Mid-Year Tax Moves

Rachel L. Sheedy

It's the perfect time to do a status check on your 2022 tax liability — and make moves to trim your tax tab.

Summer is the time to watch Fourth of July fireworks at a barbecue, or frolic in the water while hanging out on a beach. But now that the year is half over, it's also a good time to start thinking about what you may owe Uncle Sam - and consider ways you can trim your tax tab. As you determine your short-term moves, you may want to consider some long-term tax-saving strategies, too.

Your 2021 federal tax return is a good place to start when assessing your 2022 tax liability as it can help inform the moves you might make. It's also wise to think about your potential 2023 financial situation to ensure a tax move makes sense this year versus next year.

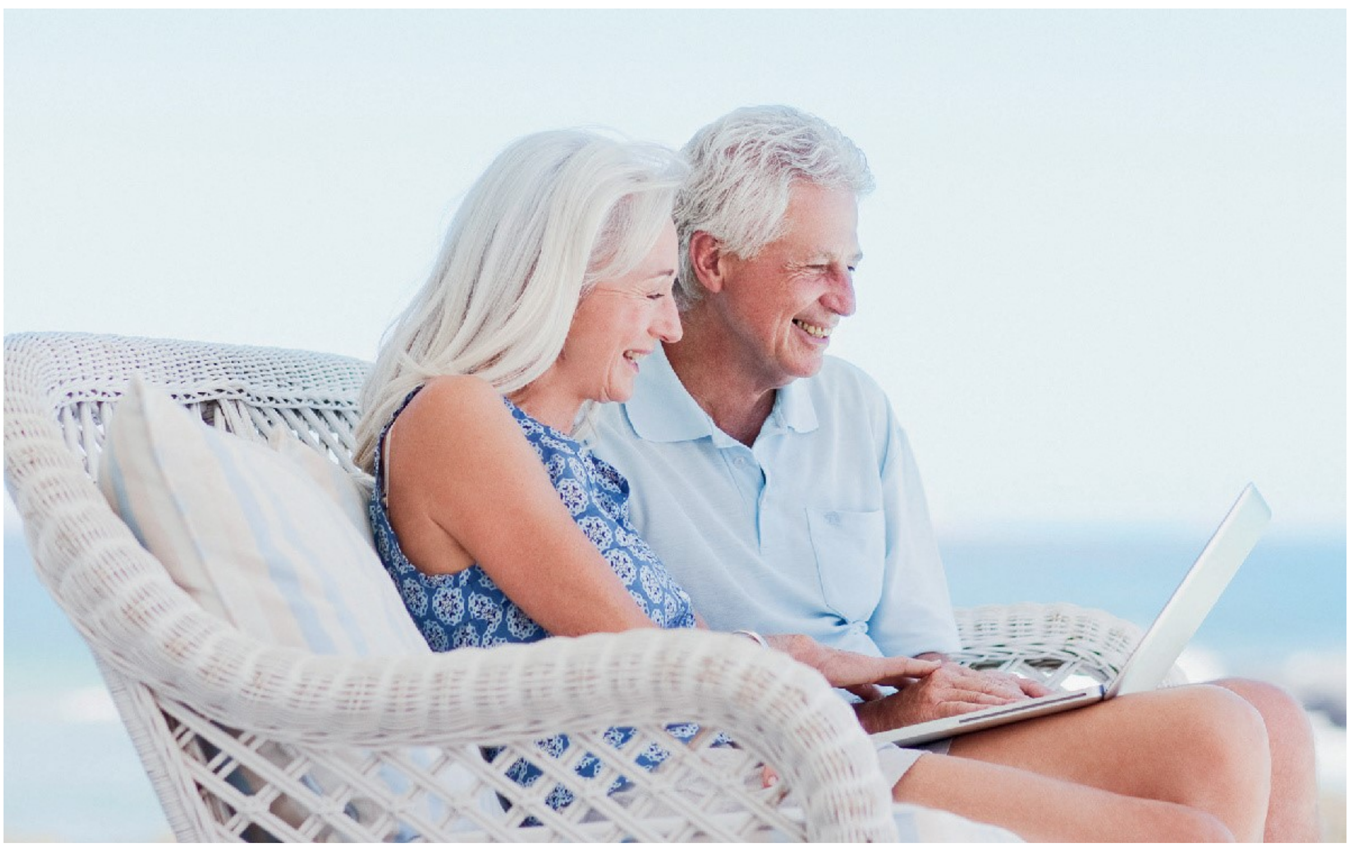
A key question: Do you expect to take the **standard deduction this year, or are your potential** itemized deductions on track to exceed that threshold? It's a tough hurdle: The standard deduction for single filers is $12,950 in 2022, while it is $25,900 for married taxpayers filing jointly. Those who are age 65 and older or blind get an extra standard deduction of $1,400 for married filers and $1,750 for single filers. Whether you expect to itemize or take the standard deduction "might dictate other moves you make this year," said Tim Steffen, CPA/PFS, CFP®, director of tax **planning for Baird,** a wealth management firm.

