BNY MELLON
WEALTH MANAGEMENT

Your **Active Wealth**
Podcast

Year-End Tax Essentials

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Featuring:

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VO [00:00:01] Is your wealth strategy supporting your long-term goals? Welcome to *Your Active Wealth* with BNY Mellon Wealth Management, where we offer insights that can help you move closer to your goals. We'll tackle timely topics through the lens of the five pillars that comprise our Active Wealth framework: Invest, Spend, Manage, Borrow and Protect, and provide guidance on navigating the unpredictable, to help you build and sustain wealth.

Terry [00:00:31] Hello, everyone. I'm Terry Sylvester-Charron, head of investment advisory and planning solutions here at BNY Mellon Wealth Management and the host of today's episode. Welcome back to *Your Active Wealth*. As we near the end of 2023, it's critical to evaluate your wealth plan and ensure it reflects any changes in your circumstances or goals, the economic landscape and the current tax environment. Today we're going to discuss year-end tax planning and some of the things you should keep in mind to ensure Tax Day goes as smooth as possible. This includes tax considerations for charitable giving, estate planning, investments, and so much more. We will identify key dates as we approach the end of the year, as well as potential strategies that can help minimize adverse tax treatment across your entire wealth plan. Today, we're speaking with Jere Doyle, senior estate planning strategist at BNY Mellon Wealth Management, who will provide answers to all of the most pressing questions when it comes to year-end tax planning, leaving no stone unturned. Jere, just to start us off, broadly speaking, with Tax Day still months away, what is the significance of year end when it comes to taxes? Are there important deadlines to keep in mind?

Jere [00:02:01] Yeah, what people want to do is they want to make sure that they can control the recognition of the income and the payment of deductible expenses to make sure they're recognized in the year that's most favorable to them. It may be a situation where people are in a lower income tax bracket this year and they'd rather recognize the income this year rather than next year when rates may be higher. Same thing with deductible expenses. They may want to deduct their expenses this year when their rate is going to be higher, as opposed to the following year. So just controlling the recognition of the income and the payment of deductible expenses. The other thing people ought to think about right around now is to review the gains that they've incurred to date or the losses for that matter. So reviewing the gains and the losses, which you want to do, if you have gains, you'd like to harvest any losses that you have incurred so far this year. So those losses can be used to offset the gains and minimize the tax. The other thing people want to think about, too, is if they're going to itemize deductions, they may want to bunch their deductions all into this year because you have to get over a certain threshold. Most people will take the standard deduction, which for married people filing joint is about $28,000. And so in order to be able to itemized deductions, you're going to have to get over that $28,000 threshold. So the more deductions you can bunch into this year, the better. And you'll be able to itemize those if you can get over the $28,000 threshold for standard deductions. Also, consider if you incurred gains or the gains are substantial, consider deferring those gains by investing in an opportunity zone fund. The other thing we have to worry about too, is in dates at the end of the year, if you want to make a gift to an individual and use your $17,000 annual gift tax exclusion, that gift has to be made to the individual before the end of the year, December 31. If you cut them a check and they don't cash it until next year, it doesn't count for 2023. It will count for 2024. People who are over their required beginning date, which for most people now is age 73, you want to make sure you take your minimum required distributions by the end of the year. If you don't, there traditionally was a 50% penalty for any under distribution. Fortunately, the SECURE Act has changed that. They've lowered the penalty from 50% to 25%. And in some situations, if you correct it in a timely manner, the penalty is as low as 10%. But you want to avoid those penalties by making sure you take your minimum required distributions before the end of the year. The other thing that people want to think about is retirement plans. Most workplace retirement plans, like 401(k) plan contributions, have to be made by year end. Keep in mind that with individual retirement accounts, the IRA contribution can be made up to April 15 of the following year. Also, consider the income tax charitable deduction. You want to make sure you get your charitable deduction this year if you're itemizing your deductions. So, make sure it's paid by the end of the year. And for those who are going to use a credit card, be aware of the fact that if you charge a donation on a credit card, they are deductible in the year they are charged, even though you pay the credit card next year. In checks, same thing. If you write a check to charity this year and you mail it by the end of the year, even though it's cashed next year, it still counts as a deduction for this year. So those are some of the important things we want to consider before December 31.

Terry [00:05:32] Great, Jere. Thank you. Are there any common pitfalls that you notice among wealthy families when it comes to ensuring their tax situation is addressed by year's end?

