UBS

2022 year-end planning guide

Advanced Planning Group

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Todd D. Mayo
Senior Wealth Strategist
Advanced Planning Group

Jacqueline Denton
Associate Wealth Strategist
Advanced Planning Group

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Foreword

For many people, planning is an ongoing process. Many aspects of their lives change and evolve with little or no regard for the calendar. Births, deaths, marriages, and divorces (usually) don't follow the rhythm of time. And yet some aspects of life are connected to the calendar. So, as the end of another year approaches, it's a good time for people to take stock of their situation. And ask questions. Is their current planning accomplishing or furthering their goals? Are there things they could be doing or could be doing better? Maybe it's saving taxes or improving their financial security. Maybe it's helping others.

In this guide, we explore an array of planning ideas, arranged thematically. We start with a foray into income tax planning, which often tops people's minds when thinking about year-end planning. The calendar year defines many aspects of tax liability, often presenting opportunities to reduce the amounts that may be owed through thoughtful planning.

We then turn to investment-related planning, retirement planning, and charitable giving. In these chapters, we consider some topics that are timely as year-end approaches—such as maximizing contributions to retirement accounts and making charitable contributions that are deductible on this year's taxes—as well as topics whose relevance persists year-round—such as ways to manage concentrated stock positions.

Shifting to state tax planning, we discuss some ways to minimize or avoid state income and death taxes. From there, we turn our focus to wealth transfer planning. We explore gifting strategies, the importance of properly reporting gifts, and the benefits of reviewing the estate plan and the way in which assets are owned. We also highlight the value of a family meeting.

In our final chapters, we look at trust planning and administration and financial planning. Here, we review some regular maintenance that helps clients follow through with their good planning.

Throughout this guide, our goal is to spark conversations that may lead people to refine their planning approach. Sometimes, that's simply considering a new idea that could possibly save on taxes. Other times, it's enabling them to better achieve their visions for their legacy.

Whichever it may be for you, we hope you find this guide to be a valuable resource.

Ann Bjerke
Head of Advanced Planning

Income tax planning

When thinking about tax planning before year end, many individuals think of their potential income tax liability. As a part of this planning, an individual might consider reviewing their projected income (including gains), deductions, and credits for this year and next year and considering whether any of these can be timed in such a way so as to minimize their income tax liability. There are a number of ways they might accomplish this.

Accelerating income and deferring deductions and credits

An individual who expects to have less income in 2022 than in 2023 might consider accelerating income into 2022 or deferring deductions and credits until 2023. For example, an individual might consider a Roth conversion, which involves converting a traditional individual retirement account (IRA) to a Roth IRA. (We discuss Roth conversions below.) Accelerating income or deferring deductions and credits isn't always feasible. When it is, it may reduce the overall taxes that the individual would pay in 2022 and 2023. Of course, the individual should consider the potential impact on state and local taxes, as well as federal taxes.

Deferring income and accelerating deductions and credits

An individual who expects to have more income in 2022 than in 2023 might consider deferring income into 2023 or accelerating deductions and credits into 2022. This may reduce the overall taxes that the individual would pay in 2022 and 2023. Deferring income or accelerating deductions and credits, however, isn't always feasible. There are some limitations on the extent to which an individual can accelerate deductions and credits. Of course, the individual should consider the potential impact on state and local taxes, as well as federal taxes.

Monitoring the alternative minimum tax

An individual should monitor their potential exposure to the alternative minimum tax (AMT). An individual who expects to be subject to the AMT might wish to shift income, deductions, and credits from one year to another so that they can minimize their overall income tax liability.

What is the AMT?

The AMT operates in parallel to the regular income tax, limiting certain tax benefits that high income taxpayers would otherwise enjoy. Through various adjustments and additions, an individual's taxable income for AMT purposes is more inclusive than an individual's taxable income for purposes of the regular income tax.[1] For example, an individual who exercises incentive stock options (ISOs) must include the spread between the exercise price and the shares' fair market value as income for AMT purposes but not regular tax purposes.[2] (We discuss ISOs below.) Similarly, an individual who excludes capital gain from the sale of qualified small business (QSB) stock acquired before September 28, 2010, must include 7% of the excluded gain in income for AMT purposes.[3]

[1] IRC § 55(b)(2). In this guide, we speak in terms of an individual being subject to the AMT when their tax for AMT purposes exceeds their tax for regular income tax purposes. Similarly, we speak in terms of an individual avoiding the AMT when they are avoiding a situation in which (either in the current year or a future year) their tax for AMT purposes exceeds their tax for regular income tax purposes.
[2] IRC § 56(b)(3).
[3] IRC § 57(a)(7).

After calculating their taxable income for AMT purposes, an individual subtracts the exemption amount.[4] In 2022, the exemption amount is:

- $118,100 for married individuals filing jointly,
- $118,100 for a surviving spouse,
- $59,050 for a married individual filing separately, and
- $75,900 for an unmarried individual (other than a surviving spouse).[5]

The exemption amount, however, phases out. In 2022, an individual's exemption amount begins phasing out when the individual's alternative minimum taxable income exceeds:

- $1,079,800 for a married individual filing jointly,
- $1,079,800 for a surviving spouse,
- $539,900 for a married individual filing separately, or
- $539,900 for an unmarried individual (other than a surviving spouse).[6]

An individual's exemption amount phases out by 25% of the amount by which the individual's alternative minimum taxable income exceeds the amount at which the phase-out begins.[7] For example, in 2022, a married individual filing jointly would see their exemption amount reduced from $118,100 to $93,100 (i.e., by $25,000) if their alternative minimum taxable income is $1,179,800 (and thus exceeds $1,079,800 by $100,000).

In 2022, an individual's exemption amount is fully phased out when the individual's alternative minimum taxable income exceeds:

- $1,552,200 for married individuals filing jointly,
- $1,552,200 for a surviving spouse,
- $776,100 for a married individual filing separately, or
- $843,500 for an unmarried individual (other than a surviving spouse).[8]

For AMT purposes, an individual's top marginal rate is 28%.[9] When an individual's tax for AMT purposes exceeds their tax for regular income tax purposes, the individual must pay their regular income tax plus that excess.[10] In future years, the individual may be able to claim that excess as a credit against their regular income.[11]

What if someone may be subject to the AMT in 2022 but not 2023?

An individual who expects to be subject to the AMT in 2022 but not in 2023 might consider accelerating ordinary income and short-term capital gains into 2022, so that they can take advantage of the lower AMT rates. The individual also might consider deferring charitable deductions until 2023, when those deductions might be more valuable. Of course, the individual should consider the potential impact on state and local taxes, as well as federal taxes.

[4] IRC § 55(b)(1)(B).
[5] IRC § 55(d)(1) and Rev. Proc. 2021-45, 2021-48 I.R.B. 764. For a discussion of filing statuses, see Brad Dillon, *2022 Planning Guide* (a publication of the UBS Advanced Planning Group).
[6] IRC § 55(d)(2) and Rev. Proc. 2021-45, 2021-48 I.R.B. 764.
[7] Id.
[8] Rev. Proc. 2021-45, 2021-48 I.R.B. 764.
[9] IRC § 55(b)(1)(A)(ii).
[10] IRC § 55(a).
[11] IRC § 53(a).

What if someone may be subject to the AMT in 2023 but not 2022?
An individual who expects to be subject to the AMT in 2023 but not in 2022 might consider deferring ordinary income and short-term capital gains until 2023, so that they can take advantage of the lower AMT rates. This isn't always feasible. The individual also might consider accelerating charitable deductions into 2022, when those deductions might be more valuable. Here again, the individual should consider the potential impact on state and local taxes, as well as federal taxes.

Harvesting losses

An individual who has recognized capital gains might consider harvesting capital losses to offset those gains. An individual harvests losses by selling off capital assets in which the individual has unrealized losses in a taxable transaction.[12] By recognizing those losses, the individual potentially can offset gains and save taxes. An individual, however, can't claim certain losses. For example, an individual generally can't claim a loss on a sale to a related party, such as a family member, a corporation that the individual controls, or a trust of which the individual is a settlor.[13] In addition, an individual can't claim a loss on a wash sale.

Navigating the wash-sale rule
An individual who is harvesting losses should be mindful of the wash-sale rule. Under this rule, an individual can't recognize a loss on a sale of securities if, within 30 days before the sale and 30 days after the sale:
– the individual buys substantially identical securities,[14]
– the individual acquires substantially identical securities in an exchange that's fully taxable for income tax purposes,[15]
– the individual enters into a contract or option to buy substantially identical securities,[16]
– the individual acquires substantially identical securities in a traditional IRA or Roth IRA,[17]
– the individual's spouse acquires substantially identical securities,[18] or
– a corporation that the individual controls acquires substantially identical securities.[19]

There are limited exceptions for a sale in connection with a trade or business and for a sale by a dealer in securities.[20]

[12] A sale isn't the only time that gain or loss is recognized. Generally speaking, gain or loss also is recognized on any disposition of a capital asset. For example, gain or loss generally is recognized upon any exchange of a capital asset for other property. In some cases, the gain or loss from a sale or disposition isn't recognized (i.e., taken into account for purposes of calculating taxable income). These nonrecognition transactions include tax-free corporate reorganizations, like-kind exchanges, and involuntary conversions. Thus, our discussion of the tax implications of a sale generally apply to any taxable disposition or other taxable transaction.
[13] IRC § 267(a).
[14] IRC § 1091(a). The statute uses the phrase "stock or securities." For simplicity, we will use the term "securities."
[15] IRC § 1091(a). See also Treas. Reg. § 1.1091-1(f).
[16] Id.
[17] Rev. Rul. 2008-5, 2008-3 I.R.B. 271.
[18] *Estate of Mitchell v. Commissioner*, 37 B.T.A. 161 (1938). See also Internal Revenue Service (IRS), *Publication 550 (2021): Investment Income and Expenses* ("If you sell stock and your spouse … buys substantially identical stock, you also have a wash sale"). Under certain conditions, however, there might be an exception. The wash-sale rule might not apply if the spouses act sufficiently independently of one another. *Young v. Commissioner*, 34 B.T.A. 648, 652–53 (1936), and *Behan v. Commissioner*, 32 B.T.A. 1088, 1091–92 (1935).
[19] *Kaplan v. Commissioner*, 21 T.C. 134, 141-42 (1953). See also IRS, *Publication 550 (2021): Investment Income and Expenses* ("If you sell stock and … a corporation you control buys substantially identical stock, you also have a wash sale").
[20] The wash-sale rule does not apply to a (1) a person (other than a corporation) who sells or disposes of the security in connection with their trade or business or (2) a dealer in stock or securities who sells or disposes of the security in in the ordinary course of their business as a dealer. Treas. Reg. § 1.1091-1(a).

Whether two securities are substantially identical depends on the facts and circumstances.[21] In the most obvious situation, shares of a company's stock are substantially identical when they are the same (i.e., issued by the same company and of the same type and class). In contrast, a bond or preferred stock issued by a company usually isn't substantially identical to common stock issued by the company.[22] Under certain conditions, however, a convertible bond or convertible preferred stock might be substantially identical to common stock.[23] For example, convertible preferred stock is substantially identical to common stock if it:

- has the same voting rights as the common stock,
- is subject to the same dividend restrictions,
- sells at prices that do not vary significantly from the conversion ratio, and
- is unrestricted as to convertibility.[24]

Securities issued by a company typically aren't substantially identical to the securities issued by another company.[25] An actively managed fund typically isn't substantially identical to a passively managed fund. A fund that tracks an index, however, might be substantially identical to one that tracks the same index.

An individual who owns shares of a company's stock, wants to recognize the unrealized loss in those shares, but doesn't want to wait 31 days to buy back the shares might consider replacing the shares with a security that's tied to the company's industry or sector. This investment potentially can serve as a temporary, approximate proxy for the company shares while enabling the individual to recognize the loss on their original position.

If the wash-sale rule applies, the individual's basis in the substantially identical securities generally includes the disallowed loss.[26] The basis of substantially identical securities acquired in a traditional IRA or Roth IRA, however, don't include the disallowed loss.[27]

Netting gains and losses

An individual must net their capital gains and losses. Specifically, the individual must net short-term capital gains and short-term capital losses. A short-term capital gain or loss arises upon the sale of a capital asset held for one year or less. A long-term capital gain or loss arises upon the sale of a capital asset held for more than one year. If their short-term capital gains exceed their short-term capital losses, the individual will have a net short-term capital gain. Otherwise, the individual will have a net short-term capital loss. Similarly, the individual must net their long-term capital gains and long-term capital losses. If their long-term capital gains exceed their long-term capital losses, the individual will have a net long-term capital gain. Otherwise, the individual will have a net long-term capital loss.

If an individual has a net long-term capital gain and that gain exceeds their net short-term capital loss, the excess is their net capital gain, which is taxed at a more preferential rate than ordinary income. In contrast, if the individual has a net short-term capital gain and that gain exceeds their net long-term capital loss, the excess is taxed as ordinary income. For capital gains, the top marginal rate generally is 20%. For ordinary income, the top marginal rate is 37%.

[21] Treas. Reg. § 1.1233-1(d)(1).
[22] Id.
[23] Id.
[24] Rev. Rul. 77-201, 1977-1 C.B. 250.
[25] Treas. Reg. § 1.1233-1(d)(1).
[26] IRC § 1091(d). See also Treas. Reg. § 1.1091-2.
[27] Rev. Rul. 2008-5, 2008-3 I.R.B. 271.

If the individual's capital losses exceed their capital gains, the individual can deduct up to $3,000 (or $1,500 if the individual is a married individual filing separately) of the excess against ordinary income. The individual can carry the nondeductible losses forward to offset gains and ordinary income in future years indefinitely. The losses that an individual carries forward retain their character as short-term or long-term capital losses.

Identifying worthless securities

An individual may wish to review their holdings for purposes of identifying any worthless securities. The individual potentially can recognize a capital loss for any worthless securities that they hold. If a security is a capital asset and becomes worthless during 2022, then the individual is treated as having sold the security on December 31, 2022, and the individual recognizes a capital loss in 2022.[28] To be allowable, the loss must be evidenced by a closed and completed transaction, fixed by an identifiable event, and actually sustained during the tax year.[29] The taxpayer must have evidence that the security is worthless.[30]

An individual can't claim a loss in 2022 for a security that became worthless in a prior year, but the individual potentially may claim the loss by amending the tax return for the year in which the loss occurred.[31] Although an individual usually must file a refund claim within three years after filing their income tax return, the individual potentially can file a refund claim with respect to worthless securities within seven years after filing their income tax return.[32]

Deferring gains by investing in a qualified opportunity fund

A person who realizes capital gains potentially can defer recognition of those gains—and thus the tax on those gains—by investing the gains in a qualified opportunity fund. A qualified opportunity fund is a fund that invests in qualifying businesses or property located in a qualified opportunity zone, which generally is a low-income community.[33] In addition to deferring gains, the person potentially can avoid any capital gains tax on their investment in the fund. While investing in a qualified opportunity fund potentially offers valuable income tax savings, a person should carefully consider the advantages and disadvantages of such an investment.

