughout the year, the fourth quarter is when taxes should be front of mind to proactively take advantage of strategies that expire after December 31st. As opposed to CPAs who generally collect data that has already occurred during the prior year, as Certified Financial Planners™ we focus on forward-looking planning throughout the year to maximize tax efficiency in clients' lives.

Here are just a few tax planning strategies to consider, and landmines to avoid, that may make paying taxes a little less painful:

Gifting to Charities

Gifting cash is the least tax efficient way of giving to the causes you care about. There are a couple ways to give from your brokerage accounts that either provide you with a tax deduction or an avoidance of ordinary income.

- Qualified Charitable Distribution ("QCD") – Even though the Required Minimum Distribution age on IRA accounts changed from 70.5 to 72, the QCD rules remained the same. That means that if you're at least 70.5 years old, you are able to give cash directly from an IRA to a 501(c)(3) charity without it being counted towards your taxable income. Keep in mind that there is a $100,000 limit per year (as of 2022) on QCDs.
- Donor Advised Fund ("DAF") – A DAF is a charitable account that is best funded with low basis stock. Since the assets deposited into the account are required to ultimately be directed to a charity, the donor is eligible for a charitable deduction for income tax purposes in the year of contribution. In

addition, the donor avoids paying capital gains on the sale of stock and can donate to charities of their choice at any time in the future. There are AGI limitations, however, so please consult your Wealth Counselor to determine the appropriate funding amount.

If a DAF is the right solution for you, consider frontloading the account with a few year's worth of charitable gifts, especially if you are in a high tax bracket and/or under the itemized deduction amount. You only receive the full benefit of a DAF contribution above the standard deduction amount ($12,950 for single or married filing separately, and $25,900 for married filing joint).

Tax Loss Harvesting

2022 is a very different year in the market compared to 2021. Take the opportunity before year-end to review your taxable accounts for realized gains and identify tax lots of stocks to potentially sell at losses to minimize your tax bill. The highest long-term capital gain bracket is 23.8% at the Federal level (including the 3.8% Net Investment Income Tax) and 13.3% at the state level if you reside in California. If you're in the highest tax brackets, save yourself 37.1% on capital gains tax in 2022 and spend the savings on a much-needed vacation. Be careful of wash sale rules if you plan on repurchasing the stock sold at a loss within a short time period though. The IRS will disallow the loss if the same investment or a "substantially identical" investment is purchased within 30 days of the sale.

Fun fact: Although the IRS has defined cryptocurrency as a capital asset and subject to capital gains tax, it has somehow avoided the IRS wash sale rules, so if you bought crypto and are likely now underwater, you are able to sell and immediately buy back to realize a capital loss.

Estimated Tax Payments

You should be cautious when paying estimated taxes. Most CPAs autogenerate estimated tax vouchers based on prior year data, which means that 2021 realized gains are assumed to be the same in 2022. The next estimated payment due date for Q4 of 2022 is January 17th, 2023. You still have time to review and make adjustments if necessary. Although it can feel good to receive a refund, it essentially means that you loaned the IRS and/or the CA Franchise Tax Board an interest-free loan.

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Roth Conversions

Instead of reducing taxes, it can be beneficial for you to intentionally create ordinary income via a Roth conversion. You are allowed to convert tax-deferred traditional IRA money into a tax-free Roth account while avoiding the 10% early distribution penalty. Although a penalty does not apply, the amount you convert is considered ordinary income. This is a great strategy if you have a low income year and expect income to rise in the future. Take advantage of this strategy if you're able to fill up lower marginal brackets with ordinary income.

Paying almost no taxes might sound smart, but in most cases it's a sign of poor planning.

W2 Withholding

Remember filling out a W-4 form when you first joined your company? Have you updated the exemptions or excess withholding amounts as your life has changed? Review and potentially update your W-2 withholdings when you have major life events such as getting married or divorced, adding dependents such as children or parents, buying a home with a mortgage, etc. If you have a "set it and forget it" approach, you will most likely over or under pay taxes at some point in the future.

Also, consider household income if you are married with dual incomes. You will most likely need to withhold excess tax above the Married Filing Joint with 0 exemptions if you are both highly compensated employees.

Equity Compensation

Planning becomes more complex if you receive Restricted Stock Units (RSUs), exercise Incentive Stock Options (ISOs), sell Employee Stock Purchase Plan shares (ESPP), etc.

RSUs are the most straightforward type of equity compensation, however the variable income makes forward-looking planning difficult. In addition, most companies sell shares as they vest and send proceeds directly to the IRS and your state of residence via payroll. The issue is that most companies do not pay tax based on your W-4 rate. Instead, companies generally only withhold 22% federal tax and 10.3% California tax. If you're in the highest tax brackets (37% federal and 13.3% California), you could be significantly under withholding.

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ISOs are more complex. As long as the transaction is considered a qualified disposition, you are not taxed at ordinary income rates when you exercise ISOs. However, you could need to pay Alternative Minimum Tax which can be significant and may come as a surprise if you are not prepared. I strongly encourage you to consult your tax preparer or qualified wealth counselor before exercising ISOs. Non-Qualified Options are much easier to plan for. It is an automatic taxable event at the time of exercise and the difference between the exercise price of the option and current market value is taxed at ordinary income rates.

Safe Harbor

Paying the amount of taxes you owe is the responsible thing to do. Paying penalties and interest is completely unnecessary if you are planning properly. The IRS will not charge you an underpayment penalty if you satisfy the safe harbor rules, which are: You pay at least 90% of the tax you owe for the current year, or 100% of the tax you owed for the previous tax year. If your AGI is over $1MM, only the 90% of current year applies.

At Osborne Partners, our knowledgeable Wealth Counselors use sophisticated tax planning software to develop a plan with the goal of creating the lowest lifetime tax bill for our clients. If you have questions on your personal situation, we are here to help!