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Year-End Tax Planning Basics



The window of opportunity for many tax-saving moves closes on December 31, so it's important to evaluate your tax situation now, while there's still time to affect your bottom line for the 2022 tax year.

Timing is everything

Consider any opportunities you have to defer income to 2023. For example, you may be able to defer a year-end bonus, or delay the collection of business debts, rents, and payments for services. Doing so may allow you to postpone paying tax on the income until next year. If there's a chance that you'll be in a lower income tax bracket next year, deferring income could mean paying less tax on the income as well.

Similarly, consider ways to accelerate deductions into 2022. If you itemize deductions, you might accelerate some deductible expenses like medical expenses, qualifying interest, or state and local taxes by making payments before year-end. Or you might consider making next year's charitable contribution this year instead.

Sometimes, however, it may make sense to take the opposite approach — accelerating income into 2022 and postponing deductible expenses to 2023. That might be the case, for example, if you can project that you'll be in a higher tax bracket in 2023; paying taxes this year instead of next might be outweighed by the fact that the income would be taxed at a higher rate next year.

Factor in the AMT

Make sure that you factor in the alternative minimum tax (AMT). If you're subject to the AMT, traditional year-end maneuvers, like deferring income and accelerating deductions, can have a negative effect. That's because the AMT — essentially a separate, parallel income tax with its own rates and rules — effectively disallows a number of itemized deductions. For example, if you're subject to the AMT in 2022, prepaying 2023 state and local taxes won't help your 2022 tax situation, but could hurt your 2023 bottom line.

Special concerns for higher-income individuals

The top marginal tax rate (37%) applies if your taxable income exceeds \$539,900 in 2022 (\$647,050 if married filing jointly, \$323,925 if married filing separately). Your long-term capital gains and qualifying dividends could be taxed at a maximum 20% tax rate if your taxable income exceeds \$459,750 in 2022 (\$517,200 if married filing jointly, \$258,600 if married filing separately, \$488,500 if head of household).

Additionally, a 3.8% net investment income tax (unearned income Medicare contribution tax) may apply to some or all of your net investment income if your modified AGI exceeds \$200,000 (\$250,000 if married filing jointly, \$125,000 if married filing separately).

Note: High-income individuals are subject to an additional 0.9% Medicare (hospital insurance) payroll tax on wages exceeding \$200,000 (\$250,000 if married filing jointly or \$125,000 if married filing separately).

IRAs and retirement plans

Take full advantage of tax-advantaged retirement savings vehicles. Traditional IRAs and employer-sponsored retirement plans such as 401(k) plans allow you to contribute funds on a deductible (if you qualify) or pre-tax basis, reducing your 2022 taxable income. Contributions to a Roth IRA (assuming you meet the income requirements) or a Roth 401(k) aren't deductible or made with pre-tax dollars, so there's no tax benefit for 2022, but qualified Roth distributions are completely free from federal income tax, which can make these retirement savings vehicles appealing.

For 2022, you can contribute up to \$20,500 to a 401(k) plan (\$27,000 if you're age 50 or older) and up to \$6,000 to a traditional IRA or Roth IRA (\$7,000 if you're age 50 or older). The window to make 2022 contributions to an employer plan typically closes at

Timing of itemized deductions and the increased standard deduction

Recent legislation substantially increased the standard deduction amounts and made significant changes to itemized deductions (generally for 2018 to 2025). It may now be especially useful to bunch itemized deductions in certain years; for example, when they would exceed the standard deduction.

Required minimum distributions

If you are age 72 or older, you're generally required to take required minimum distributions (RMDs) from traditional IRAs and employer-sponsored retirement plans (special rules apply if you're still working and participating in your employer's retirement plan). You have to make the withdrawals by the date required — the end of the year for most individuals. The penalty for failing to do so is substantial: 50% of the amount that wasn't distributed on time.

the end of the year, while you generally have until the April tax return filing deadline to make 2022 IRA contributions.

Roth conversions

Year-end is a good time to evaluate whether it makes sense to convert a tax-deferred savings vehicle like a traditional IRA or a 401(k) account to a Roth account. When you convert a traditional IRA to a Roth IRA, or a traditional 401(k) account to a Roth 401(k) account, the converted funds are generally subject to federal income tax in the year that you make the conversion (except to the extent that the funds represent nondeductible after-tax contributions). If a Roth conversion does make sense, you'll want to give some thought to the timing of the conversion. For example, if you believe that you'll be in a better tax situation this year than next (e.g., you would pay tax on the converted funds at a lower rate this year), you might think about acting now rather than waiting. (Whether a Roth conversion is appropriate for you depends on many factors, including your current and projected future income tax rates.)

Changes to note

Recent legislation has modified many provisions, generally for 2018 to 2025.

- Personal exemptions were eliminated.
- Standard deductions have been substantially increased to \$12,950 in 2022 (\$25,900 if married filing jointly, \$19,400 if head of household).
- The overall limitation on itemized deductions based on the amount of adjusted gross income (AGI) was eliminated.
- The AGI threshold for deducting unreimbursed medical expenses is 7.5%.
- The deduction for state and local taxes has been limited to \$10,000 (\$5,000 if married filing separately).
- Individuals can deduct mortgage interest on no more than \$750,000 (\$375,000 for married filing separately) of qualifying mortgage debt. For mortgage debt incurred before December 16, 2017, the prior \$1,000,000 (\$500,000 for married filing separately) limit will continue to apply. A deduction is no longer allowed for interest on home equity indebtedness. Home equity used to

substantially improve your home is not treated as home equity indebtedness and can still qualify for the interest deduction.

- The top percentage limit for deducting charitable contributions is 50% of AGI for 2022 (60% of AGI for certain cash gifts to public charities).
- The deduction for personal casualty and theft losses was eliminated, except for casualty losses attributable to a federally declared disaster.
- Previously deductible miscellaneous expenses subject to the 2% floor, including tax preparation expenses and unreimbursed employee business expenses, are no longer deductible.

Talk to a professional

When it comes to year-end tax planning, there's always a lot to think about. A tax professional can help you evaluate your situation, keep you apprised of any legislative changes, and determine whether any year-end moves make sense for you.

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