To defer the recognition of capital gains, a person must invest the capital gains in the qualified opportunity fund within 180 days after the sale or disposition.[34] By investing capital gains in a qualified opportunity fund, the person generally can defer those gains until the earlier of:

- the sale or disposition of their interest in the fund, or
- December 31, 2026.[35]

[28] IRC 165§ (a).
[29] Treas. Reg. § 1.165-1(b).
[30] *Morton v. Commissioner*, 38 B.T.A. 1270, 1278-79 (1938)
[31] IRC § 6511(a).
[32] IRC § 6511(d)(1).
[33] IRC § 1400Z-2(d). See also Treas. Reg. § 1.1400Z2(d)-1.
[34] IRC § 1400Z-2(a)(1)(A).
[35] IRC § 1400Z-2(b)(1). Under certain conditions, the IRS may view a sale or disposition of an interest in a qualified opportunity fund soon after investing in the fund as abusive. Under a general anti-abuse rule, the IRS may recast a transaction (e.g., by denying capital gain deferral) if a significant purpose of the transaction is to achieve an income tax result that is inconsistent with the statute's purposes of promoting longer-term investments in qualified opportunity zones. Treas. Reg. § 1.1400Z2(f)-1(c)(1).

A sale or disposition of an interest in a qualified opportunity fund thus accelerates the recognition of the capital gains. A disposition generally includes a gift.[36] A gift to a grantor trust, however, doesn't accelerate the recognition of the capital gains,[37] but a gift to a nongrantor trust does accelerate the recognition of the capital gains.[38] A transfer between spouses or incident to divorce also accelerates the recognition of the capital gains.[39]

A person who plans to dispose of an investment in a qualified opportunity fund in a transaction that will accelerate the capital gains should plan to have sufficient liquidity to pay the taxes on those gains. Likewise, a person who plans to continue holding an investment in a qualified opportunity fund after December 31, 2026, should plan to have sufficient liquidity to pay the taxes on the capital gains.

In addition to the deferral of capital gains, a person who invests in a qualified opportunity fund and holds the investment for 10 years or more can avoid any capital gains tax on the appreciation over their initial investment.[40]

For more information, see Todd D. Mayo, *Qualified Opportunity Zones* (a publication of the UBS Advanced Planning Group).

Deducting state and local taxes

Since 2018, an individual generally can't deduct more than $10,000 of state and local property and income taxes.[41] In the case of a married individual filing separately, the individual can't deduct more than $5,000 of these taxes.[42] In response to this cap on the deductibility of state and local taxes, more than 20 states have enacted a workaround involving an entity-level tax and a (generally) offsetting tax benefit for its owners. The state imposes an income tax on a pass-through entity, such as a partnership, a limited liability company that's classified as a partnership for federal tax purposes, or an S corporation. This tax is sometimes called a pass-through entity tax (PTE tax). In most states, this tax is elective. An individual who is subject to this cap on the deductibility of state and local taxes might explore whether this workaround could save taxes.

For federal tax purposes, the pass-through entity deducts the PTE tax when calculating its taxable income, thereby reducing each member's allocable share of the taxable income. (For simplicity, let's refer to the owner of a pass-through entity as a member.) The pass-through entity isn't subject to the limitation on the deductibility of state and local taxes, so it deducts the PTE tax in full. Importantly, an individual member doesn't take into account the PTE tax that the

[36] Treas. Reg. § 1.1400Z2(b)-1(c)(3)(i).

[37] Treas. Reg. § 1.1400Z2(b)-1(c)(5)(i). More specifically, the trust must be a grantor trust with respect to the person who's giving the stock to the trust. A grantor trust is generally disregarded for income tax purposes, and the grantor (or, in some cases, the beneficiary) reports the trust's income, deductions, and credits on their personal income tax return. IRC §§ 671 to 679.

[38] Treas. Reg. § 1.1400Z2(b)-1(c)(3)(i). A nongrantor trust is treated as a separate taxpayer for income tax purposes. The trust usually is taxable on capital gains and undistributed income, and each beneficiary usually is taxable on any distributions to the extent that they include income for income tax purposes. IRC §§ 641, 651, 652, 661, and 662.

[39] Treas. Reg. § 1.1400Z2(b)-1(c)(3)(ii).

[40] IRC § 1400Z-2(c).

[41] IRC § 164(b)(6)(B). This limitation will continue to apply until 2026.

[42] Id.

pass-through entity pays when applying the deduction limitation to which the individual is subject. For state tax purposes, the PTE tax generally shifts the incidence of tax from the pass-through entity's members to the entity, preserving the single layer of tax (which has been a key advantage of pass-through entities).

For more information about this strategy to avoid the limitation on the deductibility of state and local taxes, see Todd D. Mayo, *SALT Cap Workarounds* (a publication of the UBS Advanced Planning Group).

Exercising stock options

As year-end approaches, an individual who owns stock options might explore whether it makes sense to exercise any of them. It may make sense for purposes of avoiding the AMT or capturing the value of vested options that may be expiring soon.

Exercising incentive stock options to avoid the AMT

If an individual has ISOs, the individual might consider exercising those options to the extent that the individual can do so without becoming subject to the AMT. The exercise of ISOs is not a taxable event for regular income tax purposes, but it is a taxable event for AMT purposes.[43] When exercising ISOs, the individual includes the spread between the exercise price and the shares' fair market value in income for AMT purposes.[44] Thus, an individual may find it advantageous to exercise some ISOs to the extent that it won't push them into the AMT. An individual who waits and exercises a large number of ISOs in one year might be more likely to be subject to the AMT.

Exercising expiring options

If an individual has vested options nearing their expiration date and the value of the shares exceeds the exercise price, the individual might consider exercising those options before they expire. Otherwise, the individual would lose the economic value of those options. Again, the exercise of ISOs is not a taxable event for regular income tax purposes, but it is a taxable event for AMT purposes.[45] In contrast, the exercise of non-qualified stock options (NSOs) generally is a taxable event.[46] When exercising NSOs, the individual generally would include the spread between the exercise price and shares' fair market value in ordinary income.[47]

Further reading

For more information about stock options, see Todd D. Mayo, *Planning Opportunities with Stock Options* (a publication of the UBS Advanced Planning Group), and Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

[43] IRC §§ 56(b)(3), 83(e)(1), and 421(a).
[44] IRC § 56(b)(3). More specifically, Section 421(a) of the Internal Revenue Code is ignored for purposes of determining an individual's alternative minimum taxable income. Under section 421(a), an individual who exercises ISOs excludes the spread from their gross income for regular income tax purposes.
[45] IRC §§ 56(b)(3), 83(e)(1), and 421(a).
[46] IRC § 83(e)(3).
[47] Id.

Estimating taxes and planning to pay them

As year-end approaches, an individual might consider calculating (or re-calculating) the taxes that they expect to pay, confirming that they've made sufficient tax payments during the year (either through withholding or estimated taxes), and planning for the payment of any taxes that will be due (either estimated tax payments or a final tax payment).

Paying estimated taxes
An individual may have an obligation to pay estimated taxes if they have income that isn't subject to withholding, such as income from self-employment. For 2022 income taxes, an individual generally must pay (either through withholding or estimated taxes) the lesser of:
- 90% of the tax to be shown on their 2022 tax return,
- 100% of the tax shown on their 2021 tax return if their 2021 adjusted gross income (AGI) doesn't exceed $150,000 (or, in the case of a married individual filing separately, $75,000), or
- 110% of the tax shown on their 2021 tax return if their 2021 AGI exceeds $150,000 (or, in the case of a married individual filing separately, $75,000).[48]

An individual, however, isn't required to pay estimated taxes if they will owe $1,000 or less of tax (after subtracting any taxes withheld).[49] An individual who doesn't make sufficient tax payments during the year (either through withholding or estimated taxes) is subject to a penalty.[50]

For 2022 income taxes, the estimated tax payments generally are due:
- April 18, 2022,
- June 15, 2022,
- September 15, 2022, and
- January 17, 2023.[51]

If an individual doesn't pay the final estimated payment that's due January 17, 2023, the individual can avoid the penalty for not making their final payment by filing their 2022 income tax return and paying the taxes in full by January 31, 2023.[52]

An individual who has sizable capital gains from a nonrecurring event—such as the sale of a business—generally doesn't need to make any estimated payments of the tax on those gains. So long as the individual pays (either through withholding or estimated taxes) 100% (or, in some cases 110%) of the tax shown on their prior year's tax return, the individual would avoid the penalty for underpaying estimated taxes.

Planning to pay the taxes
An individual who expects to owe taxes should plan for how to pay those taxes. The individual may have an estimated tax payment due January 17, 2023, and a final tax payment due April 18, 2023.[53] For an individual who already has liquidity, little action may be required. An individual who doesn't have sufficient liquidity might sell assets to raise the cash to pay the taxes. Selling assets may not be the most efficient approach if those sales would cause the individual to recognize capital gains. An individual who doesn't have sufficient

[48] IRC §§ 6654(d)(1)(B) and (C).
[49] IRC § 6654(e)(1).
[50] IRC § 6654(a).
[51] IRC §§ 6654(c)(2) and 7503. For an individual who is not a US citizen, is not a US resident, and is not subject to withholding, however, the estimated tax payments are due June 15, 2022, September 15, 2022, and January 17, 2023. IRC §§ 6654(j)(2) and 7503.
[52] IRC § 6654(h).
[53] IRC §§ 6151(a), 6654(c)(2), and 7503. For anyone who is a resident of Maine or Massachusetts, however, the final tax payment is due April 19, 2023.

liquidity might consider borrowing to pay the taxes. Borrowing against eligible securities in a portfolio may enable an individual access to needed funds—for the payment of taxes—while allowing them to pursue their long-term financial strategy without creating an additional tax obligation in the following year.

Filing the income tax return

For most individuals, their 2022 income tax return is due April 18, 2023.[54] An individual may apply for an extension to file their income tax return. The IRS grants an automatic six-month extension so long as the individual files an application for extension before the original due date for the income tax return.[55] With the extension, the 2022 income tax return is due October 16, 2023.[56] An extension of time to file doesn't extend the date on which the individual must pay their taxes.[57]

[54] IRC §§ 6072(a) and 7503. See also Treas. Reg. §§ 1.6072-1(a) and (d). For an individual who is a US citizen or a US resident but lives outside the United States and Puerto Rico, the 2022 income tax return is due June 15, 2023. Treas. Reg. § 1.6081-5(a)(5). More precisely, the IRS grants an automatic two-month extension, so long as the individual attaches a statement explaining their qualification for this extension. Treas. Reg. §§ 1.6081-5(a)(5) and (b)(1). For an individual who is not a US citizen, is not a US resident, and is not subject to withholding, the 2022 income tax return is due June 15, 2023. IRC § 6072(a).

[55] Treas. Reg. § 1.6081-4(a). For an individual who is a US citizen or a US resident but lives outside the United States and Puerto Rico, the IRS grants the automatic extension, so long as the individual files the application on or before June 15, 2023. Treas. Reg. § 1.6081-5(b)(2). This would extend the due date to October 16, 2023. Treas. Reg. § 1.6081-4(a). See also IRC § 7503.

[56] Treas. Reg. § 1.6081-4(a). See also IRC § 7503.

[57] Treas. Reg. § 1.6081-4(c).

Investment-related planning

For many individuals, year-end planning includes investment-related planning, such as reviewing their portfolio, managing concentrated stock positions, steering clear of the wash-sale rule, and taking advantage of securities-backed lending.

Reviewing the portfolio

As year-end approaches, an individual may wish to review their portfolio and reevaluate their goals, risk tolerance, and future liquidity needs. This exercise may be especially valuable if there has been a significant life event—such as a marriage, divorce, birth, or death—or a significant change in financial circumstances, and it may identify changes that they wish to make to their portfolio. As they make changes, an individual should consider the tax implications of purchases and sales (e.g., with respect to the recognition of gains and losses), including the potential effects of the wash-sale rule. (We discussed the wash-sale rule above.)

Managing a concentrated stock position

An individual who has a concentrated stock position might wish to explore ways to manage that position. Liquidity, cash flow, and volatility are some of the issues that an individual may face if they have a concentrated position. In 2022, the top marginal long-term capital gains tax rate is 20%, and the net investment income tax rate is 3.8%, so the tax cost of selling out of a particular appreciated position can be high.[58] The individual might consider selling the stock incrementally over time. Alternatively, the individual might consider strategies to reduce the tax impact of selling using a different diversification technique. For example, they might consider whether equity collars, prepaid variable forwards, exchange funds, gifts to charity, or a charitable remainder trust would make sense.

Equity collars

An equity collar is a hedging technique designed to protect a stock from downside price risk, while allowing an individual to participate in some of the potential price appreciation and receive any dividend income. To implement an equity collar, the individual purchases protective put options on the shares that they own while simultaneously selling covered call options on those same shares. The put and call options typically have the same maturity date. The protective put establishes a price "floor" on the shares, while the covered call creates an upward "cap." The options are typically purchased and sold so that each strike price is "out of the money" in relation to the current price of the shares. The sale of the call options results in the collection of a premium, which is then used to finance the purchase of the put options. If the net cashflow between the put and call options is zero, the collar is often referred to as "zero premium" or "cashless" collar and can minimize the out-of-pocket costs of implementing a collar strategy.
The individual continues to hold the underlying stock during its life, retaining voting rights and any dividends paid on the stock. At maturity, the individual has the option of physically settling (delivering shares) or cash settling the transaction. As a protective hedge, an equity collar is best suited for shareholders with significant gains in their shares who feel that, while the price of the stock may be neutral or slightly bearish in the short term, the stock's long-term outlook remains bullish.

[58] IRC §§ 1(h)(1)(D) and 1411(a)(1). For certain types of gains, the top marginal long-term capital gains tax rate is 25% or 28%. IRC §§ 1(h)(1)(E) and (F). For a discussion of the net investment income tax, see Ann Bjerke, *Net Investment Income Tax* (a publication of the UBS Advanced Planning Group).

Prepaid variable forward

A prepaid variable forward is another hedging strategy that an individual might consider if they wish to achieve the economics of an equity collar, while also generating immediate cash proceeds. The proceeds generated by the prepaid variable forward can be used for any purpose, including further investment or diversification, and can help offset any cost of the equity collar or increase the yield on the stock. To execute a prepaid variable forward, the individual implements an equity collar, choosing the maturity date, floor price, and cap price. The individual then immediately receives cash equal to the floor price per share, less the financing cost for the cash advance, less any cost of the equity collar. The individual continues to hold the underlying stock during its life, retaining voting rights and the right to receive dividends. At maturity, the individual must settle the underlying equity collar as well as repay the proceeds received upfront (which equals the floor price per share). As with an equity collar, the individual has the option of physically settling (delivering shares) or cash settling the transaction. To finance a cash settlement, the individual may wish to enter a new prepaid variable forward, using the proceeds from the new transaction to finance the amount owed for the maturing prepaid variable forward.

