

2022 Year-End Wealth Planning Considerations

Maintaining Focus to Position for a Strong New Year

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This year has created wealth planning challenges due to inflation and market results. Nevertheless, a major purpose of planning is to prepare for scenarios, such as the past year, to balance short-term wealth preservation with the ability to thrive in the long-term. There are numerous strategies to consider which may prove pivotal in strengthening your wealth management plan, minimizing its tax exposure, and sustaining your family business and legacy, regardless of the market environment. The following are ideas to consider which may lead to further opportunity in 2023 and beyond.

Inflation: The Predominant Issue of 2022 (and likely into 2023)

A continued focus on how the current inflationary environment impacts your wealth plan is a starting point in determining next strategic decisions. The current inflationary environment unfortunately was not transitory. There is debate whether inflationary levels reached in 2022 will persist or begin to elevate due to interest rate hikes imposed by the Federal Reserve, supply chain improvement, and winding down of the COVID-19 pandemic. Measured by the Consumer Price Index (CPI), inflation had reached as high as 9.1% month over month in June and has been elevated over 8% for a majority of 2022.

A stress test of your wealth plan is prudent to determine the fiscal impact this year has had on your needs and aspirations. Numerous surveys have estimated that inflation may inflate household costs in excess of \$10,000 this year. This value may vary depending upon what goods and services are central to a lifestyle expense calculation. Although the immediate stress price inflation causes are burdensome, it is higher levels of inflation over an extended period of time that impacts the probability of long-term financial success. It is also prudent to maintain flexibility with cash holdings to determine their best use in a changing investment and debt landscape.

Income Tax: Management is Key

While income tax management is always an important consideration, management of income taxes will become a greater wealth planning focal point moving forward due to the passage of the Inflation Reduction Act (IRA) in August. One of the IRA's key provisions was to grant the Internal Revenue Service \$80 billion dollars of funding for artificial intelligence and hiring of 87,000 additional IRS agents to enforce current tax rules and regulations beginning in 2023. Attention paid to wealth strategy formalities and leverage of tax counsel will be significant to maintain overall compliance and efficiency.

Know Your Brackets

Key tenants of navigating income tax planning include bracket management and tax harvesting of investment gains and losses. Bracket management involves taking a comprehensive approach to your overall tax planning. This includes considering applicable ordinary income tax rates, capital gains rates, carry forward gains/losses, and credits. Once you have knowledge regarding your brackets, you can proceed with strategies that provide tax planning upside which are correlated with your planning intentions.

Income Tax: Management is Key cont.

Tax Harvesting

Market declines in 2022 provide an opportunity to rebalance your investment portfolio for 2023. Long-term capital gains rates in 2022 range are 0% (income less than \$83,850 married filing jointly (MFJ)), 15% (income range of \$83,851 to \$517,200 MFJ), and 20% (income greater than \$517,200 MFJ). As well, a net income investment tax (NIIT) rate of 3.8% may apply if threshold values are met. Implementation of a tax harvesting strategy may allow for the neutralization of tax on long-term gains through the offset of losses from positions that may have struggled to a greater extent in the current market environment. Liquification of gains and losses will also provide the opportunity to tactically position your portfolio for new strategies as the markets and economy continue their evolution.

Retirement: A Bigger Focus

The COVID-19 pandemic resulted in one of the greatest retirement events in American history. The current inflationary environment has resulted in a number of employees reconsidering their retirement planning due to significant increases in the cost of goods and services. There are various ideas to consider regarding retirement planning.

Maximize Contributions

Maximizing contributions to a qualified retirement plan provides an opportunity for current tax deferral. The annual contribution limit for 401(k) plans increased to \$20,500 in 2022. For individuals over the age of fifty, the “catch-up” allowance remained \$6,500, increasing the 401(k)-contribution limit to \$27,000. Like in 2021, the amount you can contribute to an Individual Retirement Account (IRA) is \$6,000 (with a \$1,000 “catch-up” for individuals over the age of fifty, the total contribution limit is \$7,000). There is no age limit for Traditional and Roth IRA annual contributions. Keep in mind, your IRA contribution may not be deductible, depending on your adjusted gross income (AGI).

Social Security

Social Security benefits provide a unique planning opportunity because cost of living adjustment (COLA) is linked to inflation. In October, Social Security announced that benefits and Supplemental Security Income payments for approximately 70 million Americans will increase by 8.7% in 2023. It is highly recommended that a full social security benefit distribution analysis is performed as part of your wealth plan to ensure benefits are opted into at the most beneficial time and are accurately reflected in your future cash flow.

