Financial *focus*

ACCRUENT WEALTH ADVISORS

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WINTER 2023

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Inflation Reduction Act 2022

- Tax Credits & Student Loan Forgiveness

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The Inflation Reduction Act and other items passed by Congress may affect decisions you make in 2023 and beyond. Some of these were immediately in place as of August 16th, 2022. While student loan forgiveness has dominated headlines, there are other important changes to be aware of as well as you make financial decisions.

ALTERNATIVE (ELECTRIC) VEHICLE TAX CREDIT

The existing credit of up to $7,500 for new electric vehicle purchases was extended to 2032 and a new credit was added of up to $4,000 for used electric vehicles more than two years old. The caveat is for vehicles purchased after August 16, 2022, final assembly has to be in North America so this significantly limits which vehicles qualify now (https://afdc.energy.gov/laws/inflationreduction-act) and no longer includes foreign companies like Kia, Hyundai, or Toyota. On a positive side, the previous exclusion on tax credits by manufacturer once they sell 200,000 vehicles has been removed, making GM and Tesla eligible purchases once again. The credit is limited to the vehicle's value as follows:

- New Trucks, SUVs & Vans - $80,000
- New Sedans - $55,000
- Previously Owned Vehicles - $30,000

New income limits to qualify have also been added:

- Couples - $300,000
- Individuals - $150,000

The rules for this credit continue to change based on the release of additional information by different government entities. As a result, the safest way to determine if your vehicle will qualify for the credit is to enter the VIN at https://vpic.nhtsa.dot.gov/decoder/ before you make a purchase.

ENERGY EFFICIENT HOME IMPROVEMENT CREDIT

Starting in 2023, homeowners may take a tax credit of 30% for the cost of installation and equipment of solar panels, wind power systems, and geothermal heat pumps. The prior lifetime limit for credits for eligible appliances was replaced by a $1,200 annual limit. This allows for greater use of the credit over time. In addition, credits will be available for efficient exterior doors, windows, water heaters, and biomass stoves ranging from $250 to $2,000 per year. You can find more details on these credit limits at https://www.kiplinger.com/taxes/605069/inflationreduction-act-tax-credits-energy-efficient-home-improvements.

STUDENT LOAN FORGIVENESS

Another significant change involves a new plan for student loan forgiveness. Qualifications for forgiveness include:

- Loans must be federal student loans taken out prior to July 1, 2022
- Household income below $125,000 for an individual or $250,000 for a couple for the 2020 or 2021tax year.

Pell Grant recipients can have up to $20,000 forgiven, others may have $10,000 forgiven. An important element to the program is that forgiveness amounts are capped per borrower, not per household. This means that if you and your spouse both have federal student loans, then you both could qualify. The process could move quickly if you already have had your income verified through income-based repayments and would then show up as a credit in your student loan account. If your income is not verified, an application will be available in the coming weeks to qualify.

Currently, the student loan debt relief is blocked by court orders. In the meantime, they extended the pause on student loan repayments until the earlier of 60 days after implementation of the debt relief program is allowed or litigation is resolved or 60 days after June 30, 2023. You can find more information and updates at https://studentaid.gov/debt-relief-announcement/.

Tax Loss Harvesting:
A Good Idea That is Overrated?

By Steve Martin, CFP®, CPA, JD, LLM
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Turning lemons into lemonade should be considered during the market volatility that we find ourselves in today. In periods of market downturns or even market upturns, one strategy that is often suggested is tax loss harvesting. It can be a beneficial strategy, but its application is often misunderstood or wrongly implemented.

Knowing when to utilize capital loss harvesting is beneficial. First, we must start with understanding how capital gains and capital losses are treated under the tax laws. You likely understand that long-term capital gains are taxed at different tax rates than ordinary income (such as wages and interest income). Like ordinary income, capital gains are taxed based on tiers. If one's income falls under a certain threshold, capital gains are taxed at 0%! That's huge, and there are planning opportunities here that we can hold for another day. The next two tiers are taxed at 15% and 20%. (Also note that net investment income tax can also be applied at a 3.8% rate for those exceeding certain income levels and state income taxes may apply.)

If you have a capital loss, there is an ordering rule for applying those capital losses. In simple terms (and without getting into short-term versus long-term capital gains and losses), capital losses are first applied against capital gains. Thus, if you realize a $40,000 gain on the sale of some stock and a $10,000 capital loss from the sale of another stock in one year, then your net capital gain is $30,000. If it is indeed a net long-term capital gain, then it is generally taxed at the capital gains rates. Effectively, your "deduction" for this capital loss was applied at the lower capital gains rates. If realized capital losses exceed capital gains in one year, then you can offset a portion of such losses against your ordinary income. Unfortunately, this offset against ordinary income is limited to $3,000 per year. Any unused losses (i.e., those that exceed the $3,000 limit) can be carried forward until such losses are used up. The same ordering rules apply to these carried forward amounts. Unlike many tax thresholds, the $3,000 capital loss limit is not inflation-adjusted.

