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Personal Financial Planning Section

75 BEST INCOME TAX STRATEGIES IN 2023 FOR FINANCIAL PROFESSIONALS TO GENERATE TAX ALPHA™

There are currently seven different ordinary income tax brackets – 10%, 12%, 22%, 24%, 32%, 35%, and 37%, and three different capital gains tax brackets – 0%, 15%, and 20%. Furthermore, 3.8% NIIT, further complicates the situation. For example, high income taxpayers will be subject to a 40.8% tax rate on ordinary investment income and a 23.8% tax rate on long-term capital gains.

The increased value created by using the tax saving strategies we'll refer to as "Tax Alpha." Put another way, it is your after-tax excess return minus your pre-tax excess return based on the appropriate benchmarks. Research indicates that many portfolios don't consistently beat their benchmarks on a pre-tax basis, often producing negative alpha on an after-tax basis. That is why creating Tax Alpha is important.

IRA AND ROTH IRA STRATEGIES

1. Roth IRA conversions to "fill-up brackets"
2. Roth IRA conversions by asset class
3. Roth IRA conversions when basis exists
4. Roth 401(k) bracket analysis
5. Roth IRA fees paid from "outside" broker accounts
6. Asset location with Roth IRAs and Traditional IRAs
7. Taking IRA and Roth IRA distributions in December rather than January
8. Making IRA and Roth IRA contributions in January rather than December
9. IRA Distributions to "fill-up brackets"
10. Carefully planning for pre-age 59½ distributions

CAPITAL GAIN/LOSS STRATEGIES

11. Harvest capital gains to the extent the 0% capital gain rate applies
12. Harvest capital losses to offset taxable capital gains and to reduce NII
13. Harvest capital gains when higher future tax rates are a greater concern than loss of deferral
14. Engage in capital gain and loss planning on a separate lot basis
15. Consider Charitable Remainder Trusts to diversify on a tax efficient basis
16. Consider "low-turnover" strategies to defer capital gain income

BOND INCOME STRATEGIES

17. Consider tax deferred annuities to "leap-frog" over high income years
18. Consider life insurance to replace a portion of the bond portfolio
19. Consider tax-exempt, double exempt, and private activity bonds
20. Consider a higher asset allocation to low risk / low volatile high dividend yield stocks to obtain "qualified dividends rather than interest"
21. Consider an immediate annuity to defer taxable income while recovering basis

DIVIDEND INCOME STRATEGIES

22. Avoid margin status for stocks with qualified dividends because the dividends will be taxed as ordinary income
23. Consider utilizing only "qualified dividend stocks" to obtain low tax yield
24. Avoid acquiring stocks immediately prior to the payment of dividends

OPTION TRANSACTION STRATEGIES

25. Consider that most protective puts result in "tolling" the holding period for stocks
26. Consider that most protective puts result in qualified dividends to be treated as ordinary dividends
27. Consider that the loss on covered calls, except for "qualified covered calls," results in a straddle and suspension of capital losses until the underlying stock is sold

QUALIFIED RETIREMENT PLAN DISTRIBUTION STRATEGIES

28. Consider stock distributions that take advantage of net unrealized appreciation strategies
29. Consider basis and "after-tax" amounts when analyzing distribution options
30. Carefully plan for pre-age 59½ distributions

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STOCK OPTION STRATEGIES

31. Consider the AMT Impact of incentive stock options
32. Balance deferral of stock option income with "one-stock" portfolio risks

CHARITABLE PLANNING STRATEGIES

33. Consider gifting appreciated securities
34. Consider gifting conservation or façade easements
35. Consider the impact of the 60%, 30%, and 20% deduction limitations
36. Consider Qualified Charitable Distributions (QCDs)
37. Fulfill charitable gifts with IRA assets at death

SPECIALIZED INVESTMENT STRATEGIES

38. Consider oil and gas partnerships for high income sophisticated clients
39. Consider master limited partnerships for high income sophisticated clients
40. Consider that master limited partnerships for Traditional IRAs and Roth IRAs will generate unrelated business taxable income
41. Consider REITs to add cash flow to a portfolio with some tax shelter
42. Consider real estate partnerships to add cash flow with a "depreciation tax shield"

STRATEGIC TAX ALPHA STRATEGIES

43. Consider maximizing IRAs, 401(k)s, and deferred compensation
44. Utilize low-turnover strategies for taxable portfolios
45. Focus on deferral strategies for "Bond-type" investments utilizing IRAs, annuities, and life insurance
46. Consider "locating" bonds in pre-tax qualified plans and stock to Roth and taxable accounts
47. Consider bracket management strategies to smooth out income and avoid the 3.8% NIIT and the highest margin rates
48. Fully utilize the latest draw down strategies to efficiently manage tax brackets
49. Defer capital gains for older clients to obtain a step-up in basis at death
50. Hold high turnover, small cap equity funds in Roth IRAs

TACTICAL TAX STRATEGIES

51. Develop a 10-15 year projection to determine a permanent tax bracket before and after the required beginning date
52. Consider "IRA Relocation," i.e., shifting assets from an IRA account to life insurance
53. Manage the taxation of social security benefits with deferral and timing strategies
54. Manage Medicare insurance premiums with deferral and timing strategies
55. Consider income generation strategies when the AMT is imposed to engage in low tax rate Roth conversions and taxable withdrawals
56. Time income for purposes of the 20% small business deduction
57. Utilize Defined Benefit and Defined Contribution plans to reduce taxable income to better qualify for the 20% small business deduction
58. Consider the Substantial Sale CRT strategy
59. Consider the Retirement CRT strategy
60. Consider the Income Shifting CRT strategy
61. Consider incomplete gift non-grantor trusts to avoid state income taxes
62. Consider shifting capital gain property to adult children prior to sale
63. Consider Qualified Tuition Programs (529 plans) for college savings
64. Consider Coverdell ESAs for education savings
65. Consider low-turnover index funds to manage AGI and avoid phase-outs
66. Consider that the kiddie tax does not necessarily include the NIIT
67. Consider defined benefit pension plans for select clients
68. Consider private placement partnerships that generate passive income for clients with passive loss carryforwards
69. Consider LLCs or limited partnerships to shift income to younger family members
70. Consider IRC §42, §47, or §48 partnerships for clients with sufficient income tax from passive activities to utilize the credits

TRUSTS AND ESTATES

71. Consider harvesting losses on securities in a post-mortem setting following a step-up in basis
72. Consider life insurance and annuities to avoid the 37% + 3.8% combined tax
73. Consider the choice of assets to leave to charity at death
74. Consider all available options for post-mortem IRA planning, including spousal rollovers and life expectancy distributions
75. Consider, with the client's other advisors, trust and estate distributions to shift income into the lower tax brackets

Taxes are the most important drag on investment return - greater than inflation, transaction costs or management fees. Studies performed ten to fifteen years ago showed that taxes reduced returns by an average of one to three percentage points. Recent tax increases should increase these percentages significantly, making it more important than ever to manage tax drag and create positive Tax Alpha for clients. Given the growing realization of the power of Tax Alpha, more and more investors will demand it from their advisors.

With the focus of investment strategies changing rapidly, in order for financial advisors to add value for their clients, they will need to add Tax Alpha; or, in other words, alpha by virtue of reducing the effective tax rate on investment returns. The heart of Tax Alpha is understanding and utilizing the statutory tax shelters provided within the Internal Revenue Code.

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