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Tax loss harvesting may reduce the pain of stock market losses.

By Eva Stark, JD, LL.M.

After the longest-running bull market in US history, an increasing number of stock-market investors are seeing significant losses in their taxable brokerage accounts. While losses are painful, taking advantage of tax breaks with respect to these losses can diminish the true economic cost of the loss and potentially improve overall returns. As with any tax strategy, pitfalls and traps such as the wash-sale rule are plentiful, so it is always important to review any contemplated tax strategy with one's tax advisor.

Background on taxation of capital gains

In simplest terms, when a stock is sold, a gain or loss is calculated generally by subtracting from the sales price the cost of the stock. Because a stock is characterized as a "capital asset" under the tax code, gains realized upon the sale of stocks constitute "capital gains" that may enjoy preferential income tax treatment. Capital gains (or losses) are of two distinct types: short-term or long-term. If the stock was held for more than one year prior to its sale, a gain will generally be "long-term" and be taxed at preferential long-term capital gains rates. If the stock was held for less than one year, a gain will generally constitute a short-term gain, which is taxed at less-favorable "ordinary income" tax rates.

Long-Term Capital Gains Rates and Brackets (2022)		
	Single	**Married Filing Jointly**
0%	$0-41,675	$0-83,350
15%	$41,675-$459,750	$83,351-$517,200
20%	Over $459,750	Over $517,200

Ordinary Income Rates and Brackets (2022)		
	Single	**Married Filing Jointly**
10%	$0-10,275	$0-$20,550
12%	$10,275-$41,775	$20,550-$83,550
22%	$41,775-$89,075	$83,550-178,150
24%	$89,075-$170,050	$178,150-$340,100
32%	$170,050-$215,950	$340,100-$431,900
35%	$215,950-$539,900	$431,900-$647,850
37%	Over $539,900	Over $647,850

Capital gains may additionally be subject to a 3.8% net investment income tax above an income threshold of $200,000 for single filers and $250,000 for married filing jointly.

Tax treatment of losses

While losses are never desirable, if a stock is sold at a loss, the loss may produce an immediate tax benefit. As a general rule, capital losses offset capital gains and may even be deductible against ordinary income up to certain limitations.

If the taxpayer has capital gains in addition to the losses, losses will first offset gains of the same type. Long-term capital losses first offset long-term capital gains and short-term capital losses first offset short-term capital gains. For this reason, realizing short-term losses can be very valuable if the taxpayer has short-term gains that would otherwise be taxed at higher ordinary income rates.

To the extent that a taxpayer's losses exceed gains of the same type, the loss will next offset gains of the other type (long-term losses will offset a short-term gains or short-term losses will offset a long-term gains). If short-term losses would offset long-term gains, the tax benefit is generally not as valuable and advisors often recommend against such outcome. However, individual circumstances vary and realizing such a loss may still make sense in some cases.

If the taxpayer's capital losses exceed both long-term and short-term gains, the loss can generally be deducted against ordinary income, up to $3,000 per year. Any unused loss carries over to subsequent tax years.

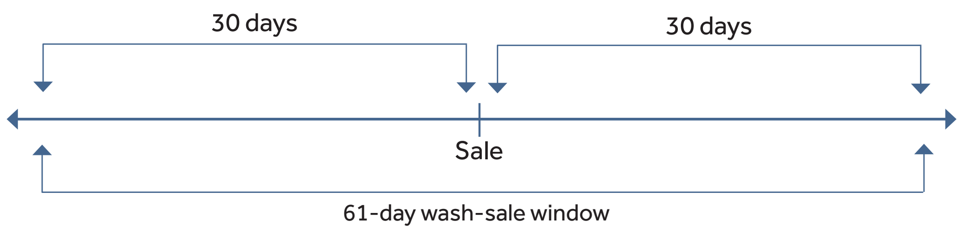
Wash-sale rule

The wash-sale rule is designed to prevent a taxpayer from benefitting from a tax loss if the taxpayer quickly reinvests into the same or "substantially identical" security. The rule is designed to prevent taxpayers from generating and benefitting from "paper losses" while maintaining the same or substantially similar investment position.