Exchange funds

If an individual is seeking to achieve broad equity market diversification of a concentrated equity position along with potential tax deferrals, then the individual may wish to consider contributing their shares to an exchange fund. Exchange funds (also known as swap funds) are private placement limited partnerships or limited liability companies that allow an individual to exchange a single stock for units in a professionally managed, diversified portfolio of pooled stocks. After a holding period of seven years, the individual may redeem their units in the form of a diversified basket of securities comprised of shares contributed by other investors in the fund.[59] If the individual redeems their units during the seven-year holding period, the redemption will be met by a distribution back to them of the single stock that they initially contributed to the fund (plus or minus additional shares to the extent the unit value differs from the single stock value). As long as the fund holds 20% of its assets in non-public securities (such as real estate partnerships), the individual would not incur any capital gains tax or net investment income tax when shares are contributed or distributed.[60]

Charitable remainder trusts

An individual who has a concentrated stock position and is charitably inclined might consider creating a charitable remainder trust and contributing some or all of the stock to the trust. A charitable remainder trust is an irrevocable trust that pays income to one or more individuals for life (or a term of up to 20 years) after which it distributes any remaining assets to one or more charitable organizations or holds the assets in trust for charitable purposes.[61] A charitable remainder trust pays income either in the form of an annuity (in which case the trust is a charitable remainder annuity trust) or a unitrust (in which case the trust is a charitable remainder unitrust). A charitable remainder annuity trust pays an annuity (i.e., a fixed dollar amount) to the income beneficiaries.[62] A charitable remainder unitrust generally pays a fixed percentage of its value to the income beneficiaries (although there are some permissible exceptions and variations).[63]

[59] IRC § 704(c)(1)(B).
[60] IRC § 721(b) and Treas. Reg. §§ 1.351-1(c)(1) and (c)(3).
[61] See IRC § 664.
[62] IRC § 664(d)(1).
[63] IRC §§ 664(d)(2) and (3).

An individual generally doesn't recognize any capital gain upon contributing appreciated property to a charitable remainder trust.[64] In addition, a charitable remainder trust is generally tax-exempt, so it typically can sell the property without incurring any tax and can reinvest the proceeds in a diversified portfolio.[65] As the individual receives distributions from the trust, the individual generally includes those distributions in income for income tax purposes.[66]

For a more in-depth discussion of charitable remainder trusts, see Benjamin C. Trayes, *Charitable Remainder Trusts* (a publication of the UBS Advanced Planning Group).

Further reading
For more information about managing a concentrated stock position, see Christine Kolm, *Concentrated Stock Positions* (a publication of the UBS Advanced Planning Group).

Navigating the wash-sale rule

An individual who is making changes to their investment portfolio should be mindful of the wash-sale rule. Under this rule, an individual can't recognize any loss on a sale of securities if the individual buys substantially identical securities within 30 days before the sale and 30 days after the sale. (We discuss the wash-sale rule above.)

Doubling up on a security

An individual who owns a security that has an unrealized loss, believes that the security ultimately will appreciate in value, and wishes to stay invested in the security might consider buying a second lot of the security in anticipation of selling the first lot and recognizing the loss once the period for a wash-sale ends (i.e., 30 days after the day on which the individual buys the second lot). Doubling up on a security allows the individual to stay invested in the security but increases the individual's exposure to the security. Thus, the individual has increased exposure to any declines in the security's value.

An example may help illustrate this strategy. Let's assume that an individual holds 50,000 shares of a publicly traded stock that has a market value of $800,000. Let's also assume that the individual's basis in those shares is $1 million. The individual thus has an unrealized loss of $200,000. The individual might consider buying an additional 50,000 shares of the stock. The individual now holds 100,000 shares of the stock. After holding those additional shares for more than 30 days after buying them, the individual generally could sell the first lot and recognize the loss. If the shares' value is still $800,000, the individual would recognize $200,000 of capital losses. The wash-sale rule would not apply because the sale occurred more than 30 days after buying the second lot. After selling the first lot, the individual again holds only 50,000 shares of the stock.

[64] See Treas. Reg. § 1.1011-2.
[65] IRC § 664(c).
[66] IRC § 664(b).

An individual who wishes to recognize a loss in 2022 using this strategy generally must buy the second lot on or before November 29, 2022, because the last trading day of the year is December 30, 2022. If, for example, the individual buys the second lot on November 29, 2022, then the individual can sell the first lot on December 30, 2022, and recognize the loss. If, however, the individual buys the second lot after November 29, 2022, the wash-sale rule would disallow any loss that the individual realizes when selling the first lot in 2022.

Using securities-backed lending

An individual may wish to review their options for borrowing against their securities. If the individual has short-term needs for liquidity, borrowing may be an effective way to satisfy those needs. Establishing a credit line before it's needed allows them to react more quickly to time-sensitive opportunities, as well as planned and unplanned liabilities. Borrowing against eligible securities in a portfolio may enable them to access needed funds while allowing them to pursue their long-term financial strategy. For example, an individual who owes an estimated tax payment on January 17, 2023, or taxes on April 18, 2023, might consider borrowing against their securities rather than selling them to raise the cash to pay the taxes.

Exercising stock options

As year-end approaches, an individual who owns stock options might explore whether it makes sense to exercise any of them. An individual who owns ISOs might wish to exercise some for purposes of avoiding the AMT (either in 2022 or a future year). An individual who owns vested ISOs or vested NSOs might wish to exercise them to the extent that they may be expiring soon. (We discussed exercising stock options above.)

Worthless securities

An individual who holds securities that became worthless in 2022 potentially can recognize a capital loss for those securities. (We discussed worthless securities above.)

Retirement planning

For an individual who has one or more retirement accounts—i.e., IRAs, qualified retirement plans, and 403(b) plans—year-end is a good time to review their retirement planning. For many individuals, some key items to review include maximizing contributions to retirement accounts, exploring Roth conversions, taking required minimum distributions (RMDs), and confirming beneficiary designations.[67]

[67] In this guide, we'll refer to IRAs, qualified retirement plans, and 403(b) plans as retirement accounts.

Maximizing contributions

An individual might consider reviewing their contributions to their retirement accounts and maximizing those contributions to the extent they aren't already doing so. By maximizing their contributions, they may reduce their current income taxes (to the extent that the contributions are deductible), they may more fully take advantage of employer contributions (to the extent their employer makes matching contributions), and they may help themselves better prepare financially for their retirement years.

Traditional IRAs and Roth IRAs

For 2022, the total contributions an individual may make to traditional IRAs and Roth IRAs can't exceed the lesser of:

- $6,000 ($7,000 if the individual has attained 50 years of age), or
- the individual's taxable compensation for the year.[68]

An individual's contributions to traditional IRAs may be tax-deductible, but their deduction may be limited if the individual or their spouse participates in a workplace retirement plan and their income exceeds certain levels.[69] (See Table 1.) An individual's contributions to Roth IRAs may be limited if their income exceeds certain levels.[70] (See Table 2.) An individual can make 2022 contributions to traditional IRAs or Roth IRAs until April 18, 2023.[71] An individual whose income is too high to make a Roth IRA contribution might consider a backdoor Roth conversion or a mega backdoor Roth conversion. (We discuss these strategies below.)

Table 1. Limits on the deductibility of contributions to traditional IRAs in 2022.

	An unmarried individual who participates in a workplace retirement plan	A married individual who files jointly and participates in a workplace retirement program	A married individual who files jointly and doesn't participate in a workplace retirement program	A married individual who files separately
Full deduction allowed	Below $68,000	Below $109,000	Below $204,000	
Phase-out range	$68,000 to $78,000	$109,000 to $129,000	$204,000 to $214,000	$0 to $10,000
No deduction allowed	Above $78,000	Above $129,000	Above $214,000	Above $10,000

Source: IRC § 219(g) and Notice 2021-61.

[68] IRC § 219(b)(5). Notice 2021-61. IRC § 408A(c)(2).

[69] IRC § 219(c). More precisely, the limitation applies based (in part) on whether the individual or the individual's spouse is an active participant. IRC § 219(g)(1). An active participant generally is an individual who (1) in the case of a defined benefit plan, is eligible to participate in the plan or (2) in the case of a defined contribution plan, participates in the plan. A special rule applies to a purely discretionary profit-sharing plan or stock bonus plan. IRC § 219(g)(5) and Notice 87-16.

[70] IRC § 408A(c)(3).

[71] IRC § 219(f)(3).

Table 2. Limits on contributions to Roth IRAs in 2022.

	Unmarried individual	Married individual filing jointly	Married individual filing separately
Full contribution allowed	Below $129,000	Below $204,000	
Phase-out range	$129,000 to $144,000	$204,000 to $214,000	Up to $10,000
No contribution allowed	Above $144,000	Above $214,000	Above $10,000

Source: IRC § 408A(c)(3) and Notice 2021-61.

Qualified retirement plans and 403(b) plans

For 2022, the total elective deferrals that an individual may make to qualified retirement plans (such as 401(k) plans) and 403(b) plans generally can't exceed:

– $20,500 if the individual has not attained 50 years of age, or
– $27,000 if the individual has attained 50 years of age.[72]

An elective deferral is a contribution that, as an employee, an individual makes to retirement plans out of the salary that the individual otherwise would receive.[73] When applying the contribution limits, the individual generally must aggregate all of their contributions to the plans in which they participate.[74]

For 2022, the total contributions to these retirement plans can't exceed the lesser of:

– $61,000, or
– the individual's taxable compensation for the year.[75]

For purposes of this limit, total contributions include elective deferrals (but not catch-up contributions), employer matching contributions, employer nonelective contributions, and allocations of forfeitures.[76]

SIMPLE 401(k) plan

For 2022, the total elective deferrals that an individual may make to a SIMPLE 401(k) plan can't exceed:

– $14,000 if the individual has not attained 50 years of age, or
– $17,000 if the individual has attained 50 years of age.[77]

The individual's employer must make a matching contribution up to 3% of the individual's compensation or a non-elective contribution of 2% of the individual's compensation.[78] Thus, during a calendar year, the total contributions to an individual's SIMPLE 401(k) plan will equal the individual's elective deferrals plus the employer's contributions.

[72] IRC § 402(g)(1) and Notice 2021-61.
[73] Treas. Reg. § 1.402(g)(1).
[74] IRC § 408(d)(2).
[75] IRC § 415(c)(1) and Notice 2021-61.
[76] IRC § 415(c)(2).
[77] IRC § 408(p)(2)(E). A SIMPLE 401(k) plan is a savings incentive match plan for employees of small employers (SIMPLE) plan that an employer maintains in accordance with Section 408(p)(2) of the Internal Revenue Code.
[78] IRC §§ 408(p)(2)(A)(iii) and (2)(B).

Funding a backdoor Roth IRA

If an individual's income is too high to contribute directly to a Roth IRA, they potentially can make a nondeductible contribution to a traditional IRA and subsequently convert the funds in the traditional IRA to a Roth IRA.[79] This strategy is often referred to as a "backdoor Roth IRA." The individual generally must pay income tax on the converted amount, and there are several factors to be considered when deciding to make a conversion. (We discuss conversions below.)

Similarly, an individual who participates in a 401(k) plan may be able to convert after-tax amounts into a Roth 401(k) or, alternatively, roll over after-tax amounts into a Roth IRA.[80] This strategy is often referred to as a "mega backdoor Roth conversion." It is possible only if the plan allows for after-tax contributions and it allows either in-plan conversions or in-service distributions. Again, there are several factors to be considered when deciding to make a conversion. (We discuss conversions below.)

Converting to a Roth IRA

In some situations, an individual might consider converting a traditional IRA to a Roth IRA. A Roth IRA potentially offers significant benefits, most notably tax-free growth of assets, tax-free distributions, and no RMDs during the individual's life.[81] When converting from a traditional IRA to a Roth IRA, the converted amount is taxable to the IRA owner as ordinary income in the year in which the conversion occurs.[82]

When deciding whether to make a conversion, an individual should consider potential changes to the income tax rates that may occur over their life. A conversion may not be optimal if the individual expects to pay income taxes at a lower rate after they retire when they will receive distributions (e.g., after retirement). The individual also should consider the liquidity needs that a conversion may create. A conversion may be less advantageous if the individual must draw from the converted amount—instead of other liquid assets—to pay the taxes caused by the conversion.

For a more in-depth discussion of Roth conversions, see Carrie J. Larson, *Roth Conversions* (a publication of the UBS Advanced Planning Group).

Taking RMDs

An individual who is the original owner of a retirement account generally must begin taking RMDs from their accounts after attaining a certain age.[83] The individual, however, does not have to take RMDs from a Roth IRA.[84] An individual who inherited a retirement account generally must take RMDs from the inherited account.[85]

Original account owner

For any IRAs of which an individual is the original account owner (including any IRA that a surviving spouse rolled over from a deceased spouse's account), the individual generally must begin taking RMDs in the year they attain 72 years of age.[86] There are two

[79] Treas. Reg. § 1.408A-4.
[80] IRS Notice 2014-54.
[81] IRC § 408A.
[82] IRC § 408A(d)(3).
[83] IRC § 401(a)(9)(A).
[84] IRC § 408A(d)(4).
[85] IRC § 401(a)(9)(B).
[86] IRC §§ 401(a)(9)(A)(ii) and (9)(C)(i).

exceptions. First, an individual who attained 70½ years of age before 2020 must have begun taking RMDs beginning in the year they attained 70½ years of age and must have continued taking RMDs regardless of when they attained 72 years of age.[87] Second, an individual who participates in an employer-sponsored qualified retirement plan generally isn't required to take RMDs from that plan until the individual retires.[88] The individual, however, can't be a 5% owner of the employer maintaining the plan, the individual must remain employed by that employer, and the plan must permit RMDs to begin at the later of an employee attaining 72 years of age or retiring.[89]

An individual generally must take each year's RMD by the last day of the year.[90] An individual, however, may defer their first year's RMD until April 1 of the second year (i.e., the year after RMDs must begin).[91] An individual who defers their first year's RMD to the second year will have two RMDs in the second year. The individual must take the first year's RMD by April 1 of the second year and must take the second year's RMD by the last day of the second year.

An individual who has two or more IRAs and is the original account owner of each of the IRAs may take the RMDs from only one of those IRAs or from any two or more of those IRAs.[92] This is also true for 403(b) plans.[93] It, however, is not true for employer-sponsored retirement plans, such as a 401(k) plans and 457(b) plans. If an individual who has one or more IRAs of which they are the original account owner also has one or more inherited IRAs, the individual must exclude the inherited IRAs when calculating the RMDs from the other IRAs (i.e., the IRAs of which the individual is the original account owner).[94]

Retirement accounts inherited by an individual before 2020

An individual who inherited a retirement account before 2020 generally must take RMDs based on their life expectancy.[95] A deceased account owner's surviving spouse, however, may delay the start of RMDs until the later of the year in which the deceased account owner would have attained 72 years of age or the year in which surviving spouse's would have attained 72 years of age.[96]

[87] IRC § 401(a)(9)(C)(i)(I) (2019), which was amended by § 114 of The Setting Every Community Up for Retirement Enhancement Act of 2019 (June 3, 2019).
[88] IRC §§ 401(a)(9)(A)(ii) and (9)(C)(ii).
[89] IRC § 401(a)(9)(C)(ii).
[90] Treas. Reg. § 1.401(a)(9)-5.
[91] Treas. Reg. § 1.401(a)(9)-2.
[92] Treas. Reg. § 1.408-8, A-9. The individual must *calculate* the RMD for each of those IRAs separately but may *take* the total amount of RMDs from any one or more of them.
[93] Treas. Reg. § 1.403(b)-6(e)(2).
[94] Treas. Reg. § 1.408-8, A-9.
[95] Treas. Reg. § 1.401(a)(9)-5, A-5(a).
[96] IRC § 401(a)(9)(e)(ii)(I) (2019).