Jere [00:05:43] Yeah, probably the biggest concern that we have with a lot of people is they don't do anything or they procrastinate doing things and by doing so they just give up the opportunity to do effective planning. Also not consulting with their tax advisors early in the fourth quarter. You want to get things underway right now so that you get all the things done that you have to before the end of the year. The other thing that I would mention to people is get organized, get your material together now. You don't want to be bringing things in a shoe box to somebody after the end of the year. Organization and avoiding procrastination are probably the two biggest points that I see with wealthy individuals that are a mistake.

Terry [00:06:23] That's all really great advice, but what would you say are the most important income tax considerations at this time?

Jere [00:06:30] Terry I think one of the most important things for people this time of year is to do tax loss harvesting. If they've incurred gains so far in their portfolio, they want to take a look at the portfolio and see if they have any loss positions. If so, sell those loss positions so the losses could offset the gains and minimize the tax. The other thing people want to keep in mind is they may be exposed to the alternative minimum tax. That's a parallel tax to the regular tax. And although there is a fairly large exemption from the alternative minimum tax, that exemption decreases as your income increases. So, for people that have substantially large capital gains that would add to their income, and if the income is large enough, that would reduce their exemption and cause them to be exposed to the Alternative Minimum Tax. In recent years, most people have not been exposed to the Alternative Minimum tax because of the fact that there's a large standard deduction. But again, if you have large capital gains that could expose you to the AMT or the Alternative Minimum Tax. The other thing people want to keep in mind, as I said earlier, is plan on making charitable donations right now for the end of the year. You want to be able to bunch up those charitable deductions so you can itemize deductions and get a tax benefit in 2023.

Terry [00:07:48] Thank you. I want to shift gears a little bit, Jere. I'm wondering if you could talk a little bit about annual gifting opportunities and charitable giving considerations that folks should keep in mind.

Jere [00:08:00] The thing that people want to keep in mind is that currently we have a $17,000 per donee per year annual gift tax exclusion, meaning that each individual can make a $17,000 gift tax free gift to an individual and not have that count as a taxable gift or have it count against their lifetime exemption. The exemption is scheduled to go up to $18,000 next year at least is projected to go up to $18,000. The other thing people want to keep in mind is whether or not their charitable donations will be made outright to a charity or to a donor advice fund. People have to keep in mind that if they haven't really decided what charity they want the donation to go to, they can make a donation to a donor advised fund, take the income tax charitable deduction this year, and then in some subsequent year, the donor advised fund can distribute that money to a charity that they select. Also with the charitable deductions, and this is really important because the Internal Revenue Service has litigated a lot of cases in this area, and that is people want to make sure they comply with the complicated substantiation requirements for charitable gifts. If somebody makes a gift to charity, especially if the gift is of property over $5,000, you have to get a qualified appraisal by a qualified appraiser. The rules are complicated, and people have lost their income tax charitable deduction because of the fact that they failed to strictly comply with the substantiation requirements. And then finally, one of the things I always say every single year is people will make gifts of cash to charity as opposed to making gifts of appreciated securities. If you make a gift of appreciated securities, you get to deduct the fair market value of that particular stock, and you don't have to pay any capital gains tax on the appreciation and that security. So it's much more efficient to give away the gain, i.e. make a gift of appreciated securities, rather than to make a gift of cash.

Terry [00:10:03] So, Jere, early on you mentioned retirement. Is there anything around retirement plans and investments as they pertain to taxes?

Jere [00:10:12] Probably the most important thing, and something I've already mentioned is make sure that the minimum required distributions are satisfied. If you don't do that, I mentioned earlier that there is a penalty involved. That penalty, as I said earlier, has been lowered to 25% and in some cases as low as 10%. And even if you are subjected to the penalty, you may be able to get the penalty waived for reasonable cause. And one of the things that is going to cause a lot of people a lot of confusion, the changes are made by the two SECURE Acts. One SECURE Act was enacted at the end of 2019 and the other SECURE Act was enacted at the end of 2022. What the first SECURE Act did is it changed the rules for the minimum required distribution period. It used to be that we would plan to take our distribution of our retirement plan over our life expectancies, but that is no longer the case. In most cases, there is a ten-year payout. The maximum you could defer the distribution from retirement plan is now ten years. There is an exception however. Those who are so-called eligible designated beneficiaries still get a life expectancy payout, and those people who are considered eligible designated beneficiaries would be a surviving spouse, a minor child of the IRA owner or plan participant, somebody who is disabled, somebody who is chronically ill, or somebody who is no more than ten years younger than the IRA owner or the participant. Those people still get a life expectancy payout. Everybody else is going to be stuck with a ten-year payout.