Under the rule, if a taxpayer sells a "stock or security" at a loss and purchases the same or a "substantially identical" stock or security within the 30 days before or after the sale, the taxpayer is prevented from recognizing the loss incurred. Instead, the basis and holding period of the newly acquired stock is adjusted to reflect the loss, which generally eliminates the immediate tax benefit that would otherwise result from the sale of a security at a loss. (*See example below.*)

Wash-sale rule considerations

- **"Stock or securities."** The wash-sale rule applies to sales of "stocks or securities." These generally include stocks, bonds, mutual funds, exchange traded funds, as well as contracts or options to purchase securities.
- **"Substantially identical."** The code or regulations do not define what "substantially identical" means for purposes of the wash-sale rule. It is generally accepted that the stock of a corporation is ordinarily not substantially identical to the stock of another corporation, even if both corporations are operating in the same industry. Ordinarily, bonds or preferred stock of a corporation are not substantially identical to the common stock of



EXAMPLE:

Tammy Taxpayer sells a share of stock in ABC corporation that had a basis of $100 for $70 on July 26th at a $30 loss. On August 3rd, she purchases a share of stock in ABC corporation for $80. Because she owns a share before and after the transaction, she arguably maintained the same position and the $30 loss is not a true loss. She is prevented from recognizing the loss by the wash-sale rule. Instead of immediately benefitting from the $30 loss, Tammy must adjust her basis in the new stock to $110, her total investment. If the new share had cost $65, the basis of the new share would be adjusted to $95. The holding period of the original share is also tacked onto the holding period of the new share. Her losses are deferred into the future by operation of the wash-sale rule, a generally undesirable outcome.

the same corporation. However, exceptions to these general rules exist. The question of what may or may not be substantially identical is even murkier when it comes to mutual funds or exchange traded funds. The issue of whether two securities may be substantially identical should be reviewed by the client's tax advisor.

- **Method for determining cost-basis.** The tax code and brokerage firms provide different methods for determining cost-basis where multiple lots of the same security are purchased. The actual cost method—which enables the taxpayer to designate the higher cost shares to be sold—is generally more advantageous for tax loss harvesting.
- **Other transactions.** Other transactions involving substantially identical securities by the taxpayer or certain related parties—such as purchases by a spouse, purchases inside a tax-deferred retirement account, vesting of restricted stock, or the exercise of options inside an employee stock purchase plan—during the wash-sale period could unexpectedly cause the taxpayer to run afoul the wash-sale rule. Therefore, other transactions involving substantially identical securities should also be reviewed by the client's tax advisor.
- **Harvesting tax losses typically only makes sense in a taxable account.** Accounts such as 401(k)s or IRAs are tax-deferred so "gains" or "losses" upon the sale of securities inside such accounts generally do not factor into income tax liability. Instead, these balances typically constitute ordinary income as they are withdrawn from the accounts.

It's not only about taxes

Strategic harvesting of losses for tax purposes can be very beneficial and may improve overall returns in some circumstances. However, it is important to emphasize that while taxes are an important consideration, planning and investment decisions should not be driven by tax-savings objectives alone.

Utilizing complex tax strategies can also increase the risk of falling into pitfalls and traps so professional advice is paramount. The potential advisability as well as the correct implementation of these strategies should be reviewed by the client's tax, investment, and other advisors.

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Revised RMD tables enhance tax-deferral opportunities in retirement savings plans.

By Randolph Buchanan, JD, CPA, LL.M.

The release of the highly anticipated revised required minimum distribution (RMD) tables, combined with the recent passage of the original SECURE Act and the likely passage of "SECURE 2.0," has raised many questions on how the revised tables work in the context of the new retirement planning legislation. Understanding these changes can highlight new planning opportunities for additional tax deferral strategies.

