Year-end tax planning for retirees

Tax-loss harvesting and charitable contributions can lower what retirees owe the IRS.

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Between rising prices and falling portfolio values, 2022 has been a brutal year for most Americans, particularly retirees on fixed incomes squeezed by inflation and concerned about their dwindling nest eggs. But some well-timed year-end tax moves, coupled with higher Social Security benefits beginning in January, could offer some future financial relief.

The annual Social Security cost-of-living adjustment for 2023, which will be announced on Oct. 13, is expected to top 8%, according to the Senior Citizens League. That would be the largest increase since 1981.

The silver lining of recent stock market losses is the potential for tax-loss harvesting. Selling depreciated assets that have been held for more than one year in a non-retirement account can result in long-term capital losses that could offset equal amounts of taxable gains and up to $3,000 of ordinary income.

Generally, you can't claim a loss on retirement accounts, which already are receiving favorable tax treatment. The only time you would have a loss is when you receive a distribution that had previously been taxed.

Timing is key. Short-term capital gains on the sale of assets held one year or less are taxed at ordinary income tax rates, which can range as high as 40.8% after adding the 3.8% Medicare surtax to the top tax bracket of 37%. But long-term gains may be taxed at as little as 0%, 15% or 20%, depending on income level.

Determining the taxability of investment gains and losses involves a specific matching sequence: net short-term gains and short-term losses; net long-term gains and long-term losses; net short term against long term. Finally, taxpayers can deduct up to $3,000 of excess losses against ordinary income per year and carry any remaining losses over to future tax years.

In 2022, individuals with taxable income of up to $41,675 would pay no capital gains taxes and those with taxable income between $41,676 and $459,750 would pay a 15% rate on long-term capital gains and qualified dividends. Individuals with taxable income over $459,751 would be subject to the maximum 20% capital gains rate.

Married couples filing jointly in 2022 would pay no capital gains tax if their joint taxable income was $83,350 or less. If their taxable income was between $83,351 and $517,200, they would pay a 15% capital gains rate and if their taxable income exceeded $417,201, they would pay the maximum 20% capital gains rate.

Charitable contributions offer another opportunity to lower taxable income, but it may take some extra effort. After Congress nearly doubled the standard deduction and capped the deduction for state and local taxes with the Tax Cut and Jobs Act of 2017, fewer taxpayers are able to itemize their deductions, including charitable contributions.

In 2022, individual taxpayers and married couples filing separately have a standard deduction of $12,950; it’s $19,400 for heads of households; and married couples filing jointly have a standard deduction of $25,900. Plus, individual taxpayers 65 and older qualify for an additional standard deduction of $1,750 and married couples 65 and older qualify for an additional standard deduction of $1,400 per person.

One option is to bunch charitable deductions into one year and take the standard deduction in an alternate year if eligible. For example, rather than making contributions this December, you might defer then until January, and then later in 2023, make other contributions to give you enough of a deduction to itemize next year.

A donor-advised fund offers another way to bunch charitable contribution. This vehicle allows you to make a tax-deductible contribution in one year, assuming the contribution exceeds the standard deduction for your age and marital status. You can decide which charities will receive gifts at a later date.

Individual retirement account owners who are 70½ and older have another option. They can direct up to $100,000 a year directly from their IRA to a charity through a qualified charitable distribution with no income tax consequences. It can be used to satisfy some or all of an individual's annual required minimum distribution. Even though the minimum RMD age has been increased from 70½ to 72, those 70½ and older can still take advantage of this unique QCD tax strategy. However, gifts made to donor-advised funds or charitable gift annuities are not eligible for QCD treatment.

While the QCD doesn't qualify for a charitable deduction, the excluded income could reduce an individual's overall tax liability and possibly reduce or avoid future Medicare high-income surcharges. Modified adjusted gross income in 2022 will determine Medicare premium surcharges for 2024.

Speaking of Medicare, next year premiums for Medicare Part B, which covers outpatient services such as doctor's visits, and high-income surcharges will drop for the first time in a decade, according to the Kaiser Family Foundation. The premium will fall from $170.10 this year to $164.90 in 2023. The income-related monthly adjustment amounts paid by higher-income beneficiaries will also go down for 2023, and the income for each bracket will be adjusted upward.