OUTLOOK
WEALTH ADVISORS, LLC

20 WAYS TO REDUCE TAXES IN RETIREMENT

INTRODUCTION

Thank you for requesting a copy of "20 Ways to Reduce Taxes in Retirement." Books on taxes have never been classified as "easy reads," but that's what we attempted to do with this eBook.

We purposely dedicated no more than one page to each tax-saving strategy. Each strategy is broken down in table format and defined by the following characteristics:

- **Best Used By** – Who can benefit most from the strategy.
- **Complexity** – How hard it is to implement the strategy yourself. We define the complexity as SIMPLE, MODERATE or SOPHISTICATED.
- **Financial Impact** – How big of an impact the particular strategy can have on your financial affairs. We rate this using a 5-star rating system, with one ★ representing a small impact and five ★★★★★ representing a significant impact.
- **How it Works** – A brief description on the details of the strategy. This section isn't designed to give you all the information, but to help you understand the basics and give you a foundation to build upon.
- **Benefits** – A summary of the most important benefits the strategy can provide.
- **Potential Pitfalls** – Pitfalls and roadblocks to look out for when considering the strategy.
- **Case Study** – An example to help you understand how the strategy could potentially be used and the financial impact it could have.

Keep in mind that the strategies we address in this book are not individual recommendations or personal tax advice. We are not licensed tax preparers or attorneys. As financial planners, we engage in tax planning as it relates to their entire portfolio with clients, but always recommend they work with a qualified CPA or other tax professional to assist in implementing strategies and preparing tax returns.

We hope you find this information beneficial. Please feel free to reach out with any comments, questions or feedback. We'd love to hear from you!

Best Regards,

Allen Neuenschwander, CPA, CFP®
Michael Neuenschwander, CPA, CFP®

TABLE OF CONTENTS

STRATEGY #1 - PRE-TAX RETIREMENT CONTRIBUTIONS

BEST USED BY:

Individuals who have earned income, are saving for retirement, and believe they are in the same or lower tax bracket than they will be in retirement.

COMPLEXITY:

SIMPLE

FINANCIAL IMPACT:

★★★★★

HOW IT WORKS:

You can contribute to a pre-tax retirement account either through your employer if a plan is provided (401(k), 403(b), SIMPLE IRA, etc.) or individually (Traditional IRA, tax-deferred accounts). Contributions you make into a pre-tax retirement account are tax deductible. For example, if you put $5,000 in a 401(k), you receive a $5,000 tax deduction. While the money is in the account and invested, all taxes on dividends, interest and capital gains are deferred, meaning you don't pay taxes on them until you take distributions from the account. After attaining a certain age, you are eligible to take withdrawals from your account that are taxed at ordinary income tax rates.

BENEFITS:

- Tax-deductible contributions
- Tax -deferred growth

POTENTIAL PITFALLS:

You can't deduct contributions to a Traditional IRA if you exceed the income limits.

Employer-sponsored plans have their own rules on when and how you can access the money. In general, you can take withdrawals from a 401(k) once you have separated from service and reached the age of 55. If you take a withdrawal from a Traditional IRA before age 59 ½, you are assessed a 10% penalty.

CASE STUDY:

Maria makes $200,000 per year as a marketing executive. She is in the 32% federal tax bracket* and has the goal of reducing her tax liability today while still saving for retirement. Her company offers access to a 401(k) plan where she can save up to $26,000 per year because she is over the age of 50.** Maria defers from her paychecks the full $25,000 throughout the year. This reduces her taxable income to $175,000 and saves her $5,000 in taxes for the year.

Upon retiring, Maria has accumulated a significant nest egg in her 401(k), thanks to her contributions, her employer's matching contributions and investment growth. With a taxable income of $100,000 in retirement, she finds that withdrawals from her 401(k) will only be taxed at the 24% rate.*

By saving in her 401(k), Maria was able to lower her tax liability while working, invest for her retirement, and realize her income at a lower tax rate (24% vs 32%) in retirement.

** Rates are based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

*** Based on 2021 contribution limits.*

STRATEGY #2 - ROTH RETIREMENT CONTRIBUTIONS

BEST USED BY:

Individuals who have earned income, are saving for retirement, and believe they are in the same or lower tax bracket than they will be in retirement.

COMPLEXITY:

SIMPLE

FINANCIAL IMPACT:

★★★★★

HOW IT WORKS:

You can contribute to a Roth retirement account either through your employer if a plan is provided (Roth 401(k), Roth 403(b) or individually (Roth IRA). Contributions you make into a Roth retirement account are made after tax. While the money is in the account and invested, all dividends, interest and capital gains are deferred, meaning you don't pay tax on them. After attaining a certain age, qualified withdrawals are completely tax free. You can ALWAYS take out your contributions tax and penalty free.

BENEFITS:

- Tax-free growth and withdrawals
- Tax- and penalty-free withdrawals of contributions at all times

POTENTIAL PITFALLS:

You can't contribute directly to a Roth IRA if you exceed the income limits.

Employer-sponsored plans have their own rules on when and how you can access the money. In general, you can take withdrawals from a Roth 401(k) once you've separated from service and have reached age 55. If you take a withdrawal of earnings from a Roth IRA, it must be five tax years after your first contribution to any Roth IRA and you must be age 59 ½ or older to avoid being taxed and assessed a 10% penalty.

