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Year-End Estate and Tax Planning 2023:

Optimizing Planning Opportunities Amid the Uncertainty

At the start of 2023, the uncertainty and economic turbulence we experienced in 2022 continued to dominate our economic outlook with respect to stock market volatility, increased interest rates, high global inflation, and fears of recession. Fast forward to the fourth quarter of 2023, and there is cause for optimism as more economic data are released, primarily driven by a strong labor market and wages keeping pace with inflation.* Nevertheless, the next couple of months will determine whether a recession will be occurring or whether the efforts of the Federal Reserve achieve the so-called "soft landing" for the U.S. economy.

Key points:

- Despite ongoing economic uncertainty and turbulence in 2023, the current environment provides opportunities for potentially beneficial income and estate and gift tax planning
- With newly enacted retirement planning legislation and a more restrictive estate planning framework on the horizon, now is the time to assess your current income, estate, and gift tax situation and consider implementing appropriate planning strategies to help optimize your overall tax and financial situation
- Even in the absence of tax law changes or concerns, the ever-shifting of personal and family lives and business situations underscore the importance of routine year-end planning to help ensure your wealth plan is in alignment with your long-term goals

Despite the current economic environment, there is a silver lining to be found—a number of new opportunities for valuable year-end planning. The federal estate and gift tax exemptions remain at an all-time high, and 2023 is the first year in which the SECURE Act 2.0 has been in effect, offering new approaches to income tax planning. Additionally, we are one year closer to material changes to the estate and

*Source: https://www.wilmingtontrust.com/library/article/revisiting-our-2023-capital-markets-forecast

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Tailoring year-end planning to your current financial situation, while keeping in mind how new legislation may play a role, can help optimize your existing financial plan.

gift tax environment, as they are set to revert to pre-Tax Cuts and Jobs Act (TCJA) amounts beginning in 2026. While you cannot control the uncertainty and outcome of the current economic or future tax environment, as the end of 2023 approaches, you can help create peace of mind for your future with a well-structured plan that you routinely review and revise to be sure it aligns with your personal, business, and financial needs and goals. Thus, there can potentially be some certainty amid the uncertainty.

Income tax planning opportunities

In order to determine what income tax planning opportunities might be most advantageous for you to consider before year end, it's important to first consider what the past year has looked like from an income level standpoint for you and your family. In a higher-than-usual income year, maximizing contributions to tax-advantaged accounts, accelerating income deductions, and tax-loss harvesting might play a larger role in your planning than in years past. On the other hand, a year with a lower level of income provides a separate set of opportunities, such as accelerating income and converting tax-deferred assets to Roth individual retirement accounts (IRAs).

A second consideration is how recently enacted legislation might impact how you typically approach year-end planning. The year 2023 is the first in which the SECURE Act 2.0, which was signed into law on December 29, 2022, has been in effect. While this legislation includes approximately 100 provisions and various dates new rules go into effect, there are notable items that could influence your planning this year. Tailoring year-end planning to your current financial situation, while keeping in mind how new legislation may play a role, can help optimize your existing financial plan.

Maximize contributions to tax-advantaged accounts

Each year, the Internal Revenue Service (IRS) sets a maximum contribution limit, for taxpayers who are eligible to contribute, for tax-advantaged accounts. These accounts, funded with pre-tax dollars, grow in value on a tax-deferred basis until account owners begin taking distributions. In years of higher-than-normal income levels, taking full advantage of these accounts to defer income, and therefore the tax associated with that income, to later years is an important part of incorporating a long-term view into your income tax planning. The maximum contribution limits for 401(k), 403(b), and 457 plans increased from $20,500 in 2022 to $22,500 for 2023 to account for inflation, and there is an additional catch-up contribution of $7,500 for those over the age of 50. As a result of the SECURE Act 2.0, beginning in 2024, these catch-up contributions are required to be made as after-tax Roth IRA contributions for those whose wages exceed $145,000.