You also need to assess the taxation of your income streams. How much of your pay may be tax-exempt? Will you turn on a stream of taxable military pension income this year, or will you receive tax-free VA disability payments? Will you sell long-term investments that qualify for favorable capital gains tax rates? Paint the picture of where your money will be coming from and what kind of tax bill may be attached to each income stream. (Factor in the tax bite your state may take, too.)

With all that in mind, here are some tax moves, for the short term and long term, to mull over as you enjoy the long summer days

Retirement

Boost contributions. One of the first tax moves to consider if you have earned income is to make IRA contributions or increase 401(k) or Thrift Savings Plan (TSP) contributions, said Jo Willetts, director of tax resources at Jackson Hewitt. Besides saving for retirement, you lower your taxable income now by making pretax contributions to employer plans and deductible contributions to a traditional IRA if you're eligible. Families with one breadwinner have a workaround.



"The working partner can contribute to an IRA for a nonworking spouse," said Willetts.

The working spouse can contribute up to $6,000 to their own IRA and another $6,000 to a spousal IRA if the worker's earnings cover the total contribution. A catch-up contribution of $1,000 can be added for each spouse who is 50 or older — for a total of $14,000 in contributions if both spouses are 50-plus in 2022.

Participants in retirement plans, such as the TSP, can contribute up to $20,500 (plus an extra $6,500 for those 50 and older) for 2022.

“TSP is terrific because it’s so low cost,” said Col. Dr. Steven Podnos, USAFR, CFP®, principal of financial firm Wealth Care. “Seek to max out the deferral.”

Servicemembers with tax-exempt combat pay can boost their tax-advantaged retirement savings even more because they can put that money into a traditional TSP up to the $61,000 annual addition limit for 2022. Go to www.tsp.gov to learn more.

If you’re now self-employed, there are several options to set up your own tax-advantaged retirement plan, such as a SEP IRA, Simple IRA, or solo 401(k). For those bringing in a hefty sum, perhaps from consulting for a large aerospace or engineering firm, a personal defined benefit plan may allow a self-employed business owner to make a large tax-deductible contribution, said former Maj. David Chepauskas, USA, CFP®, senior wealth planner at Summit Financial.

Consider a Roth conversion. While converting money from a traditional IRA to a Roth IRA will add to your taxable income this year, the move reduces your taxes in the long run. Money in a Roth account grows tax-free and qualifies for tax-free withdrawals.

“A market downturn provides a good opportunity to consider Roth conversions,” said Chepauskas. After the conversion, any earnings growth from a market bounce back will be tax-free in a Roth IRA.

Before doing a conversion, consider your tax rate now and in the future. If you think your tax rate is lower now, then doing a conversion this year could make sense. James Rabasca, senior tax specialist at Summit Financial, notes that under current law, the lower tax rates implemented by the Tax Cuts and Jobs Act are set to expire at the end of 2025.

On the legislative chopping block last year, the “backdoor Roth” is still available at press time.

“As of today, people still can take advantage of the backdoor Roth if they don’t qualify for Roth contributions,” said Eric Bronnenkant, CPA, CFP®, head of tax at financial firm Betterment.

The strategy works like this: A taxpayer whose modified adjusted gross income exceeds the Roth contribution thresholds can make nondeductible contributions to a traditional IRA and then convert that money to a Roth IRA. To make this work smoothly, you need to hold only nondeductible contributions in your IRA.