Terry [00:11:45] Jere, what about estate planning considerations? Is there anything there that our listeners should understand?

Jere [00:11:52] Over the past four or five years, we've been telling people that there is an increased lifetime exemption for estate, gift and generation skipping tax. That currently is $12,920,000. So, unless you have more than $12,920,000 in your estate when you die, you don't have to pay any federal estate tax. That's a huge exemption. And that exemption is indexed every year for inflation. So it changes every January 1. It is projected that next year the lifetime exemption will be $13,610,000. And that is about a $690,000 increase from last year. Once we get to 2026, that huge exemption is going to revert back to $5 million index for inflation. And when you do the math, that exemptions probably going to be in the seven to the seven and a half million-dollar range. So, what we've been encouraging people to do in light of the huge exemption is to use it now before you lose it. So, it's basically a use it or lose it proposition. And a lot of people are concerned about giving away that much money. They want to use the exemption. So what a lot of people have done is use these vehicles called Spousal Lifetime Access Trust or the acronym is a SLAT, Spousal Lifetime Access Trust. That's an irrevocable trust where you can make a gift to the trust, use up your exemption, but your spouse can be a discretionary beneficiary of that trust. As long as you remain married to your spouse and your spouse doesn't die, you'd still have indirect access to the money that's in that trust. That's been a problem for a lot of people. A lot of people have been concerned over the fact they don't want to make an irrevocable gift and not have control over the money. A SLAT lets you have your cake and eat it, too. If you are deciding to do a Spousal Lifetime Access Trust or some other type of estate planning vehicle to use your exemption, a lot of people are waiting till the last minute because in 2012 we had a similar situation where the exemption was $5 million, and it was scheduled to revert to $1 million. And a lot of people waited till the last minute. They made gifts and then they found out that the government never reduced the exemption. It stayed at that $5 million level, and they had givers remorse. They would not have made the gift had they known that the exemption would not have gone down. A lot of people now are waiting till the last minute. If that's the case and you're deciding you're going to wait to pull the trigger later on, the best advice now probably is get the document drafted that you want to use. If you're going to use a Spousal Lifetime Access Trust, get that document drafted. And if you're going to make a gift of property to it that needs an appraisal, get the appraisal done now. That way you'll have your document drafted and you'll have the appraisal done so you can pull the trigger at the last minute when everybody else is trying to find an attorney to draft the documents or the appraisal. And the attorney or the appraiser are saying, sorry, we've just got too much work. We can't handle it for you. The other thing people have to keep in mind is that we're in an increasing interest rate environment. The techniques that we've used in the past, so-called Charitable Lead Annuity Trusts, Grantor Retained Annuity Trusts, and making loans at lower rates to family members may not be viable anymore. We may have other techniques that work better in a rising interest rate environment, kind of like a Charitable Remainder Trust. Or even if the interest rates go up a little bit further, a Qualified Personal Residence Trust. So, in a rising interest rate environment, the techniques that we've used in the past may no longer be viable and we may have to switch our techniques and use things that work in a higher interest rate environment like the ones that I just mentioned.

Terry [00:15:48] Great. Should there be any type of reevaluation of existing trusts at this time of year to ensure they're still tax efficient?

Jere [00:15:58] One of the problems with trust, especially income taxation of trust, is that the income tax rates for trust in estates are extremely compressed. You hit the highest marginal income tax bracket of 37% for ordinary income and 20% for long term capital gains and qualified dividends at roughly $14,000 of taxable income. Compare that with an individual that has to have hundreds of thousands of dollars of taxable income before they reach those same high maximum income tax rates. So, from a trust point of view, I think what you'd want to do strictly from a tax point of view is take a look at the income in the trust and determine whether or not to make a distribution to a beneficiary. If a distribution is made to a beneficiary, the trust gets an income tax deduction for the amount that they distributed to the beneficiaries. So that lowers the trust taxable income, and that money will be taxable to the beneficiary, hopefully at their lower income tax bracket. So, one of the things we want to do is consider whether or not we want to make a distribution from a trust to have the income taxed to the beneficiary's lower income tax bracket rather than at the compressed tax rates for trust in estates. The other thing we want to keep in mind too, is whether or not we want to retain grantor trust status for certain trusts that are structured as a grantor trust. A grantor trust is basically a trust whereby the income in that trust is taxed back to the grantor. It's not taxed to the trust as a separate taxable entity. In some cases, it makes sense to terminate or turn off grantor trust status. The trust is treated as its own taxable entity. That would be the case if there was a substantially large capital gain that the grantor would have to pay the income tax on. If the grantor wants to avoid paying the income tax on that, they want to revoke grantor trust status and have the trust pay the tax on the gain at the trust level rather than having the grantor be responsible for the gain on his or her individual income tax return.

