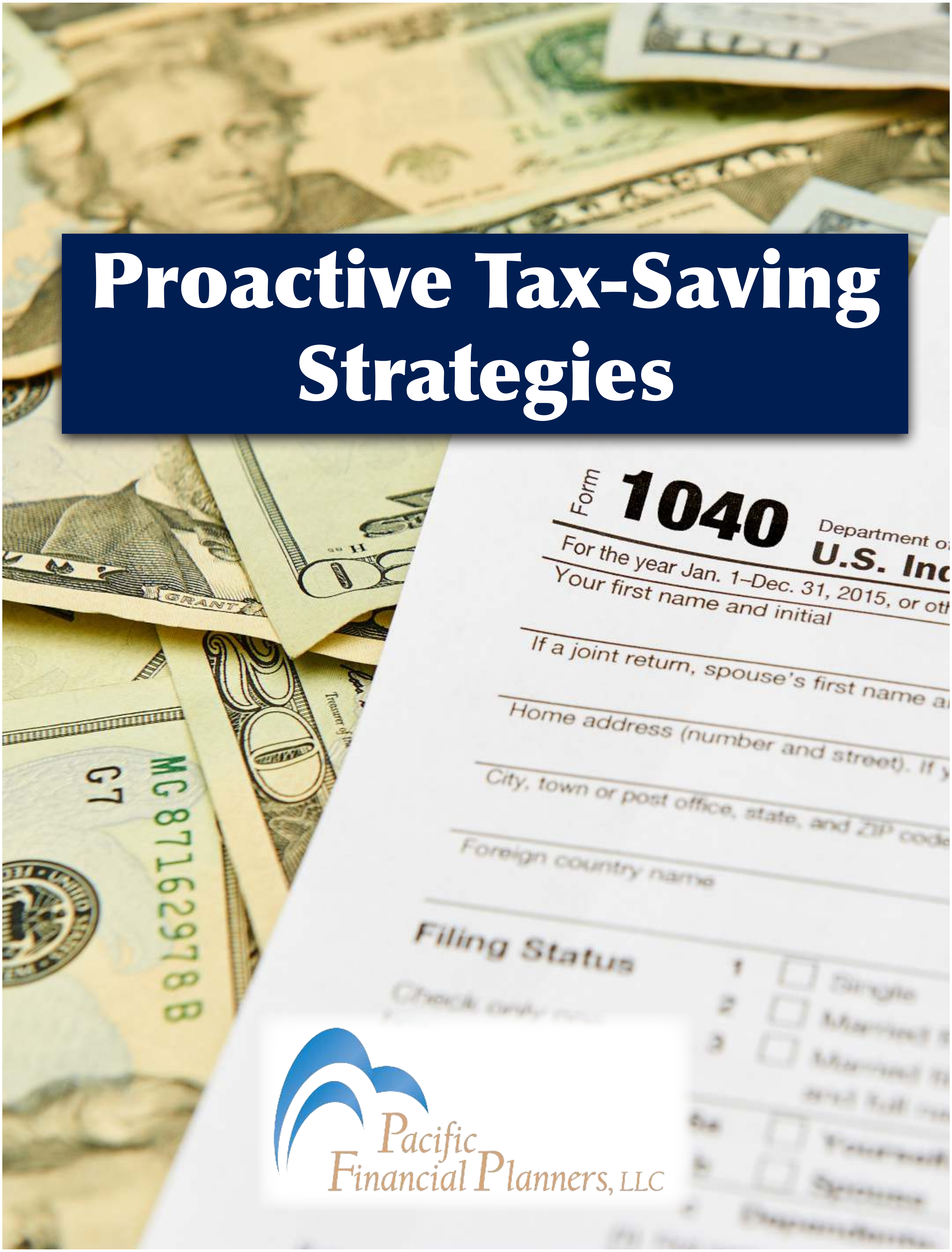
Proactive Tax-Saving Strategies



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With Donald Trump's tax plan now in front of lawmakers, reforms may still occur in time to impact your 2017 taxes. But, new tax laws are always being enacted or proposed, so pending legislation—no matter how broad or narrow—should never be used as an excuse to prevent you from taking a proactive approach to tax planning. The chances are slim that any tax-saving moves you make now are going to be nullified by anything that happens on Capitol Hill, so it would be good to meet with your CPA or financial advisor this year (as it is every year) to talk about potential savings strategies as they exist under *current* tax rules and guidelines. While it's always best to have that meeting in November or December in order to beat all of the IRS's year-end deadlines, a meeting in January or February can also be extremely beneficial and potentially save you thousands of dollars. The savings strategies discussed in this paper are ones primarily geared toward filers in the 15% to 28% tax brackets.

