Ways to Reduce Your Tax Liability

Want to pay less taxes? If given a way to legally reduce tax liability, most Americans would welcome that opportunity with open arms. But methods for doing so aren't always obvious—and may be tricky in certain circumstances. Two such situations include working in the gig economy and navigating required minimum distributions (RMDs) from retirement accounts. Let's explore strategic tax planning options for both cases.

Tax Planning for Gig Workers

The gig economy refers to the rise in freelance work through apps such as Uber, TaskRabbit, DoorDash, and Etsy. As a gig worker, you have the flexibility to work on your own time and be your own boss, but you're responsible for managing your income, expenses, and tax obligations. This could prove difficult and time-consuming, especially if you aren't well-versed in tax law. There are ways, however, for freelancers to reduce their tax burden and comply with IRS rules and regulations.

- **Track business expenses and deductions.** As a gig worker, you can deduct business expenses from your taxable income. These might include home office expenses, equipment, supplies, and travel expenses. Keeping track of your expenses throughout the year can help maximize deductions and lower taxable income.
- **Learn about tax deductions for freelancers.** Gig economy jobs are viewed as independent contract roles by the IRS and are therefore eligible for various tax deductions aside from business expenses. These include deductions for health insurance, retirement contributions, and even a portion of self-employment taxes. Understanding these

deductions will help reduce overall tax liabilities; your financial advisor can help clarify which expenses qualify.

- **Contribute to retirement accounts.** When performing freelance work, you don't have an employer-sponsored retirement plan but can still contribute to a traditional IRA or Roth IRA to save for the future. Contributions to traditional IRAs are tax deductible, whereas contributions to Roth IRAs are not tax deductible but grow tax free. Contributing to a retirement account may reduce your taxable income and provide long-term savings.
- **Consider estimated quarterly tax payments.** Gig workers, who often receive income without taxes withheld, are responsible for paying estimated taxes throughout the year. You can use tax software or an accountant to calculate your estimated taxes and ensure that you are paying the right amount. Making quarterly estimated tax payments can help avoid penalties and ensure that taxes are paid throughout the year rather than in one lump sum during tax season.

Using RMDs for Tax Planning in Retirement

As baby boomers retire and life expectancy increases, tax planning for retirement is becoming increasingly important for American workers. One way to maximize tax savings in retirement is through RMDs. You're required to take RMDs from certain retirement accounts the year you turn 73. Withdrawing them, however, could result in a large tax bill because these are considered taxable income. Here's how to cut down on what you'll owe.

- **Withdraw more early on.** You can start withdrawing money from retirement accounts without a tax penalty at age 59½. If you expect to be in a lower tax bracket when you retire, it could help to take larger distributions at the beginning of your retirement to reduce your account balance and lower your RMDs later (reducing the taxes you owe on them).

- **Make charitable donations.** Another way to reduce your tax liabilities is by donating your RMD to a qualified charity. This strategy, known as a qualified charitable distribution (QCD), satisfies RMD requirements and can reduce your taxable income while supporting a cause you care about. Just note the following requirements:
  - You must be 70½ or older.
  - You are limited to $105,000 in 2024.
  - The QCD must be made directly from the trustee of the IRA to the charity.
  - You won't be able to claim a QCD as a charitable deduction on your taxes.
- **Consider a Roth IRA conversion.** Although you will be taxed on retirement funds you convert to a Roth IRA at the time of conversion, future withdrawals from a Roth IRA are tax free. The onetime tax payment might be worth paying so you can avoid RMDs altogether and withdraw the money later without paying taxes on it. Strategic Roth conversions can help manage tax brackets in retirement, but they aren't the right move for everyone, so discuss this possibility with your financial advisor and a tax professional before proceeding.
- **Coordinate with social security.** If you're able to withdraw funds from your tax-deferred retirement accounts before you claim social security benefits, you may minimize tax liabilities. Also, if taking distributions from your retirement funds allows you to delay collecting social security beyond your full retirement age, your benefit will increase.