However, based on further guidance from the IRS, this provision has been granted a two-year administrative transition period, and will not be required until 2026. What does this mean in the context of year-end planning? Well, this guidance offers greater flexibility for high-earning older workers who are deciding how their retirement savings are taxed. In addition to contributing to employer-sponsored plans, and if eligible, you might also consider fully contributing to a traditional IRA account. The

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If done in coordination with your broader wealth plan, itemizing deductions in a year of higher-than-normal income may have a larger impact on your tax planning.

contribution limits for traditional IRAs increased from $6,000 in 2022 to $6,500 this year, with an additional catch-up contribution of $1,000 for those over the age of 50. Going forward, these catch-up contributions made to IRA accounts will be indexed for inflation, courtesy of SECURE Act 2.0. The deductibility of your contribution is determined by your income level and if you participate in a retirement plan at work.

It's clear to see how current contribution rules and limits directly impact your current tax planning. What may be less clear are the benefits waiting down the road, when planning around the distributions from tax-deferred accounts comes to the forefront. There are certain provisions within SECURE Act 2.0 that directly impact the distribution phase of these accounts. Maybe the most notable being that the beginning age for taking required minimum distributions (RMDs) rose to 73 from 72 for owners of traditional IRAs, 401(k)s, and other workplace retirement plans. This new rule applies to account owners who turn 72 after 2022. Therefore, if you turned or will turn 73 in 2023, you must take your first RMD by April 1, 2024. However, if you work past the age of 73, you can delay taking RMDs from your employer's 401(k) until retirement. Another item of note related to the RMD rules is that the penalty imposed on IRA account owners who failed to take their full RMD amount by the deadline has been reduced from 50% of the amount not taken to 25%, and if the account owner remedies the issue by taking the full RMD amount and reports this by the end of the second year after it was initially meant to be taken, the penalty further reduces to 10%. If your employer-sponsored retirement plan is a Roth 401(k), the SECURE Act 2.0 ended RMD rules for this account, enabling more flexibility when mapping out future distributions from retirement accounts.

Lastly, fully taking advantage of the triple tax savings available in Health Savings Accounts (HSAs) can help optimize your wealth plan, especially when considering high medical expenses later in life. Contributions to an HSA reduce taxable income in the year contributions are made, the account balance grows tax free, and withdrawals are not considered taxable if used for qualified medical expenses. The maximum annual contribution limit this year for individuals is $3,850 and $7,750 for families, with catch-up contributions for those over the age of 55 of $1,000. In order to fund an HSA, the account owner must be enrolled in a high-deductible health plan, among other requirements.

Accelerate income tax deductions

The standard deduction for married couples filing jointly for 2023 increased by $1,800 to a total of $27,700. For single taxpayers and married individuals filing separately, the standard deduction is $13,850 for 2023, and $20,800 for heads of households. With such high standard deductions, choosing to itemize deductions has become less common. However, if done in coordination with your broader wealth plan, itemizing deductions in a year of higher-than-normal income may have a larger impact on your tax planning.

If your wealth plan includes charitable gifting over time, you may want to consider implementing a "bunching" strategy for these gifts to coincide with a higher-than-

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While tax-loss harvesting can be an appropriate year-end planning strategy for some, it should always be done while keeping in mind your overall portfolio's investment strategy.

usual income year. Consolidating these gifts to occur in one year could allow you to take advantage of a larger income tax deduction than the standard deduction previously mentioned. Furthermore, there are new rules resulting from SECURE Act 2.0 you should be aware of for your charitable intents. Under the new legislation, the existing qualified charitable distribution (QCD) amount of $100,000 will now be indexed to inflation, rounded to the nearest $1,000, beginning in 2024. Keep in mind that in order to make a QCD from your IRA, you must be older than 70½. In doing so, this gifting strategy can help you accomplish your charitable goals with tax-free money while also satisfying a portion or all of your RMD. Additionally, IRA account owners who are older than 70½ can now make a one-time distribution to a charitable remainder trust and/or a gift annuity up to $50,000. Proactively aligning your charitable and income tax planning can help further optimize your wealth plan.

