Fall 2023

Issues related to taxable income

Tax on capital gains: Gain or loss from the sale of capital gain property (such as investments) held more than one year is treated as a long-term capital gain or loss. Property held one year or less is treated as short-term.

Long-term capital gains (as well as qualified dividends) are taxed at preferential tax rates that are lower than the ordinary income tax rates and detailed in the following chart. Short-term capital gains are taxed at ordinary income rates.

Rate	Taxable income breakpoint (2023) (Rev. Proc. 2022-38)
0%	Single: $44,625 MFS: $44,625 MFJ: $89,250 HOH: $59,750 Estates and trusts: $3,000
15%	Single: $492,300 MFS: $276,900 MFJ: $553,850 HOH: $523,050 Estates and trusts: $14,650
20%	No breakpoint

If your income is below the taxable income breakpoint for the 0% rate, then harvesting long-term capital gains to generate free income can be a great tax strategy.

Capital losses: Capital losses are only deductible to the extent they offset capital gains, with the small exception that capital losses can be used to offset up to $3,000 of ordinary income each year ($1,500 for married couples filing separately). Any unused capital losses carry forward to future years.

Retirement account distributions (in general): Distributions from retirement accounts, such as IRAs, 401(k) or other employer-sponsored retirement plans are taxed as ordinary income. Any stock market transactions within these structured retirement accounts do not give rise to a taxable event. The taxable event is the act of pulling the money out of the account.

Required minimum distributions (RMDs): The mandatory age to begin taking required minimum distributions (RMDs) is increased from age 72 to:

- Age 73 for those who turn age 72 after 2022 (taxpayers born in 1951 through 1958); and
- Age 75 for those who turn age 74 after 2032 (taxpayers born after 1958).
  (SECURE 2.0 Act §107; IRC §401(a)(9)(C)(i)(I))

Limited RMD relief for taxpayers born in 1951

Acknowledging the difficulty many plan administrators and other payors are having complying with changes made by the SECURE 2.0 Act to certain required minimum distribution (RMD) rules, the IRS issued Notice 2023-54 granting relief to taxpayers born in 1951.

Taxpayers who were born in 1951 and received RMDs prior to August 31, 2023, but shouldn’t have because the RMD age requirement was increased to age 73 could have rolled these distributions back into their retirement accounts even if the 60-day period has lapsed, as long as the rollover was completed by September 30, 2023.

You can delay your first RMD to the year after you turn age 73, but must take the first distribution by April 1 of the second year and you must take your second year’s RMD by December 31. In other words, if you choose not to take your RMD in the year you turn age 73, then you must take two RMDs the next year.

Calculating the RMD is very simple. It’s as simple as dividing the balance of your retirement account on December 31 of the previous year by a life-expectancy factor published in IRS Publication 590-B. For example, a person who is age 74 in 2023 has a life expectancy factor of 25.5 years. Assume this person has an IRA with an account balance of $275,000 on December 31, 2023. This person’s 2023 RMD is $10,784 ($275,000 ÷ 25.5).

Missed RMDs: Taxpayers who fail to take their required RMD are subject to a special excise tax equal to 25% of the missed RMD. This penalty was 50% until the end of 2022. The penalty is reduced to 10% of the missed RMD if the taxpayer corrects the error during a specified “correction window" period. However, taxpayers who file Form 5329, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts, with their income tax return can request a penalty waiver for the entire penalty amount. The IRS is typically very lenient when it comes to waiving this penalty.

Qualified longevity annuity contracts (QLAC): Qualified longevity annuity contracts (QLACs) are investment vehicles that allow taxpayers to remove assets from their IRA and hold them until later retirement years. (Treas. Regs. §1.401(a)(9)-6, Q&A 17)

The cornerstone of the QLAC is the removal of RMD requirements for assets placed in a QLAC. They make it easier for retirees to address the risk of outliving their assets by using a limited portion of their retirement savings to purchase a policy in a retirement plan that will provide guaranteed income for life starting at an advanced age. Distributions from the QLAC must commence no later than age 85 (although the contract may specify an earlier age).

The premiums paid for all QLAC contracts for the benefit of any individual cannot exceed $200,000 (indexed for inflation starting in 2025). (SECURE 2.0 Act §202)

IRA contributions: Taxpayers can continue making contributions to either a traditional IRA or Roth IRA at any age, as long as the taxpayer has earned income. Earned income is income earned from working, not from investments. The IRA contributions limits for 2023 are $6,500, plus an additional $1,000 catch-up contribution for those age 50 and over.

Whether a taxpayer can claim a deduction for contributions to a traditional IRA depend on whether the taxpayer or their spouse is an active participant in an employer-sponsored retirement plan and the amount of the taxpayer’s adjusted gross income. Taxpayers can always make non-deductible contributions to traditional IRA accounts but should be careful to track their basis year-over-year and should consider using a “back-door” Roth IRA conversion strategy when available.

Whether a taxpayer can contribute to a Roth IRA depends on the amount of the taxpayer’s adjusted gross income. If their income is too high, then they cannot make a Roth IRA contribution. However, taxpayers can always do a Roth conversion, no matter their income level.

Qualified charitable distributions (QCD): Taxpayers may exclude up to $100,000 annually in “qualified charitable distributions” (QCDs) from their AGI. (IRC §408(d)(8))

QCDs are:

- Made directly by the IRA trustee to a charitable organization; and
- Made on or after the date the taxpayer reaches age 70½.