These are strategies related to retirement contributions, investments, savings, healthcare expenses, charitable donations, and other key areas. But first, let's go over some basic tax guidelines as they now stand for 2017.

Deductions & Exemptions

You can easily access and review the 2017 income tax brackets online at websites such as taxfoundation.org or IRS.gov. Brackets have widened slightly due to inflation, but tax rates haven't changed. The standard deduction did increase slightly:

- Singles get $6,350, plus an additional $1,550 if age 65 or over.
- Married couples get $12,700, plus $1,250 per spouse if both are 65 or over.
- Heads of household get $9,350, plus $1,550 if age 65 or over.

Personal exemptions are the same at $4,050 for taxpayers and dependents. However, the income threshold for both personal exemption phase-out (PEP) and Pease have increased from last year to $261,500 for single filers and $318,800 for married couples filing jointly. PEP will end at $384,000 for singles and $436,300 for married couples filing jointly, meaning that taxpayers with adjusted gross income above these limits will no longer benefit from personal exemptions.

Most people know how basic tax preparation works: your adjusted gross income minus deductions and exemptions equals your taxable income. Beyond your standard deductions and personal exemptions, you and your advisor may want to explore and possibly implement some of the following additional strategies:

401(k)s and Other Qualified Plans – It is generally a good idea to maximize tax-deferred 401(k) contributions whenever possible. If you feel you can't afford to put in the maximum amount of money allowed, try to contribute at least the amount that will be matched by employer contributions. Contribution limits for 401(k), 403(b), and 457 plans remain unchanged for 2017: $18,000, with an additional $6,000 catch-up contribution limit if you are over age 50. You might even consider taking an entire paycheck in December and putting it into your 401(k), if that's feasible, or taking the equivalent amount from a savings account and putting that into the 401(k) in order to maximize the contribution.

IRA Contributions – Maximizing IRA contributions also always makes sense when allowed. You have until Tax Day, 2018, to make IRA contributions for 2017, but the sooner you do it, the sooner it can start its potential tax-deferred growth. In addition, making deductible contributions can reduce your taxable income for the year. For both traditional and Roth IRAs, you can contribute a maximum of $5,500 for 2017 if you are under age 50, with a limit of $6,500 if you are over age 50. You should know that there are income limits for being able to deduct traditional IRA contributions and that these income limits have increased for 2017 as follows:Singles and heads of household with a workplace retirement plan can claim a fully deductible contribution if their income is below $62,000.

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- For married couples filing jointly, a spouse who contributes to a workplace retirement plan can claim a full deduction if their income is below $99,000.

Income limits pertaining to Roth IRA contributions have also increased as follows:

- Single filers earning less than $118,000 can make a full Roth IRA contribution, but contributions are eliminated for filers who earn more than $133,000.

- Married couples filing jointly can make a full contribution if their combined income is less than $186,000. However, they are ineligible to contribute if their income is over $196,000.

Itemized Deduction Bunching – If your tax deductions normally don't meet the threshold for itemizing—or even if you can only itemize marginally—you might benefit from a "bunching" strategy. It's a legitimate, perfectly legal tactic in which you time the payments of tax-deductible items in order to maximize your itemized deductions in one year, with the intention of taking the standard deduction the following year. Itemized deductions generally include medical expenses, property taxes, state and local income taxes, home mortgage and investment interest, charitable deductions, unreimbursed expenses, and casualty losses. The "bunching strategy" is most commonly used for medical expenses, tax payments, and charitable deductions, although it is sometimes applicable to other types of deductions. For example, you might choose to pay next year's property tax bill this year, or—if you tithe at your church—explain to your pastor that you'll be making next year's contributions a year in advance for tax purposes. By bunching effectively, you can meet the itemized deduction threshold and take advantage of the savings.