RMD Age Limits May Increase to 75

Most taxpayers generally cannot keep funds in their individual retirement accounts indefinitely* and have to start taking RMDs from their IRAs or retirement plans when they reach age 70½ or 72. Under the SECURE Act passed in 2019, if an individual turned age 70½ before January 1, 2020, then his RMDs started immediately after turning that age; if the same individual turned age 70½ after December 31, 2019, then no withdrawals are required until he reaches age 72.

If a follow-up bill, the Securing a Strong Retirement Act of 2022 (nicknamed SECURE 2.0), is approved by Congress, the RMD age would gradually be increased to 75, providing individuals with several additional years of enhanced tax deferral on their retirement savings. SECURE 2.0 was approved by the US House of Representatives in early 2022 and is currently pending in the Senate.

New RMD Tables Factor Life Expectancy to 120

Adding to the opportunities for additional tax deferral on retirement savings, the IRS released revised RMD tables earlier this year. Among other things, these highly anticipated revised tables now reflect longer life expectancies and include life expectancy factors through age 120.

* Unless it is a Roth IRA which does not require withdrawals until after the death of the account holder.

The two most commonly used RMD tables are:

- The Uniform Lifetime Table, which is used by all single IRA owners calculating their own withdrawals and married IRA owners whose spouses are not more than 10 years younger and are not the sole beneficiaries of their IRAs; and
- The Single Life Expectancy Table, which is only used by non-spouse beneficiaries of the IRA owner.

If an individual does not fall within those two categories, then he or she would use the Joint Life Table, which should be used by IRA owners whose spouses are more than 10 years younger and are the IRA's sole beneficiaries. (Find current copies of all the RMD tables on www.IRS.gov.)

Calculating RMDs

Calculating required minimum distributions after an account owner dies depends on whether the beneficiary is designated or not. A designated beneficiary is one that is either named on the beneficiary form by the account owner or is named in the IRA or plan document.

Under the 2019 SECURE Act, a designated beneficiary may also be considered an "eligible designated beneficiary" which provides additional tax deferral opportunities. For individuals and employees with retirement accounts who die before January 1, 2020, designated beneficiaries of IRAs and retirement accounts calculate their RMDs using the Single Life Table, which provides a life expectancy factor based on the beneficiary's age. The beneficiary uses the life expectancy factor based on their age in the year after the IRA owner's death. The account balance is divided by the life expectancy factor to determine the first RMD. The life expectancy factor is then reduced by "1" to calculate the individual's RMDs for all subsequent

Single Life Expectancy Table

Age of IRA or Plan Beneficiary	Life Expectancy (in years)	Age of IRA or Plan Beneficiary	Life Expectancy (in years)	Age of IRA or Plan Beneficiary	Life Expectancy (in years)
0	84.6	40	45.7	80	11.2
1	83.7	41	44.8	81	10.5
2	82.8	42	43.8	82	9.9
3	81.8	43	42.9	83	9.3
4	80.8	44	41.9	84	8.7
5	79.8	45	41.0	85	8.1
6	78.8	46	40.0	86	7.6
7	77.9	47	39.0	87	7.1
8	76.9	48	38.1	88	6.6
9	75.9	49	37.1	89	6.1
10	74.9	50	36.2	90	5.7
11	73.9	51	35.3	91	5.3
12	72.9	52	34.3	92	4.9
13	71.9	53	33.4	93	4.6
14	70.9	54	32.5	94	4.3
15	69.9	55	31.6	95	4.0
16	69.0	56	30.6	96	3.7
17	68.0	57	29.8	97	3.4
18	67.0	58	28.9	98	3.2
19	66.0	59	28.0	99	3.0
20	65.0	60	27.1	100	2.8
21	64.1	61	26.2	101	2.6
22	63.1	62	25.4	102	2.5
23	62.1	63	24.5	103	2.3
24	61.1	64	23.7	104	2.2
25	60.2	65	22.9	105	2.1
26	59.2	66	22.0	106	2.1
27	58.2	67	21.2	107	2.1
28	57.3	68	20.4	108	2.0
29	56.3	69	19.6	109	2.0
30	55.3	70	18.8	110	2.0
31	54.4	71	18.0	111	2.0
32	53.4	72	17.2	112	2.0
33	52.5	73	16.4	113	1.9
34	51.5	74	15.6	114	1.9
35	50.5	75	14.8	115	1.8
36	49.6	76	14.1	116	1.8
37	48.6	77	13.3	117	1.6
38	47.7	78	12.6	118	1.4
39	46.7	79	11.9	119	1.1
				120+	1.0

