LAKE BLACKSHEAR TAX PROS

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9 Easy Ways to Reduce Your Tax Bill

9 EASY WAYS TO REDUCE YOUR TAX BILL – 2016 Edition

Introduction - Small Life Changes Make a Big Difference

The first tip to reduce your income tax bill is this. Realize that the IRS changes the tax code and has rules that "phase in" or "phase out". Often the IRS has specials, almost like the special of the day at your favorite diner, that are temporary and have an expiration date. They also, as needed, amend the tax code and change it mid-year depending on the economic circumstances that are driving the need.

For instance, in 2008, the mileage allowance for reimbursement was 50.5 cents per mile from January 1, 2008 to June 31, 2008, but as gas prices skyrocketed they changed to 58.5 cents per mile from July 1, 2008 through December 31, 2008. Why is it important to understand this? People tend to think of their past experiences as a permanent condition. They also view things that have happened to their siblings or parents, in regard to income taxes, as permanent. The tax code is a moving, changing document. Many people think, "Well, I've never had enough to itemize, so I'll just take the standard deduction again this year." Because of that mind set, they may forget some of the components that go into the calculation and not realize that they could get extra tax savings because of a single event, or a number of small events.

For example, "Mary Jones," 66 years old, carefully kept track of her medical expenses and taxes for several years. Each year, she presented them to her CPA only to have him say that itemizing those expenses was a "waste of time," and to take the standard deduction rather than to itemize especially now that the calculation has been increased to 10%. Mary didn't consider the many things that have occurred since the last time she had tried to itemize when she was 62 years of age.

- At 62, she was working and earning more W-2 wages, so the now 10% threshold that she had to beat in order for itemization to work was much greater. Now, Mary is retired and has a part-time job.
- Also, her employer, at the time that she was fully employed, was paying 75% of her health insurance premiums. Since then, she has gone to the part-time job and has lost her employer-paid health insurance.
- She has enrolled in Medicare Part A and has enrolled in Medicare Part B, which was deducting $104.90 per month from her Social Security check. She has also enrolled in Medicare Part D, which was also deducted from her Social Security. She didn't write premium checks directly to companies, so she didn't think of the dollars being deducted from her Social Security by the government as money she had spent.
- She has purchased long-term care insurance and several years later purchased a new car, carrying with it a steep excise tax.
- She has substantial increases in her home's property tax and at her winter residence property tax, a small mobile home in a park in Florida.

Overall, on examination, we realized that at age 66, Mary was over $1,300 above the standard deduction and had been missing substantial tax savings because of what a CPA had told her four years previous! Moreover, she hadn't thought about how many little things had changed in her life.

<u>Tax Tip #1</u>

Remember, the tax code constantly changes, so you can't compare one year to the next. Always look at the coming tax year as a new episode, or a new chapter in a book, and greet it with an open mind. Those changes may represent an opportunity to reduce your tax bill. It is imperative to work with a financial advisor who takes a *proactive* approach to tax planning, rather than allowing the tax piece of the financial plan to be prepared elsewhere. Indeed, your tax preparation should be a part of your overall financial plan. A good financial advisor, aware of all the year-to-year changes to the tax code can be your best resource especially if that advisor offers professional tax preparation.

<u>Tax Tip #2</u>

CD interest penalties are ***deductible***. That's right. If you have been working with a financial advisor and have decided on employment of a tax-advantaged investment strategy, such as tax-free municipal bonds or tax deferrals in annuities or life insurance products, you may be contemplating moving money from a certificate of deposit or other savings accounts. Often people delay changing the way their dollars are invested or stored because there would be a penalty for early withdrawal. They don’t realize that part of that penalty would actually lower their income tax bill on the adjusted gross income, line 30, penalty for early withdrawal.

<u>Tax Tip #3</u>

Another commonly overlooked strategy by those who are near the limit on their itemized deductions is prepaying expenses that are deductible. For instance, if in 2016 you were planning on spending approximately $10,000 on deductible expenses, health insurance, property taxes, charitable donations, excise taxes, or other itemized deductions, then you could *prepay* next year's charitable contributions, next year's health insurance, and in some cases, even next year's property taxes.

For example, if a person paid all of their 2016 and 2017 expenses at the end of calendar year 2016, $20,000 of paid expenses would allow them to itemize and take greater deductions. Then, in 2017, they would simply claim the standard deduction because they would have no expenses that were on the itemized list. They were prepaid in 2016. This strategy leaves a smart tax payer in an every-other-year posture. One year, double up, file the long form and itemize. The next year, claim standard deductions. The next year, double up and itemize. The next year, take the standard deduction. (In sequence: itemize - standard deduction – itemize - standard deduction.)

For people with the proper cash flow and circumstances, this is an excellent strategy for tax savings especially now that its 10% up from 7.5%.