CASE STUDY:

Steve has only five years before he retires and is earning $90,000 per year. His wife, Lisa, is retiring this year after a long career as a dental hygienist. Steve and Lisa have the goal of saving as much as they can in Steve's last five years of employment and will do so by maxing out Steve's Roth 401(k) at $26,000.* Since Lisa retired, they are currently in the 12% tax bracket.**

Steve and Lisa plan on "living it up" the first few years of retirement while they're still healthy. They figure an income of $150,000 in retirement will be enough to do what they want, which puts them in the 22% tax bracket.

By maxing out Steve's Roth 401(k) at $26,000, Steve and Lisa essentially pre-pay the taxes on their retirement income at the 12% rate. While their money is invested in the Roth 401(k), it grows tax deferred. When they take withdrawals in retirement, instead of having their money taxed at the higher 22% tax rate, it's completely tax free.

** Rates are based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

*** Based on 2021 contribution limits.*

STRATEGY #3 - ROTH IRA CONVERSIONS

BEST USED BY:

Individuals who are temporarily in a lower tax bracket, have concentrated savings in pre-tax retirement accounts, are worried about high taxes in retirement, and want to create more tax-free income.

COMPLEXITY:

MODERATE

FINANCIAL IMPACT:

★★★★

HOW IT WORKS:

In any year, regardless of income, you can convert money in a pre-tax retirement account to a Roth retirement account. The value of conversion is included in your taxable income for the year and reported on from 1099-R. After the conversion, all future growth and qualified withdrawals are completely tax free.

BENEFITS:

- Tax- and penalty-free withdrawals of basis after five years or age 59 ½
- Reduced required minimum distributions (RMDs) in retirement
- Lower taxable income in retirement, potentially resulting in lower Medicare premiums, higher premium tax credit, and lower capital gains rate

POTENTIAL PITFALLS:

You'll want to ensure that the amount you convert doesn't push you into a higher tax bracket than you'll be at once you withdraw money. Otherwise, you'll be "pre-paying" taxes at a higher rate. Also ensure you have enough cash to pay for the tax liability instead of taking money from the conversion to pay the tax liability. Track the conversion on your tax return using form 8606.

CASE STUDY:

Chase and Natalie just retired and did a great job saving for retirement. However, the vast majority of their savings are in pre-tax IRAs, approximately $1 million. Between their Social Security, a rental property and an annuity, they have $75,000 of income each year, which puts them in the 12% tax bracket* (after deductions) and is enough to cover all their expenses annually. However, in five years, when Chase and Natalie turn 72, they'll have to begin taking mandatory withdrawals from their IRAs. Based on today's value, their required minimum distributions (RMDs) will total $36,500 and pushes them into the 22% tax marginal tax rate. Chase and Natalie don't need that money and would rather keep it in their account growing tax deferred.

Over the next five years, Chase and Natalie convert $30,000 from their IRAs, which is enough to fill up the 12% tax bracket but not push them into the 22% tax bracket. By doing so, they essentially "pre-pay" their taxes on $90,000 of income at 12% instead of 22%, saving them $9,000. It also reduces their RMDs by $3,300, which saves them over $700 in taxes their first year.

** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

STRATEGY #4 - BACKDOOR ROTH IRA (BDR)

BEST USED BY:

Individuals who are over the income limits to save in a Roth IRA directly ($208,000 joint and $140,000 single) and who also don't have current savings in deductible IRAs.*

COMPLEXITY:

SOPHISTICATED

FINANCIAL IMPACT:

★★★★

HOW IT WORKS:

If you are over the income limits, you can't contribute to a Roth IRA directly. However, you can still contribute the annual maximum by doing a backdoor Roth (BDR). This is done by making a non-deductible contribution to a Traditional IRA (no income limits on who can do this) and converting the contribution to a Roth IRA (again, no income limits on who can do this). Track the transaction each year on tax form 8606.

BENEFITS:

- Tax-free growth
- Tax-and penalty-free withdrawals of conversions after five years or age 59 ½

POTENTIAL PITFALLS:

If you have savings in a pre-tax IRA, the conversion of the non-deductible portion is prorated. For example, if you already have $50,000 in a deductible IRA and you add $7,000 of non-deductible contributions then convert it, only 12% of the conversion will be tax free ($7,000/$57,000) and the rest will be taxable. Ensure you don't claim a tax deduction for your Traditional IRA contribution when you file your taxes for that year, because that will result in the conversion being 100% taxable.

CASE STUDY:

Charles and Hannah are married and file their taxes Married Filing Jointly. Charles works as a firefighter earning $50,000, while Hannah is an Emergency Medicine Doctor earning $300,000. With a combined income of $350,000, they are well over the income limits to contribute directly to IRAs but are eligible to do so through a BDR.

Charles and Hannah both open a Traditional IRA and Roth IRA in each of their names. They each make a $6,000 contribution** to their respective IRAs. After a few days, once the transaction has cleared, they convert the contribution. Then they present the proper documentation (a form 1099-R and form 5498) to their tax preparer to report the BDR.

By completing the BDR, Charles and Hannah are able to contribute the maximum amount to their Roth IRAs each year and ensure tax-free growth and withdrawals in retirement.

