Multi-Year Planning to Save Taxes

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The midterm election returns give Americans an opportunity to map out their next three tax returns, tax advisers said.

Though some races remain too close to call, Republicans appear on track to regain control of the House of Representatives. A Democratic-controlled Congress might tackle bipartisan retirement legislation and other smaller tax provisions during its coming lame-duck session. A divided Congress is unlikely to pass major tax legislation, according to Howard Gleckman, a tax expert at the nonpartisan Urban-Brookings Tax Policy Center.

The divided government means individuals can plan strategies that work over the next few years, tax advisers said. The 2017 tax overhaul under then-President Donald Trump, which included raising the standard deduction, appears likely to remain in place until it expires at the end of 2025, barring action by Congress, Mr. Gleckman said.

That three-year window could allow Americans to make long-term moves to cut their bills, tax planners said. “We’re talking at least a few thousand dollars a year in money in one’s pocket,” said Timothy Wyman, a certified financial planner and lawyer in Southfield, Mich.

When taxpayers plan one year at a time, they might save in the short term but end up paying more later, Mr. Wyman said. For example, one new client, a retiree, had taken large medical-expense deductions and paid $0 in federal income tax for 2020, missing opportunities for greater tax savings. “Was that great planning? No,” said Mr. Wyman.

Had the client considered a longer planning horizon, Mr. Wyman said, the retiree could have moved money from his individual retirement account into a Roth account, paying taxes upfront in the low 10% and 12% marginal tax brackets, compared with paying at a higher rate later. He also could have sold stocks that had gone up in value, taking advantage of the 0% capital-gains rate for earners at his income.

The goal should be to plan a strategy over multiple years, Mr. Wyman said. Here’s where tax advisers say people should start. The 2023 Tax tables and Standard Deductions have also been increased for inflation, which also helps:

Bunching Charitable Deductions

With the expanded standard deduction set to remain in place through 2025, it can pay to bunch deductions into one year and then use the standard deduction the next year, said Robert Keebler, a certified public accountant in Green Bay, Wis. Most people take the standard deduction, which is $13,850 for single taxpayers and $27,700 for married couples filing jointly for 2023.

For example, Mr. Keebler said, a married couple in the 24% tax bracket who typically give $15,000 annually to charity would save $3,384 in taxes by lumping together their 2022 and 2023 gifts this year and itemizing, and then taking the standard deduction in 2023.

During the lame-duck session, Congress might reinstate an extra charitable deduction for 2022 for nonitemizers of $300 for single filers and $600 for married couples filing jointly.

Harvesting Gains at 0% or 15%

Taxpayers can sell investments in their brokerage accounts that have gone up in value and pay taxes at the current historically low capital-gains rates, Mr. Wyman said. The 2017 tax law allows more taxpayers to harvest gains at lower tax rates, even zero, through 2025. For taxpayers with a lot of gains, they will need to spread out those gains over several years to keep taxes down, he said.

The 0% capital-gains tax rate applies for a married couple with income up to $83,350 for 2022. In other words, a married couple starting with $60,000 in adjusted gross income could sell stock with a gain of as much as $49,250 this year, take the standard deduction and owe zero in capital-gains tax. The 15% rate applies for a married couple with income greater than $83,350 up to $517,200; the top 20% rate applies above that.

On top of the capital-gains rates, a 3.8% net investment income tax applies above an income threshold of $250,000 for a couple or $200,000 for single taxpayers.

Harvesting Losses

Most taxpayers with investing losses in their brokerage accounts should consider tax-loss harvesting, which means selling some investments at a loss to offset capital gains, said Mr. Keebler. These losses can also be carried over into future years, so the tax hit from future gains can be cut to as little as 0% later. Those afraid to take losses for fear of missing out on a rising market can get right back in; investors could sell an S&P 500 index fund, then buy an S&P 1000 fund, for example, he said.

Tax Diversification

Just as investors diversify their portfolios with a mix of asset classes, Mr. Wyman suggests they should also make sure their investments are diverse tax-wise. He recommends putting some money in pretax savings such as a traditional 401(k) or individual retirement account, some in after-tax Roth accounts, and some in a taxable brokerage account.

A multiyear savings strategy is helpful for everyone, but it is especially important to tweak your savings strategy if you know you are going to have a low-income year, which calls for Roth savings, followed by a high-income year, which calls for pretax savings, or vice versa, Mr. Wyman said. "Tax diversification gives flexibility in the future regardless of who wins at the polls," he said.

Retirement-account contribution limits are rising by a record amount for 2023 because of high inflation. A divided Congress might take up bipartisan retirement legislation this year, and one provision in play is to raise the dollar amount older workers can contribute in catch-up contributions, and require them to be made with after-tax dollars.

Roth Conversions

Roth conversions continue to be a popular strategy given current tax rates, said Mr. Keebler, who advocates multiyear tax plans. In a Roth conversion, you move money from a pretax retirement account into a Roth account, paying the income tax upfront, and leaving the money to grow tax-free. Roth accounts don't require annual withdrawals the way traditional IRAs and pretax 401(k)s do starting at age 72.

Say, a husband and wife have $2 million in IRAs. When one of them dies, the surviving spouse will have to take out money as a single taxpayer, which means more money will be taxed at higher rates compared with when they filed taxes jointly as a couple. Making micro-Roth conversions quarterly over several years can help lessen the tax bite, Mr. Keebler said.

Estate Planning

The threshold for the estate tax will be $12.92 million per person for 2023. That number is scheduled to drop approximately in half at the start of 2026, making far more estates subject to the tax. Taxpayers who might be affected can consider an annual gifting program now to get money out of their estates, Mr. Keebler said.

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