Retirement accounts inherited by an individual who is an eligible designated beneficiary after 2019
An individual who inherits a retirement account after 2019 and is an eligible designated beneficiary generally must take RMDs based on their life expectancy.[97] An eligible designated beneficiary is:

– the deceased account owner's surviving spouse,
– a child of the deceased account owner who has not attained the age of majority (which, for this purpose, is 21 years of age),
– an individual who is disabled or chronically ill, or
– an individual who is not more than 10 years younger than the deceased account owner.[98]

A deceased account owner's surviving spouse, however, may delay the start of RMDs until the later of the year in which the deceased account owner would have attained 72 years of age or the year in which the surviving spouse's would have attained 72 years of age.[99] A deceased account owner's child must receive the remaining balance of the retirement account by the end of the 10th year after the child attains the age of majority.[100] An eligible designated beneficiary generally is not subject to the 10-year rule, which we explore below.[101]

An individual who has two or more inherited IRAs from the same decedent may take the RMDs from only one of those IRAs or from any two or more of those IRAs.[102] For purposes of satisfying the RMD rules, an individual can't aggregate distributions from an inherited IRA with distributions from an IRA of which they are the original account owner, and the individual can't aggregate distributions from an inherited IRA from one decedent with distributions from an inherited IRA from another decedent.[103]

Retirement accounts inherited by an individual who isn't an eligible designated beneficiary after 2019
An individual who inherits a retirement account after 2019 and isn't an eligible designated beneficiary must receive the account assets in full by the end of the 10th calendar year after the deceased account owner's death.[104] Although the statute enacting this 10-year rule doesn't expressly require the beneficiary to take RMDs during the 10-year period, the IRS issued proposed regulations in which they interpret the statute as requiring the beneficiary to take RMDs (based on the beneficiary's life expectancy) in each of the first nine years and take the remaining balance of the retirement account by the end of the 10th year if the beneficiary inherited the retirement account from a deceased account owner who was required to take RMDs.[105]

[97] IRC § 401(a)(9)(B)(iv).
[98] IRC § 401(a)(9)(E)(ii). In this guide, a deceased account owner refers only to the original account owner (e.g., an individual who made contributions to an IRA or an employee who made contributions to a qualified plan), and it doesn't include a deceased beneficiary of an inherited retirement account. The determination of whether an individual is an eligible beneficiary is made at the time of the deceased account owner's death. IRC § 401(a)(9)(E)(ii) (flush language). The statute doesn't define the age of majority. In early 2022, however, the IRS issued proposed regulations in which it proposes to define the age of majority as 21 years. See *Required Minimum Distributions*, 87 Fed. Reg. 10,504, 10,509 (February 24, 2022).
[99] IRC § 401(a)(9)(E)(ii)(I).
[100] IRC § 401(a)(9)(H). See also Treas. Reg. § 1.401(a)(9)-3, A-2.
[101] A plan may require distributions to be made under the 10-year rule, or it may permit an eligible designated beneficiary to elect to receive distributions either over their lifetime or under the 10-year rule. See Prop. Reg. §§ 1.401(a)(9)-3(b)(5)(ii) and (iii).
[102] Treas. Reg. § 1.408-8, A-9. The individual must *calculate* the RMD for each of those IRAs separately but may *take* the total amount of RMDs from any one or more of them. See also Prop. Reg. § 1.408-8(e).
[103] Id.
[104] IRC § 401(a)(9)(H). In addition to the 10-year rule, there is a five-year distribution rule, which generally applies to beneficiaries who are not individuals (such as estates and certain trusts). In such a case, the balance of the retirement account must be distributed by December 31 of the year containing the fifth anniversary of the deceased account owner's death.
[105] Prop. Reg. § 1.401(a)(9)–5(d).

An individual who inherited a retirement account in 2020 and isn't an eligible designated beneficiary should consider whether, in light of the proposed regulations, they should take a RMD for 2021 and seek abatement for any penalties.[106] Similarly, an individual who inherited a retirement account in 2021 and isn't an eligible designated beneficiary should consider whether, in light of the proposed regulations, they should take a RMD for 2022.[107]

An individual who has two or more inherited IRAs from the same decedent may take the RMDs from only one of those IRAs or from any two or more of those IRAs.[108] For purposes of satisfying the RMD rules, an individual can't aggregate distributions from an inherited IRA with distributions from an IRA of the they are the original account owner, and the individual can't aggregate distributions from an inherited IRA from one decedent with distributions from an inherited IRA from another decedent.[109]

Making qualified charitable distributions

An individual who has attained 70½ years of age and is charitably inclined might consider making a qualified charitable distribution. A qualified charitable distribution, which counts toward the individual's RMD, is a distribution from a traditional IRA to a qualifying charitable organization.[110] (We explore qualified charitable distributions below.)

Checking beneficiary designations

An individual should periodically review the primary and contingent beneficiary designations on their retirement accounts. The individual should confirm that those designations reflect their current wishes. A change of circumstances—especially a significant life event such as a marriage, divorce, birth, or death—might warrant a change to the beneficiary designations. When designating a beneficiary of a qualified retirement plan, an individual's spouse usually must consent if the individual designates a non-spouse primary beneficiary.[111] If an individual hasn't designated any beneficiaries (or everyone whom the individual has designated is deceased), then the account will pass according to the retirement plan's default rules.

[106] See IRC § 4974(a).
[107] Id.
[108] Treas. Reg. § 1.408-8, A-9. The individual must *calculate* the RMD for each of those IRAs separately but may *take* the total amount of RMDs from any one or more of them. See also Prop. Reg. § 1.408-8(e).
[109] Id.
[110] IRC § 408(d)(8)(B).
[111] IRC § 401(a)(11)(B)(iii)(I).

Charitable giving

If an individual is charitably inclined, then that person should review the charitable gifts they've made so far for the year and also consider whether they wish to make additional gifts. In addition to helping an individual achieve their philanthropy objectives, a charitable gift often provides tax benefits. The individual may be able to claim an income tax charitable deduction (which can reduce their regular income tax and AMT), and sizable gifts may help to reduce the individual's estate for estate tax purposes (which potentially can reduce estate taxes).

Making year-end gifts

If an individual wishes to obtain an income tax charitable deduction for 2022, the individual must make their gift on or before December 31, 2022.[112] A gift typically is made once the charitable organization receives it.[113] A special rule applies to a check sent via the US Postal Service. If the individual writes a check payable to a charitable organization, mails the check (via the US Postal Service) to the organization on or before December 31, 2022, and the organization cashes the check in due course, then the individual generally can claim the deduction for that gift in 2022.[114]

When contemplating year-end gifts, an individual should be mindful of the practical issues with completing the gift. For example, a gift of stock for which the donor has a physical stock certificate may take several weeks to complete. Similarly, a gift of real estate involves preparing a deed, signing it, and delivering it to the charitable organization.

Just as there are a number of different assets that can be used to make gifts, there are also several types of charitable organizations to receive those gifts. Below, we explore various types of charitable organizations and the differences between them.

Public charities

A public charity is a type of tax-exempt charitable organization. The universe of tax-exempt charitable organizations—more specifically, 501(c)(3) organizations—comprises public charities and private foundations.[115] A public charity generally is an organization that qualifies as a public charity by reason of its specific activities (e.g., a hospital, school, or church) or by reason of having a requisite level of public support.[116] In contrast, a private foundation usually is supported predominantly or exclusively by one donor or family.[117] Contributions to public charities generally receive more favorable tax treatment than contributions to private foundations. Also, donor advised funds and supporting organizations are public charities, but certain contributions to them are treated differently from contributions to other public charities.[118]

An individual who contributes cash to one or more public charities generally can deduct those contributions up to 60% of their adjusted gross income.[119] An individual who contributes the following property to one or more public charities generally can deduct those contributions up to 50% of their adjusted gross income:

- ordinary income property,
- capital assets that the individual has held for one year or less,
- tangible personal property that the charity doesn't use as a part of its charitable activities,
- capital gain property if the individual elects to use their basis in the property as the amount of the contribution, and
- capital assets in which there isn't any unrealized gains.[120]

[112] IRC § 170(a)(1).
[113] Treas. Reg. § 1.170A-1(b).
[114] Id.
[115] IRC § 509(a). See, e.g., *Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated*, 80 Fed. Reg. 79684 (December 23, 2015) ("An organization described in section 501(c)(3) is classified as either a private foundation or a public charity"). A 501(c)(3) organization is an organization that is organized and operated exclusively for religious, charitable, scientific, or another qualifying purpose and is exempt from tax under Section 501(c)(3) of the Internal Revenue Code.
[116] IRC § 509(a)(1).
[117] Id.
[118] More precisely, a contribution to a donor advised fund is treated as a contribution to a public charity because the sponsoring organization that sponsors the fund is a public charity. For simplicity, we will generally speak in terms of a donor advised fund as if it is itself a public charity.
[119] IRC § 170(b)(1)(G)(i). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[120] IRC § 170(b)(1)(A).

For those types of property, the amount of the contribution is based on the individual's basis in the property.[121] An individual who contributes long-term capital gain property to one or more public charities generally can deduct those contributions up to 30% of their adjusted gross income.[122] When an individual contributes long-term capital gain property to a public charity, the amount of the individual's charitable contribution generally is the property's fair market value.[123] When an individual contributes tangible personal property that the donor has held for more than a year to a public charity, the amount of the individual's charitable contribution is the donor's basis in the property unless the charity uses the property as a part of its charitable activities.[124] When an individual contributes property other than long-term capital gain property to a public charity, the amount of the individual's charitable contribution generally is the donor's basis in the property.[125]

A public charity is generally exempt from income tax.[126] Thus, it generally won't incur any tax upon the sale of assets that it receives as a gift from a donor. A public charity, however, is subject to the unrelated business income tax.[127] This tax may apply if the public charity has income from a trade or business or it has income from debt-financed property.[128] This tax applies to a public charity's proportionate share of income from an S corporation.[129]

Donor advised funds

A donor advised fund is a fund or account that is sponsored by a public charity and to which a donor makes contributions.[130] The donor or someone whom the donor designates—such as one or more members of the donor's family—generally can advise on distributions from the fund.[131] Distributions generally are made to public charities.[132] The donor or someone whom the donor designates potentially may advise on the investment of the assets in the fund.[133] The ability to advise on investments may be either in addition to or in lieu of being able to advise on distributions.[134] A donor advised fund generally enables a donor to make a charitable contribution, claim an income tax charitable deduction for that contribution, and maintain a pool of assets from which grants to public charities can be made over time.

Although a donor can generally make a qualified charitable distribution to a public charity, a donor can't make a qualified charitable distribution to a donor advised fund.[135] (We discuss qualified charitable distributions below.)

[121] IRC § 170(e)(1).
[122] IRC § 170(b)(1)(C). Long-term capital gain property is capital gain property that the donor has held for more than one year.
[123] Treas. Reg. § 1.170A-1(c).
[124] IRC § 170(e)(1)(B)(i)(I).
[125] IRC § 170(e)(1)(A).
[126] IRC § 501(a).
[127] IRC § 511.
[128] See IRC § 512.
[129] IRC § 512(e).
[130] IRC § 4966(d)(2). More precisely, a donor advised fund is separately identified by reference to contributions of one or more donors, and it is owned and controlled by a sponsoring organization. Id. A sponsoring organization is a public charity other than a governmental body. IRC § 4966(d)(1). A sponsoring organization must notify the IRS that it maintains donor advised funds. IRC § 508(f).
[131] Id.
[132] A donor advised fund is prohibited from making distributions to individuals but is permitted to make distributions to other persons for charitable purposes. IRC §§ 4966(c)(1) and (c)(2). A sponsoring organization must exercise expenditure responsibility—essentially a comprehensive set of due diligence obligations—for a distribution to a person other than a public charity. IRC § 4966(c)(1)(B)(ii). Many sponsoring organizations won't permit distributions to persons other than to public charities.
[133] IRC § 4966(d)(2)(A)(iii).
[134] Id.
[135] IRC § 408(d)(8)(B)(i). A donor also can't make a qualified charitable distribution to a supporting organization.

A donor generally can deduct gifts to a donor advised fund to the same extent that the donor can deduct gifts to other public charities. Accordingly, an individual can generally deduct cash contributions to a donor advised fund (and other public charities) up to 60% of their adjusted gross income[136] and generally can deduct non-cash contributions to a donor advised fund (and other public charities) up to either 50% or 30% of their adjusted gross income depending on the type of property, how long the individual has held the property, and, in the case of tangible personal property, how the charity will use the property.[137] (We discuss these rules in more detail above.)

A donor advised fund is generally exempt from income tax.[138] Thus, it generally won't incur any tax upon the sale of assets that it receives as a gift from a donor. A donor advised fund, however, is subject to the unrelated business income tax.[139] This tax may apply if the fund has income from a trade or business or it has income from debt-financed property.[140] This tax applies to a fund's proportionate share of income from an S corporation.[141] Some sponsoring organizations won't accept contributions of property that would cause it to be subject to the unrelated business income tax. Some may accept the contribution but allocate any taxes to the donor advised fund to which the contribution was made.

For a more in-depth discussion of donor advised funds, see Rebecca Sterling, *Donor Advised Funds and Private Foundations* (a publication of the UBS Advanced Planning Group).

Supporting organizations

A supporting organization is a tax-exempt charitable organization that vicariously enjoys public charity status, because of its close relationship with a public charity.[142] A supporting organization generally includes:

– an organization that's controlled by a public charity (i.e., a subsidiary of a public charity),[143]
– an organization that's under common with a public charity (i.e., an entity that's a sibling of a public charity),[144] and
– subject to certain conditions, an organization that operates in connection with a public charity.[145]

The donor and the donor's family generally can participate in the governance of a supporting organization but cannot control it.[146]

A donor generally can deduct gifts to a supporting organization to the same extent that the donor can deduct gifts to other public charities. Accordingly, an individual can generally deduct cash contributions to a supporting organization (and other public charities) up to 60% of their adjusted gross

[136] IRC § 170(b)(1)(G)(i). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[137] IRC §§ 170(b)(1)(A) and (1)(C).
[138] IRC § 501(a).
[139] More precisely, the sponsoring organization is subject to the unrelated business income tax. IRC § 511. A sponsoring organization generally will pay any unrelated business income tax attributable to a donor advised fund from the fund.
[140] See IRC § 512.
[141] IRC § 512(e).
[142] IRC § 509(a)(3).
[143] IRC § 509(a)(3)(B)(i).
[144] IRC § 509(a)(3)(B)(ii).
[145] IRC § 509(a)(3)(B)(iii).
[146] IRC § 509(a)(3)(C).

income[147] and generally can deduct non-cash contributions to a supporting organization (and other public charities) up to either 50% or 30% of their adjusted gross income depending on the type of property, how long the individual has held the property, and, in the case of tangible personal property, how the charity will use the property.[148] (We discuss these rules in more detail above.)

Although a donor can generally make a qualified charitable distribution to a public charity, a donor can't make a qualified charitable distribution to a supporting organization.[149] (We discuss qualified charitable distributions below.)