** Based on 2021 income limits.*

*** Based on 2021 contribution limits.*

STRATEGY #5 - MEGA BACKDOOR ROTH IRA (MBDR)

BEST USED BY:

Individuals who have the capacity to save more than the maximum employee deferral to their 401(k) ($19,500/$26,000).*

COMPLEXITY:

SOPHISTICATED

FINANCIAL IMPACT:

★★★★★

HOW IT WORKS:

Some 401(k) plans offer an after-tax saving option (this is different than a Roth option). If you maxed out your 401(k) deferrals, you can save additional money in the after-tax portion of the 401(k) up to the Internal Revenue Code (IRC) limit of $58,000 or $64,500 for those over age 50.* (This is calculated by adding together all of your contributions and your employer's.) Contributions into your after-tax account can always be withdrawn tax- and penalty-free and any growth is taxed as ordinary income upon withdrawal. A MBDR is done by making contributions out to a Roth IRA to ensure that all future growth is tax free.

If any growth was accumulated on the after-tax contributions before the rollover happens, the growth is rolled over to a Traditional IRA and will be taxed when you eventually withdraw it.

BENEFITS:

- Ability to save more in a Roth IRA than direct contribution limits allow
- Tax-free growth and qualified withdrawals

POTENTIAL PITFALLS:

Ensure you will max out your 401(k) by the end of the year before making after-tax contributions. Ensure that your employer allows for in-service distributions such as age or frequency restrictions. Ensure you receive the proper tax reporting documents (1099-R and 5498).

CASE STUDY:

Carlton is 60 years old and makes $120,000 per year as an accountant. He maxes out his pre-tax 401(k) contributions, but recently decided he wants to save more in Roth accounts for tax-free income in retirement. His 401(k) plan allows for after-tax contributions and in-service withdrawals once per year. He decides to defer an extra $20,000 in his after-tax account throughout the year and to roll over the entire after-tax balance in December. By that time, he's made his $20,000 in contributions and also had $1,000 in investment growth on top of that. He rolls the $20,000 in contributions to his Roth IRA and the $1,000 of earnings to his Traditional IRA tax-free. Carlton repeats this practice until his retirement at age 70, at which point he's rolled a cumulative $200,000 into this Roth IRA (compared to only $70,000 he could make in direct contributions).

** Based on 2021 contribution limits.*

STRATEGY #6 - HEALTH SAVINGS ACCOUNTS (HSA)

BEST USED BY:

Individuals or families with a high-deductible health insurance plan who want to save, invest and pay for medical expenses tax free.

COMPLEXITY:

SIMPLE

FINANCIAL IMPACT:

★★★★★

HOW IT WORKS:

If you have a high-deductible insurance plan, you can save up to $3,600 as an individual or $7,200 as a family in a health savings plan (HSA).* Contributions to your HSA are tax deductible. Once your money is in the HSA, you have the option to leave it as cash or invest it for potential growth. Upon withdrawal, if used for qualified medical expenses, any growth or interest you received is completely tax free. Contributing and keeping in cash at least your annual deductible in your HSA is a no-brainer, simply for the ability to run all your medical expenses through the HSA for the tax deduction. Once you've saved at least your annual deductible in your HSA and you have room to save more, you can do so and invest it for future medical expenses, ideally retirement medical expenses. Once you've reached age 65, you also have the option to take withdrawals from your HSA penalty free (but taxable) for any expense you want.

BENEFITS:

- Tax deduction for contributions
- Tax-deferred growth
- Tax-free withdrawals for qualified medical expenses
- Ability to take penalty free but taxable withdrawals from the HSA for non-medical expenses upon turning age 65

POTENTIAL PITFALLS:

Keep at least your annual deductible in cash to cover short-term medical expenses. Ensure you have documentation for all qualified medical expenses in order to avoid the 20% withdrawal penalty. Ensure you meet the qualifications of a high-deductible health insurance plan.

CASE STUDY:

Matt and Brittany are 50 years old and have a health insurance plan with a $3,000 deductible. They are generally healthy and hardly ever meet their deductible but have always kept $3,000 in their HSA just in case. Now that they have a little bit more in their budget to save, they decide to max out their HSA each year and invest it for retirement medical expenses. Over the next 15 years, they put in $105,000 worth of tax-deductible contributions and earn $45,000 of investment growth, giving them a balance in their HSA of $150,000 that can be used completely tax free for medical expenses. They can also take penalty-free (but taxable) withdrawals for non-medical expenses as well.

** Based on 2021 saving limits.*

STRATEGY #7 - DONOR-ADVISED FUND (DAF)

BEST USED BY:

Individuals and families who are charitably inclined, have low-basis investments, and/or have a large concentration in one stock and/or want to "front load" their charitable contributions to increase their tax deduction in a certain year.

COMPLEXITY:

MODERATE

FINANCIAL IMPACT:

★★★★

HOW IT WORKS:

A donor-advised fund (DAF) is a charitable investment account that allows you to make donations, receive an immediate tax deduction, and then recommend grants to charities over time at your own discretion. You can donate cash, stock, real estate and more to a DAF.

A DAF works best in two scenarios:

- If you have low-basis stock with a large unrealized gain in a taxable account, you can donate the stock to the DAF, receive a tax deduction based on the fair market value of the stock, then donate the stock to a charity of your choosing. (The DAF will sell the stock when you make the grant and send the charity cash.) Effectively, this exempts you from realizing and paying tax on your gain, all the while still getting a tax deduction for your charitable donation.
- A DAF also works well if you are in a situation where you'd like to "front-load" your charitable contributions in order to receive a large tax deduction all in one year and then make grants to various charities over time. You can find more on front-loading charitable contributions in the next strategy.