Check on required minimum distributions. RMDs for tax-deferred retirement accounts kick in when you turn 72 years old. For your first RMD, you can delay withdrawing the money until April 1 of the year after your 72nd birthday. If you delay your first RMD, you will have to take the second one by the end of that year, too.

“Two distributions in one year could push you into a higher tax bracket,” said Bronnenkant.

If you missed your RMD, take it sooner rather than later, and ask Uncle Sam for forgiveness by

If you missed your RMD, take it sooner rather than later, and ask Uncle Sam for forgiveness by filing Form 5329. The penalty for missing an RMD is hefty — 50% of the shortfall. Tax experts say first-time offenders are often granted penalty relief, so it's worth requesting the waiver if you find yourself in this situation.

All subsequent RMDs must be taken by the end of the year. You can take money out monthly, quarterly, or whatever schedule you like as long as the total is withdrawn by December 31.

The big change for RMDs this year: The IRS has implemented new tables that account for today's longer life expectancies, noted Steffen. Your RMD will be smaller than it would've been under the previous life expectancy table, which means more money can continue to grow tax-deferred in your retirement account.

Charitable Giving

Do a qualified charitable distribution (QCD). Starting at age 70 1/2, you can donate money directly from your IRA to charity. When you hit RMDs at age 72, a QCD can also satisfy your RMD. But to have your distribution do double duty, do the QCD before you take your full RMD.

"The first dollars out have to be the RMD," said Steffen. "So the first dollars have to go to a QCD if you want to also satisfy the RMD."

You can always give more money, up to $100,000 per year, as a QCD, or you can split up your RMD so that only part of it is a QCD and the remainder is distributed to you.

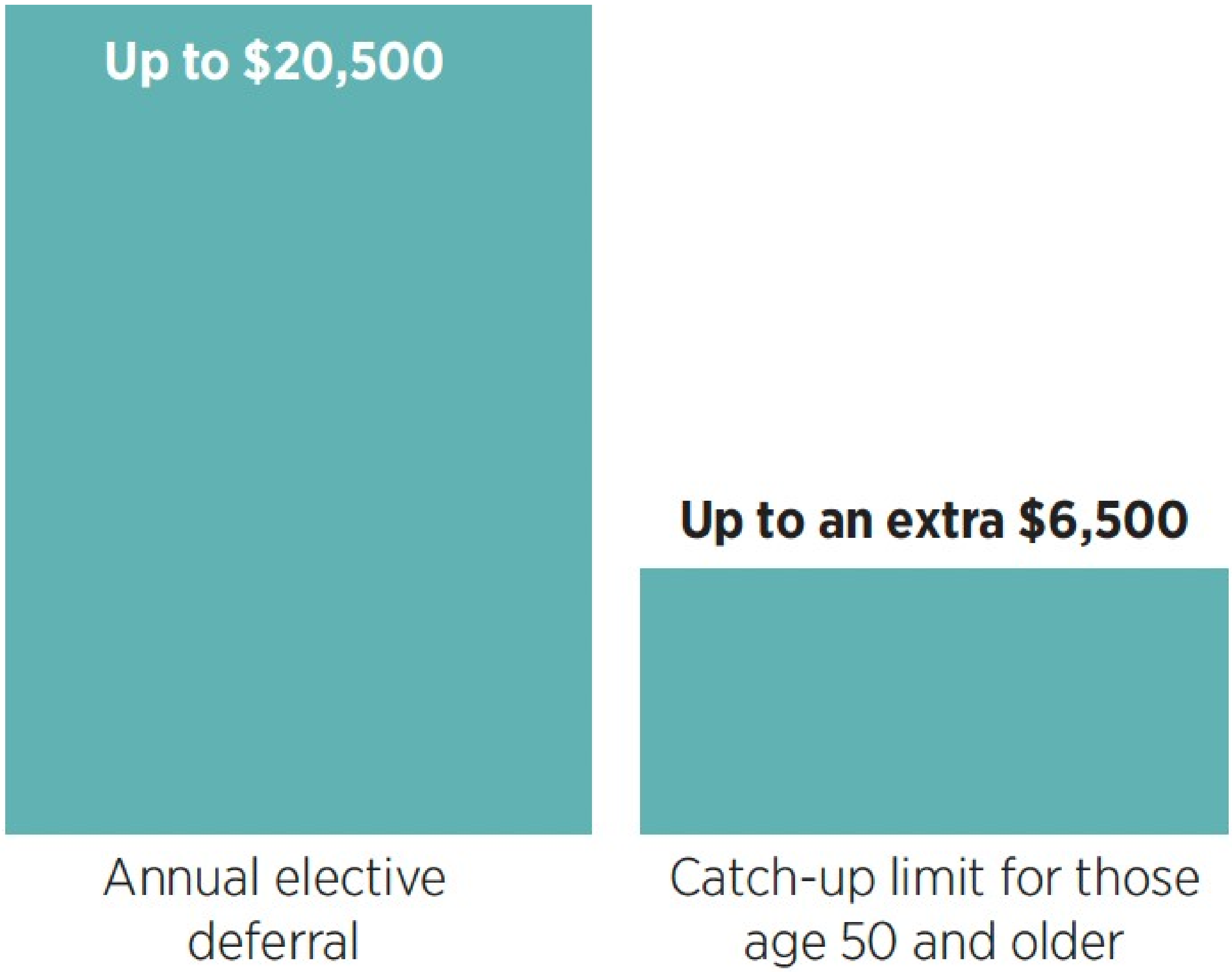
The QCD is a particularly smart move for taxpayers who take the standard deduction. The QCD money is not taxed, even if it is also satisfying your RMD.