A supporting organization is generally exempt from income tax.[150] Thus, it generally won't incur any tax upon the sale of assets that it receives as a gift from a donor. A supporting organization, however, is subject to the unrelated business income tax.[151] This tax may apply if the supporting organization has income from a trade or business or it has income from debt-financed property.[152] This tax applies to a supporting organization's proportionate share of income from an S corporation.[153]

Private foundations

A private foundation is a tax-exempt charitable organization other than a public charity.[154] A private foundation usually is supported predominantly or exclusively by one donor or family. The donor and the donor's family generally run or oversee the foundation, serving as the foundation's directors or trustees and making decisions concerning grants and investments. A private foundation may make grants to public charities, administer scholarship programs, or, in some cases, directly engage in charitable activities. A private foundation generally enables a donor to make a charitable contribution, claim an income tax charitable deduction for that contribution, and manage a pool of assets from which to make grants for charitable purposes to individuals, public charities, and other persons over time.

There are two types of private foundations. A private nonoperating foundation, which is more common, typically supports charitable purposes through grants to individuals, public charities, and other persons. In contrast, a private operating foundation, which is less common, directly conducts charitable activities, devoting a substantial portion of its financial resources directly to those activities.[155] Some museums, libraries, research laboratories, parks, and think tanks are private operating foundations. Contributions to private operating foundations receive more favorable treatment than contributions to private nonoperating foundations.

In the case of a private nonoperating foundation, an individual generally can deduct cash contributions up to 30% of

[147] IRC § 170(b)(1)(G)(i). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[148] IRC §§ 170(b)(1)(A) and (1)(C).
[149] IRC § 408(d)(8)(B)(i). A donor also can't make a qualified charitable distribution to a donor advised fund.
[150] IRC § 501(a).
[151] IRC § 511.
[152] See IRC § 512.
[153] IRC § 512(e).
[154] IRC § 509(a). See, e.g., *Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated*, 80 Fed. Reg. 79684 (December 23, 2015) ("An organization described in section 501(c)(3) is classified as either a private foundation or a public charity").
[155] IRC § 4942(j)(3).

their adjusted gross income.[156] In the case of publicly traded securities held for more than one year, an individual generally can deduct the securities' fair market value, and the individual generally can deduct those gifts up to 20% of their adjusted gross income.[157] In the case of any other property, the individual generally can deduct their basis in the property, and the individual generally can deduct those non-cash gifts up to 30% of their adjusted gross income.[158]

In the case of a private operating foundation, a donor generally can deduct contributions to the same extent that the donor can deduct gifts to public charities. Accordingly, an individual generally can deduct cash contributions to a private operating foundation up to 60% of their adjusted gross income[159] and generally can deduct non-cash contributions to a supporting organization (and other public charities) up to either 50% or 30% of their adjusted gross income depending on the type of property, how long the individual has held the property, and, in the case of tangible personal property, how the charity will use the property.[160] (We discuss these rules in more detail above.)

A private foundation is subject to a 1.39% tax on its investment income.[161] Thus, it may incur a tax upon the sale of assets that it receives as a gift from a donor. Let's assume that Alex gifts $1 million of publicly traded stock to a private foundation, Alex's basis in the stock is $200,000, and, immediately after receiving the gift, the foundation sells the stock. The foundation would incur a tax of $11,120 (i.e., 1.39% of $800,000) on the sale, so it would net $988,880.

For a more in-depth discussion of private foundations, see Rebecca Sterling, *Donor Advised Funds and Private Foundations* (a publication of the UBS Advanced Planning Group), Ann Bjerke, *Managing a Private Foundation* (a publication of the UBS Advanced Planning Group), and Catherine McDermott and Julie Binder, *Private Operating Foundations* (a publication of the UBS Advanced Planning Group).

Charitable contribution carryforwards

To the extent that an individual's charitable contributions exceed the amount allowable as an income tax charitable deduction under the percentage limitations, the individual has a charitable contribution carryforward, which the individual can use over the next five years.[162]

Bunching charitable gifts

An individual who typically makes annual charitable gifts but doesn't have itemized deductions in excess of the standard deduction might consider bunching multiple years of charitable gifts into a single year. Since 2018, many individuals do not have sufficient itemized deductions to exceed the

[156] IRC § 170(b)(1)(B). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H).
[157] IRC § 170(b)(1)(D)(i).
[158] IRC § 170(b)(1)(B).
[159] IRC §§ 170(b)(1)(A)(vii) and (G)(i). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[160] IRC §§ 170(b)(1)(A) and (1)(C).
[161] IRC § 4940(a). Under limited conditions, a private operating foundation is exempt from this tax. IRC § 4940(d). For tax years beginning before December 20, 2019, a private foundation was subject to a 2% tax on its net investment income or, if it met certain minimum distribution requirements, a 1% tax on its net investment income.
[162] IRC § 170(d)(1).

standard deduction.[163] Bunching multiple years of charitable gifts may cause the individual's itemized deductions to exceed the standard deduction and therefore maximize their income tax charitable deduction. The individual might consider contributing the bunched amount to a donor advised fund so that the individual can make grants periodically to one or more charities in future years.

Selecting assets to give to charity

For many individuals, the selection of assets to give to charity often comes down to a choice between cash (largely due to simplicity) and appreciated, long-term publicly traded securities (largely due to being able to benefit from the income tax charitable deduction while avoiding the unrealized capital gains). But the choice isn't always so simple, and there are several factors that a donor might wish to consider. When selecting assets to give to charity, some key factors to consider include:

- the extent to which the contribution provides tax benefits,
- the extent to which the contribution would be deductible under the percentage limitations,
- the ease or complexity of making the contribution, and
- the ease or complexity of substantiating the contribution.

The selection of assets can affect the tax benefits that the donor enjoys. For purposes of evaluating those benefits, there are four questions that a donor may wish to ask. First, does the gift provide an income tax charitable deduction? Most gifts do, but there are some that don't (such as a gift of transferrable, unvested NSOs or a gift of a remainder interest in undeveloped land that isn't farmland).[164] Second, in the case of a non-cash gift, is the deduction based on the property's fair market value or something less (such as the donor's basis in the property)? For example, an artist who gives artwork that they created generally can deduct only their basis in the artwork.[165] Similarly, a donor who gives publicly traded stock held for one year or less can deduct only their basis in the stock,[166] but a donor who gives publicly traded stock held for more than one year generally can deduct the stock's fair market value.[167] Third, does the donor get the income tax deduction while avoiding tax on unrealized capital gains? For many donors, this is the essential reason they choose to give appreciated, long-term capital gain property (rather than cash) when making gifts to donor advised funds, supporting organizations, and other public charities or appreciated, long-term publicly traded securities when making gifts to private nonoperating foundations.[168] Fourth, would the donor lose a tax benefit by making the gift? For example, an individual who owns publicly traded stock in which there's an unrealized loss typically would be better off selling the stock, recognizing the loss, and donating the proceeds to charity. If the individual contributes the stock to charity, the amount of the individual's contribution would be the stock's fair market value, and the individual would lose the ability to claim the loss.

When picking assets to give to charity, some individuals may consider the extent to which their gifts would be deductible under the percentage limitations. An example may help illustrate this point. Let's assume that an individual wishes to minimize their taxable

[163] See IRC § 63(c).
[164] See Rev. Rul. 98-21.
[165] IRC § 170(e)(1)(A).
[166] Id.
[167] Treas. Reg. 1.170A-1(c).
[168] See IRC § 170(e)(5)(A).

income as much as possible through gifts to a public charity.[169] The individual might give cash in an amount equal to 60% of their adjusted gross income. Alternatively, the individual might choose to give a mix of cash and property. To that end, the individual might choose to give (1) publicly traded stock that has a fair market value equal to 30% of the donor's adjusted gross income and has been held by the donor for more than one year and (2) cash in an amount equal to 20% of their adjusted gross income.

The ease or complexity of making a contribution may affect a donor's choice of assets to give to charity. Sometimes, it's a matter of how fast and easy it is to transfer the asset to charity. For example, donating publicly traded stock that a donor holds through a brokerage or other investment account typically is straightforward. In contrast, donating publicly traded stock that the donor holds as physically certificated shares is more involved. Sometimes, it's a matter of how much work the charity needs to do to decide whether it should accept the gift. For example, a charity typically conducts due diligence before accepting a gift of real property or an interest in a privately held business.

The ease or complexity of substantiating the contribution also may affect a donor's choice of assets to give to charity. When a donor gives property (other than publicly traded securities) to a charity, the donor generally must obtain a qualified appraisal to substantiate the value of the property.[170] This increases the cost and inconvenience of making the gift. Thus, when choosing between publicly traded stock and privately held stock, a donor might favor publicly traded stock, because the donor can avoid the need for an appraisal. Of course, a donor might choose the privately held stock—even though the donor will need to obtain an appraisal—if the donor anticipates a sale of the business later in the year, because the amount of the contribution potentially would be the stock's fair market value (so long as the donor has held the stock for more than one year) and the donor potentially would avoid the capital gains on the future sale of the stock.[171]

Making qualified charitable distributions

An individual who has attained 70½ years of age and is charitably inclined might consider making a qualified charitable distribution, which is a distribution from an IRA to a qualifying charity.[172] An individual generally can make up to $100,000 of qualified charitable distributions during a calendar year.[173] An individual's qualified charitable distributions count toward the individual's RMDs.[174]

[169] Let's also assume that the individual doesn't have any net operating loss carrybacks, so that the individual's contribution base is their adjusted gross income.
[170] IRC § 170(f)(11)(C).
[171] A donor, however, potentially is taxable on the capital gain if the donor contributes the stock after the sale is all but a done deal. For a more in-depth discussion of this issue (which, in tax parlance, is called the assignment of income doctrine), see Ann Bjerke, *When to Give to Charity: Before or after the Sale of a Business* (a publication of the UBS Advanced Planning Group).
[172] IRC § 408(d)(8)(B). A distribution from an active SEP IRA or an active SIMPLE IRA, however, doesn't qualify as a qualified charitable contribution. A SEP IRA is an IRA that's set up by or for an employee under a simplified employee pension (SEP). See IRC § 408(k)(1). A SIMPLE IRA is an IRA that's set up for an employee under a savings incentive match plan for employees of small employers (SIMPLE) IRA plan. See IRC § 408(p)(1). An SEP IRA or SIMPLE IRA is active (or, in the IRS's parlance, ongoing) if the employer makes a contribution to it during the plan year that ends in the calendar year in which the employee would make a qualified charitable distribution. Notice 2007-07, A-36.
[173] IRC § 408(d)(8)(A). This cap may be less if the individual has made contributions to IRAs after attaining 70½ years of age. We discuss this below.
[174] Id.

A distribution qualifies as a qualified charitable contribution if:

- the IRA owner has attained 70½ years of age,[175]
- the distribution is made from an IRA directly to a public charity (other than a donor advised fund or supporting organization),[176]
- the distribution would be includible in the IRA owner's income (ignoring the rule that excludes a qualified charitable distribution from income),[177] and
- the distribution would qualify for an income tax charitable contribution (ignoring the rule that disallows an income tax charitable deduction for a qualified charitable distribution and ignoring the percentage limitations that limit the deductibility of charitable contributions).[178]

An IRA owner may make qualified charitable distributions even though they aren't required to take RMDs. For example, an individual who attains 70½ years of age in 2022 may make a qualified charitable distribution, even though the individual won't be required to take RMDs from their traditional IRA until they attain 72 years of age. (We discuss RMDs in more depth above.)

To qualify as a qualified charitable distribution, the distribution must be made from an IRA directly to a qualifying charity.[179] There are a couple ways to satisfy this direct payment requirement. The IRA trustee can transfer the funds directly to the charity (e.g., by sending a check directly to the charity or via electronic funds transfer). Alternatively, the IRA trustee can provide to the IRA owner a check from the IRA made payable to the charity and the IRA owner can deliver that check to the charity.[180]

A distribution qualifies as a qualified charitable distribution only if it would be includible in the IRA owner's income (ignoring the rule that excludes a qualified charitable distribution from income).[181] Accordingly, to the extent that a distribution is from non-deductible contributions that the IRA owner made to an IRA, the distribution won't qualify as a qualified charitable distribution. For these purposes, distributions are treated as coming first from amounts that would be includible in the IRA owner's income.[182]

During a calendar year, the total amount of qualified charitable distributions can't exceed $100,000.[183] This amount, however, is reduced by any contributions that the individual has made to one or more IRAs in the years after attaining 70½ years of age (to the extent those contributions didn't limit the qualified charitable distributions that the IRA owner made in prior years).[184] An example may help. Let's assume an individual who attained 70½ years of age in 2021 makes a $7,000 contribution to a traditional IRA in 2022. Consequently, the individual's qualified charitable distributions can't exceed $93,000 in 2022. If the individual makes $93,000 qualified charitable distributions of charitable contributions in 2022 and doesn't make any contributions to the IRA in 2023, then the individual's qualified charitable distributions

[175] IRC § 408(d)(8)(B)(ii).
[176] IRC § 408(d)(8)(B)(i).
[177] IRC § 408(d)(8)(B) (flush language).
[178] IRC § 408(d)(8)(C).
[179] IRC § 408(d)(8)(B)(i).
[180] Notice 2007-7, A-41.
[181] IRC § 408(d)(8)(B) (flush language).
[182] IRC § 408(d)(8)(D).
[183] IRC § 408(d)(8)(A).
[184] Id. To the extent the individual makes non-deductible contributions to the IRAs, those contributions are ignored for purposes of calculating this reduction.

can't exceed $100,000 in 2023. The $100,000 limit applies per IRA owner regardless of filing status. Thus, for married individuals filing a joint return, the limit is $100,000 per IRA owner.[185]

A qualified charitable distribution isn't includible in the IRA owner's income and thus isn't subject to income tax.[186] A qualified charitable distribution doesn't qualify for an income tax charitable deduction.[187] This makes sense, because it also isn't included in income. Excluding a qualified charitable deduction from income *and* allowing an income tax deduction for the distribution would be a double tax benefit.

Creating a charitable remainder trust

An individual who owns appreciated property, wishes to diversify in a tax-efficient manner, and is charitably inclined might consider creating a charitable remainder trust. The trust potentially enables the individual to sell the appreciated property, defer recognition of the capital gains, and receive a stream of income (typically for life). This may be an attractive strategy for someone who owns a low-basis concentrated stock position or a business owner who anticipates that there may be a sale of the company in the not-too-distant future.

A charitable remainder trust is an irrevocable trust that pays income to one or more individuals for life (or a term of up to 20 years) after which it distributes any remaining assets to one or more charitable organizations or holds the assets in trust for charitable purposes.[188] A charitable remainder trust pays income either in the form of an annuity (in which case the trust is a charitable remainder annuity trust) or a unitrust (in which case the trust is a charitable remainder unitrust). A charitable remainder annuity trust pays an annuity (i.e., a fixed dollar amount) to the income beneficiaries.[189] A charitable remainder unitrust generally pays a fixed percentage of its value to the income beneficiaries (although there are some permissible exceptions and variations).[190] The present value of the remainder interest must equal at least 10% of the fair market value of contributed property at the time of contribution.[191]

An individual generally doesn't recognize any capital gain upon contributing appreciated property to a charitable remainder trust.[192] In addition, a charitable remainder trust is generally tax-exempt, so it typically can sell the property without incurring any tax and can reinvest the proceeds in a diversified portfolio.[193] As the individual receives distributions from the trust, the individual generally includes those distributions in income.[194] In the year in which the individual funds the trust, the individual generally can claim an income tax charitable deduction for the present value of the trust's remainder interest.[195]

[185] Notice 2007-7, A-34.
[186] IRC § 408(d)(8)(A).
[187] IRC § 408(d)(8)(E).
[188] See IRC § 664.
[189] IRC § 664(d)(1).
[190] IRC §§ 664(d)(2) and (3).
[191] IRC §§ 664(d)(1)(D) and (d)(2)(D).
[192] See Treas. Reg. § 1.1011-2.
[193] IRC § 664(c).
[194] IRC § 664(b).
[195] IRC § 170(f)(2)(A).

