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Why End-Of-Year Tax Planning Is Hazy

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With the Tax Cuts And Jobs Act (TCJA) slated to sunset after next year, tax planning today looks suspiciously similar to advising when the Bush tax cuts were nearing their scheduled expiry at the end of 2010. “What I learned back then, and I’m still applying it now, is being very careful to leave flexibility in year-end tax decisions,” says Jim Holtzman, CEO of Legend Financial Advisors Inc., in Pittsburgh.

And with good reason. After all, much of the Bush-era legislation ultimately stayed intact beyond 2010.

Adding to this year’s planning haziness is the election. Its outcome will undoubtedly affect the tax code’s future. So if a tax move today paints the client into a corner and the law’s eventual landing spot differs from your assumption, “whatever strategy you implemented could hurt the client,” Holtzman warns.

Show clients projections under both existing rules and a TCJA sunset scenario when discussing strategies with them, advises Sharif Muhammad, a partner at JMG CPAs LLC, in Somerville, N.J. “It helps the client see how the landscape changes if tax rules change,” he says.

Andrew Christakos takes the same approach. “We can’t predict the future so we have to work with the data that we have right now,” he tells clients. “Then we work with the client to decide what is best for them,” says Christakos, a CPA and wealth advisor at Christakos Financial in Cranford, N.J.

If the current law expires and tax rates revert to their pre-TCJA schedule, many clients would pay a heftier rate. As a result, advisors say some clients are taking advantage of today’s potentially lower rates by speeding up distributions from traditional retirement accounts, including inherited IRAs, and using the funds to pursue capital gains in taxable accounts.

Siren Song

The specter of higher tax rates enhances the allure of Roth conversions this year as well as next, according to Christopher Fundora, director of retirement planning at Traphagen CPAs & Wealth Advisors, in Oradell, N.J. The rate a client pays on a conversion now could be less than the rate they’d pay if the funds stay in a traditional retirement account and are withdrawn later. In addition, thanks to final Internal Revenue Service regulations issued in July, “a conversion can have significant estate planning benefits because children inheriting a Roth IRA can allow it to grow tax-free for 10 years,” Fundora says.

But be careful. The income from a Roth conversion can affect more than federal tax. There might be income-based state and local breaks, such as property tax exemptions. Or perhaps the client is moving to a state with no income tax, such as Florida, Texas or Wyoming. "Maybe you wait until they've established residency there and then do the conversion to save state taxes," Fundora says.

Finally, consider whether a conversion would impact the client's future Medicare premiums due to IRMAA, the income-related monthly adjustment amount, which elevates premiums for individuals with higher incomes.

Planning For Other Potential Changes
TCJA's demise would chop the standard deduction to roughly half of 2024's amounts, which are $29,200 on a joint return and $14,600 for single filers. Yet that would make it easier to itemize. So pushing deduction-generating events to 2026 could prove savvy.

Consider a client with a donor-advised fund who won't benefit from itemizing for 2024, posits Steven Warren, a senior manager at Schechter Dokken Kanter CPAs in Minneapolis. "This year they could give to the charities of their choosing from the donor advised fund"—an event that doesn't generate a deduction, which the client can't use anyway—"and if there is a law change that takes the standard deduction down, after the change's effective date would be a good time to either replenish the donor advised fund or give directly to charities. They'd get a charitable deduction [then] and may be better able to take advantage of itemizing," Warren says.

The estate tax is also up in the air. If today's law succumbs, the estate tax exemption would fall about 50% from $13.61 million per person this year. Vice President Kamala Harris supports taking it lower, to $3.5 million, as well as raising the tax rate to 55% or higher, depending on the estate's size.

Warren says he's giving clients who would fall prey to the estate tax if the exemption drops "some ideas to think about, but I encourage them to sit down with their estate planning attorney who really specializes in this. And if they don't have one, I encourage them to get one."

Don't Overlook Estimated Taxes
Anyone with significant interest income probably should have been making quarterly tax payments this year. "And some people aren't withholding from their social security the way they should. It's like a foreign concept," says Jeremy Keil, with Keil Financial Partners in New Berlin, Wis. He thinks that's partly because taxpayers must proactively request withholding from their federal benefits either by calling the Social Security Administration or submitting Form W-4V.

Urge existing and prospective clients to remedy payment deficiencies as soon as possible, preferably via additional withholding from their social security, paycheck or pension payments for the rest of the year, or by withholding tax from a late-year retirement plan distribution. All of these are treated as having been paid evenly throughout the year and therefore lower earlier quarters' shortfalls, Keil tells clients. "That will help reduce penalties."

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