"Rather than receiving an itemized charitable deduction, the qualified charitable distribution is excluded from your taxable income," said Rabasca.

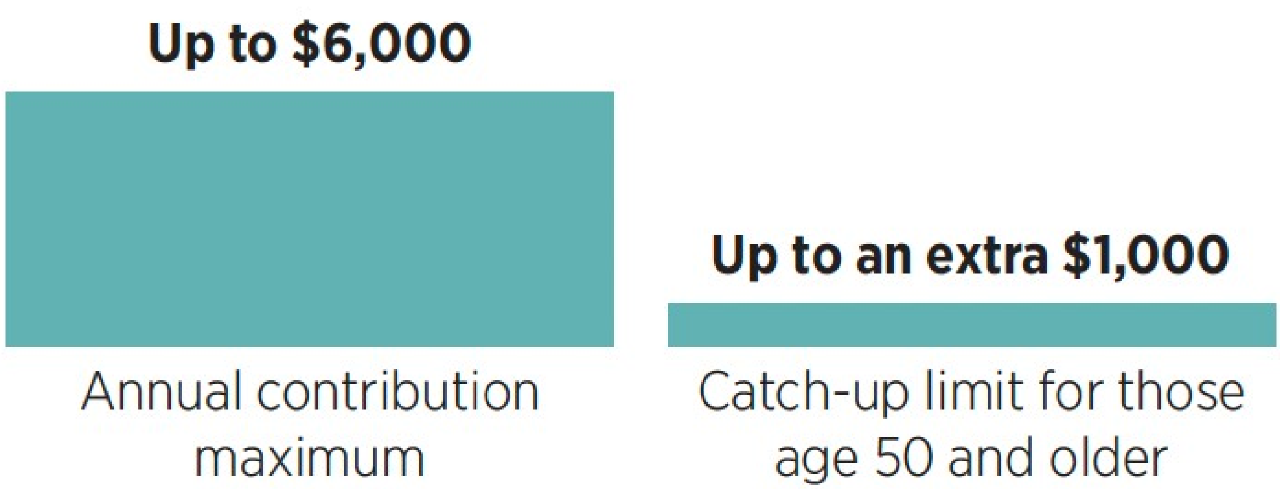
Keep track of donations. As you make charitable donations during the year, collect receipts and acknowledgments and put them in a dedicated file. Track donations throughout the year in a spreadsheet or written list. When you volunteer, write down the mileage you drive in service of charity (which is deductible at 14 cents per mile) and the expenses you incur for charitable work. That way, you'll have all the information you need at your fingertips to write off your charitable donations when tax-filing season arrives. You can also easily check to see how your gifts are stacking up so far this year.

