

# Want to Reduce Your Income Tax? Start Planning Now!

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**Y**ou probably just filed your 2021 tax return a month ago or so, and you're ready to put taxes at the back of your mind for at least a few months. This may not be your best thinking because, if you want to pay less in 2022, now's the time to start planning.

What you do from now until December 31 of this year, can have a significant impact on how much income tax you'll owe, or the size of the refund you can expect to receive, next year. That's why here at SWC, we're encouraging our clients to schedule their Mid-Year Meeting as soon as possible.



In fact, tax planning is becoming increasingly important for two reasons:

- First, thanks to inflation and other economic pressures, increases in income aren't likely to keep pace with inflation. Saving on taxes may help alleviate some of that pain.
- Second, if any pieces of current administration's tax plan are implemented, tax rates for both individual and corporate taxpayers could increase. Having a tax plan in place to account for these potential increases and maximize the deductions and credits for which you qualify, may help to counter some of those increases.

As you prepare for your Mid-Year Meeting with us, we encourage you to start thinking about

the various steps you can take now to avoid any nasty surprises next year, including:

1. Consider adjusting your tax withholding or estimated payments
2. Get a grip on the timing of investment gains and losses
3. Take advantage of lower tax rates on investment income
4. Check your deduction strategy
5. Be prepared for issues related to virtual currency
6. Consider if a reverse mortgage is right for you

In this singlette, we're going to cover all of the above and more. First up, tax withholding and estimated payments.

## Review Your Tax Withholding or Estimated Payments

The U.S. has a pay-as-you-go tax system, meaning that citizens pay taxes as they earn money. Here's what that means:

- If you have a job, your employer deducts income taxes and other taxes from your pay automatically and remits those amounts to the taxing authorities (federal, state, and local) on your behalf.
- If you're self-employed or own your own business, you're required to send in quarterly estimated tax payments based on what you or your business earned over the course of each quarter.
- If you don't pay enough income tax over the course of the year, you get hit with a tax bill and, in many cases, a penalty. For those accustomed to receiving refunds every year, an unexpected tax bill can be a real hardship.

To avoid getting a large, unexpected tax bill at the end of the year, we encourage our clients to reevaluate their tax withholdings or your quarterly estimated taxes.

***Pro Tip:** If you haven't reviewed your withholding recently, consider using the Internal Revenue Service (IRS) online [Tax Withholding Estimator](#). You will need your most recent pay stubs (for both spouses if married filing a joint return), details of other sources of income, and a copy of your most recent tax return. If you're self-employed or own a small business, use [Form 1040-ES](#) (Estimated Tax for Individuals), instead.*

Keep in mind that the IRS calculator isn't precise. For more specific guidance, we would be happy to do a 2022 tax projection for you to ensure that you're not underpaying or overpaying taxes throughout the year.

## Estimate Capital Gains and Losses

Whenever you sell an investment (typically stocks or mutual funds), any profit from the sale is a *capital gain* (i.e., the difference between the adjusted basis — the net cost of an asset after

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*adjusting for various tax-related items — in the asset and the amount you realized from the sale is a capital gain or a capital loss*). If you owned the investment for longer than a year, the profit is taxed as a *long-term capital gain*. If you owned it for less than a year, it is taxed as a *short-term capital gain*. The difference in tax rates for long- and short-term capital gains is significant.

Short-term capital gains are taxed at the same rates as income. For 2022, those rates are applied as follows:

- 10 percent for single filers earning up to \$10,275, married couples earning up to \$20,550, or heads of household earning up to \$14,650
- 12 percent for single filers earning \$10,275–\$41,775, married couples earning \$20,550–\$83,550, or heads of household earning \$14,650–\$55,900
- 22 percent for single filers earning \$41,775–\$89,075, married couples earning \$83,550–\$178,150, or heads of household earning \$55,900–\$89,050
- 24 percent for single filers earning \$89,075–\$170,050, married couples earning \$178,150–\$340,100, or heads of household earning \$89,050–\$170,050
- 32 percent for single filers earning \$170,050–\$215,950, married couples earning \$340,100–\$431,900, or heads of household earning \$170,050–\$215,950
- 35 percent for single filers earning \$215,950–\$539,900, married couples earning \$431,900–\$647,850, or heads of household earning \$215,950–\$539,900
- 37 percent for single filers earning \$539,900 or more, married couples earning \$647,850 or more, or heads of household earning \$539,900 or more