tax years. Spousal beneficiaries who do not elect to roll over the IRA or treat it as their own also use the Single Life Table, but they can look up their age each year.

However, for individuals and employees with retirement accounts who die after December 31, 2019, the SECURE Act eliminated the ability of a designated beneficiary to stretch RMDs over the life expectancy of the beneficiary of an inherited IRA unless the beneficiary is considered an “Eligible Designated Beneficiary.” Eligible designated beneficiaries include surviving spouses, disabled or chronically ill individuals, individuals that are less than 10 years younger than the IRA owner, and minor children of the IRA owner (but only until the minor child reaches the age of majority, at which point the ten-year rule becomes applicable). Moreover, certain trusts that are created for the exclusive benefit of disabled or chronically ill beneficiaries would also be included as an eligible designated beneficiary. And a surviving spouse beneficiary may delay the start of their distributions until the later of the year that the employee or IRA owner would have reached age 72 or the surviving spouse’s required beginning date.

If there is an eligible designated beneficiary, the stretch rules are still applicable, which means that the life expectancy of the beneficiary of the inherited IRA may be used for purposes of calculating the beneficiary’s RMD, which usually provides greater tax deferral opportunities. For all other beneficiaries, the ten-year rule is applicable, which means that the beneficiary must withdraw the entire account balance by December 31st of the year containing the tenth anniversary of the IRA owner’s death.

EXAMPLE: *The daughter (age 46) of an IRA owner who died last year (age 77) is the sole designated beneficiary of an IRA with a value of $1,000,000. Since the daughter would be considered a non-spouse beneficiary, she would use the Single Life Table (as shown above) to calculate her RMD. According to the table, her life expectancy factor that will be used to calculate her initial RMD payout would be 40, so the IRA balance she inherited will be paid out or distributed to her over 40 years and will have a value of zero at the end of that period. However, under the pending new rules, she would no longer be considered an eligible designated beneficiary – which means she can no longer stretch her distributions over her life expectancy of 40 years. Rather, she must withdraw and pay taxes on the entire balance of $1,000,000 over 10 years, which dramatically decreases her opportunities for tax deferral related to these distributions ($100,000 vs $25,000).*

The example above illustrates how the provisions of the pending SECURE 2.0 bill dramatically differ from the current rules under the 2019 act, affecting how quickly an individual would have to pay taxes on the distributions from an inherited IRA.

While the provisions of the SECURE Act would also apply to RMDs calculated using the Uniform Tables, such as single IRA owners trying to determine their own withdrawals, different rules would apply to the calculation of these individual’s RMDs.

In Summary

The revised RMD tables combined with the bipartisan support of the pending bill that would expand the original SECURE Act's provisions designed to bolster retirement savings presents a timely reminder of the importance of conducting periodic reviews and making strategic updates to your estate plan. To explore these new planning opportunities for additional tax deferral and to determine which table is most applicable to your personal tax situation, talk with your financial professional or local tax counsel.

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SALT cap work-arounds for pass-through entities can decrease individual taxes.

By Michelle M. Kenyon, JD, CLU®

Prior to 2018, an individual taxpayer was allowed to deduct state and local property tax as well as either state and local income or sales taxes, as itemized deductions, without limitation (other than the Pease limitations[1]).