Taking losses against capital gains can be advantageous in a few respects:

1. The losses may allow you to avoid recognizing the gain at a higher tax rate.

2. Taking losses may allow you to take advantage of other tax breaks (deductions or credits) or minimize financially-related penalties by reducing certain key thresholds.

3. Minimizing income taxes earlier may have a time value of money benefit.

Offsetting losses against ordinary income can be even more beneficial considering the generally higher ordinary income tax rates compared to capital gains rates. Of course, one key is understanding your relative capital gains rates and ordinary income rates over the relevant period.

There are a few caveats before implementing this strategy:

1. Understand that taking losses also reduces your tax basis in the portfolio, and this can result in larger capital gains down the road. This can, in turn, lead to higher taxes in the future.

2. When deciding whether to buy and sell assets, the investment characteristics should be the primary factor.

3. Consider the transactional costs and the time required to implement this strategy.

4. Be aware of the wash sale rule.

Thus, capital loss harvesting should be considered, especially during market downturns. It can produce economic benefits in the right situation, but there are certainly other tax strategies that are often more beneficial. If done incorrectly, implementing this strategy can backfire on you. In additional to capital loss harvesting, there are a host of other strategies to consider when trying to minimize capital gains taxes, and these strategies should be coordinated with your overall cash flow and financial plan. If you would like help with this or other tax strategies, you should search for a financial planner that has expertise in the tax arena as that has the potential to enhance your overall situation.

Recognize Your Freedom To Choose

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"When we are no longer able to change a situation, we are challenged to change ourselves." - Viktor Frankl

We may not always be able to control the circumstances of a given situation we find ourselves in. But we always have the freedom to choose how we respond. The choice we make – and how we make it – often determines how well we survive the situation, and if we go on to thrive.

If challenges in your family life, your career, or your finances are making you feel powerless, try approaching the challenge from a new angle. This simple three-step process can put you back in touch with your freedom to choose how and why you live your life.

1. Consider your reaction.

Take a step back from the problem. Take a breath. Take a walk. Pour yourself a cup of coffee.

By creating some space, you'll be able to ask yourself, "Why am I reacting the way that I'm reacting? Is there a better perspective I could be taking? Am I letting past experiences influence my reaction for better? For worse?"

When we feel overwhelmed by a challenge, we often fall back on established patterns in our thinking. Often these default reactions are negative. If we're arguing with our spouse, we might replay past arguments in the back of our heads. Financial difficulty might trigger memories of our parents struggling with money as we were growing up.

Identifying the negative experiences and perspectives that create our immediate reactions to challenges can help us find ways to create more positive and empowering reactions.

2. Consider your purpose.

Instead of allowing the situation to dictate how you're responding, push back. Refocus how you choose to respond around the goal that you are trying to accomplish.

For example, if your business partner backs out of the new company you've been planning to start, that loss of manpower and capital could make you feel defeated and powerless. But the reality is that you are choosing to dwell on negatives that you can't control.

So, what can you control?

If you're really committed to starting your new company, you can choose instead to focus on alternative funding sources. You can reach out to other friends, family, and colleagues about potential partnerships. You can choose to work on Plan B.

Another example is the investor who feels powerless as market volatility chips away at his nest egg for a quarter. No, you can't control the natural disaster or political spat that's giving the market fits right now. But you can choose to focus on your long-term purpose: a secure retirement for you and your family. That positive thinking and big-picture perspective could prevent a costly knee-jerk reaction.

3. Consider your values

One of the best ways to drive negative thinking from our reactions is to focus on the things that matter the most to us. Reconnecting our decision making to our values can lead to solutions that make life more fulfilling.

Work might be the most common source of challenges in our lives. And while no one loves absolutely everything about their job all the time, it's worth considering how your job affects your sense of freedom. Do those 40 hours per week give you the financial resources to spend your free time doing what you want with the people you love? Are your skills and talents utilized in ways that make you feel like you're making positive contributions? Does your employer have a mission bigger than profit that's important to you?

If your answers are no, no, and no, you can choose to keep dragging yourself out of bed every Monday, resigned to the uninspiring week ahead. Or you can follow your values towards a more empowering choice. Consider a career change. Learn a new skill that will bolster your resume or line you up for a better job at your current employer.

If switching careers is really out of the question right now, choose to appreciate the parts of your job that you do well because of your unique skillset. And when you're not working, make time for the hobbies, interests, and experiences that do fully engage your core values. Who knows? One day these pursuits might lead to exciting new opportunities for you and your family. If you've been committed to your values all along, you'll be ready to make the right choice.