Long-term capital gains are taxed at much lower rates for most investments:

- 0 percent for single filers earning less than \$41,675, married couples earning less than \$83,350, or heads of household earning less than \$55,800
- 15 percent for single filers earning \$41,675–\$459,750, married couples earning \$83,350–\$517,200, or heads of household earning \$55,800–\$488,500
- 20 percent for single filers earning \$459,750 or more, married couples earning \$517,200 or more, or heads of household earning \$488,500 or more

If your taxable income hovers around these threshold amounts, you can take steps now to lower your reported income. For example, by making contributions to an individual retirement account (IRA) or an employer retirement plan or by deferring bonuses. If you own a business and use the cash method of accounting, you can wait until the end of the year to send out some client invoices.

If your income is still too high to benefit from a lower rate, consider gifting investments to grandchildren, children, or loved ones. If they will be in the 0 percent or 15 percent capital gains tax bracket when they later sell the investments, any gain will be taxed at the lower rates, assuming that you and your loved one owned the investments for more than one year.

This approach has two risks, however.

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- First are gift tax consequences if you transfer assets worth more than \$16,000 during 2022 to a single recipient (\$32,000 if married and each spouse makes an equitable gift).
- Second, all children under age 18 and most children age 18 or ages 19 to 23 who are full-time students are subject to the “Kiddie Tax” rules. Kiddie Tax rates are tied to the parent’s tax bracket. The Kiddie Tax limits the opportunity for parents to take advantage of the 0 percent capital gains rate by gifting appreciated property to their children, including college age children.

## Beware of the Net Investment Income Tax (NIIT)

Higher-income individuals also may be hit with the 3.8 percent Net Investment Income Tax (NIIT), which can result in an effective marginal federal rate of up to 23.8 percent (20 percent plus 3.8 percent) on long-term capital gains.

Under the current administration’s proposed tax plan, the rate on long-term gains would increase to 39.6 percent for taxpayers making over \$1 million, which, when combined with the NIIT, would result in a marginal rate on long-term gains of up to 43.4 percent (39.6 percent plus 3.8 percent).

*Recommendation: Until we know exactly where the capital gains rates will fall in 2023, the best approach at the moment is to remain watchful.*

## Keep an Eye on Your Holding Period for Investments

Because long-term capital gains are taxed at a much lower rate, it often makes sense to hold investments that are performing well for at least one year and a day before selling them. Biting the bullet and selling some *loser securities* (securities currently worth less than you paid for them) before year end may also be beneficial.

Any capital losses taken before year end will offset capital gains from other sales in the same year. If capital losses for this year exceed capital gains, you will have a net capital loss for 2022. You’re allowed to use that net capital loss to shelter up to \$3,000 of this year’s higher-taxed ordinary income from salaries, bonuses, and self-employment (\$1,500 if you’re married and file separately). Note that any excess net capital loss will be carried forward to 2023.

## Decide Whether to Itemize or Claim the Standard Deduction

If you have significant personal expenses, itemizing is generally best. However, we don’t want you to rule out the standard deduction. For 2022, joint filers can claim a standard deduction of \$25,900. The standard deduction for heads of household is \$19,400, and single taxpayers (including married taxpayers filing separately) can claim a standard deduction of \$12,950.

There are a couple strategies for increasing your itemized deductions to make itemizing a more attractive choice, such as:

- Bunch state and local taxes into alternating years by paying two years’ worth of

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taxes in a single calendar year. Unfortunately, tax reform passed in 2017 limited the deduction for state and local taxes to \$10,000 (\$5,000 if married filing separately), and we don't expect that to change any time soon.

