The Wealth Report

Proactive tax planning isn't limited to just "tax season" — it's a year-round event. Your financial professional can help you deploy these three strategies to potentially optimize your income and lower how much you pay in taxes each year.

3 TAX-PLANNING STRATEGIES TO DEPLOY YEAR-ROUND

Overview

Credits and deductions. AGI. Capital gains. These words seem to be used more frequently recently — which means it must be tax-return season!

Many people consider taxes to be a one-time-per-year event, kicking off when they receive their first W-2 or 1099 and ending when they hit "submit" on their annual return. And some think they simply owe what they owe, and there's no way to proactively plan for taxes or even reduce their bill.

Fortunately, it *is* possible to plan for and potentially lower how much you pay in taxes. This can be done by considering "tax season" as a 12-month event and considering how each financial decision throughout the year impacts how much you pay in taxes annually.

But what year-round strategies can you use to potentially reduce your tax bill? Here is a look at three frequently used methods.

1. Postpone your income

Your annual taxable income can come from a variety of sources: Paychecks. Social Security or disability benefits. A pension or annuity. An IRA or 401(k). Reducing — or removing — one of these sources during a tax year results in less taxable income and may even move you down a tax bracket.

How do you postpone income? For pre-retirees, one method is to defer money into a qualified retirement plan, such as a traditional IRA or employer-sponsored plan. All contributions to these qualified accounts are directly deducted from your taxable income, lowering your taxes for the year in which the contribution was made. Keep in mind, however, that you will have to pay taxes on those funds eventually, when you start taking withdrawals.

For retirees, postponing income may involve delaying distributions from a qualified retirement account and covering expenses with money from a non-taxable account, such as a Roth IRA. This may be an especially good idea if you have other taxable sources of income, like Social Security benefits or a paycheck from a part-time or full-time job.

Other ways to help reduce your annual taxable income include making contributions to health savings accounts (HSAs), flexible spending accounts (FSAs) or dependent care flexible spending accounts (DCFSAs), all of which allow for tax-deductible contributions. However, eligibility for these types of accounts may depend on income limits or availability through an employer. Contributions to 529 college-savings plans may also be deductible on your state taxes, if the plan is hosted by your state. (There is no federal tax deduction for 529 plans.[1])

2. Optimize your deductions and credits

An estimated 90% of taxpayers claim the standard deduction on their taxes[2]; after all, it's much simpler than keeping track of all potentially deductible expenses. But optimizing your deductions can be a great way to reduce your annual taxable income. The challenge is finding enough in itemized deductions to exceed the required threshold.

2022 and 2023 Standard Deductions

	Tax year 2022[3]	Tax year 2023[4]
Single	$12,950	$13,850
Head of household	$19,400	$20,800
Married filing jointly	$25,900	$27,700

One way to optimize deductions is to strategically "bunch" them. For example, instead of making annual charitable contributions, make two years' worth of contributions in the same year and take the itemized deduction. If you selectively choose to make the contribution in a high-taxable-income year, you can lower your tax bill for the year in which you made the donation. Take the standard deduction for the following year, and repeat the cycle as needed.

You can also take advantage of available credits, which reduce your taxable income dollar-for-dollar. These may include family and dependent credits (such as the Child Tax Credit or Dependent Care Credit), health care credits or even homeowner credits. These credits may play into your decision about specific purchases; for example, you may decide to upgrade your furnace if you know you'll receive an energy-efficiency credit on your tax bill. Check with your accountant or CPA to see which tax credits apply to you.

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3. Sell assets strategically

When you sell a security for more than you paid, the profit is called a capital gain — and capital gains are taxable. There are generally two types of capital gains: Short-term gains are realized on assets held for one year or less, while long-term gains apply to assets held for more than 365 days. While short-term gains are taxed at the same rate as ordinary income, long-term gains have their own tax rates:

2022 Long-Term Capital Gains Tax Rates[5]

	0%	15%	20%
Single	$0 - $41,675	$41,676 - $459,750	$459,751+
Head of household	$0 - $55,800	$55,801 - $488,500	$488,501+
Married filing jointly	$0 - $83,350	$83,351 - $517,200	$517,201

2023 Long-Term Capital Gains Tax Rates

	0%	15%	20%
Single	$0 - $44,625	$44,626 - $492,300	$492,301+
Head of household	$0 - $59,750	$59,751 - $523,050	$523,051+
Married filing jointly	$0 - $89,250	$89,251 - $553,850	$553,851+

Timing can make a big difference in how much you pay in capital gains. For example, say you and your spouse want to sell assets totaling $100,000 in long-term capital gains. If you took the entire $100,000 in capital gains in 2022, you'd end up paying 15% in taxes. But if you sold half the assets in 2022 and half in 2023, your total taxes on the long-term capital gains would be 0%.

You could also offset some capital gains by selling assets at a loss. Known as tax-loss harvesting, this option also reduces your taxable income. Again, correctly timing the sale of an asset can make a big difference in how much you owe at tax time.

Final Thoughts

When you work with a financial advisor, they can provide insights into how each financial decision you make impacts your current and future taxes. They can also assist you in identifying and implementing tax-friendly strategies to make the most of your income. We recommend contacting your advisor any time there's a shift in your financial situation, so they can provide a thorough analysis of how changing circumstances may affect your tax bill.

[1] *H&R Block. "Are 529 contributions tax deductible?" https://www.hrblock.com/tax-center/filing/adjustments-and-deductions/are-529-contributions-tax-deductible/. Accessed Jan. 17, 2023.*

[2] *Rocky Mengle. Kiplinger. Dec. 14, 2022. "What's the Standard Deduction for 2022 vs. 2023?" https://www.kiplinger.com/taxes/tax-deductions/602223/standard-deduction. Accessed Jan. 17, 2023.*

[3] *IRS.gov. Nov. 10, 2021. "IRS provides tax inflation adjustments for tax year 2022." https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2022. Accessed Jan. 17, 2023.*

[4] *IRS.gov. Oct. 18, 2022. "IRS provides tax inflation adjustments for tax year 2023." https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2023. Accessed Jan. 17, 2023.*

[5] *James Royal. Bankrate. Nov. 23, 2022. "What is the long-term capital gains tax?" https://www.bankrate.com/investing/long-term-capital-gains-tax/. Accessed Jan. 17, 2023.*

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