BENEFITS:

- Immediate tax deduction
- Forego realizing gains on taxable investments

POTENTIAL PITFALLS:

Make sure you know the process of the DAF you will donate your investments to. Some DAFs will let you hold the investment you originally donated, while others will sell it immediately and give you a few options on what to invest it in (or to keep it as cash). Also ensure the charity you plan on making a grant to is a qualified and eligible 503(c).

CASE STUDY:

Wanda bought 500 shares of Amazon 20 years ago at $30 per share. Now trading at $1,900 per share, she has a $935,000 unrealized gain in her Amazon position. In her spare time, she volunteers for Habitat for Humanity and has decided that along with her time, she'd also like to donate financial resources. She has a goal of donating $20,000 per year for the rest of her life. Over the next 20 years, Wanda donates $20,000 worth of her Amazon stock to DAF and then subsequently directs the DAF to sell the stock and grant it to Habitat for Humanity. Over the 20-year period, she donates $400,000 and saves about $60,000 in long-term capital gains taxes by donating through the DAF.

STRATEGY #8 - FRONT-LOAD CHARITABLE CONTRIBUTIONS

BEST USED BY: Individuals and families who are charitably inclined and want to maximize their tax deductions in a specific year.

COMPLEXITY: MODERATE

FINANCIAL IMPACT: ★★★

HOW IT WORKS: Front-loading charitable contributions can help you receive a tax deduction when you otherwise wouldn't qualify for one. Now that the standard deduction is so high - $25,100 for married couples and $12,550 for single filers* – most people don't itemize their deductions and therefore don't receive a tax deduction for their charitable contributions. If you know you will be making annual charitable contributions and at the same time taking the standard deduction, you could front-load or make all of your charitable contributions in one year to increase your deductions above and beyond the standard deduction for that year. That way, you can itemize your deductions in that year and still qualify for the standard deduction in future years. This can be done by making a donation directly to the charity all in one year or donating to a DAF and then making a grant to the charity each year. It can also be beneficial if you are in a high tax bracket for one year and would benefit more from a tax deduction in that year than in future years.

BENEFITS:

- Allows you to itemize deductions when you'd otherwise just take the standard deduction
- Allows you to increase the value of your tax deduction in years when you are in a high tax bracket

POTENTIAL PITFALLS: Don't strain your cash flow for the tax deduction by committing a bunch of money to a charity in one year.

CASE STUDY: Carl and Breanne are married and have joint income of $150,000 per year. They are in the 22% marginal tax bracket** and plan on retiring at the end of the year. In retirement, they plan on having an income of $75,000 per year, which puts them in the 12% marginal tax bracket. They also take the standard deduction each year. Each year, they make a $10,000 donation to their church, and they figure since they'll be in a lower tax bracket in retirement than they are now, they should front-load five years' worth of charitable contributions in order to get the best "bang for their buck." In addition, they'll be able to itemize their deductions this year. By front-loading their charitable donations, they are able to itemize their deductions this year at a higher tax rate and still qualify for the standard deduction the next four years.

**Based on 2021 standard deductions.*

*** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

STRATEGY #9 - QUALIFIED CHARITABLE DISTRIBUTIONS (QCDS)

BEST USED BY:

Individuals who are age 70 ½ or older, have savings in pre-tax retirement accounts that are subject to required minimum distributions (RMDs), and plan on making charitable contributions.

COMPLEXITY:

MODERATE

FINANCIAL IMPACT:

★★★★

HOW IT WORKS:

If you have savings in pre-tax retirement accounts such as a 401(k) or Traditional IRA and turned age 70 ½ before Jan. 1, 2020 or reached age 72 on or after Jan. 1, 2020, you are most likely subject to required minimum distributions (RMDs). This means this year you are required to withdraw a certain percentage from your accounts, regardless of whether or not you need the money. This is the government's way of forcing taxation upon your savings that have grown tax-deferred over the years, and 100% of your withdrawal is included in taxable income. However, if you plan on making a donation to a charity, you can direct your custodian to send your RMD directly to the charity. By doing so, your RMD is not included in your taxable income. This is more beneficial than taking receipt of money and then making a donation to the charity because of how your tax donation is handled. When you take receipt of the money and then make a donation to charity, the withdrawal is included in your taxable income and you can only deduct the donation if you itemize your deductions. If you take the standard deduction, then you don't get the tax deduction for your taxable income in the first place, so it doesn't matter if you itemize or take the standard deduction.

BENEFITS:

- You can exclude RMDs from taxable income, whether or not your itemize deductions

POTENTIAL PITFALLS:

Make sure you don't ever take receipt of the withdrawal. The check should be made out directly to the charity. You may have your custodian send the check to you, but not in your name.

CASE STUDY:

Jon and Bailey are 72 years old and have a Traditional IRA in Jon's name worth $250,000. This year his RMD will be approximately $9,756. He directs his custodian to make the check payable to The Boys and Girls Club of American and to send it directly to them. Consequently, when Jon and Bailey file their taxes for the year, the $9,756 withdrawal is completely excluded from their income. Since Jon and Bailey take the standard deduction each year, they wouldn't have received a tax deduction for their donation. By doing the QCD and assuming a 27% combined Federal and State marginal tax rate, they save $2,635 in taxes by doing a QCD.*

** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

BEST USED BY: Parents, grandparents or anyone saving money for their own or someone else's college tuition and expenses.