- Bunch charitable contributions into alternating years. In many instances, this can be accomplished through a donor-advised fund, also known as a *charitable gift fund* or *philanthropic fund*. Taxpayers can claim the charitable tax deduction in the year they fund the donor-advised fund and schedule grants over the next two years or other multiyear periods.

For taxpayers over age 70½ who won't itemize in 2022 but still want to make contributions, a Qualified Charitable Distribution (QCD) from an IRA is a great way to give to charity. Making a direct contribution from the IRA to the charitable organization has the added benefit of not increasing your Adjusted Gross Income (AGI), which can decrease the amount of Social Security benefits that is taxable, as well as affect other favorable tax provisions that phase out based on AGI. Note that a QCD counts towards the taxpayer's required minimum distribution (RMD).

### Consider the Tax Implications of Dealing in Virtual Currency

Virtual currency (also known as *cryptocurrency*), such as Bitcoin, Ethereum, and Tether may be used to pay for goods or services or held for investment. If you receive virtual currency as payment for services, it is considered taxable income and will be subject to both income and Social Security taxes. However, for federal tax purposes, virtual currency is also treated as property, so calculating the taxes owed on transactions involving virtual currency can get complicated.

Your basis in virtual currency is its Fair Market Value (FMV) on the date you received it. If you then use that currency to buy something that has a FMV exceeding your adjusted basis in the currency, you will have a taxable gain. If the FMV of what you purchased is less than your adjusted basis in the currency, you will have a loss. The character of the gain or loss depends on whether the virtual currency is considered your capital asset.

We can help you reduce your 2022 tax liability on virtual currency transactions by using the Highest-in, First-out (HIFO) accounting method as opposed to the First-in, First-out (FIFO) method, which may result in a larger gain. What you need to do is keep detailed records of all virtual currency purchases to substantiate your basis on sale, and for that we recommend using our [downloadable 2021 Crypto Activity Worksheet](#). If you don't keep detailed records, the IRS will default to the FIFO method.

Fortunately, since virtual currency is considered property and not stock, *wash-sale rules* do not apply, so you may be able to sell some virtual currency at a loss and then repurchase the same units immediately in order to claim the loss in a given year while retaining possession of the currency. Wash sale rules are in place to prevent investors from doing this with stocks. Proposals have been put forth to extend the rules to virtual currencies, but none have yet passed.

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**Wash Sale Defined:** For the uninitiated, the *wash-sale rule* prohibits selling an investment for a loss and replacing it with the same or a substantially identical investment 30 days before or after the sale. The practical application of this is that if you do have a wash sale, the IRS will not allow you to write off the investment loss, which could make your taxes for the year higher than you planned.

## Consider a Reverse Mortgage

With inflation rates on the rise, many people – especially those on fixed incomes – are encountering cash flow issues. If you're 62 or older and have substantial equity in your residence, a *reverse mortgage* may provide a solution. With a reverse mortgage, you can cash out much of the equity in your home while continuing to live in it. Your home ownership is protected until you no longer reside in the home, and the money you cash out is not subject to tax.

To avoid default, you must maintain the home and pay your property taxes, homeowner's insurance, and any homeowners association fees. Also, if you're married, be sure that you and your spouse are both listed on the deed so that any surviving spouse can stay living in the home without being required to pay off the mortgage.

If you're interested in learning more about a reverse mortgage and need some guidance to decide whether it's worth considering, let us know. There are some important factors to look at, such as whether the proceeds from the reverse mortgage may impact your Social Security or Medicaid benefits, whether you can deduct the interest that accrues on the loan (short answer, you can't), and how the reverse mortgage will impact the value of your estate over time. We can help you weigh the pros and cons.

After reading this singlette, you may feel overwhelmed. What's important is that you [schedule your Mid-Year Meeting](#), so we can meet with you, analyze your situation, and identify opportunities for you to build wealth and reduce your taxes. The sooner you start to plan, the more opportunities you have.

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