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Take Tax Advantage of a Low-Income Year

Article Highlights:

- Exercise Stock Options
- Convert a Traditional IRA to a Roth IRA
- Maximize IRA Distributions
- Sell Appreciated Stock
- Delay Business Expenditures
- Release Dependency
- Delay Personal Deductible Expenditures

People generally assume that tax planning only applies to individuals with the big bucks. But think again, as some tax moves benefit lower-income taxpayers and those who are having a lower-than-normal income year. So, if 2022 is not producing a lot of income for you, or your income will be substantially lower this year than it usually is, you may be surprised to know that you actually might be able to take advantage of some tax-planning opportunities. Implementing some of these ideas will require action on your part before the close of the year. Here are some possibilities to consider.

Exercise Stock Options – If you are an employee of a corporation, the company may offer you the option to purchase shares of it at a fixed price at some future date, so that you can benefit from your commitment to the company's success by sharing in the company's growth through the increase in stock value. If those options are non-qualified, then you must report the difference between your preferential option price and the stock's value when you exercise the option as income. This income will be included in your wages on your year-end W-2 form. In a low-income year, this may give you the chance to exercise some or all of your options without any or with minimal income tax liability.

Convert a Traditional IRA to a Roth IRA – Roth IRA accounts provide the benefits of tax-free accumulation and, once you reach retirement age, tax-free distributions. This is why many taxpayers convert their traditional IRA account to a Roth IRA. However, to do so, you must generally pay tax on the converted amount. Many taxpayers overlook some great opportunities to make conversions, such as in years when their income is unusually low or a year when their income might even be negative due to abnormal deductions or business losses. The current standard deduction is higher than ever before, which may offer a taxpayer the opportunity to convert some or all their traditional IRA to a Roth IRA without any conversion tax. If you are in any of these circumstances this year, you should consider converting some or all of your traditional IRA to a Roth IRA before the end of the year.

Maximize IRA Distributions – If you are retired and taking IRA distributions, make sure that you are maximizing your withdrawals with respect to your tax bracket. With the robust standard deduction and a lower-than-normal income, it may be tax-effective to actually withdraw more than the minimum required by law. In fact, you may even be able to take a distribution from your IRA with no tax liability. Presented with this situation, you would certainly want to take advantage of it before year's end, even if you do not need the funds, which you could bank for the future.

Sell Appreciated Stock – Income tax rates increase as a taxpayer's taxable income increases. The regular tax rates start at 10% and then increase in step amounts as one's taxable income increases, reaching a maximum rate of 37%. However, long-term capital gains are given special treatment and only have three tax rates: 0%, 15%, and 20%. The 0% tax rate applies for taxpayers with taxable incomes up to the following amounts for 2022:

TAXABLE INCOME RANGE FOR THE 0% LONG-TERM CAPITAL GAIN RATE (2022)

Filing Status	Single	Head of Household	Married Filing Joint	Married Filing Separate
Taxable Income	$0–$41,675	$0–$55,800	$0–$83,350	$0–$41,675

This provides a unique opportunity to sell investments that will produce long-term capital gains (investments held for at least a year and a day) and benefit from the 0% long-term capital gain rates. Thus, if you have stocks that have appreciated in value, you may be able to sell them before the end of the year and pay no tax on the gain. The tops of the 0% ranges are adjusted each year for inflation.

Delay Business Expenditures – If you are self-employed, you may find it beneficial to delay business-related purchases until next year to avoid reducing your current yearly income any further and save the deduction until next year, when the items are purchased.

Release Dependency – If you are the custodial parent of a child and receive no benefit from the nonrefundable child tax credit, you may want to consider releasing the dependency of the child to the non-custodial parent for the current year, allowing the non-custodial parent to claim the $2,000 child tax credit. Doing so will not affect your ability to claim the child care credit or the refundable earned income tax credit. However, if the child is attending college, then any tuition credit will go to the one claiming the child. The dependency is released on IRS Form 8332, but care should be taken when completing the form to avoid unintentionally releasing the dependency for more than one year.

Delay Personal Deductible Expenditures – If you itemize your deductions and the deductions will provide no or minimal tax benefit this year, you might consider delaying paying that medical expense, real property tax bill, or state estimated tax payment, or making a charitable contribution, until after the first of the year. Many taxpayers find it beneficial to “bunch” deductions in one year and then claim the standard deduction in the alternate year. For example, by paying two years of church tithing or pledges to a charitable organization all in one year, deducting the total in that year, and then contributing nothing and taking the standard deduction the next year, the combined tax for the two years may be less than if a contribution was made in each year. However, before postponing payments until next year, make sure that no penalties will be associated with delaying your tax-obligation payments.

If you have questions about employing any of these strategies or wish to make a tax-planning appointment, please give this office a call.