Tax Tip #4

It is not uncommon for some taxpayers to not be in a tax bracket at all, because they have money in tax-free or tax-deferred vehicles, collect Social Security, and have low fixed expenses. Yet, those people often still have some IRA monies. People under the age of 70 not required to take their RMDs are allowed to leave money in IRAs and simply enjoy being at the zero bracket.

Those people, however, often could have taken hundreds, even thousands of dollars out of their IRAs or deferred accounts and continued to pay zero tax. If you're working with a proactive financial advisor, they may suggest a “what if” tax return in the month of December to determine how much actual income you are going to be reporting. If there are a few hundred dollars or more left that you could earn and still pay zero tax, it makes sense to take those dollars from IRA and either roll them into a Roth IRA, or simply re-categorize those assets, expose them to the possibility of taxation, avoid paying the tax, and restore them in any non-IRA.

Tax Tip #5

Many people with capital gains from sales of stock or from mutual fund distributions, know that they can offset those gains with a loss, but few actually sit down and do the annual exercise. It is a good idea to meet with a financial advisor or broker to look at your losses. By selling those losing assets you can offset your other investment gains and end up with an equivalent of no capital gains. Many people would rather not sell their underperforming assets because they believe they’re about to "come back" and wouldn’t dare wait the 31-day waiting period to repurchase the same asset as an allowable purchase.

However, many people don’t realize that an ETF (Exchanged Traded Fund) is in a different asset class than a mutual fund, and many ETFs are comprised of many of the same assets as their mutual fund counterparts. For instance, someone invested in the Vanguard S&P 500 mutual fund could sell that fund at a loss and buy the Vanguard S&P 500 ETF the next day without violating the 31-day rule. There are other nuances to changing asset classes that must be considered, but the point is clear. In December compare your investment winners and losers and plan accordingly.

Tax Tip #6

De-characterization of Roth rollovers. Many people have converted monies from an IRA to a Roth IRA and have also inherited taxable IRAs from a relative who has passed away. This leaves them exposed to an unintentional tax bill. Under certain circumstances, if you rolled money to a Roth during the year, the IRS will allow you to "unroll" that Roth back to regular IRA. So, don't feel that because you've converted money to a Roth IRA and then had another tax anomaly take place that you're stuck with that conversion. Once a year you can "un-Roth" money back to an IRA to undo a taxable event.

Tax Tip #7

Another special tax deduction that has been extended for the lower brackets is the ***Capital Gains Tax****.* Many people believe that the Capital Gains Tax Rate is 15% because that's what they paid the last time they sold an investment at a gain. For instance, if Mary sold stock in 1998, she may have paid 15% capital gains on the federal level and then an additional tax on the state level making it unattractive to sell other stocks with large gains. However, the Capital Gains Tax Rate is *not* 15%. It is on a sliding scale based on what your actual personal tax rate is.

In 2016, if you are in the 10% tax bracket, then you might be able to sell a stock or other appreciated asset and pay 0% capital gain. That's right. For many tax brackets the minimum Capital Gains Tax Rate for 2016 is still zero! For many people who primarily have Social Security income, which is not taxable up to a certain income limit, and perhaps a small pension or IRA income stream, it is not uncommon for them to be in the 10% or 15% tax bracket. Those people could sell highly appreciated assets this year and pay no capital gains tax whatsoever. ALSO, don't forget if you sell a stock at a gain there is ***NO 30 DAY RULE***! You could repurchase the same stock the next day. The 30-day rule is if you take tax losses, ***NOT*** profits! Selling a profit but still paying no tax means a free step up in cost basis. After 2016 it's not likely there will be a 0 capital gains rate again. **Carpe Diem!!**

Tax Tip #8

When you find an error in your tax work for a particular tax year, you may have more than just that year to worry about. If an error was made, it is often carried forward from previous years, so look at the previous year's return as well. Even if there's an error in your favor, amend those returns. Form 1040X can be used to go back up to three years. Many people are afraid to ask for errors to be corrected.

Many taxpayers believe, irrationally, that the IRS will look for other things "to get even" for filing for an additional refund. This is simply not the case. If you underreported deductions, or over reported income and subsequently paid too much tax, the IRS is happy to refund from prior years.

Tax Tip # 9

There is one thing that almost everyone you speak to agrees on. The fact is, in the future, 2016 and beyond, tax brackets, tax rules and laws are going to be changing and becoming more and more of an issue. If your financial planner, insurance planner, or other trusted advice giver is not giving you advise from a ***tax perspective,*** then you may want to reconsider your choices. Also, IRS ***"letter audits"*** are on the rise and the US is still in financial trouble. If your current advisor says, "Don't let the tax tail wag the dog" as a response to tax planning questions, ***fire them***! They are side stepping a major factor in your future financial security!

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