Terry [00:18:04] Are there any possible changes to tax laws on the forefront? And if so, how should families prepare?

Jere [00:18:13] One of the concerns that tax advisors have had for years, the proposals that come out in the administrations Green Book every single year. Every single year, the administration issues a Green book which lists the proposed changes that they want to have enacted. A lot of those changes that have been suggested in the Biden administration Green Book for this year could adversely affect a lot of our clients. But a lot of those proposals have been around for years, even since the Clinton administration, and none of them have seen the light of day. So as an advisor, we're always looking at the Green Book proposals and keeping in the back of our mind the fact that these proposals could be enacted and could have a very adverse effect on the techniques that we've used for clients for estate and income tax planning. The best advice for a lot of people is to keep an eye on the proposed legislation. We're doing that and we're telling our clients what we think is going to happen. But at this point in time, because Congress is a little bit dysfunctional, I don't believe you're going to see any substantial tax changes before the end of the year. They're not going to affect people's 2023 income tax return. What happens in the future? Anybody knows and the election in 2024 is going to have a big effect on what may happen as far as proposed legislation goes.

Terry [00:19:36] Any unique tax considerations for business owners which they should address before year end?

Jere [00:19:43] Yeah, a couple of things people want to keep in mind right now. If you have or are starting up a small business, you might want to structure the business in such a way that it will qualify for the so-called qualified small business stock exclusion. Generally speaking, if you have a C corporation and you sell stock, you hold the stock for over a certain period of time. The rules are complicated, but if you hold the stock for a certain period of time, you can exclude up to $10 million of the gain on the sale of that C corporation stock. And you can spread the wealth. If you gave the stock to other individuals like your children, for example, they also can get up to a $10 million exclusion of the gain. The qualified small business stock is something. That is very important for a lot of people who are starting a small business. The other thing is if you have a closely held business and there are multiple shareholders, you want to consider executing a buy sell agreement in case somebody gets divorced, dies, becomes incompetent, etc. If you already have a buy sell agreement, take a look and update that agreement. The value of the company may have increased or decreased and you want to amend the buy sell agreement to reflect those changes. And the other thing that we see a lot of is when people sell their businesses, when the sale is imminent, what they want to do is they want to give part of that business interest to a charitable organization to be able to take an income tax, charitable deduction for the value of the business and avoid paying tax on the gain. Well, one of the problems with a lot of the people who are trying to do that particular type of transaction is they wait until the deal is a done deal to give the stock to the charitable organization. Unfortunately, there's this concept in tax law called assignment of income. If the income is something you've earned, you can't assign that and have that taxed to somebody else, like a charity which is tax exempt. So they wouldn't pay tax on that. The bottom line is this. If you are considering selling your business and transferring part of it to charity, make sure that transfer of the business interest is done to charity well in advance of the finalization of the sale. The further out in time you are, the better off you are and the more likely you're going to get an income tax charitable deduction without having the government come back and say, hey, it was your gain, you pay the tax on it, not the charities gain.

Terry [00:22:14] That's terrific. Jere, do you have any final takeaways for our listeners?

Jere [00:22:20] I think the final takeaways I'd leave people with is, first of all, engage your tax advisor and your wealth manager right now early in the fourth quarter. That will allow you to take advantage of the tax strategy we've talked about, especially tax loss harvesting, and it may enable you to take advantage of certain techniques or tax strategies that you didn't even know about. The sooner you get in touch with your tax advisor and your wealth manager in the fourth quarter, the better off you'll be and you'll put a lot of the frustrations to bed and be able to hopefully save a lot of money.

Terry [00:22:54] Jere, thank you so much for joining us today. These insights have been really terrific.

Jere [00:22:59] Thank you for having me, Terry. Hopefully, some of the things we mentioned will be beneficial to our listeners.

Terry [00:23:06] To learn more about year-end tax planning, I encourage you to reach out to a BNY Mellon wealth manager or visit our website, bnymellonwealth.com. That's bnymellonwealth.com. Thanks so much for joining and we'll see you on our next episode of *Your Active Wealth*.

VO [00:23:33] Thank you for listening to this episode of *Your Active Wealth*. Be sure to subscribe to this podcast on Apple Podcasts, Spotify, Google Podcasts or Stitcher and visit bnymellonwealth.com to view the latest insights on the subjects that matter most to you.