For a more in-depth discussion of charitable remainder trusts, see Benjamin C. Trayes, *Charitable Remainder Trusts* (a publication of the UBS Advanced Planning Group). For more information about using charitable remainder trusts to manage a concentrated stock position, see Christine Kolm, *Concentrated Stock Positions* (a publication of the UBS Advanced Planning Group). For more information about using charitable remainder trusts in pre-sale planning, see David Leibell, *Planning for the Sale of a Closely Held Business* (a publication of UBS Family Office Solutions and the UBS Advanced Planning Group).

Creating a charitable lead annuity trust

An individual who is charitably inclined and likes the idea of shifting wealth on a gift and estate tax free basis to children (or others) might consider creating a charitable lead annuity trust. A charitable lead annuity trust is a trust that annually pays an annuity (that is, a fixed dollar amount) to one or more charities for a period of time (often, 10 or 20 years), after which the remaining property is distributed (either outright or in trust) to one or more non-charitable beneficiaries (typically, the donor's children). The trust could pay the annuity to the individual's donor advised fund or private foundation, or it could pay the annuity to one or more charities that the trustee selects each year.

A charitable lead annuity trust usually is designed as a zeroed-out charitable lead annuity trust, which means that the present value of the remainder interest (i.e., the interest of the donor's children or other non-charitable beneficiaries when the annuity term ends) is zero. To the extent that, over the annuity term, the trust's property grows in value more than the section 7520 rate that applied when the trust was funded, the trust will shift that appreciation to the non-charitable beneficiaries free of any gift and estate taxes. The section 7520 rate, which is the interest assumption that's used for valuing certain interests for gift and estate tax purposes, thus acts like a hurdle rate. The IRS publishes the section 7520 rate monthly.[196]

If the trust is designed as a grantor trust, then the donor generally can claim an income tax charitable deduction for the present value of the charitable interest in the trust (i.e., the annuity interest).[197] Thus, in a zeroed-out charitable lead annuity trust, the donor generally can claim an income tax charitable deduction for the full value of the property that the donor contributes to the trust.[198] Of course, if the trust is designed as a grantor trust, then the donor must include the trust's income, deductions, and credits on the grantor's income tax return.[199] If, in contrast, the trust is designed as a nongrantor trust, then the donor can't claim an income tax charitable deduction for the donor's contribution to the trust, but the trust generally can claim an income tax charitable deduction for the annuity payments that it makes.[200]

For a more in-depth discussion of charitable lead annuity trusts, see Jennifer Lan, *Charitable Lead Annuity Trusts* (a publication of the UBS Advanced Planning Group).

[196] Treas. Reg. § 1.7520-1(b)(1)(i).
[197] IRC § 170(f)(2)(B).
[198] Id. If the donor dies before the end of the annuity term, then a portion of the income tax charitable deduction is includible as income and is reportable the donor's final income tax return. See Treas. Reg. § 1.170A-6(c)(4).
[199] IRC § 671.
[200] IRC § 642(c).

Substantiating charitable gifts

An individual who made charitable contributions during the year should make sure they have proper substantiation of those contributions. In recent years, several court cases have denied taxpayers a charitable deduction for failing to comply strictly with these substantiation requirements.[201]

For a gift in excess of $250, a donor must obtain a receipt.[202] This is so even if the donor made the gift to their own private foundation. The donor must obtain the receipt before filing the income tax return on which they claim the income tax charitable deduction.[203] The receipt must be in writing, state the amount donated, describe any non-cash property that the donor donated, and indicate the value of any goods or services provided by the charity as consideration for the gift.[204] A canceled check does not meet these requirements.[205]

For a gift of property (other than publicly traded securities) having a value of more than $5,000, a donor generally must obtain a qualified appraisal.[206] The donor must obtain the appraisal before filing the income tax return on which they claim the income tax charitable deduction.[207] Given the time that's often involved in preparing an appraisal, a donor should start the process of obtaining an appraisal as soon as possible.

Managing a private foundation

An individual who created a private foundation and remains involved in its management (such as a director or trustee) should review the foundation's investments and operations before year end.[208] Some key things to consider doing:

- Confirm that the directors and trustees have or will have had any meeting that the foundation's governing documents or state law may require and that those meetings have been properly documented (e.g., through minutes of those meetings).
- If there have been any changes affecting who is serving as a director, officer, or trustee, confirm that any appointment, resignation, or removal has been properly documented.
- Calculate an estimated amount of grants that the foundation must make this year.
- Confirm that, before year end, the foundation made (or will have made) all of the grants that it was required to make for last year.
- Consider making a grant from the private foundation to a donor advised fund before year's end if there isn't time to decide which charities should receive some or all of the amount that the foundation must grant this year.
- Consider making grants of low-basis stock instead of selling the stock to raise cash for the grants, so that the foundation avoids the 1.39% excise tax on the gain from such sales.
- If the foundation recognized any losses during the year, consider selling appreciated property, so that the foundation can offset those losses (because the foundation can't carry losses forward to next year).

[201] See, e.g., *Albrecht v. Commissioner*, T.C. Memo 2022-53, *Ohde v. Commissioner*, T.C. Memo 2017-137, and *Durdan v. Commissioner*, T.C. Memo 2012-140.
[202] IRC 170(f)(8)(A).
[203] Id.
[204] IRC § 170(f)(8)(B).
[205] Treas. Reg. § 1.170A-15(a).
[206] IRC § 170(f)(11)(C).
[207] Id.
[208] For simplicity, we will assume that the foundation's taxable year is the calendar year, which is commonly the case.

For a more in-depth discussion of managing private foundations, see Ann Bjerke, *Managing a Private Foundation* (a publication of the UBS Advanced Planning Group).

Further reading
For a comprehensive discussion of charitable giving, see David Leibell, *Charitable Giving: Rules of the Road* (a publication of UBS Family Office Solutions, the UBS Advanced Planning Group, and UBS Family Advisory and Philanthropy Services).

State tax planning

In addition to considering any federal tax consequences, an individual should also consider any actions that would impact their state income tax liability. This is especially true for those individuals who reside in states with high state and local income taxes.

Managing residency

An individual who spends time in multiple states might wish to assess whether they could be treated as a resident in more than one of those states. States have different standards for determining whether someone is a resident, and the standard for income tax purposes sometimes differs from the standard for estate tax purposes. In some cases, an individual's domicile (where they intend to live indefinitely) is more relevant than their residency (generally where they are physically present). For income tax purposes, residency sometimes is based strictly on physical presence (i.e., a day-count test). Other times, other factors are relevant (e.g., whether the individual rents or owns an apartment, house, or other dwelling in the state). By managing residency, an individual potentially can avoid unexpected taxes.

Changing residency

An individual who resides in a state with high taxes might consider changing residency to a state with lower taxes. Again, states have different standards for determining whether someone is a resident or domiciliary, and the standard for income tax purposes sometimes differs from the standard for estate tax purposes. Establishing ties with a new state—and, often more importantly, breaking ties with the old state—can take time and effort. Of course, changing residency affects a lot more than taxes. It affects an individual's personal, social, and business connections and may affect quality of life. In addition, beyond income and estate taxes, there are other taxes and costs to consider (e.g., property taxes, automobile registration fees, and auto and homeowners' insurance premiums). For a more in-depth discussion of changing residency, see Christine Kolm, *Changing State of Residence* (a publication of the UBS Advanced Planning Group).

Shifting income and gains out of state

An individual who lives in a state that imposes an income tax might consider creating a nongrantor trust in a state that doesn't impose an income tax on trusts. To the extent that the individual contributes assets to such a trust, the individual can potentially shift income and gains out of the individual's home state and thus potentially avoid state income taxes on the trust's income and gains. States that don't impose income taxes on trusts include Florida, Nevada, New Hampshire, South Dakota, Tennessee, and Wyoming.

A business owner who is looking to sell their business in the next few years might find it appealing to contribute some shares of their business to a nongrantor trust established in one of the trust-friendly states. When they ultimately sell the business, the gain on the shares held by the trust potentially wouldn't be subject to any state income tax.[209] A business owner who previously created a nongrantor trust that holds shares of the business and isn't already in a trust-friendly state might consider moving it to one.[210] Similarly, a business owner who previously created a grantor trust that holds shares of the business might consider converting the trust to a nongrantor trust and, if it isn't already in a trust-friendly state, moving it

[209] In some states, it may not be possible to avoid state income taxes on the sale if the business is taxable as a partnership or S corporation for federal income tax purposes. See, e.g., *Burton v. New York State Department of Taxation and Finance*, 43 Misc. 3d 316 (N.Y. Sup. Ct. 2014).

[210] More precisely, the business owner would seek to eliminate any connections (nexus) that the trust has to the business owner's home state (or any other state that might impose an income tax on the trust).

to one.[211] Again, when in either of these situations they ultimately sell the business, the gain on the shares held by the trust potentially wouldn't be subject to any state income tax.[212]

In California and New York, residents are taxed on distributions from nongrantor trusts in a manner that aims to erase the economic benefit of the trusts having avoided state income taxes in the years before the distribution.[213] (These states impose a throwback tax, which is what erases that economic benefit.) Despite this, using a nongrantor trust in a trust-friendly state may still be advantageous if the beneficiaries are likely to change their residency before the trust makes any distributions to them.

States take different approaches to determining whether a trust has sufficient connections (in tax parlance, nexus) with the state to be taxable in the state. A trust may be subject to tax based on:

– A settlor's residence
– A beneficiary's residence
– A trustee's residence
– The trust's place of administration
– The location of assets

In some cases, courts have held that a state's taxation of a trust based solely on the settlor's residency at the time that the trust became irrevocable is unconstitutional.[214] In addition, the United States Supreme Court has held that a state's taxation of a trust based solely on the trust having a beneficiary who's a resident of that state is unconstitutional.[215]

Even if a state doesn't tax a trust on all of its income, a state will tax a trust on source income (that is, income that traces back to the state). For example, a state typically would tax rents that a nongrantor trust receives from any real property located within the state.

When using a nongrantor trust for purposes of reducing state income taxes, an individual needs to consider whether the trust will be a completed gift trust or an incomplete nongrantor (ING) trust. In the case of a completed gift trust, contributions to the trust are completed gifts for gift tax purposes, and (so long as the trust is properly designed and administered) the trust property isn't includible in the settlor's estate for estate tax purposes. In the case of an ING trust, contributions to the trust are incomplete gifts for gift tax purposes, and the trust property is includible in the settlor's estate for estate tax purposes. A completed gift, nongrantor trust thus incorporates income and estate tax planning. In contrast, an ING trust incorporates income tax planning (but not estate tax planning).[216]

For New York income tax purposes, an ING trust generally is treated as a grantor trust.[217] A New York resident who is the settlor of an ING trust thus reports the trust's income, deductions, and credits on their personal New York income tax return.[218] In California, the state tax agency proposed a similar law, but nothing has yet been enacted.[219]

[211] Converting a grantor trust to a nongrantor trust—a process that's often described as toggling off grantor trust status—has other potential implications. These include possibly recognizing certain gains, losing potential gift and estate tax advantages, and losing flexibility in the administration of the trust.
[212] See note 209.
[213] N.Y. Tax Law § 605(b)(3)(D) and Cal. Rev. & Tax Code § 17745(b).
[214] See, e.g., *Fielding v. Commissioner*, 916 N.W.2d 323 (Minn. 2018), aff'g No. 8911-R, 2017 BL 194423 (Minn. Tax Ct. May 31, 2017), *Linn v. Department of Revenue*, 2 N.E.3d 1203 (Ill. App. Ct. 2013), *Residuary Trust A v. Director, Division of Taxation*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013), aff'd on other grounds, 28 N.J. Tax 541 (N.J. Super. Ct. App. Div. 2015) (New Jersey), and *McNeil v. Commonwealth*, 67 A.3d 185 (Pa. Commw. Ct. 2013).
[215] *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, 588 US ___, 139 S.Ct. 2213 (2019).
[216] For a more in-depth discussion of ING trusts, see Ann Bjerke and Todd D. Mayo, *ING Trusts* (a publication of the UBS Advanced Planning Group).
[217] NY Tax Law § 612(b)(41).
[218] NY Tax Law §§ 611(a) and 612(a). See also Instructions to 2021 N.Y. Form IT-205, p. 5.
[219] California Franchise Tax Board, *Legislative Proposal C*. See Casey C. Verst, *California Tax Agency Proposes Law to End Use of ING Trusts* (a publication of the UBS Advanced Planning Group), and Casey C. Verst, *ING Trusts Remain Viable Estate Planning Strategy for California Residents* (a publication of the UBS Advanced Planning Group).

Wealth transfer planning

In addition to income tax planning and considerations regarding retirement accounts, year-end is also a great time to consider wealth transfer planning. There are a number of opportunities for planning that can be done on an annual basis.

Making annual exclusion gifts

An individual who wishes to reduce their estate for estate tax purposes might consider making non-taxable gifts to family members and others. In 2022, an individual can give $16,000 to another person, and the gift will be non-taxable for gift tax purposes.[220] The annual exclusion adjusts annually for inflation.[221] In addition to removing the money or other property from the individual's estate for estate tax purposes, the gift removes any future appreciation with respect to that money or property from the individual's estate.

An outright gift to another person usually qualifies for the annual exclusion.[222] A contribution to a 529 plan, a Uniform Gifts to Minors Act account, or a Uniform Transfers to Minors Act account is treated as an outright gift to the beneficiary.[223] Paying another individual's debts or expenses generally is treated as a gift to the individual.[224] A gift in trust typically is treated as a gift to the trust's beneficiaries.[225] Under certain circumstances, a gift in trust may qualify for the annual exclusion.[226]

Contributing to a traditional IRA or Roth IRA

Instead of making an outright gift to someone like a child or grandchild, an individual might make a contribution to a traditional or Roth IRA on the other individual's behalf. Contributing to a traditional or Roth IRA on another individual's behalf is a gift to the other individual. For 2022, the total contributions an individual may make (or someone could make on their behalf) to traditional IRAs and Roth IRAs can't exceed the lesser of:

– $6,000 ($7,000 if the individual has attained 50 years of age), or
– the individual's taxable compensation for the year.[227]

An individual's tax-deductible contributions to traditional IRAs may be limited if the individual or their spouse is covered by a workplace retirement plan and their income exceeds certain levels.[228] An individual's contributions to Roth IRAs may be limited if their income exceeds certain levels.[229] (We discuss these limits above.)

For purposes of the IRA contribution rules, an individual generally can contribute to a traditional IRA or Roth IRA on or before April 15 and can treat the contribution as if made in the prior year.[230] For gift tax purposes, however, an individual who contributes to a traditional IRA or Roth IRA on behalf of another individual makes a gift upon making the contribution, regardless of whether the contribution is treated as having been made in the current year or the prior year for purposes of the IRA contribution rules.[231]

[220] IRC § 2503(b)(1) and Rev. Proc. 2021-45.
[221] IRC § 2503(b)(2).
[222] IRC § 2503(b)(1).
[223] IRC § 529(c)(2)(A) and Rev. Rul. 59-357.
[224] Treas. Reg. § 25.2511-1(a).
[225] Treas. Reg. § 25.2503-2(a).
[226] Rev. Rul. 73-405.
[227] IRC §§ 219(b)(5) and 408A(c)(2) and Notice 2021-61.
[228] IRC § 219(c).
[229] IRC § 408A(c)(3).
[230] IRC § 219(f)(3).
[231] Treas. Reg. § 25.2503-1.