Lastly, if you plan on funding 529 college savings accounts for children or grandchildren, several states offer an income tax deduction for contributions that you make. These plans allow for tax-free growth of contributions, and tax-free withdrawals if used for qualified education expenses for the beneficiary of the plan. Additionally, a new planning opportunity exists for the unused money from these accounts resulting from SECURE 2.0. Beginning in 2024, rollovers from a 529 account into a Roth IRA for the same beneficiary can be done if the 529 account has been open for at least 15 years. The amount rolled over each year cannot exceed the Roth contribution limit with a maximum total of $35,000. It is important to check with your tax advisor to see if your state offers an income tax deduction for these types of contributions.

Tax-loss harvesting

In a year where the economy and market trends have faced challenging periods, 2023 may have delivered mixed performance for your portfolio. Utilizing tax-loss harvesting at year end can be an opportunity to realize the losses from ill-performing holdings to offset some, or all, of the capital gains from your well-performing holdings. If, after all the gains have been canceled out with losses and you find yourself with an excess of capital losses, any unused capital losses this year could be used against ordinary income up to $3,000. If still excess losses remain, they can be carried forward to use in future tax years. It is important to keep the IRS' wash-sale rule in mind when taking advantage of capital losses. This rule states that a loss may be disallowed for tax purposes if the security you are selling was purchased 30 days before or repurchased 30 days after the sale. To avoid this timing constraint, you are allowed to purchase a similar but not a "substantially identical" security to the one sold.

While tax-loss harvesting can be an appropriate year-end planning strategy for some, it should always be done while keeping in mind your overall portfolio's investment strategy. Therefore, determining how your portfolio might benefit from tax-loss harvesting should be done in collaboration with your advisor.

Accelerate income and Roth IRA conversions

Let's now address applicable planning opportunities in years with lower-than-usual income. Taking advantage of lower tax rates by purposefully triggering taxable

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Keep in mind that Roth IRA conversions are best done as a long-term strategy to help ensure that your immediate cash flow needs and goals are not reliant on using converted assets.

income presents a chance to optimize your wealth plan as it relates to income tax planning over the long term. Directly contributing to a Roth IRA is restricted by income level, with contributions phasing out at adjusted gross incomes (AGIs) of $218,000 to $228,000 for married couples and $138,000 to $153,000 for single filers for this year. If your income level is above these thresholds and directly contributing is not possible, or if you have an existing traditional IRA account, converting pre-tax assets to a Roth might be something to consider. By utilizing conversions in a year with lower-than-usual income, you could avoid being pushed into a higher tax bracket later when your RMDs from the account are distributed. In doing so, you could proactively mitigate future tax expenses by paying the tax at a lower rate. How expensive the strategy is to you depends on your income picture in the year of conversion, therefore it is worth considering this opportunity in the broader context of your financial plan. Lastly, it is important to keep in mind that this is best done as a long-term strategy, ensuring your immediate cash flow needs and goals are not reliant on using the converted assets.

Another income-accelerating opportunity for years of lower-than-usual income is proactively taking distributions from your IRA account, being sure to avoid situations that would trigger penalties. By choosing to pay the tax on those distributions at a lower rate rather than a potentially higher rate in the future, you're smoothing out your income picture over time. This opportunity may be particularly applicable if you have recently inherited an IRA account. Based on the new rules surrounding distributions enacted by the first SECURE Act in 2019, inherited IRA account owners who are subject to the "10-year rule" might wish to avoid possibly large distributions from these accounts in future years by taking advantage of their lower tax bracket now.

Estate and gift tax planning opportunities to utilize increased federal exemptions

Lifetime gifting exemption

The federal unified estate and gift tax exemption for 2023 has been at an all-time high of $12.92 million ($25.84 million per married couple), up $860,000 from 2022 due to a significant inflation adjustment. The projected inflation adjustment to the exemption amount for 2024 will result in another significant increase of approximately $690,000, bringing the federal unified estate and gift tax exemption to approximately $13.61 million ($27.22 million per married couple). While the size of the 2025 inflation adjustment will depend on the course of inflation over the next year, a further increase in the range of approximately $430,000 to $570,000 is currently projected. Finally, the gift tax annual exclusion amount is projected to increase from $17,000 per donee this year to $18,000 per donee in 2024.