The SALT Cap

The 2017 Tax Cuts and Jobs Act (TCJA) imposed limits on the total deduction an individual taxpayer can claim for personal state and local taxes to $10,000 for 2018 through 2025. This SALT cap only applies to individuals and does not apply to business entities, and will expire at the end of 2025 under the terms of the TCJA, unless subsequent legislation is enacted to extend or make it permanent.

For example, if a taxpayer paid state income tax of $11,000, real property tax of $10,000, and state sales tax of $8,000, in 2017 the taxpayer could deduct $21,000 ($10,000 in property tax and income tax of $11,000, since this amount is larger than the sales tax of $8,000). If the same taxes are paid in 2022, the total deduction would be limited to $10,000. The $10,000 limit on personal state and local taxes is reduced to $5,000 in the case of a married individual filing a separate return.

Work-arounds for pass-throughs

After 2017, many states began looking for ways to alleviate the increased tax burdens on their residents due to the SALT cap. As of March 2022, twenty-two states have enacted legislation allowing a pass-through entity (PTE) to elect to pay the tax and provide an owner a credit or deduction for the tax paid by the pass-through entity.

The first state to enact a SALT cap work-around was Connecticut. Other states with work-arounds include Alabama, Arizona, Arkansas, California, Colorado, Georgia, Idaho, Illinois, Louisiana, Maryland, Michigan, Massachusetts, Minnesota, North Carolina, New Jersey, New York, Oklahoma, Oregon, Rhode Island, South Carolina, and Wisconsin.

Seven additional states that have introduced PTE tax bills include Iowa, Mississippi, Ohio, New Mexico, Pennsylvania, Utah, and Virginia.

Work-arounds are different for each state, and taxpayers who want to take advantage of the work-arounds should discuss the specific rules for their state, or other states in which they pay taxes, with their accountants or attorneys. Many states have deadlines for making an election and making estimated tax payments, so early planning and implementation is critical.

Entity Level Taxation

Since the SALT cap only applies to individuals and not to business entities, the work-arounds usually impose an entity level income tax on pass-through entities such as partnerships, limited liability companies taxed as partnerships, and Subchapter S corporations. When the individual owners of the PTEs report their share of the entity's

1 Pease limitations reduced certain itemized deductions for taxpayers whose AGI exceeded stated amounts (in 2017, $261,500 for single taxpayers/$313,800 for taxpayers filing a joint return).

income on their individual income tax returns, the entity level work-arounds shift state taxes on PTE income to the PTE and away from the individual owner.

While the specific requirements vary from state to state, the states have generally adopted one of two approaches, either an exclusion from income or a credit for the state and local taxes paid.

- Under the exclusion method, income that is taxed at the PTE level is excluded from the owner's state taxable income.
- Under the credit method, the PTE owner's share of distributed income is passed through in the usual method and the individual owners are allowed a credit for the tax paid by the PTE.

The information below highlights the New York credit and the Georgia exclusion as examples of how each method works.

New York Pass-Through Entity Tax (PTET)

Eligible entities include partnerships and New York S corporations. An eligible entity must make a timely election to pay the PTET. For 2022, the election must have been made by March 15, 2022.

- The New York PTE pays an entity level tax at the same personal income tax rate on that income which would have been subject to New York personal income tax by its owners on a flow-through basis.
- Payments are made in quarterly installments on March 15, June 15, September 15, and December 15.
- Credit is then allocated among the owners in the same percentages in which the income taxable in New York would have been allocated to those owners.
- Credit is claimed on the New York state personal income tax returns of each owner.

EXAMPLE. Assume a New York partnership, NYS, has three equal partners: Hudson, Della, and Larry. The partnership makes the election and has income of $1,500,000 before any New York state income tax. Quarterly installments totaling $102,750 ($1,500,000 x 6.85% NY tax rate) are paid.

For federal income tax purposes, the amount of ordinary income allocated to each partner would have been $500,000 ($1,500,000/3) if no election was made.