Front-loading a 529 plan

A 529 plan is a tax-advantaged investment plan that is designed to pay the beneficiary's qualifying educational expenses.[232] When an individual contributes to a 529 plan, they are treated as making a gift to the beneficiary of the plan.[233] The gift counts against the individual's annual exclusions to the beneficiary.[234]

An individual can elect to treat a gift to a 529 plan as made ratably over five years.[235] An individual thus can front-load a 529 plan with five years' worth of annual exclusion gifts. For purposes of making the election, the individual must file a gift tax return for the year in which the individual actually makes the gift to the 529 plan.[236] Let's say that, in 2022, Dylan gives $80,000 to a 529 plan for the benefit of Dylan's child Ezra and elects to treat the gift as made ratably over five years. By doing so, Dylan is treated as making a $16,000 gift to Ezra in 2022 and each of the four following years. So long as Dylan doesn't make any other gifts to Ezra in 2022 through 2026, each of those gifts would be nontaxable (under the gift tax annual exclusion) and wouldn't use up any of Dylan's lifetime exemption.

If an individual makes this special election for a gift to a 529 plan and dies before the end of the fourth year, then the individual's estate includes the portion of the gift attributable to the years after the individual's death.[237] Let's again say that, in 2022, Dylan gives $80,000 to a 529 plan for the benefit of Dylan's child Ezra and elects to treat the gift as made ratably over five years. What happens if Dylan dies in 2024? For estate tax purposes, Dylan's estate will include $32,000, which is the portion of the gift that Dylan would've been treated as making in 2025 and 2026 if Dylan hadn't died.

For more information about 529 plans, see Brad Dillon, *Funding Education: 529 Accounts and Annual Giving Trusts* (a publication of the UBS Advanced Planning Group).

Paying tuition

When an individual pays another individual's tuition and makes the payment directly to the school or other educational provider, the payment is treated as a nontaxable gift.[238] The payment doesn't use up any of the gift tax annual exclusion or lifetime exemption.[239] This exclusion applies only to the payment of tuition and doesn't apply to any payment of room, board, books, or other educational expenses.[240]

Let's say that, in 2022, Florian pays $40,000 of tuition on behalf of Garnet, who is one of Florian's grandchildren. Florian makes the payment directly to the university that Garnet is attending. In addition, Florian gives $16,000 to Garnet. Both gifts are nontaxable. Florian's payment of the Garnet's tuition is nontaxable under the exclusion for tuition payment, and Florian's other gift is nontaxable under the gift tax annual exclusion. Neither gift uses up any of Florian's lifetime exemption.

232 IRC § 529(a).
233 IRC § 529(c)(2).
234 Id.
235 IRC § 529(c)(2)(B).
236 IRC §§ 529(c)(2)(B) and 6019.
237 IRC § 529(c)(4)(C).
238 Treas. Reg. § 25.2503-6(b)(1)(i).
239 IRC § 2503(e)(1).
240 Treas. Reg. § 25.2503-6(b)(2).

Paying medical expenses

When an individual pays another individual's medical expenses and makes the payment directly to the healthcare provider, the payment is treated as a nontaxable gift.[241] The payment doesn't use up any of the gift tax annual exclusion or lifetime exemption.[242] For purposes of this exclusion, premiums for healthcare insurance generally are treated as a medical expense.[243]

Making gifts to a spouse

A married individual might consider giving money or other property to their spouse. For example, a married individual may wish to make those gifts so that their spouse has sufficient assets to use their lifetime exemption. Under the gift tax marital deduction, an individual generally may make unlimited gifts to a spouse who is a US citizen.[244] The gift tax marital deduction, however, does not apply to gifts to a spouse who is not a US citizen.[245] In 2022, an individual generally may give up to $164,000 of gifts to a spouse who is not a US citizen, and the gift will be non-taxable for gift tax purposes.[246] This annual exclusion adjusts annually for inflation.[247]

Making charitable gifts

An individual who is charitably inclined might consider making substantial gifts to charity during their life, especially if the individual plans to leave a substantial portion of their estate to charity upon their death. By making charitable gifts, the individual reduces their estate for estate tax purposes. In addition, the individual potentially can claim the income tax charitable deduction for those gifts. If the individual didn't make the gifts during life—instead waiting until their death to leave the assets to charity—they would reduce their estate for estate tax purposes but would not get any of the benefits of the income tax charitable deduction. We discuss charitable giving in more depth above.

Making gifts using the lifetime exemption

An individual who wishes to reduce their estate for estate tax purposes might consider making gifts that use their lifetime exemption (i.e., gift and estate tax exemption). These are gifts that don't qualify for the gift tax annual exclusion, tuition exclusion, medical expense exclusion, marital deduction, or charitable deduction. In tax parlance, these are called taxable gifts, even though an individual doesn't pay any gift tax on them until the total amount of taxable gifts that an individual makes during their life exceeds their lifetime exemption.[248] In 2022, an individual's lifetime exemption is $12.06 million.[249] The lifetime exemption indexes annually for inflation.[250] After 2025, the lifetime exemption will decrease by approximately 50%.[251]

[241] IRC § 2503(e)(2)(B)
[242] IRC § 2503(e)(1).
[243] Treas. Reg. § 25.2503-6(b)(3).
[244] IRC § 2523(a).
[245] IRC § 2523(i).
[246] IRC § 2523(i) and Rev. Proc. 2021-45.
[247] IRC § 2523(i)(2).
[248] Treas. Reg. § 25.2505-1(a).
[249] IRC § 2010(c) and Rev. Proc. 2021-45. This assumes that the individual is a US citizen. For a discussion of the gift and estate taxation of non-US persons, see Carrie Larson, *Planning for Non-US Citizens* (a publication of the UBS Advanced Planning Group).
[250] IRC § 2010(c)(3)(B).
[251] Pub. L. 115-97, § 11061 (2017) (commonly known as the Tax Cuts and Jobs Act).

By making gifts that use their lifetime exemption, the individual potentially removes from the individual's estate any future appreciation with respect to the money or property that the individual gives away. In addition, by making those gifts before the lifetime exemption decreases after 2025, the individual potentially can take advantage of the higher exemption.[252] Let's assume that an individual has made $12 million of taxable gifts by the end of 2025 and, as a result of the scheduled decrease, the lifetime is $7 million in 2026. The individual generally won't be subject to gift or estate taxes on the $5 million of taxable gifts that they made while the higher exemption was in effect.[253]

When making gifts that use their lifetime exemption, an individual might make gifts into an irrevocable trust for the benefit of their spouse and descendants (sometimes called a spousal lifetime access trust) or an irrevocable trust for the benefit of their descendants.[254] Using a trust may offer important advantages. A trust can potentially insulate trust property from the claims of a beneficiary's creditors (including a spouse or former spouse), and it can potentially keep the trust property out of a beneficiary's estate for estate tax purposes. A trust, however, requires proper administration, which involves some time and expense.

For more information about trust administration, see Casey C. Verst, *Duties of a Trustee* (a publication of the UBS Advanced Planning Group).

Shifting future appreciation out of your estate

An individual who has used as much of their lifetime exemption as they are comfortable using but isn't looking to accumulate more wealth might consider implementing one or more strategies that freeze the value of their estate (or a portion of it) for estate tax purposes. These strategies effectively shift future appreciation out of an individual's estate without using any of the individual's lifetime exemption or causing the individual to incur any gift or estate taxes.

Selling assets to a grantor trust

If an individual hasn't previously created a grantor trust, then the individual would make a gift to an irrevocable trust that's designed to be a grantor trust with respect to that individual.[255] This gift may be a seed gift—possibly, about 10% or 11% of the value of the assets that the individual intends to sell to the trust—or it may be more substantial.[256] The individual subsequently would sell assets to the trust in exchange for a promissory note. Since the trust is a grantor trust with respect to the individual, the sale is ignored for income tax purposes.[257] Thus, the individual doesn't recognize any gain upon the sale. The transaction, however, is respected for gift and estate tax purposes.[258]

The promissory note may be designed so that the trust pays only interest until maturity and a lump-sum (balloon) payment at maturity, or it may be designed so that it's amortized. For

[252] Treas. Regs. §§ 20.2010-1(c)(1) and (c)(2).
[253] Id.
[254] Treas. Reg. § 25.2503-2(a) (a gift in trust is generally treated as a gift to the beneficiaries of the trust). For a discussion of the spousal lifetime access trusts, see Catherine McDermott, *Spousal Lifetime Access Trusts* (a publication of the UBS Advanced Planning Group).
[255] A grantor trust is generally disregarded for income tax purposes, and the settlor (or, in some cases, the beneficiary) reports the trust's income, deductions, and credits on their personal income tax return. IRC §§ 671 to 679.
[256] The purpose of this seed gift is to provide the trust with sufficient financial capacity so that the trust isn't financing the entire purchase price, which would not usually occur in an arm's length transaction. The gift also provides the trust with some liquidity so that it has funds to service the interest payments on the promissory note.
[257] Rev. Rul. 85-13.
[258] See IRC § 2511(a).

purposes of avoiding potential gift tax issues, the interest must not be less than the applicable federal rate. To the extent that, over the term of the promissory note, the trust property appreciates more than applicable federal rate, the sale to the grantor trust potentially would shift wealth to the trust and out of the individual's estate without any gift or estate tax costs.

For a more in-depth discussion of sales to grantor trusts, see Casey C. Verst, *Sales to Grantor Trusts* (a publication of the UBS Advanced Planning Group).

Creating a grantor retained annuity trust
A grantor retained annuity trust (GRAT) is an irrevocable trust that distributes an annuity to the settlor for a term of years, after which the remaining assets are distributed to one or more individuals (typically, the settlor's children) or a trust for their benefit. A zeroed-out GRAT is a GRAT that's designed so there isn't any taxable gift upon its creation and any appreciation over a hurdle rate (specifically, the 7520 rate) would pass to the beneficiaries without incurring any gift or estate taxes.

For a more in-depth discussion of GRATs, see Jennifer Lan, Grantor *Retained Annuity Trusts* (a publication of the UBS Advanced Planning Group).

Creating a charitable lead annuity trust
An individual who is charitably inclined and wishes to potentially shift wealth on a gift and estate tax free basis to children (or others) might consider creating a charitable lead annuity trust. A charitable lead annuity trust pays an annuity to one or more charities (possibly the individual's donor advised fund or private foundation) for a term of years, after which the remaining property is distributed (either outright or in trust) to one or more non-charitable beneficiaries (typically, the donor's children). The trust often is designed so that there isn't any taxable gift upon its creation and any appreciation over a hurdle rate (specifically, the 7520 rate) would pass to the non-charitable beneficiaries without incurring any gift or estate taxes. In addition, the donor potentially may be entitled to an income tax charitable deduction upon funding the trust. (We discuss charitable lead annuity trusts in more depth above.)

Reporting gifts

An individual generally must file a gift tax return only if the individual makes one or more taxable gifts during the year.[259] Taxable gifts don't create any gift tax unless the individual has fully used their lifetime exemption.[260] Sometimes, it's useful to report a transaction that isn't a gift.

[259] IRC § 6019. An individual who isn't a US citizen or US resident generally must file a gift tax return only if the individual makes a taxable gift of US-situs property (e.g., if, in 2022, the individual gives more than $16,000 of such property to someone or gives more than $164,000 of such property to a non-citizen spouse). IRC § 2501(a)(2).
[260] Treas. Reg. § 25.2505-1(a).

Here are some situations in which an individual must file a gift tax return:

– An individual makes a gift in excess of $16,000 to someone other than their spouse.[261]
– An individual makes a gift to a 529 plan and the individual wishes to treat the gift as made over five years (i.e., a frontloaded gift to a 529 plan).[262]
– A married couple wishes to elect gift-splitting, so that one spouse is treated as making one-half of the gifts that the other spouse made.[263]

If a married individual makes a gift from an account that the couple own as joint tenants or tenants by the entirety, they aren't automatically treated as each making one-half of the gift.[264] In contrast, a gift of community property is treated as made one-half by each spouse.[265]

An individual isn't subject to any penalty for failing to file a gift tax return or filing it late, unless the individual owed gift taxes.[266] If, however, the individual makes gifts into trust and doesn't file a timely gift tax return, there may be unfavorable generation-skipping transfer (GST) tax consequences.[267] It's often more tax efficient to affirmatively allocate GST tax exemption to gifts to a trust on a timely gift tax return. If the individual gifts non-cash property (other than publicly traded securities), the individual won't start the statute of limitations against the IRS for challenging the value of the gift until they file a gift tax return reporting the gift.[268] Similarly, if the individual engages in a non-gift transaction (such as a sale to a grantor trust, a zeroed-out GRAT, or a zeroed-out charitable lead annuity trust), the individual won't start the statute of limitations against the IRS for asserting that the transfer was a gift until they file a gift tax return reporting the transfer.[269] The IRS can challenge the value of a gift or the position that a transfer isn't a gift so long as the statute of limitation remains open. In some cases, the IRS challenge has come when the donor dies decades after the transfer.[270]

Obtaining an appraisal

When reporting a gift, a qualified appraisal can play an important role in substantiating the value of the gift. By attaching a qualified appraisal to their gift tax return, an individual can start the statute of limitations against the IRS for challenging the value of a gift.[271] On the gift tax return, the individual also must include:

– a description of the transferred property,
– a description of any consideration that the individual received in exchange for the property,
– the identity of each transferee,
– the relationship between the individual and each transferee,
– if the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument.[272]

[261] Treas. Reg. § 25.2019-1(a).
[262] IRC §§ 529(c)(2)(B) and 6019.
[263] Treas. Reg. § 25.6019-2.
[264] See Treas. Reg. § 25.2511-1(h)(4) and Rev. Rul. 69-148.
[265] See Treas. Reg. § 25.2511-1(h)(9).
[266] IRC § 6651(a)(1).
[267] Treas. Reg. § 26.2632-1(b). For a discussion of the GST tax and how it applies to trusts, see *Generation-Skipping Transfer Tax* (a publication of the UBS Advanced Planning Group).
[268] Treas. Reg. § 301.6501(c)-1.
[269] IRC § 6501(a).
[270] *Estate of Redstone v. Commissioner*, 145 T.C. 259. In *Redstone*, Edward Redstone made a transfer in 1972 and died in 2011, having never reported the transfer. The IRS subsequently (and successfully) assessed a gift tax on the 1972 transfer.
[271] Treas. Reg. § 301.6501(c)-1(e)(2). Alternatively, the individual can provide a detailed description of the method used to determine the fair market value of the gift. The individual must include this description with their gift tax return. With a qualified appraisal, the regulatory requirements are clearer, so there's usually more certainty with respect to whether the individual has adequately disclosed a gift on a gift tax return.
[272] Id.

Given the time that's often involved in preparing an appraisal, an individual should start the process of obtaining an appraisal as soon as possible.