Given the now divided Congress, and absent some bipartisan compromise that would either extend or otherwise alter current legislation, many of the changes imposed under the TCJA—including these all-time high increased exemption amounts—will sunset after December 31, 2025, with the laws currently scheduled to revert to those that existed prior to the TCJA. While legislation could change at any time and, as such, plans need to be flexible to adapt to any such changes, there is no new tax

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Whether you have already begun implementing gifting strategies to take advantage of the increased exemption or have fully utilized the current exemption amount, there is still time to build flexibility into your planning and, where appropriate, continue to use future exemption planning strategies to optimize your overall estate tax mitigation efforts.

legislation at this time. Thus, absent any new legislation, these high exemption thresholds are temporary and are currently set to expire and be significantly reduced at the end of 2025 to a pre-2017 level of $5 million, adjusted for inflation. The good news—there is still about two more years to take advantage of valuable planning opportunities to optimally utilize these increased exemption amounts. However, any difference in these higher exemption amounts and the post-2025 reduced amounts will be lost if not used. Therefore, there is a "use it or lose it" window of opportunity to engage in planning to take advantage of these increased exemptions, and proactively designing and implementing the proper gifting and estate plan will be important.

Depending on your assets, current estate and gift tax exposure, and broader cash flow and estate planning goals, there are a number of gifting strategies, including outright gifts and gifts to trusts, to consider implementing prior to 2026 to take advantage of this window of opportunity. Whether you have already begun implementing gifting strategies to take advantage of the increased exemption or have fully utilized the current exemption amount, there is still time to build flexibility into your planning and, where appropriate, continue to use future exemption planning strategies to optimize your overall estate tax mitigation efforts. Finally, because various states have their own estate and inheritance tax rules, depending on your state of domicile, state transfer taxes should be considered and coordinated with your overall plan to help ensure that state transfer tax savings are also optimized.

Annual exclusion gifting

A simple way to begin reducing potential estate and gift tax exposure is to make annual exclusion gifts before the end of the year. Annual exclusion gifting allows each individual (or married couple) to make gifts every year on a tax-free basis up to $17,000 ($34,000 for a married couple) to as many beneficiaries as desired. These gifts can be made directly to a beneficiary or in trust. Annual exclusion gifts can also be made to 529 plans. Further, there is an unlimited exclusion from gift tax for tuition payments paid directly to an educational institution and medical expenses paid directly to the medical provider. Neither annual exclusion gifts nor payments made for education and medical expenses count against your lifetime federal estate and gift tax exemption amount. Thus, these are "free" lifetime gifting strategies that can be implemented to take advantage of higher exemption amounts and help reduce future estate and gift tax liabilities. Even if you are not yet ready to implement a full estate and gift tax mitigation planning strategy, but may still have some estate tax exposure after the anticipated decrease in the lifetime federal estate and gift tax exemption in 2026, making these free lifetime gifts can be a proactive planning strategy for you to begin reducing estate tax exposure in a more modest way.

Strategic gifting strategies

As a result of the continued market volatility in 2023, certain assets may be depressed in value. Gifting such assets, whether directly to a beneficiary or in trust, that have decreased in value but have the potential for rapid appreciation if the market rebounds effectively allows you to move assets out of your estate using less

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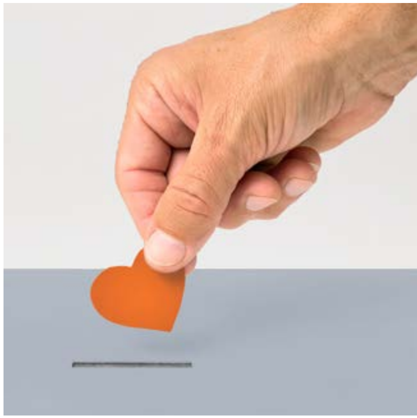