The Impact of Rising Interest Rates on Bonds and Bond Funds

By Jane Young, CFP®, EA, MBA
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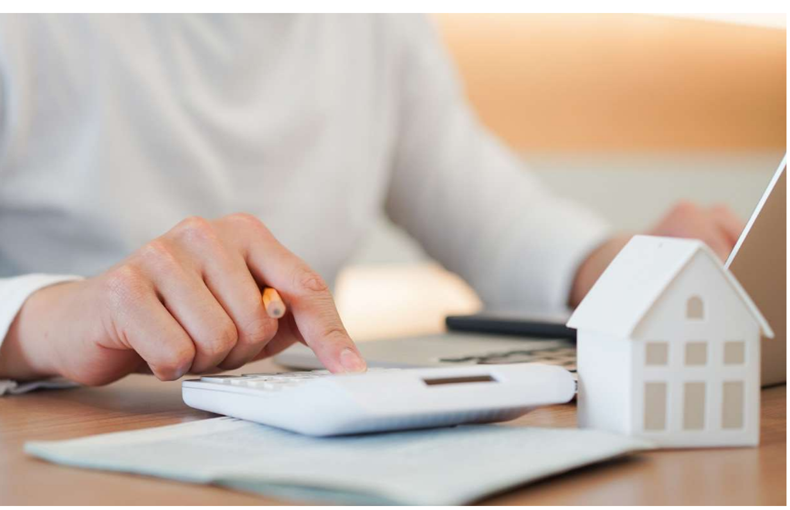
High inflation and rising interest rates in 2022 have resulted in one of the worst years on record for U.S. Bond mutual funds. The largest diversified bond funds are reporting year to date losses of around 16%, as of the end of November. We have never seen such large decreases in diversified investment grade bond funds.

This year has been unusually bad for bonds because the federal reserve is aggressively raising interest rates in response to inflation, plus we started at a historically low level of interest rates. Most of the damage has been done but bond prices will continue falling while interest rates continue to increase. Eventually rising interest rates should result in higher unemployment, a weaker economy and lower inflation. This will result in a pivot by the federal reserve on interest rates and a rally in bonds.

Investing in bonds comes with two primary types of risk. The first is credit risk which represents the loss of capital if the issuing company or entity defaults on paying interest due on the bond. Buying bond mutual funds reduces credit risk because the bond fund holds thousands of individual bonds compared to buying an individual bond from one issuer such as a company, or municipality that may default on payment.

The second and most common risk with bonds is interest rate risk. Fundamentally, increases in interest rates cause the value of bonds to drop. This is simply a function of supply and demand. As interest rates rise, new bonds are issued with higher returns and old bonds are paying interest rates that are below the current market rate. This decreases demand for the older, lower interest-paying bonds.



When interest rates rise, sellers holding older bonds must offer a lower price (a discount) than sellers of new bonds to offset the lower interest rate and smaller dividends over the remaining life of the older bond. In cases where you can hold your older bond to maturity, the drop in price doesn't matter because you receive the full value of the bond at maturity. If it is a short time, e.g., two years, until your bond matures, your loss from the new higher interest rates will be smaller than if holding a longer term 5-, 10- or 20-year bond to maturity at a below market interest rate.

Interest rate risk also hits the prices of long and intermediate term bond funds much harder than short-term bond funds. Short-term bonds will see a comparatively small price decrease because they can quickly replace their lower paying bonds as they mature with new bonds paying higher returns.

Capital losses may be incurred if you sell a bond before maturity, or you own shares in a bond fund that experiences heavy redemptions, and the fund is forced to sell bonds within the fund at a loss. Losses may be temporary if bonds in the fund are held to maturity. Bond fund managers can then use the proceeds of matured bonds to purchase new bonds at the current higher interest rate.

Additionally, bond funds and exchange traded funds must report the current market value of their holdings daily. The reported value probably represents a loss greater than you will experience if you hold on to your bond fund shares. Bond funds pay dividends that are reinvested in new bonds paying higher interest rates and as bonds within the fund mature, new higher paying bonds are purchased. Over the long term the rise in interest rates should more than offset your losses.

Fixed income investments play an essential role in your portfolio. While bond prices go down when interest rates increase, fluctuations in bond prices are much smaller than those of the stock market. Like the stock portion of your portfolio, the fixed income portion should be diversified to reduce both credit risk and interest rate risk. Money needed in the next few years should be invested in cash, certificates of deposit, and Treasury bills, all short-term to protect against interest rate risk. Money needed in the medium to long-term can be invested for a higher yield in short and intermediate term bond funds.

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