Reducing your tax bill sounds great, but it requires careful planning and understanding of tax laws. Whether you're a gig worker hoping to take advantage of deductions, a retiree trying to use RMDs to your advantage, or you're looking at another possible way to legally reduce what you owe the IRS, please reach out to us. We'd love to help with your strategic tax planning. As always, we aim to help you make the most informed decision to optimize your financial well-being.

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Death, Taxes and Change…What's in Store for 2024

Sarah Ruef-Lindquist, JD, CTFA

By Sarah Ruef-Lindquist, JD, CTFA
For Pen Bay Pilot

We’ve all heard the adage that the only things that are sure in this life are death and taxes…we need to be mindful of change, at least as it pertains to taxes.

Retirement Savings
It’s important to maximize saving for retirement and take advantage of the provision of the tax law that allow taxpayers to save funds in tax-deferred accounts…for 2024, the limit or most plans (401(k), 403(b) and 457 plans) increases from $22,500 to $23,000 with another $7,500 for those age 50 and over. That means that taxpayers age 50 and over can add $30,500 to their plans in 2024, the highest amount ever allowed.

Similarly, SIMPLE plans will have new elective deferral limits: $16,000 up from $15,500 and a catch-up amount of $3,500 for those 50 and over. IRAs will have a 2024 contribution limit of $7,000 up from $6,500 this year, with an unchanged catch-up amount of $1,000 for those 50 and older.

There are other changes for SEPs, ESOPs and cash-balance plans in store for 2024. For those who participate in them, taxpayers should consult their accountants and financial advisors for more details. Why maximize savings in these types of plans and accounts? Earnings in these plans are tax free until withdrawn, which for many is not required until age 73 or if born in 1960 or later, age 75.

Gift and Estate Tax
Taxpayers can make gifts or have an estate of over $13 million in 2024 without having a federal gift or estate tax imposed. The maximum amount that may be given as a gift without having to report it to the IRS to count against that credit – what is known as the annual exclusion amount – is going up to $18,000

for 2024 from $17,000 in 2023. This amount has been increasing steadily over the past several years.

Corporate Transparency Act
Taking effect in 2024 is a new federal law to help the Financial Crimes Enforcement Network (FinCen) uncover criminal activity through corporations, LLCs and the like. It requires certain types of existing entitles to report beneficial ownership information by December 31, 2024 and for new entities formed after this year, to make such reports within 30 days of formation. If you are an owner or have a beneficial interest in a corporation or LLC or other entity that is formed by filing documents with the state, you may be required to make reports. For more information, go to https://www.fincen.gov/boi.

Please remember that financial and tax situations differ widely from person to person, and there is no one size fits all for most of these situations. Consult with your financial and tax advisors for how any of these or other provisions that are changing in 2024 may affect you.

Making Lemonade From Lemons: Long-Term Capital Loss Stock Creates Another Type of Tax-Efficient Charitable Gifting

Opportunity

Sarah Ruef-Lindquist, JD, CTFA

By Sarah Ruef-Lindquist
For Pen Bay Pilot

For those of us working in the area of wealth management, 2022 will long be remembered as the year the stock market rolled gains back – way back – to pre pandemic levels. 2021 ended on a high note…the indices at or near all-time highs, after a climb from a downtick in early 2020 as the pandemic set in and the economy shut down. As 2021 came to a close, charitable gifts of long-term capital gain stock were the norm, and plentiful.

Then the markets began a slide as January slipped into February and valuations, including bond values as interest rates were raised by the Fed, walloping investors who have long relied upon a balanced portfolio to weather the storms of market volatility. As 2022 comes to a close, investors are seeing some signs of market value recovery, but it's feeling a like it could be a very slow, volatile, long climb ahead.

Donors may feel that what would have been a great, tax-efficient opportunity to use long-term appreciated stock has gone by…and it may have, for a while. But let’s not forget the other side of that charitable gifting sword: using long-term capital losses to fund charitable gifts.