COMPLEXITY: MODERATE

FINANCIAL IMPACT: ★★★

HOW IT WORKS: Each state sponsors their own 529 plan that allows you to save and invest money for college expenses in a tax-advantageous way. Depending on the state plan you choose, you may receive tax benefits such as a credit or deduction for money you put into the account. While invested, all your earnings grow completely tax deferred. In addition, withdrawals are completely tax free if used for qualified educational expenses.

BENEFITS:

- Potential tax credits and deductions for contributions
- Tax-deferred growth
- Tax-free withdrawals for qualified expenses

POTENTIAL PITFALLS: Ensure you use the money on qualified expenses such as tuition, books, computers and room and board (as defined by the university). You are not beholden to your own state's plan, so shop around to find the best plan for you. Compare plans based on deductions/credits, investments offered, cost of the plan and customer service. Withdrawals not used for qualified expenses are included in taxable income and penalized at 10%.

CASE STUDY: Spencer and Kristen recently had twin babies, a boy and girl. They have decided to open a 529 account for each twin to make monthly savings for their college education. They also plan on having Grandma and Grandpa and any relatives make contributions to the account each year instead of buying their kids birthday and Christmas presents.

Spencer and Kristen plan on making $100 contributions each month to both accounts. They live in Utah and decided to use their state plan. By doing so, they receive a $120 state tax credit to offset their Utah state income tax liability. They invest their contributions in a variety of Vanguard funds that automatically become more conservative as the twins get closer to college.

By the time the kids are 18, the couple has saved $90,000 between the two accounts, $39,000 of which is from investment growth. All the savings are used on qualified expenses, so the withdrawals are completely tax free. By saving in a 529 plan, Spencer and Kristen saved approximately $8,000 in taxes between their state tax credits and not paying long-term capital gains tax on investment growth.

** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

BEST USED BY: Those with taxable investment accounts who are in the 15% or 20% capital gains tax bracket.

COMPLEXITY: MODERATE

FINANCIAL IMPACT: ★★★★

HOW IT WORKS:

Earnings (interest, dividends and capital gains) from mutual funds and exchange-traded funds (ETFs) within a taxable brokerage account are taxable in the year they are earned. Actively managed funds and ETFs generally generate more capital gains distributions than passively managed index mutual funds because there is much more trading going on behind the scenes. Passive index funds simply mirror an index; for example, an S&P 500 index fund simply holds all the same stocks as the S&P 500 Index. The only time stocks are sold and replaced in the index fund is when changes occur in the S&P 500 Index. Since there isn't much turnover (selling and buying) within the fund, you don't incur substantial capital gains each year. Compare this to an actively managed fun that has a goal of outperforming an index. For example, an actively managed fund with the objective of outperforming the S&P 500 may have 75% turnover in one year, meaning 75% of the portfolio was sold and replaced within a 12-month period. Any stocks sold for a profit will generate a capital gain that is passed on to the investor.

BENEFITS:

- More tax-deferred growth and less tax drag than investing in actively managed funds
- Additional investment benefits on top of tax benefits, including lower cost, more diversification, funds that stick to their stated asset class, etc.

POTENTIAL PITFALLS:

Interest bearing passive index funds like a bond fund is still tax inefficient, since interest payments are made monthly or quarterly and taxed in the year they are received. However, this isn't a reason to avoid them in taxable accounts altogether. Make sure the index funds you invest in are actually true index funds and have a low tracking error with its stated index.

CASE STUDY:

Doug and Bridget have $300,000 saved in a taxable brokerage account. They are in the 15% long-term capital gains tax bracket* and have the goal of increasing their after-tax investment return. Currently, their account is invested in an actively managed U.S. Large Cap fund that has an objective of outperforming the S&P 500. The fund has an average turnover of 75%, meaning about ¾ of the portfolio is sold and replaced each year. This created a capital gains distribution of $30,000, which was taxed at 15% for a total tax liability of $4,500. Doug and Bridget could have invested in a passive index fund that tracked the S&P 500. With a turnover of 4%, only $6,000 was distributed as a capital gain, creating a tax liability of only $900.

** Based on 2021 capital gains tax rates. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

STRATEGY #12 - INVESTING IN MUNICIPAL BONDS

BEST USED BY:

Those who are in a high tax bracket, have a significant amount of savings in taxable accounts and want to create tax-free income.

COMPLEXITY:

MODERATE

FINANCIAL IMPACT:

★ ★ ★

HOW IT WORKS:

As an incentive to invest in your community, interest paid from municipal bonds (munis) are exempt from federal income tax and, in many cases, state and local taxes as well. Because of their tax-free income, the yield on munis is usually lower than comparable corporate bonds that pay taxable interest. However, if you are in a high tax bracket, the after-tax yield of a muni bond may be greater than a taxable corporate bond. Since investment earnings in retirement accounts are tax-deferred, in almost all cases it only makes sense to invest in municipal bonds within a taxable account. You can invest in individual issues or invest in a municipal bond within a taxable account or invest in bond funds that hold hundreds of individual issues. Keep in mind that while the interest paid is tax free, if you end up selling a muni bond at a profit before it matures, the gain is still included in taxable income.

BENEFITS:

- Tax-free income

POTENTIAL PITFALLS:

Ensure the muni bonds you choose qualify for a tax exemption. In most cases, if you invest in local muni bonds, interest will be tax free at both the federal and state levels. If you want to diversify and invest in other states' munis, check your state's Reciprocity List before investing. Do not invest in munis in tax-advantaged accounts. Make sure your after-tax yield is greater than comparable corporate bonds. Educate yourself on the difference between revenue and general obligation bonds and how each classification affects the yield on the bond.