Preparing to file a gift tax return

An individual's 2022 gift tax return generally is due April 18, 2023.[273] By filing an application to extend the due date for filing an income tax return, an individual also automatically extends the due date for filing their gift tax return.[274] Accordingly, with the extension, an individual's 2022 gift tax return is due October 16, 2023.[275]

Reviewing the estate plan

An individual should periodically review their estate plan to ensure that their plans reflect their current wishes and objectives. This includes both tax and non-tax objectives. This review may be especially important if there has been a significant life event—such as a marriage, divorce, birth, or death—or a significant change in financial circumstances.

Reviewing dispositive terms

An individual may wish to review the dispositive terms of their estate plans. Those are the provisions that spell out who gets what and when. As circumstances change and an individual's thinking evolves, an individual may wish to update or change those dispositive terms.

Reviewing fiduciaries

An individual may wish to review whom they've named to serve in different roles in their estate plan. These persons include:

- Agents under a healthcare proxy or similar document
- Agents under a power of attorney for financial and legal matters
- Guardians for the individual
- Guardians for the individual's minor children
- Personal representatives (under the will)
- Trustees
- Trust protectors
- Trust advisors, distribution directors, investment directors, and similar roles under the terms of a trust

Sometimes, these persons colloquially are called "fiduciaries." (In some cases, a trust protector, trust advisor, distribution director, or a person serving in a similar role might not be subject to a fiduciary duty and thus might not be a fiduciary in a more literal sense.)

Reviewing family limited partnerships and similar structures

An individual who owns an interest in a family limited partnership or similar structure might consider reviewing the governing documents such as the partnership agreement and the entity's administration to ensure that it achieves the desired tax and non-tax objectives. If the family limited partnership or similar structure isn't properly structured and administered, it may not achieve those objectives. The consequences can be severe. For example, in one case, the IRS successfully argued that all of the assets in a family limited partnership were includible in an individual's estate for estate tax

[273] IRC § 6075(b).
[274] Treas. Reg. § 25.6081-1(a).
[275] Treas. Reg. § 1.6081-4(a). See also IRC § 7503.

purposes, because the individual had created the partnership and was also entitled to vote on whether to dissolve the partnership.[276]

For more information about the use of limited liability companies and other entities in estate planning, see Casey C. Verst, *Family Business Entities* (a publication of the UBS Advanced Planning Group).

Reviewing healthcare wishes
An individual should review living wills and verify that they are comfortable with the healthcare and end-of-life-related instructions that they previously made.

Refreshing the advanced directives
An individual who signed their financial power of attorney or healthcare power of attorney more than two or three years ago might consider signing new ones, even if nothing has changed.

Organizing documents and information
As a part of reviewing the estate plan, an individual should consider taking the time to confirm that their estate planning documents and information are well organized and accessible by the persons who will need to access them upon the individual's incapacity or death.

Further reading
For more information about estate planning, see Christine Kolm, *Estate Planning: An Overview* (a publication of the UBS Advanced Planning Group).

Reviewing ownership of assets

An individual should review how they own their assets for purposes of making sure that the way in which they own them aligns with their estate plan. They should confirm the titling of the assets, so that they can ensure those assets will be distributed according to their goals and objectives. In some cases, that may involve titling non-retirement assets in the name of the individual's revocable trust.

Reviewing beneficiary designations
An individual should periodically review the beneficiary designations for purposes of ensuring that they reflect the individual's current wishes and objectives. Assets that have beneficiary designations include:
– IRAs, qualified plans, and 403(b) plans
– annuities
– life insurance
– pay on death (POD) accounts
– transfer on death (TOD) accounts

For example, an individual who is divorced may still have their former spouse named as a beneficiary on certain assets.

Reviewing jointly owned property
An individual who owns an account or property jointly (whether with their spouse or someone else) should evaluate whether that's the best way to own the account or property. There may be tax and asset protection reasons why a different form of ownership may be better.

Funding revocable trusts
An individual who has created a revocable trust should periodically review which assets are held in trust and which assets aren't.

[276] *Estate of Powell v. Commissioner*, 148 T.C. 392 (May 18, 2017).

Since one of the advantages of a revocable trust is probate avoidance, an individual might consider transferring into the trust any assets that aren't already held in trust.

Managing digital accounts and assets
An individual should maintain a list of usernames and passwords for their digital accounts and assets. Upon incapacity or death, the persons who are responsible for managing the individual's affairs will need to access their online accounts, such as online bank and brokerage accounts, credit card accounts, and frequent flyer and other loyalty programs. In some cases, it may be worthwhile to enable them to access email and social media accounts. Of course, it's important to safeguard this information in a secure but accessible manner. An individual's estate planning documents should address how their digital accounts and assets will be handled upon their incapacity or death.

Further reading
For more information about asset titling, see Catherine McDermott, *Asset Titling* (a publication of the UBS Advanced Planning Group).
For more information about planning after a divorce, see Christine Kolm, *Planning after a Divorce* (a publication of the UBS Advanced Planning Group).

Planning for liquidity

Depending on their age and financial circumstances, an individual may wish to evaluate whether their family is likely to have sufficient liquidity after their death. What funds will be available to pay debts, expenses, and taxes? What funds will be available to support a surviving spouse or other family members? Will there be sufficient liquid assets with which to pay any estate taxes (which generally are due nine months after an individual's death)? For a married couple, some of these issues—such as the payment of estate taxes—may be a concern only when the surviving spouse dies.

For more information, see Rebecca M. Sterling, *Planning for Estate Liquidity* (a publication of the UBS Advanced Planning Group).

Conducting a family meeting

A family meeting can help a family coordinate financial and other matters and can be valuable learning experiences for children and grandchildren to help them understand the benefits and burdens of wealth. As year-end approaches, an individual might consider arranging a family meeting to discuss investments, planning, philanthropy, and more.

For a more in-depth discussion of family meetings, see Laura Chooljian, *Family Meetings* (a publication of the UBS Advanced Planning Group). For a more in-depth discussion of family governance, see Joyce Crivellari, *Family Governance* (a publication of the UBS Advanced Planning Group).

Trust planning and administration

As year-end approaches, an individual may wish to review the administration of any trusts of which they are a settlor, beneficiary, or trustee.

Sending Crummey notices

In some cases, an individual may design an irrevocable trust so that one or more of the beneficiaries has the power to withdraw some or all of each contribution made to the trust. To the extent that a beneficiary can withdraw a contribution to a trust, the contribution is a gift to the beneficiary and qualifies for the gift tax annual exclusion.[277] When an individual makes a contribution to a trust, the trust agreement may require the trustee to provide notices to the beneficiaries who can withdraw some or all of the contribution. Even if the trust agreement doesn't require the trustee to send those notices, it may be advantageous to do so to ensure that the contribution qualifies for the gift tax annual exclusion (to the extent of the withdrawal powers).

Considering the income tax implications of a grantor trust

In the case of a grantor trust, the settlor (or sometimes a beneficiary) must report the trust's income, deductions, and credits on their personal income tax return. The trust itself is generally disregarded for income tax purposes. While it's often advantageous for a trust to be a grantor trust—by paying the tax, the settlor (or beneficiary) allows the trust property to accumulate without any diminution due to those taxes—the tax bite sometimes becomes unpalatable.

What if the tax bite is unpalatable? The individual may be able to borrow from the trust for purposes of paying the taxes. By borrowing from the trust, the individual gets the liquidity to pay the taxes but doesn't increase the individual's estate for estate tax purposes. In the case of a self-settled trust, the trustee may have the power to distribute trust property to the settlor. In the case of a spousal lifetime access trust, the trustee may have the power to distribute trust property to the settlor's spouse. In the case of a trust that's a grantor trust with respect to the settlor, the trustee (or possibly another person) may have the power to reimburse the settlor for the income taxes attributable to the trust. An individual might wish to avoid a pattern of distributions or reimbursement payments, because the individual may be seen as having retained an interest that would cause the trust property to be includible in the individual's estate for estate tax purposes.

An individual who created a trust that is a grantor trust with respect to them might consider whether they should toggle off grantor trust status. This individual usually can cause a trust to become a nongrantor trust—and thus its own taxpayer—by releasing certain powers that the individual has under the terms of the trust. For example, the individual may have the power to swap or substitute assets, or the individual may have the power to borrow from the trust. By releasing those powers, the individual might be able to toggle off grantor trust status, so that they will no longer be taxable on the trust's income. In some cases, the process for converting a trust from a grantor trust to a nongrantor trust is more involved. Of course, it's important to think through all of the ramifications of toggling off grantor trust status. For example, converting a trust from a grantor trust to a nongrantor is an inclusion event with respect to any qualified opportunity fund, causing the immediate recognition of any deferred gains. A conversion also might trigger certain gains.

[277] *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968).

Making year-end distributions from nongrantor trusts

As year-end approaches, a settlor or beneficiary of a nongrantor trust might ask the trustee to consider distributing the trust's income (and, depending on the terms of the trust, the trust's capital gains) to the beneficiaries who are taxed at lower rates than the trust. This may be more tax efficient, because trusts are subject to compressed income tax brackets and a lower threshold for the 3.8% net investment income tax. Under the 65-day rule, the trustee may make a distribution within the first 65 days of 2023 and, for tax purposes, treat it as being made on December 31, 2022.[278] This gives the trustee some extra time to evaluate whether to make a distribution. Of course, the trustee should consider the tax status, goals, and objectives of the trust and beneficiaries before making any tax-motivated distributions to any of the beneficiaries.

Reviewing trust structures

If an individual created a trust that owns an interest in a family-controlled limited partnership or limited liability company, they might consider reviewing the structure to ensure that it achieves their tax and other objectives. If the structure isn't properly designed and administered, it may not achieve those objectives. For example, if an individual created the trust and is the manager of a trust-owned limited liability company, it may be best to have an independent manager who makes decisions about distributions from the limited liability company to the trust.

For more information about the use of limited liability companies and other entities in estate planning, see Casey C. Verst, *Family Business Entities* (a publication of the UBS Advanced Planning Group).

[278] IRC § 663(b).

Financial planning

As year-end approaches, an individual may wish to review their financial plan, personal balance sheet, and budget. In addition, they may wish to organize and update their financial documents and records.

Reviewing the personal balance sheet

An individual should maintain a personal balance sheet. While it is beneficial to have a complete list of assets and liabilities, the need for a regularly updated, comprehensive personal balance sheet has grown increasingly important as society enters the modern digital age. As we move away from receiving paper statements and instead rely on information provided electronically, there may no longer be a file cabinet full of paper statements that people can reference in order to determine what someone owns and what they owe if they are unable to manage their own financial affairs.

Reviewing the budget

An individual should review their spending and create a budget for next year. This should include reviewing any large, planned asset sales or purchases so that they can plan how to handle the proceeds or how they will cover expenses. If liquid investment assets need to be sold to cover a purchase, they should consider the timing of these sales and whether, in light of the tax implication, to complete the sales before or after year-end. Additionally, if they plan to use debt, they should review loan options and ensure their credit report is accurate.

Reviewing debts

An individual should review their outstanding debt (including the interest rates and terms) to determine whether there is an opportunity to refinance at better terms. For example, an individual might evaluate whether they should convert a variable rate loan to a fixed rate loan.

For a discussion of the deductibility of interest payments, see Todd D. Mayo, *Tax Aware Borrowing* (a publication of the UBS Advanced Planning Group).

Reviewing life insurance coverage and policies

An individual should review their life insurance policies annually. Is the coverage still adequate given the purpose for which the individual has the policy? For example, if an individual maintains a policy to replace the income that their family would lose upon their death, is the amount of coverage in line with their current level of income? Do they have the right kind of policy given their age, circumstances, and goals?

Checking beneficiary designations on your life insurance policies

An individual should periodically review the beneficiary designations on their life insurance policies. They should make sure that those designations reflect their current wishes and circumstances. A significant life event—such as a marriage, divorce, birth, or death—may affect an individual's choices concerning beneficiaries.

Reviewing irrevocable life insurance trusts

If an individual created an irrevocable trust to own one or more insurance policies, they should consider reviewing the trust and its administration for purposes of ensuring that the trust continues to fulfill their goals and is being administered properly. For example, is the individual making gifts to the trust using their gift tax annual exemption, so that the trustee can pay the premiums on the life insurance policies? If so, is the trustee sending notices (sometimes called Crummey letters) to the beneficiaries who have a right to withdraw some or all of the contribution to the trust?

Checking your credit report

The Fair Credit Reporting Act (FCRA) requires each of the nationwide credit reporting companies to provide an individual with a free copy of their credit report once every 12 months. An individual can request it through annualcreditreport.com. They should be wary of other websites that offer similar "free" reports, because those offers may come with strings attached. For more information, see the Federal Trade Commission website at consumer.ftc.gov/articles/free-credit-reports.

While an individual may request a copy of their credit report from all three reporting companies at the same time, they may also choose to request the report at different times during the year and request a different company's report each time. For instance, they may choose to order a free credit report from Experian in December, then from Equifax in April, and then from TransUnion in August so they can keep an eye open for issues year-round.

An individual may also consider whether to place a fraud alert on their credit files or request a credit freeze from the three reporting companies. A credit freeze or security freeze restricts third party access to information about their credit, making it more difficult for identity thieves to open new accounts in their name. Since 2018, consumers can freeze and unfreeze their credit reports at no cost. Notably, each of the three credit bureaus require separate requests in order to take this action.

Key dates

The following is a list of key dates relating to tax planning.

Table 3. Key dates for individuals.

2022

Date	Event
September 15	– Estimated tax payment due
October 17	– 2021 income tax return due if an application for extension was timely filed
November 29	– Last day to buy a security as a part of a doubling-up strategy
December 30	– Last trading day
	– Last day to sell publicly traded securities that are held in an investment account and recognize a loss in 2022 (unless the wash-sale rule or another loss disallowance rule applies)
	– Last day to make a non-charitable gift using publicly traded securities that are held in an investment account
	– Last day to make a gift to charity using publicly traded securities that are held in an investment account
December 31	– Last day to make a non-charitable gift
	– Last day to make a gift to charity

2023

Date	Event
January 17	– Estimated tax payment due
January 30	– First day to buy the same or substantially identical security as a security sold on December 30, 2022 (i.e., the last trading day in 2022) without being subject to the wash-sale rule
April 18	– For anyone who isn't a resident of Maine or Massachusetts, 2022 income tax return due, unless an application for extension is timely filed
	– For anyone who isn't a resident of Maine or Massachusetts, 2022 taxes due
	– Estimated tax payment due
April 19	– For anyone who is a resident of Maine or Massachusetts, 2022 income tax return due, unless an application for extension is timely filed
	– For anyone who is a resident of Maine or Massachusetts, 2022 taxes due
June 15	– Estimated tax payment due
October 16	– 2022 income tax return due if an application for extension was timely filed

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About the Advanced Planning Group

The Advanced Planning Group consists of former practicing estate planning and tax attorneys with extensive private practice experience and diverse areas of specialization, including estate planning strategies, income and transfer tax planning, family office structuring, business succession planning, charitable planning and family governance.

The Advanced Planning Group provides comprehensive planning and sophisticated advice and education to ultra high net worth (UHNW) clients of the firm. The Advanced Planning Group also serves as a think tank for the firm, providing thought leadership and creating a robust intellectual capital library on estate planning, tax and related topics of interest to UHNW families.

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