With the election in place, ordinary income allocated to each partner's federal income tax return is now $465,750 ($500,000-$34,250). Since the partnership paid the tax, the partners are not required to report the tax paid as SALT for purposes of personal itemized deductions on their individual federal income tax returns.

For New York state individual income tax purposes, the amount of tax paid by the partnership allocated to each partner would be a New York state add-back. Assuming no other add-backs, each partner would report a New York state taxable income of $500,000 and then report a credit of $34,250.

See example below.

Georgia PTE Work-around

Eligible entities include S corporations and partnerships that are 100% directly owned and controlled by individuals. Accordingly, PTEs with corporate shareholders or partners are not eligible to make the election in Georgia.

Upon making the election, the PTE is subject to the entity level tax at the maximum Georgia individual tax rate of 5.75%. Under Georgia's workaround, the individual owners subtract (exclude) the income subject to the entity level income tax from their individual Georgia income tax return.

EXAMPLE. Assume a Georgia partnership, ATL, with two equal partners: Cobb, and DeKalb. The partnership makes the election and has income of $2,000,000 before taxes. Georgia income tax of $115,000 ($2,000,000 X 5.75% GA tax rate) is paid on business income.

For federal income tax purposes, the amount of ordinary income allocated to each partner would have been $1,000,000 ($2,000,000/2) if no election was made, and each partner would be limited to a deduction of $10,000.

With the election in place, ordinary income allocated to each partner's federal and state income tax return is now $942,500 ($1,000,000-$57,500).

New York PTET Example		
Tax Summary / Partner	**No election**	**Election**
New York PTE tax	-0-	$34,250
New York tax - paid by owners	$34,250	-0-
Federal AGI	$500,000	$465,750
Standard deduction (single filer)	($12,400)	($12,400)
Taxable income (federal)	**$487,600**	**$453,350**
Federal tax - paid by owners	$145,204	$133,217
Total tax paid	**$179,454**	**$167,467**
Estimated savings		$11,988

Georgia PTET Example		
Tax Summary / Partner	**No election**	**Election**
Georgia PTE tax	-0-	$57,500
Georgia tax - paid by owners	$57,500	-0-
Federal AGI	$1,000,000	$942,500
Standard deduction (single filer)	($12,400)	($12,400)
Taxable income (federal)	**$987,600**	**$930,100**
Federal tax - paid by owners	$329,484	$308,209
Total tax paid	**$386,984**	**$365,709**
Estimated savings		$21,275

If the election is made, federal income tax is $308,209 (maximum tax rate of 37%, with taxable income of $930,100).

If no election is made, federal tax is $329,484, with taxable income of $987,600 ($1,000,000 – standard deduction of $12,400). Federal taxes are based on 2022 rate schedule for a single taxpayer. See example above.

These examples are fairly simple, and it should be noted that if the taxpayer is itemizing his or her deductions, results may vary depending on the types and amounts of deductible expenses.

Additionally, non-resident filers, taxpayers who pay state taxes in several states, or taxpayers who do not owe state taxes, may find that the work-around is more complex and may not be advantageous.

IRS Notice 2020-75

IRS issued this Notice in November 2020 and stated that it intended to issue proposed regulations clarifying that specified income tax payments are deductible by a PTE corporation in computing its non-separately stated income or loss. A specified income tax payment is defined as any amount paid by a partnership or an S corporation to a state, a political subdivision of a state, or to the District of Columbia to satisfy its liability for income taxes imposed by such state or local government on the partnership or S corporation.

While the IRS has not recognized individual work-arounds to the SALT cap deduction, Notice 2020-75 gave states a green light to enact their own PTE taxes.

Conclusion

Taxpayers should work with their financial advisors to determine whether a work-around could reduce their federal income tax liability. Those who itemize and pay more in state and local property taxes and income or sales taxes than they are allowed to deduct on their federal income tax return due to the SALT limitations may benefit.

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