Weigh bunching deductions. Deciding to bunch your deductions may allow you to itemize — and may affect how you give money. Let's say you plan to give $10,000 a year for the next five years. You instead could make a $50,000 deductible gift to a donor-advised fund this tax year. Bunching up your gifts into one year may allow you to itemize and get a write-off on the donation, whereas a smaller gift each year might not be tax-deductible if you don't have enough itemized deductions to exceed the standard deduction.

2022 TSP CONTRIBUTION LIMITS



2022 IRA CONTRIBUTION LIMITS



LONG-TERM CAPITAL GAINS TAX RATES FOR 2022

TAX RATE	TAXABLE INCOME	
	Single filers	Joint filers
0%	Up to $41,675	Up to $83,350
15%	$41,676 to $459,750	$83,351 to $517,200
20%	More than $459,750	More than $517,200

SOURCE: IRS

Medical

Track medical expenses. If you have some big medical bills this year or will be making accessibility changes to your home, you might be able to itemize and deduct these expenses. You can deduct only the amount of your total medical expenses that exceeds 7.5% of your adjusted gross income in 2022. See IRS Publication 502, "Medical and Dental Expenses," to learn more about the expenses that qualify.

Home

Deduct interest and taxes. Homeowners who itemize can deduct part or all of their mortgage interest and property taxes. Under current rules, interest on mortgages of up to $750,000 is deductible. Interest on home equity loans is deductible if you use the money to buy, build, or substantially improve your home; the interest isn't deductible if you use a home equity loan for personal expenses.

The state and local tax deduction is capped at $10,000 for 2022. Property taxes are subject to that cap.

Deduct moving expenses. Civilians can't deduct moving expenses, but people moving for military service still can.

"Only military moves are tax deductible," said Willetts. You can deduct unreimbursed expenses if you are on active duty and your move is due to a military order and the result of a PCS.

Take the home office deduction. If you are self-employed and have a dedicated home office space, you may be eligible to take a home office deduction. Those with side gigs may qualify for a deduction on their self-employment income. You can figure the deduction by either using a calculation with actual expenses or the simplified method, which has a rate of $5 a square foot for business use of the home with a maximum deduction of $1,500.

Keep receipts for home improvements. The cost of home improvements can be added to your home's basis; the higher the basis, the less in potentially taxable profit you may have when you sell a primary home.

Generally, homeowners who lived in their home for two of the last five years can exclude up to $250,000 in home-sale profit for single filers, and up to $500,000 for joint filers. Any excess is a taxable capital gain. Military servicemembers can get a break on the ownership and use tests if they have been on qualified official extended duty.

PORTFOLIO

Harvest tax losses. With significant market volatility, you may have some losers in your investment portfolio. The good news is that capital losses can off set capital gains and up to $3,000 in ordinary income.

"If you have losses to take, take them to sterilize any gains you might have," said Podnos.

Consider harvesting losses when rebalancing your portfolio. Just be mindful of the wash-sale rule, said Bronnenkant. You disqualify the deductibility of your loss if you sell an investment and repurchase it within 30 days of the sale.

Take advantage of the 0% rate. Investments held for more than a year qualify for capital gains tax rates. The star of those attractive set of rates is the 0% tax rate that applies to single filers with taxable income up to $41,675 and joint filers with taxable income up to $83,350 for 2022. The higher capital gains tax brackets are still favorable, at 15% and 20%, depending on taxable income.

While you need to be careful rebuying similar investments when you sell at a loss, there is no such worry when selling at a gain. You could sell a long-term investment to pay a 0% tax rate on its gain, and then turn around and buy the same investment back, giving you a new, higher basis for whenever you sell those new shares.

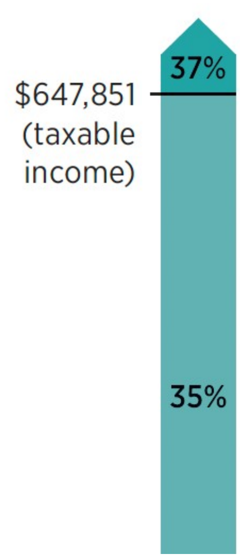
All these moves may not apply to you, but you can mix and match those that do. By doing at least a mid-year status check on your tax situation, you give yourself time to make adjustments.