CASE STUDY:

Ron recently sold his construction business for $2 million and deposited the proceeds into a taxable brokerage account. As Ron does his due diligence on what to invest in, he comes across two different bond funds he likes. Fund As is an investment-grade corporate bond fund yielding 4% annually, which will pay Ron $80,000 per year, and Fund B is a municipal bond fund yielding 3.5% annually which will pay him $70,000 per year. Both funds have the same credit rating and average maturity. Since Ron will be in the 24% federal tax bracket and the 5% state tax bracket*, he will pay $23,200 in taxes on the $80,000 of yield he receives from Fund A, leaving him with $56,800 or a 2.84% tax-equivalent yield. By investing in Fund B, the municipal bond fund, Ron pays no taxes on his income and keeps the full $70,000, netting him $13,200 more after taxes.

** Based on 2021 capital gains tax rates. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

STRATEGY #13 - ASSET LOCATION

BEST USED BY: Those with significant savings in a taxable investment account(s).

COMPLEXITY: SOPHISTICATED

FINANCIAL IMPACT: ★★★

HOW IT WORKS: Investment earnings such as realized capital gains, dividends and interest are taxed differently based on the type of account the earnings accrue in. Within a taxable investment account, earnings are taxed in the year they occur. Within a tax-advantaged retirement account, earnings are tax-deferred and taxed as ordinary income upon withdrawal. Since some investments are naturally more tax efficient than others, you can reduce your tax liability by placing your most tax-efficient investments (high capital growth, low dividend/interest/turnover) in a taxable account and your least tax-efficient investments (high dividend/interest/turnover) in a tax-deferred account.

BENEFITS:

- Reduce tax liability on investment earnings

POTENTIAL PITFALLS: Avoid making broad assumptions about the tax efficiency of certain investments and funds which end up being placed in the wrong account. You should also take care to avoid becoming too aggressive in your asset allocation within one account that you may need to withdraw from in the short term, or becoming too conservative in your asset allocation within one account that you may need to withdraw from in the long term.

CASE STUDY: Dean and Paula have $1 million in investments, with half in a taxable brokerage account and half in a 401(k). They are in the 15% long-term capital gains tax bracket* and have the goal of increasing their after-tax investment return. They have an asset allocation of 50% stock and 50% bonds. Their stock investments pay out an average of 1.5% in dividends and capital gains distributions each year, about $15,000. To reduce the amount of tax they owe on their investment income while maintaining their asset allocation of 50% stocks and 50% bonds, they place their most tax-efficient investments, stocks, in the taxable brokerage account, where the earnings will be included in their taxable income. They place the least tax-efficient investments, bonds, in their 401(k), where the interest will be tax-deferred.

Make note that the asset location is typically more complex than putting all of your stocks in one account and all of your bonds in another. Some bond funds may pay low interest, while some stock funds might pay a lot in dividends. You also need to ensure your asset allocation isn't too aggressive or too conservative based on when you will take withdrawals from the account.

** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

BEST USED BY:

Those who are in the 15% or 20% capital gains tax rate*, have realized capital gains for the year, and have down positions in their taxable accounts with unrealized losses.

COMPLEXITY:

SOPHISTICATED

FINANCIAL IMPACT:

★★★

HOW IT WORKS:

Tax-loss harvesting is the practice of offsetting realized gains by intentionally realizing losses on investments and then immediately replacing them with similar but not substantially identical securities. Realized capital gains are offset by realized capital losses, which can reduce or eliminate your gain altogether. If you have realized gains in your taxable account for the year, and you have investments in your account that have unrealized losses, you can sell those positions to realize the loss and offset the realized gains. In order to not lock in a loss by selling the investment, you can purchase a similar investment the same day with the cash generated from realizing the investment with a loss. To avoid the "Wash Sale" rule (discussed below), you cannot buy the security you sold at a loss 30 days before or after you sell it. After 30 days, if you want to repurchase the investment you sold, you can sell the "replacement" investment and repurchase the "original" investment.

BENEFITS:

- Offset capital gains and reduce your tax liability

POTENTIAL PITFALLS:

Wash Sale rules prohibit you from buying a security you sold at a loss 30 days before or after you sold it at a loss. If you do this, you will not able to deduct or offset the capital gain with the loss. When replacing the security, ensure you buy something that is similar but not substantially identical. For example, if you sell a Fidelity Mid Cap mutual fund at a loss, don't replace it with another Fidelity Mid Cap mutual fund. Instead, replace it with something like an iShares Mid Cap ETF (for example). If you are in the 0% capital gains tax bracket, then tax-loss harvesting provides no benefit.

CASE STUDY:

Tami has a taxable brokerage account and sold ABC Technology Mutual Fund this year, generating a $20,000 capital gain. She also has DEF Real Estate Mutual Fund in her account that has a $20,000 unrealized loss and sells the DEF fund to realize the $20,000 loss and offset her $20,000 capital gain. That same day, she takes the proceeds from the DEF fund and buys the GHI Real Estate ETF, which more or less invests in the same securities. After 30 days, her GHI ETF is up 5%, and the DEF fund is also up 5%. Tami can now sell the GHI ETF and re-buy the DEF mutual fund if she wants. She still gets to offset her realized gains and didn't miss out on any appreciation. Best of all, by harvesting her losses, Tami saved $3,000 in capital gains tax.

** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

STRATEGY #15 - TAX-GAIN HARVESTING

BEST USED BY: Those who have unrealized capital gains in a taxable account and are either in a low tax bracket and/or have realized losses to offset their gains.

COMPLEXITY: SOPHISTICATED

FINANCIAL IMPACT: ★★★

HOW IT WORKS:

Tax-gain harvesting is the opposite of tax-loss harvesting. If you have investments in your taxable brokerage account with large unrealized gains, you can strategically realize those gains in years when you are in a low tax bracket or have realized losses to offset gains. There are three capital gains tax brackets: 0%, 15% and 20%.* If you are in the 10% or 12% ordinary income tax bracket, your capital gains are taxed at 0%. Therefore, if you have investments in a taxable account with an unrealized gain, you can sell those investments, realize the gain, "pay" a 0% tax rate, and then re-buy the investments which resets your unrealized gain to $0. You can also harvest gains in years when you have realized losses. The gains and losses will offset each other, and you can re-buy the investment and reset your unrealized gain to $0.

BENEFITS:

- Reduce the amount of capital gains you pay on taxable investments

POTENTIAL PITFALLS:

Your realized capital gains affect your ordinary income rate, which in turn affects your capital gains tax rate. Don't realize so much of gain that you increase your income to a point where your capital gains tax rate increases.

No Wash Sale rule applies when you sell at gain, so you can re-buy the investment the same day.

CASE STUDY:

Shortly after being married, Lance and Lisa receive an inheritance from Lisa's grandma. They received $50,000 of ABC Mutual Fund held in a taxable account. As an inheritance, they receive a step-up basis and therefore have a basis of $50,000. Still in their mid-20s, Lance and Lisa together earn $70,000, which puts them in the 0% capital gains tax rate. The first year after receiving their inheritance, their investment rises to $54,000. Lance and Lisa harvest the gain by selling the entire fund and realizing the $4,000 gain. Since they are in the 0% capital gains tax rate, they pay no taxes on the gain and increase their cost basis to $54,000 at the same time. Over the next five years, Lance and Lisa stay in the 0% capital gains rate. The fund continues to rise by 8%, and the couple continues to harvest the gains. By realizing five years of gains at a 0% tax rate, Lance and Lisa saved $2,815 in taxes.

** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

STRATEGY #16 - 1031 EXCHANGE)

BEST USED BY:

Owners of rental property with built-in capital gains who want to sell their property and reinvest in another property without realizing their capital gains.

COMPLEXITY:

SOPHISTICATED

FINANCIAL IMPACT:

★★★★

HOW IT WORKS:

A 1031 exchange allows you to sell a property, reinvest the proceeds in a new property, and defer all capital gains tax. You must purchase a new property of the same or greater value and leverage. The property must be identified within 45 days of your current property being sold, and you must close on a new property within 180 days. In addition, you must work through a qualified intermediary who facilitates the 1031 exchange by holding the funds involved in the transaction until they can be transferred to the seller of the replacement property

BENEFITS:

- Allows you to exchange investments without realizing a capital gain

POTENTIAL PITFALLS:

There are many rules and restrictions about doing 1031 exchanges. Work through a qualified intermediary who can guide you through the rules. Never take possession of the funds from the sale of your property.

CASE STUDY:

Susan bought a rental property 10 years ago worth $250,000. In those 10 years, she has taken $70,000 worth of depreciation, reducing the basis to $180,000. The rental property is now worth $350,000.

Susan recently moved two states away and would like to sell her original rental property and purchase a new one closer to her. However, she doesn't want to realize the $170,000 capital gain and generate a $32,500 tax bill. Instead, Susan decides to work through a qualified intermediary and do a 1031 exchange.

Susan sells her original property, and the proceeds are directed to the qualified intermediary. She identifies a new property worth $350,000 within 45 days and closes on that property within 180 days. Her basis in the new property is still $180,000 and she owes no tax on the sale of her original property.

STRATEGY #17 - OPTIMIZE PREMIUM TAX CREDIT

BEST USED BY:

Individuals and families who don't have access to health insurance through an employer or through a state or federal sponsored program such as Medicare or Medicaid.

COMPLEXITY:

MODERATE

FINANCIAL IMPACT:

★★★★★

HOW IT WORKS:

As part of the Affordable Care Act (ACA), the Premium Tax Credit (PTC) was created as a refundable credit that helps cover the cost of premiums for health insurance policies purchased through the Health Insurance Marketplace. The amount of the credit you receive depends on your family size, income and state you live in. You will receive at least a portion of the PTC if your income is below 400% of the federal poverty line. For those who retire before they are eligible for Medicare, structuring your income to qualify for the PTC can save you thousands in premiums. For purposes of the PTC, your income is based on your Modified Adjusted Gross Income (MAGI), which is the total of wages, tips, self-employment income, unemployment compensation, Social Security (both the taxable and non-taxable portion), Social Security Disability, taxable retirement withdrawals (not Roth withdrawals), capital gains and investment income. For most retirees, if you can structure your income to come primarily from investment earnings and Roth distributions, you can potentially qualify for the PTC.

BENEFITS:

- Substantially reduce private health insurance premiums before Medicare eligibility

POTENTIAL PITFALLS:

You can choose to estimate what your MAGI will be at the beginning of the year and then have your credit offset your monthly premiums. If you understate your MAGI, you will have to pay back the extra credit you received throughout the year when you file your taxes.