Certain planning strategies are more appealing in a higher interest rate environment, such as charitable remainder trusts and qualified personal residence trusts.

of your lifetime estate and gift tax exemption, while also allowing you to protect all future growth from any eventual increase in asset values outside your taxable estate. Similarly, assets previously transferred to grantor trusts with retained substitution powers also should be assessed for opportunities to move low-basis assets out of such trusts at a lower current value in exchange for higher-basis assets of equivalent value. Using a substitution of assets to “undo” prior planning strategies could allow you to mitigate capital gains on the lower-basis assets that have appreciated inside the trust by returning them to your taxable estate, and thus allowing them to benefit from the step-up in basis at death (thereby reducing income tax liability exposure), with no impact to your remaining available lifetime estate and gift tax exemption and no increase in the size of your taxable estate.

The effectiveness of several planning strategies use numbers derived from the federal funds rate; that is, the monthly published applicable federal rates (AFRs), which are most often used when loans are made among family members without banks involved, and the IRC Section 7520 rate (7520 rate), which is a factor used in making various calculations (remainder interests, charitable deductions, minimum thresholds) for estate planning strategies. As a result, certain planning strategies are more appealing in a higher interest rate environment. One such strategy that may become more attractive in light of rising interest rates is the charitable remainder trust (CRT), which combines philanthropy with tax planning.

The CRT is an irrevocable trust that pays an annual payment to an individual or individuals (one of whom is typically the grantor) during the term of the trust, with the remainder passing to one or more named charities. Because the value of the grantor’s retained interest is lower when the Section 7520 rate is higher, the value of the interest passing to charity, and, therefore, the grantor’s income tax deduction, is higher. Further, the grantor’s taxable estate is reduced by the assets gifted to the CRT, as well as all future appreciation on such assets.

Another strategy that can benefit from a higher interest rate environment is the qualified personal residence trust (QPRT). A QPRT allows a primary residence to be transferred at a deeply discounted gift tax value and also freezes the value of the residence as of the date the QPRT is created. If the grantor survives the QPRT term, the residence (and any appreciation after the transfer) is excluded from the taxable estates of both the grantor and the grantor’s spouse. As the 7520 rate increases along with interest rates, the grantor’s right to use the residence during his or her lifetime increases, while the value of the taxable gift (the remainder interest) decreases, making the use of a QPRT more advantageous from an estate and gift tax perspective. Thus, whether you are considering implementing new gifting strategies, enhancing the planning structures you already have in place, or have previously used your exemption amount, valuable current and future exemption planning opportunities still exist in this higher interest rate environment.

In contrast, other strategies may become less appealing in light of rising interest rates. As with the CRT and QPRT, the ultimate success of strategies such as a

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As we approach the end of 2023, there are timing requirements to be aware of with respect to year-end gifts that can be critical to achieving your desired tax planning results.

grantor retained annuity trust (GRAT), an intentionally defective grantor trust (IDGT), and intra-family loans are linked to the monthly 7520 rate and AFRs. For example, with respect to a GRAT, the IRS allows a gift tax deduction for the actuarial value of the income interest retained during the term of the GRAT, which is calculated using the interest rate specified in IRC Section 7520 at the time the GRAT is established. In times of rising interest rates, the GRAT assets will need to outperform the Section 7520 rate in order for the appreciation over the retained income interest to pass to the GRAT beneficiaries free of gift and estate tax. Selling assets likely to appreciate to an IDGT in return for a promissory note bearing interest at the applicable federal rate may produce significant gift and estate tax savings. However, as with a GRAT, the value of the assets sold must grow at a greater pace than the prevailing applicable federal rate in order for the appreciation to be transferred to beneficiaries free of gift or estate tax. Similarly, intra-family loans will need to charge a higher interest rate to avoid being treated as gift loans. While these strategies still may serve your planning goals, evaluating their performance is especially important in the 2023 interest rate environment, and you may wish to implement these strategies sooner rather than later to avoid further increases in interest rates.