Consider a Conversion to a Roth IRA

A conversion of traditional IRA assets to a Roth IRA may be prudent if account proceeds are seen more for legacy/estate planning purposes versus retirement needs. The overall “conversion cost” for a Roth conversion may be less today due to market declines and subsequent decreased account values. A wealth planning cash flow and Monte Carlo probability analysis can confirm if a Roth IRA conversion strategy may be considered.

Marrying Philanthropic and Retirement Planning Goals

Philanthropic retirees may consider the funding of a Charitable Remainder Trust (CRT) to create an ongoing income stream while meeting future charitable intentions by leaving the trust remainder to the charity or charities of the donor’s choosing. A CRT may be useful to potentially offset a significant capital gain, such as the sale of a closely held business, through the receipt of an income tax deduction in the year of the capital event. Distributions from the trust as “tiered” (ordinary income, capital gains, return of basis) to potentially provide a blended rate of taxation.

A CRT may also be funded as a retirement supplement. This type of CRT is named a Net Income Makeup Charitable Remainder Trust or NIMCRUT. Unlike a traditional CRT, a NIMCRUT will minimize income distributions before the donor’s retirement and maximize distributions once retirement begins. Trust assets are managed to generate little to no income during the retirement accumulation phase of the strategy. Upon retirement, assets are shifted to generate greater income. Use of the trust’s “net income makeup” allows for the trust to catch up income distributions when needed and allow for tax-deferral of investment growth without the age distribution restrictions of a qualified plan or IRA.

Estate Planning: “The Golden Age Continues”

The non-adoption of tax reform last year has provided a continuation of rules that are favorable for impactful, generational legacy planning. Keep in mind that the “golden age” is finite. The current federal gift and estate tax rules are scheduled to sunset at the end of 2025 to pre-Tax Cuts and Jobs Act levels of 2017.

Leverage Your Current Annual and Lifetime Exemptions

For 2022, the annual exclusion gift limit is \$16,000 each to an unlimited number of recipients. Spouses may combine their exclusions for a \$32,000 gift. Beginning January 1, 2023, the annual exclusion gift limit will increase to \$17,000 each to an unlimited number of recipients and spouses may combine their exclusions for a \$34,000 gift. These gifts may be made directly to individuals or specific types of trusts for the benefit of others designed for this purpose. The gifts can also be comprised of non-cash assets, including stocks and bonds, ownership interests in real estate and businesses. If you believe you are in a position to shift wealth to the next generation, please consider using all, or a portion, of your lifetime gift tax exemption (\$12,060,000 per person in 2022 and \$12,920,000 per person in 2023) to remove assets from your taxable estate. Valuation decreases in closely held business and account values may present a unique gifting opportunity to position for future appreciation outside of your taxable estate. Closely held business interests may be eligible for valuation discounts if certified by an accredited, defensible business valuation.

A Sale of Assets May Be Preferred Versus Gifting Today

IRS Applicable Federal Interest Rates (AFRs), used in sales transactions between generational family members, entities, and trust, are still relatively low but will have at a minimum doubled by the end of 2022. Securing an interest rate today may save significant dollars in interest to transfer assets to future generations. In turn, the sale of an asset, so long as cash flow is significant enough to cover promissory note interest, may be preferred versus an irrevocable gift as current gift exemption will likely be available until 2025 without risk of reduction.

Grantor Trust Structures Still Favored

As with any irrevocable strategy, if you have more than enough assets to maintain your lifestyle, a Grantor Trust may be the next logical step in your estate plan. A Spousal Lifetime Access Trust (SLAT) is a viable way to indirectly maintain access to cash flow through your spouse while shifting future appreciation to the next generation. The use of a Grantor Retained Annuity Trust (GRAT) or Intentionally Defective Grantor Trust (IDGT) options are also for estate compression and security of legacy.

Charitable Giving is Viable

Contribution of cash or non-cash assets before December 31st may be eligible for an income tax deduction so long as you itemize versus applying the standard deduction. The \$300 charitable allowance “above the line” (\$600 for married couples) is no longer viable due to expiration of the CARES Act at the end of 2021. AGI limitations previously increased pursuant to the CARES Act have also return to pre-pandemic values.

Conclusion

While 2022 has been a challenging year regarding inflation and the financial markets, as we approach year end, there are numerous strategies available to help you achieve personal and financial objectives by enhancing your overall wealth plan. Our local Private Wealth Management teams look forward to discussing these and other ideas to achieve your financial goals.



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