# Tax Tips: Practical Ways to Reduce Your Tax Bill

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# AAFMAA Wealth Management & Trust

**Our Mission**: to be the premier provider of financial planning, investment management, and trust services to the American Armed Forces community.

# AAFMAA WEALTH MANAGEMENT & TRUST

Focusing exclusively on the needs of the military family, we work to provide innovative, personalized, and lifestyle appropriate financial services.

Bound by a **fiduciary standard** - any advice or service we offer must always be in the best interest of the client.

# Agenda

1. Federal Income Tax Law Changes
2. Phases of life
3. Common Tax Tips
4. Is Social Security Taxable?
5. Summary

# Benjamin Franklin

"… in this world nothing can be said certain, except death and taxes."

# Federal Income Tax Law changes

In 2018, many tax law changes took affect that impact your 2018 and 2019 tax returns.

- Results from the Tax Cut and Jobs Act

# Tax Cut Highlights

- Tax brackets shifted
- Standard deductions almost doubled
  - Married filing jointly - $24,400 (for 2019)
  - Single or filing separately - $12,200 (for 2019)
  - May not need to itemize – simplifies your return
- Personal exemptions eliminated
- Deduction limit of $10,000 for state and local taxes

# Tax Cut Highlights

- Mortgage interest deductions capped at $750,000 (for loans after 12/15/2017)
  - Home equity loan interest is no longer deductible
- Child tax credit raised to $2000/child
  - Higher income limits to take this credit
- Estate tax exemption doubles to $11.4M per individual
- Annual gift exclusion remains at $15,000 per recipient

# Albert Einstein

When asked about completing his income tax form, Albert Einstein replied:

*"This is a question too difficult for a mathematician. It should be asked of a philosopher"*

# Phases of life

Tax planning takes different focuses depending on where you are with respect to retirement

- **Pre - retirement** – focus on safely growing your retirement savings while minimizing current and future tax implications
- **Near - retirement** – focus on creating tax efficient income streams and deciding your best social security claiming strategy
- **Post - retirement** – focus on enjoying your retirement, while minimizing taxes paid on social security benefits, retirement account withdrawals, and RMDs

# Pre-retirement

Max out your retirement account contributions

- For 2019:
  - 401k contribution limit is $19,000
    - Plus $6,000 catch-up for those 50 and over
  - Traditional and Roth IRA
    - Contribution limit raised to $6,000
    - Plus $1,000 catch-up for those 50 and over
    - Contributions limits (based on Modified AGI)
      - Traditional: S=$64K-$74K, MFJ=$103K-$123K
      - Roth: S=$122K-$137K, MFJ=$193K-$203K

# Pre-retirement

- Fund an Health Savings Account (HSA) – if eligible
  - Funded with pre-tax contributions
  - Must have HSA-eligible health insurance plan
  - Couples can contribute up to $7,000 (plus $1,000 catch-up)
    - Singles can contribute up to $3,500
  - After 65, HSA distributions not penalized (treated as ordinary income)

# Pre-retirement

Carefully consider which type of retirement account to fund

- Traditional IRAs and 401k
  - Contributions are **pre-tax dollars**
  - No tax paid now, but each withdrawal in retirement is fully taxed
  - Some employers offer 401k contribution matching
- Roth IRA and Roth 401k
  - Contributions are after-tax **dollars**
  - Total account value grows tax-free, no tax on withdrawals in retirement
- Non-qualified savings
  - Taxes paid on dividends, interest and capital gains each year
  - However, no additional taxes when used / spent in retirement

# Near retirement

As you approach retirement, you need to refine your income tax strategy

- Maximize funding tax-efficient accounts
- Identify your prospective retirement income streams
- Identify social security claiming strategy
  - Understand tax ramifications of claiming social security while still working
  - Understand how much of your social security benefit is taxed

# Post-retirement

Filing and paying income taxes still required in retirement!

Ensure retirement distributions from pre-tax accounts have some tax withholding.

Social Security benefits are taxed if combined income above specified thresholds.

- Before Full Retirement Age (FRA)
  - Combined income subject to an “earnings test”
- Any time in retirement, social security benefit taxed at different rates depending on income

# Earnings Test

Penalty on social security benefit while working:

- If you begin benefits prior to FRA you may incur a penalty for your earned income.
  - From ages 62 to FRA, you will incur a $1 penalty for every $2 you earn over $17,640.
  - In the year you reach FRA, this amount increases to $46,920 and the penalty is $1 for every $3 earned over this amount.
  - These amounts are indexed for inflation
- Amounts withheld by Social Security due to the earnings test will be recouped after reaching FRA
  - SSA will recalculate your monthly benefit.

# Social Security is taxed

- Up to 50% of your benefit taxed if:
  - Married filing jointly – income over $32,000
  - All other filing status – income over $25,000

- Up to 85% of your benefit taxed if:
  - Married filing jointly – income over $44,000
  - All other filing status – income over $34,000

# Required Minimum Distributions

When you reach age 70½ and over:

- Applies to Traditional IRAs, Rollover, SEP or SIMPLE IRA type retirement accounts
- Must take an annual distribution from these accounts based on your life expectancy and the total retirement account balances
- Included as income for the amount of RMD in year withdrawn – Federal income tax comes due
  - Direct charitable contributions of RMDs can be tax-free
- 50% penalty if full amount of RMD not taken on time

# Distribution objectives

- Minimize income taxes
- Avoid penalties

# THE IRS

# Summary

- Different types of retirement accounts have different tax implications
- Utilizing different types of accounts provides more tax flexibility
  - Minimize need to tax Social Security benefits
  - Reduce impact of RMDs
- Specific investments in different types of account can be tailored for investment horizon of that specific account

# Summary

- **Tax laws change frequently** – investment decisions are affected by current tax laws
- **Plan ahead** – choosing the right investment types of accounts can give you more flexibility in retirement and help you minimize your tax burden
- **Get professional help** – tax laws are complicated.
  - Penalties are stiff if you don’t pay the U.S. his share at the right time
- A **comprehensive financial plan** will help you prepare for retirement and develop a strategy to minimize the tax burden

# Questions

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