As we approach the end of 2023, there are timing requirements to be aware of with respect to year-end gifts that can be critical to achieving your desired tax planning results. In order to obtain any tax benefit, a gift must be “complete” by year end. This means that the gift has been delivered to and accepted by the recipient. Gifts to charitable organizations are generally treated as completed gifts (and, therefore deductible by the donor) in the year such gifts are mailed by the donor to the charity. However, gifts to individuals must be fully completed before the end of the calendar year (December 31) in order for the gift to be complete for gift tax purposes. If making a gift of cash by check close to the end of the calendar year, such gifts should be both delivered by the donor to the beneficiary and deposited into the beneficiary’s own account no later than December 31. As to gifts of non-cash assets such as securities, the transfer of those securities should likewise be fully completed and registered in the beneficiary’s name no later than December 31.

Routinely evaluating your financial foundation

A core tenet of year-end planning is the ability to evaluate your formalized financial plan and assess if you are still on course. Creating a custom plan that lays out your current financial situation and illustrates planning opportunities like those discussed previously is critical in mapping out how to achieve long-term goals. Confirming the accuracy of the assumptions made in your plan or readjusting those that may have changed over the course of the year can help ensure your financial plan is providing the best picture for you. You may find that how you previously have approached planning has not been within a formalized process. Speaking with your advisor about your year-end planning can be a great way to begin building your custom financial plan.

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Revisiting your estate plan on an annual basis can help you identify planning opportunities that better suit your current situation and provide for as much flexibility as possible.

Revisiting and updating your estate plan

As the end of 2023 approaches, now is the time to engage in a year-end review of your current estate plan (or a perfect time to create an estate plan if you do not already have one in place) to help ensure it aligns with your personal, business, and financial needs and goals. Changes in personal, family, and financial circumstances amid an uncertain economic climate and a changing tax environment can have a direct impact on your estate plan. A planning strategy that was good for you in 2021 may not be the most suitable plan for you now. Revisiting your estate plan on an annual basis can help you identify planning opportunities that better suit your current situation and provide for as much flexibility as possible.

In assessing your estate plan on an annual basis, you will want to review current distribution schemes and fiduciary appointments and make necessary adjustments based on new circumstances. For example, as a result of the stock market volatility in 2023, your assets may have decreased in value. In such a case, can any bequests you have incorporated into your estate plan still be fulfilled as you intended? Similarly, you will want to review how your assets are currently titled, including beneficiary designations on retirement accounts and life insurance policies, to make sure that the beneficiaries of those assets are coordinated with the rest of your estate plan.

Additionally, it will be important to review your overall estate plan and update it accordingly to take into consideration any changes you may have made as a part of your other year-end planning efforts (such as any income tax planning strategies you may have implemented). For example, if you have begun making sizable gifts to trusts to make use of your higher exemption amount, you may wish to consider updating your broader estate plan to coordinate other dispositions with any newly implemented trusts and gifting strategies. As you reassess your wealth plan at year end, you may find planning opportunities to help optimize your overall tax and financial situation and create some certainty and peace of mind that your plan can help carry you through uncertain market conditions such as those that we have experienced throughout 2023. Finally, remember that, like our lives, planning is an evolving process: *Don't set it and forget it!*

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Source for all data: www.irs.gov

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Definition of terms

Cost basis – The original value of an asset for tax purposes.

Grantor trust - A trust created by the grantor that is a "disregarded entity" for income tax purposes and all income, deductions, and any taxes due from the trust are reported on the grantor's personal income tax return.

Step-up in basis – The adjustment in the cost basis of an inherited asset to its fair market value on the date of the decedent's death.

Substitution powers – A power provided under the trust instrument whereby the grantor is allowed to remove an asset or assets from the grantor trust, at any time, in exchange for an asset or assets of equivalent value.

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