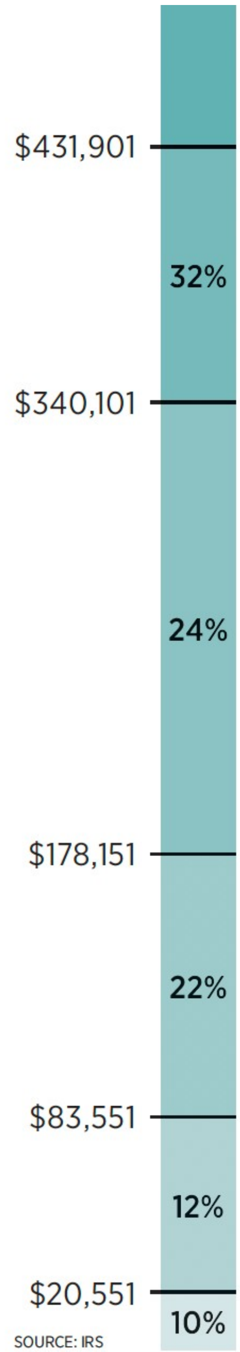
"If you have any surprises at the end of the year, you want to get surprised and get more money," said Willetts.

Rachel L. Sheedy, CFP® is a senior editor for MOAA.

2022 TAX RATES

Federal income tax brackets for joint filers

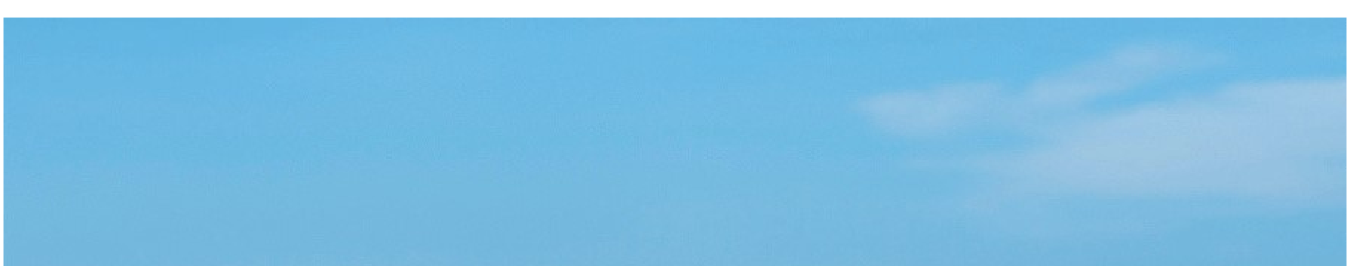




2022 TAX RATES

Federal income tax brackets for individual filers


$539,901
(taxable
income)
35%
$215,951
32%
$170,051
24%
$89,076
22%
$41,776
12%
$10,276
10%



CHECK TAX PAYMENTS TO AVOID PENALTIES

Not paying enough federal income tax as you earn money can trigger penalties when you file, but there are ways to avoid that nightmare.

A few safe harbors can protect you: Pay at least 100% (or 110% for high incomers) of your last year's tax liability, pay 90% of this year's tax liability, or owe less than $1,000 when you file your tax return.

"If you have a big gain this year, you can use last year's tax liability as a base for determining your estimated tax payments. That protects individuals who have a large spike in income," said Henry Grzes, CPA, lead manager for tax practice and ethics with the American Institute of CPAs.

Check to see if you are meeting at least one safe harbor. If you are falling short, you can boost your tax withholding. Withholding on one stream of income can cover tax on other income, such as money from a side gig or a Roth conversion. Otherwise, you can make a quarterly estimated tax payment.

"Halfway through the year is a great time to do a status check," said Tim Steffen, CPA/PFS, CFP®, director of tax planning for Baird, a wealth management firm. "Make sure your withholding or estimated payments are on track."

Retirees have an extra quiver to help mitigate the risk of tax penalties while ditching the hassle of quarterly tax payments. You can ask your account custodian to increase the withholding on your RMD to cover your entire tax bill for the year. Any money **withheld for tax, even in December, is considered to** have been paid evenly throughout the year.