How could that work? A sale of stock that has been held more than 1 year that has declined in value below its basis or purchase price can generate a loss, and the proceeds of the sale can be used for a charitable gift.

Let’s say you purchased or inherited stock with a basis of $5,000 and held it for more than a year. The current value is $1,000. If you sell it, your loss is $4,000, which can be used to offset gains now or in future years as a carry-forward. What gains? Many mutual funds declare gains, even in years when the stock market has had an overall decline, so many investors will actually have realized gains within their portfolios, even if they haven’t sold anything. Losses can be used to offset gains.

You can use the $1,000 proceeds to make a gift of stock to charity and if you itemize, you can take an itemized deduction for that $1,000. That’s a lot of tax savings, now and in future years.

Consult with your tax or financial advisor to learn more about this opportunity and how it could apply to your situation before Dec. 31, 2022.

Your Guide to Year-End

Financial Planning for 2022

As 2022 comes to a close, you’ll want to reassess your financial goals, examine any life changes that will affect your saving or spending, and learn about recent developments in the world of taxes and finance that might benefit you. So, before you head to your annual meeting with your financial advisor, read over these questions and use them as a helpful guide for your conversation.

1. Can I Contribute More to Retirement Funds?

While the state of the economy might make you hesitant about setting additional income aside, consider whether you’re financially able to maximize (or increase) contributions to your workplace retirement plan. At the very least, find out if you’re contributing the minimum to take full advantage of any employer match benefit. Increasing your contributions to a traditional IRA is another option, though you should be mindful that those with higher incomes may not qualify for a tax deduction.

2. Do I Have FSA Dollars to Spend or Carry Over?

Use what you can from your flexible spending account (FSA), and check your employer’s plan to see how much of any unused funds you can carry over to the next plan year. Although the rollover option applies to your employer’s plan year rather than the calendar year, this year-end assessment is a good reminder to make sure you’re on track. If permitted, the maximum FSA carryover amount is $570. If you have a dependent care FSA, you can save as much as $5,000 (family limit) or 2,500 (married filing separately) in 2022.

Now is also a great time to discuss with your advisor maximum health savings account (HSA) contributions if you have a high-deductible health plan (HDHP). This can be a fairly complex topic in general, so it's a great idea to tap into your advisor's knowledge to learn more.

3. Should I Consider Roth Conversions?

If you have some room in your current tax bracket before reaching a higher federal income tax rate, you may want to consider doing a Roth Conversion. This would involve converting some of your pre-tax retirement savings, like in a traditional IRA, into a post-tax account, like a Roth IRA, so you'd never have to pay taxes on future earnings. Taxes would be paid up front on the conversion amount, and you'd enjoy tax-free growth in the future. If this interests you, discuss this strategy with your advisor, who can help determine if it's an ideal time to do a conversion. He or she can also run projections to see if you would end up paying less in taxes overtime with this strategy.

4. What Is Tax-Loss Harvesting?

If some investments in your portfolio have suffered a loss, the end of the year is a common time to consider if it would make sense to "harvest losses" by selling them. Doing so can offset gains you have realized in your portfolio, as well as up to $3,000 of your earned income. Tax-loss harvesting can get complex, so this is a great topic about which to seek professional help. Be aware: Investments can only be rebought after a certain period, as selling a security for a loss and buying back within 30 days does not qualify.

5. Do My Charitable Donations Qualify for a Tax Deduction?

Charitable contributions donated directly to a qualified charity or to a donor-advised fund can help you get a federal tax deduction. Keep in mind, however, that this will often only be beneficial if you're itemizing. It's worthwhile to discuss with your tax professional if your charitable contributions, in addition to other deductions, will surpass your standard deduction.

6. What Should My Strategy for Stock Options Be?

If you have vested stock options included in your compensation package from your employer, now may be a good time to consider whether it would be more beneficial to sell them in January of 2023 as opposed to this year. Review your stock option statement and plan document with your tax professional and discuss which year may provide you the best opportunity from an income tax perspective.