Be Aware of the Alternative Minimum Tax – It's important to know that accelerating tax deductions can actually end up costing you if you are in the Alternative Minimum Tax (AMT), a provision of the tax code that increasingly impacts the middle class. The AMT is calculated separately from your regular taxes and with different rules. For example, property taxes are not deductible under the AMT, so you wouldn't want to make an advance payment on them if you expect to be subject to the AMT in this tax year. The AMT exemption amounts have increased in 2017 to $84,500 for married-joint filers and surviving spouses; $54,300 for single filers; $42,250 for married-separate filers, and $24,100 for estates and trusts. The 28% tax rate applies to income over $93,900 for people who are married and filing separately, and $187,800 for all other taxpayers. (Note: Both the Trump tax plan and House GOP tax plan would eliminate the Alternative Minimum Tax).

Loss Harvesting – This common year-end strategy involves selling investments such as stocks and mutual funds to realize losses, then using those losses to offset any taxable gains you made during the year. The losses offset gains dollar for dollar, and if your losses exceed your gains, you can use the excess—up to $3,000—to nullify other income. If your excess losses total more than $3,000, you can carry over the additional amount to next year, and continue doing so year after year.

Healthcare – Health savings accounts can offer nice tax perks and long-term opportunities. In 2017, any healthcare plan with a deductible over $1,300 for individuals and $2,600 for families is classified as a high-deductible plan. For single coverage, a contribution of $3,400 can be made to a health savings account, and for family coverage, a contribution of up to $6,750 can be made. Investors age 55 and over can make a catch-up contribution of $1,000. You should also be aware that medical expense deductions and long-term care deductions have changed for 2017. Limits for deducting long-term care premiums have increased. Listed below is how much taxpayers can write off based on their age:

- Age 71: $5,110
- Age 61-70: $4,090
- Age 51-60: $1,530
- Age 41-50: $770
- Age 40: $410

Education Savings – Education savings can provide great tax-saving opportunities for parents and grandparents. You can contribute up to $14,000 annually to a 529 college savings plan without having the contribution count toward the gift tax. An up-front contribution of up to $70,000 can be made to a 529 plan on behalf of an individual, which also wouldn't count toward gift tax, but this method eliminates further contributions for the next five years. It's worth noting that there is a lot of flexibility with education savings accounts. For instance, the owner can transfer the funds to different family members, and if the account is not used, it can be transferred down to the next generation, which is great for estate planning purposes.

Charitable Donations – If you itemize, donating to charities is a great and popular way to reduce your tax bill—provided you are proactive and make your deductible donations before the IRS's December 31 deadline. Rather than cash, some people donate appreciated securities, which may also allow you to avoid capital gains tax. You should also be aware that the Qualified Charitable Distributions law was made permanent in 2016, which also makes donating to a qualified charity a great option for satisfying Required Minimum Distributions (RMDs) in a cost-effective way. Basically, a QCD allows you to transfer a gift of up to $100,000 *directly* to a qualified charity from an Individual Retirement Account (IRA) without counting it toward your adjusted gross income (AGI) or incurring a tax. In addition to the tax savings, the QCD can count toward—or can be used to fully satisfy—RMDs for the year in which the donation is made. That's a great advantage if you are a charity-minded IRA owner who doesn't need any part of your RMD for personal income, or if you don't already have it earmarked for some other purpose.

Note: As was the case in 2017, the filing deadline to submit your tax returns in 2018 will not be the traditional April 15. The 15th falls on a Sunday, and the 16th is Emancipation Day, thus the filing deadline for 2018 will be Tuesday, April 17.

Don't Try this at Home – One of the most common financial mistakes retirees and near-retirees make is not taking full advantage of all the tax-saving strategies for which they qualify. Doing so begins with taking a proactive approach to tax planning. That means scheduling an annual meeting (preferably in November or December) with a qualified financial advisor (ideally one who specializes in working with retirees and near-retirees) to identify those strategies and maximize their savings potential. Again, tax laws and guidelines are tricky, confusing, and always changing—and may soon undergo big changes if the Trump administration's reforms are approved. Therefore, working with a qualified professional is by far the best way to ensure your tax strategies are aligned with your income-based retirement plan and contributing to your long-term financial goals!

1. IRS: IR-2016-139, October 25, 2016
2. IRS: IR-2016-141, October 27, 2016
3. The Kiplinger Tax Letter, December 30, 2016
4. By Debra Taylor, CPA/PFS, Esq. Feb 6, 2017
5. Turbotaxintuit.com, 2017