Issues related to tax deductions

Standard deduction for 2023: The standard deduction remains high through 2025 thanks to the Tax Cuts and Jobs Act. The standard deduction for 2023 is:

Filing status	2023
Married filing joint and qualifying widow(er)	$27,700
Head of household	$20,800
Single	$13,850
Married filing separate	$13,850

Taxpayers who are age 65 by the end of the year or who are blind can claim an additional standard deduction of:

Filing status	2023
Unmarried	
Elderly or blind	$1,850
Elderly and blind	$3,700
Married	
Elderly or blind (per taxpayer)	$1,500
Elderly and blind (per taxpayer)	$3,000

Medical expenses: Taxpayers can deduct medical expenses paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. However, medical expenses generally only deductible to the extent the taxpayer can climb two hurdles:

- They are only deductible to the extent they exceed 7.5% of adjusted gross income; and
- The taxpayer must itemize their deductions.

Issues related to estate and gift taxes

Lifetime estate and gift exemption (aka, the unified exclusion): Taxpayers will only pay estate tax (a tax on the transfer of wealth after you die) if the net value of their assets when they die is over $12.92 million (the unified exclusion). Married couples can essentially double this figure.

The unified exclusion is adjusted annually for inflation and increases incrementally each year. However, lawmakers on each side of the political aisle constantly battle over the amount of unified exclusion. Under current law, the unified exclusion is set to revert back to $5 million in 2026.

Annual gifts: Taxpayers can make tax-free gifts of up to $17,000 to anyone they wish without having to file a gift tax return. There is no limit the number of people a taxpayer can make a gift to. For example, a grandparent with 10 grandchildren can gift each grandchild up to $17,000 for the year ($170,000 of gifts in total). The gifts are completely tax free to the grandchildren and the taxpayer is not required to file a gift tax return.

Taxpayers who make gifts over $17,000 to any one person must file a gift tax return to report their “taxable gift.” A gift is referred to as a taxable gift if it is over the annual gifting limit. However, gift taxes will only be paid if the lifetime gifts made by the taxpayer exceed the unified exclusion amount ($12.92 million in 2023).

If any gift tax is owed on a taxable gift, then it is owed by the person making the gift. Gifts are always tax free to the recipient. There is an exception to this rule if the IRS cannot collect gift taxes from the person who made the gift. In that scenario, the person receiving the gift can be the one left holding the tax bag.

Annual gift exceptions: There are two unique exceptions to the annual gift tax limits. Taxpayers can pay tuition or medical bills without using up any portion of their $17,000 annual gift. Tuition must be paid directly to the educational organization and medical bills must be paid directly to the provider. The money cannot go to the person it’s benefiting first.

Grandparents who want to make tuition gifts will find that paying tuition directly to a college or university is more beneficial than making a gift to a §529 education savings plan where the grandchild is near, or has already reached, college.

Portability: Taxpayers who estate is under the unified exclusion amount when they die are not required to file an estate tax return (IRS Form 706). However, they must file a gift tax return if they want to elect “portability.” Portability means that that a deceased taxpayer can give their unused exclusion to their surviving spouse.

For example, assume a married couple has a net estate worth $8 million when Spouse 1 dies in 2023. The surviving spouse may decide to not file an estate tax return because the total assets are under the $12.92 million unified exclusion. If an estate tax return is not filed and the estate remains at $8 million when Spouse 2 dies in 2026 (when the unified exclusion is reduced to $5 million), then Spouse 2 will have a $3 million taxable estate ($8 million estate upon death minus $5 million unified exclusion). With an estimated estate tax rate of 40%, Spouse’s estate will pay $1.2 million in estate taxes.

However, if Spouse 2 were to file an estate tax return upon Spouse 1’s death, then Spouse 2’s unified exclusion at the time of her death would be $17.92 million ($12.92 million exclusion transferred from Spouse 1 plus Spouse 2’s exclusion amount of $5 million at the time of her death). In this scenario, Spouse 2’s exclusion would be greater than the value of her estate and her estate would pass to her heirs without any tax liability. The simple act of filing an estate tax return saved $1.2 million in federal taxes.

Inherited retirement accounts

Retirement accounts that are inherited from a taxpayer who dies after December 31, 2019 generally must be fully distributed by the end of the year that contains the 10^{th} anniversary of the account owner's date of death. There are only five types of beneficiaries who can stretch out their inherited account over their life expectancy:

- Surviving spouses;
- Minor children of the decedent (under age 21);
- Those who are not more than 10 years younger than the decedent;
- Those who are disabled; and
- Those who are chronically ill.

Since the SECURE Act's enactment, the IRS has issued numerous points of guidance and regulations to clarify the rules, such as what happens when the beneficiary is a trust and the trust's only beneficiary is the surviving spouse. The rules in this area are very detailed and nuanced.

California-specific issues

Property tax transfers: California's Proposition 19 made major changes to California's property tax regime in two areas:

- Base-year value transfers; and
- Parent-child transfers.

Taxpayers age 55 and over can now transfer their Proposition 13 base-year value up to three times in their lifetime. The transfer applies to all counties in California. Prior to Proposition 19, taxpayers could only transfer their base-year value once in their lifetime and only if the county where the taxpayer's new home is located allowed base-year value transfers from other counties.

In order to transfer your base-year value to a new home, the replacement home must be equal or lesser value than the old home.

Parents can no longer transfer their Proposition 13 base-year value to their children, the following limitations apply:

- The child must use the home as their principal residence within one year of the transfer; and
- Only the first $1 million of additional assessed value is excluded from reassessment.

The new parent-child transfer rules apply to real estate transfers on or after February 16, 2021. Transfers that took place before that date apply the old transfer rules that did not contain the two limitations above.