7. Do I Need to Think About RMDs?

Some retirement accounts are subject to required minimum distributions (RMDs). This means once you are nearing approximately age 72, you may be required to start taking distributions from your retirement accounts, owing taxes on the way out. It's not uncommon for people to forget to take RMDs. What's more, recent legislation has made them a bit more complex, so RMDs for retirees and their beneficiaries are best planned with your advisor to be sure you're following the rules.

8. When Do I Need to Resume Repaying Student Loans, and Do I Qualify for Student Debt Relief?

Student loan payments are set to restart at the commencement of 2023. Under the Biden administration's one-time student loan debt relief plan, payments could be reduced to 5 percent of discretionary income for most undergraduate loans. More information on this plan will be announced in the coming days and weeks. To get the latest, consult this helpful fact sheet and sign up for updates on the U.S. Department of Education website.

9. Should I Update My Estate Plans?

It’s always a good idea to review estate plans as part of year-end financial planning. As life events happen, such as marriage or the birth of a child, your estate plan should be updated accordingly with your attorney. At the end of each year, discuss with your family how the life events you’ve experience over the last year might affect your estate planning. When you meet with your advisor, be sure to update and review beneficiary designations, trustee appointments, power of attorney provisions, and health care directives.

Take Advantage of Your Advisor’s Knowledge

Although this year-end financial planning checklist covers a lot of ground, it’s intended to serve just as a springboard for your planning conversations with your financial advisor. You’ll have a great starting point to talk through issues and deadlines that are most relevant to you, and you should be sure to add anything else you want to know to this list so you don’t forget to inquire. An annual planning meeting is a great time to ask any questions you need answered regarding your financial plans for the coming year.

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2023 Will Bring Greater Potential for Estate and Gift Tax Savings

By Sarah Ruef-Lindquist, JD, CTFA
For Pen Bay Pilot

U.S. Taxpayers enjoy a lifetime gift and estate tax exemption. This is the amount a person can transfer at death or during life without triggering a transfer tax.

The exemption amount for 2023 is set to rise $860,000 to $12,920,000 per person ($25,840,000 per married couple) from the 2022 figure ($12,060,000 per person, $24,120,000 for a married couple).

Moreover, taxpayers can use an “annual exclusion amount:” This is the amount one can give away to any number of people each year without triggering the need to file a gift tax return or eat into one’s lifetime exemption. Each year, these amounts are adjusted for inflation.

The annual exclusion amount is set to rise to $17,000 per donee, from $16,000. This can translate into increased flexibility for transferring wealth without incurring taxes on these transfers. Families find this an excellent way for grandparents to help fund education expenses for grandchildren, often using 529 Education Savings Plans that can grow tax-free and be withdrawn tax free for qualifying expenses.

These annually determined, inflation-adjusted exemption amounts are scheduled to 'sunset' at the end of 2025, reverting to levels around $6,000,000, unless Congress takes action to extend them. The annual gifting exclusion amount is not currently slated to revert to lower levels.

Consult with your wealth, estate and tax advisors to understand the impact these changes could have on your particular situation.

Tax-Smart Planning Strategies

Minimizing your annual income taxes requires a regular review of your overall financial position. With tax season underway, now is the perfect time to evaluate some effective strategies that could help reduce your current and future taxes. Tax planning should be a year-round activity, so it's wise to revisit these topics regularly in the context of your current financial situation.

Manage Your Retirement Savings Accounts

If you have the means, maximizing your annual contribution to a retirement account will give your savings strategy a healthy boost. But it’s important to understand how the different types of available retirement accounts differ. The most common options include:

Employer-sponsored retirement plans. Employer-sponsored 401(k) plans allow your investments to grow with taxes deferred until you take money out through a withdrawal or distribution. Some employers offer both a traditional 401(k) plan and a Roth 401(k); if yours does, you should be aware of the different rules for taxes on contributions and distributions:

- With a **traditional 401(k) plan**, contributions are made with pretax dollars, thus reducing your current income and, possibly, your current-year taxes. Choosing this option may make sense if you want to reduce your income in the current year and/or expect to be in a lower tax bracket in retirement. Required minimum distributions from the account begin at age 72.
- With a **Roth 401(k) plan**, contributions are made with after-tax dollars, and the account’s accumulated funds have the potential to be distributed tax-free and penalty-free in retirement, if certain IRS requirements are met. This could make sense if you’re not looking for a current-year tax deduction and anticipate being in a higher tax bracket in retirement. Under circumstances known as “triggering events” (one example is termination of employment), Roth 401(k) funds could be rolled tax-free into a Roth IRA and eliminate the need to take required minimum distributions from those assets. Required minimum distributions begin at age 72 in Roth 401(k) accounts but are not required in Roth IRAs.

Retirement plans for the self-employed. If you run your own business, you can use an individual 401(k), SEP (Simplified

Employee Pension), or SIMPLE (Savings Incentive Match Plan for Employees) plan to shelter income.

IRAs. If you qualify, you may also be able to make a contribution to an IRA. As of 2020, there is no age limit on making regular contributions to traditional or Roth IRAs. Different rules for taxes on contributions and distributions do apply:

- With a **traditional IRA**, contributions are generally made with pretax dollars, thus reducing your current income and, possibly, your current-year taxes. Eligibility for making tax deductible contributions to an IRA depends on your tax filing status, modified adjusted gross income (MAGI), and whether you're covered by an employer-sponsored retirement plan. Required minimum distributions begin at age 72.
- With a **Roth IRA**, contributions are made with after-tax dollars, and the account's accumulated funds have the potential for tax-free and penalty-free distribution in retirement. Eligibility for contributing to a Roth IRA is based on your tax filing status and MAGI. There is no requirement for minimum distributions when you reach a certain age.
- **Converting traditional IRA assets to a Roth IRA** is another strategy to consider. Generally, this move makes the most sense for those who anticipate being in a higher tax bracket in retirement than they are now. Eliminating the need to take required minimum distributions is a meaningful benefit.

Maximize Your Deductions

Some deductible items, such as medical expenses and charitable contributions, must meet a specific threshold before deductions can be taken. If you fall short of the minimum in a particular year, you might be able to time future discretionary expenses or charitable contributions such that you exceed the threshold one year but not the next.

Review Form 1040

Examining your 1040 could help you spot opportunities for making investments that provide greater after-tax savings. Pay special attention to the Taxable Interest, Tax-Exempt Income, and Dividend Income sections of the form.

Consider Tax-Advantaged Municipal Bonds

Municipal bonds are an excellent tax-advantaged investment, especially for people who are in a high income tax bracket or have moved into a higher tax bracket after a promotion or career change. Interest earned on municipal bonds is exempt from federal income taxes and, in most states, from state and local taxes for residents of the issuing states (although income on certain bonds for particular investors is often subject to the Alternative Minimum Tax).

Plan for Capital Gains and Losses

To determine when to recognize capital gains or losses, you will have to know whether you want to postpone tax liability (by postponing recognition of gains) or to recognize capital gains or losses during the current year. If the gains will be subject to a higher rate of tax next year (because of a change in tax bracket), or if you cannot use capital losses to offset capital gains, you could recognize capital gains this year.

Don’t Forget Life Insurance

Life insurance can provide liquidity to pay estate taxes and could be an attractive solution to other liquidity problems, such as those family-owned businesses, large real estate holdings, and collectibles may face. Structured properly, life insurance proceeds can pass free of income and estate taxes.

Putting the Pieces Together

These are just a few of the most common tax planning strategies. We can work with you and your tax professional to assess your current situation and determine which options could be beneficial to you. Making proactive, tax-smart decisions throughout the year is an essential piece of overall financial planning.

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Municipal bonds are federally tax-free but may be subject to state and local taxes, and interest income may be subject to federal alternative minimum tax (AMT). Bonds are subject to availability and market conditions; some have call features that may affect income. Bond prices and yields are inversely related: when the price goes up, the yield goes down, and vice versa. Market risk is a consideration if sold or redeemed prior to maturity.