CASE STUDY:

Shawn and Marge both retired this year at 62. They have savings in a 401(k), Roth IRA and joint brokerage account. They plan on living on $100,000 per year in retirement. $25,000 of their income will come from dividends and interest from their joint brokerage account, while they'll withdraw the remaining $75,000 from their 401(k) or Roth IRA. Since they won't be eligible for Medicare for three more years, they have been shopping around for a private health insurance company policy. They've found a plan with a $5,000 deductible and a 70% coinsurance that costs around $24,000 per year. If Shawn and Marge decide to pull $75,000 from their 401(k), their total income will be $100,000 and they won't be eligible for the PTC. They'll end up paying the full $24,000. Instead, they decide to withdraw the $75,000 from their Roth IRA which is completely tax free. Their MAGI for the year ends up being $25,000, which is 152% of poverty level. They will qualify for a PTC of approximately $23,580 and only have to pay $420 ($35 per month) for their health insurance.

STRATEGY #18 - DEDUCTION BUNCHING

BEST USED BY:

Individuals and families whose itemized deductions are slightly lower than the standard deduction.

COMPLEXITY:

MODERATE

FINANCIAL IMPACT:

★ ★

HOW IT WORKS:

Bunching your deductions together in one year may allow you to itemize your deductions when you'd normally take the standard deduction. Certain expenses that qualify as itemized deductions can be paid in advance or planned out to occur in a certain year.

BENEFITS:

- Increase your itemized deductions
- Lower your tax bill

POTENTIAL PITFALLS:

The juice may not always be worth the squeeze in this strategy. Don't strain your cash flow to get a little bit more in deductions.

CASE STUDY:

Jacob and Darlene are retired, live on about $150,000 of income, and normally take the standard deduction of $25,100.* They have a few itemized deductions: state income tax ($5,000), property taxes ($3,000) and charitable donations ($10,000) that add up to $18,000. Jacob plans on getting a surgery next year that will cost him about $15,000 out of pocket, resulting in a $3,750 itemized deduction. So instead of making a charitable donation this year, Jacob and Darlene decided to double up on their charitable donation next year to get them above the standard deduction. The result is they still get to take their standard deduction of $25,100 this year, and next year they get to itemize their deductions for a total of $31,750, which saves them almost $1,500 in tax liability.

Based on 2021 standard deduction.

STRATEGY #19 - AVOIDING THE IRMAA SURCHARGE

BEST USED BY: High-income individuals and couples who will be enrolled in Medicare within two years or are already enrolled.

COMPLEXITY: MODERATE

FINANCIAL IMPACT: ★

HOW IT WORKS: The income-related monthly adjustment amount (IRMAA) is a surcharge high-income people pay in addition to their regular Medicare Part B and Part D premiums. Being cognization of the income limits that trip these surcharges and planning your taxable income around them can help save thousands of dollars in premium surcharges over the years. This is best done by strategically withdrawing money from pre-tax, Roth and taxable accounts to give you the income you need in retirement but keeping your taxable income below certain limits.

BENEFITS:

- Reduce the cost of Medicare Part B and Part D premiums

POTENTIAL PITFALLS: Not understanding how certain income is taxed can result in higher-than-expected taxable income. IRMAA surcharges are based on the adjusted gross income (AGI) of your tax return from two years ago, so planning ahead is vital.

CASE STUDY: Frank and Janie want to withdraw $175,000 from their investments this year for their annual expenses. They also want to convert $50,000 from Janie's pre-tax IRA to her Roth. They have a substantial amount of money in a savings account, pre-tax IRAs and Roth IRAs. If Frank and Janie were to withdraw $175,000 from their pre-tax IRAs and then convert $50,000 to their Roth IRAs, their adjusted gross income (AGI) would be $225,000 for the year, triggering a surcharge of $763 in premiums in two years. Instead, Frank and Janie withdraw $125,000 from their pre-tax IRA and take $50,000 out of their savings, keeping their AGI below the trigger and saving $763 on their premiums.

STRATEGY #20 - REDUCING YOUR STATE AND LOCAL TAXES (SALT)

BEST USED BY: Individuals and families who are open to relocating.

COMPLEXITY: MODERATE

FINANCIAL IMPACT: ★★★★

HOW IT WORKS: State income taxes and property taxes make up a large part of your total tax bill. You can reduce your tax bill by relocating to a state that charges less in income taxes and/or property taxes.

BENEFITS:

- Reduce state and property taxes

POTENTIAL PITFALLS: Taxes aren't the only consideration you must make when relocating. Cost of living can vary substantially from state to state.

CASE STUDY:

Carla is single, lives in a $400,000 condo in Los Angeles, and lives on $175,000 per year as a retiree. Between her state income taxes ($13,280) and her property taxes ($4,640), Carla pays $17,920 in SALT taxes.*

Carla has been thinking she would like a change of scenery and is looking to move to a state that has a lot of outdoor recreation. She's considering moving to either Utah or Washington.

Utah has a 4.9% state income tax and an average 0.55% property tax rate. She'll pay $8,575 in state income taxes and $2,200 in property taxes (assuming she buys a similarly priced home). A move to Utah means her total SALT taxes decrease by $7,145 per year.

Washington doesn't have an income tax and an average 1.06% property tax rate. She'll pay $0 in state income taxes and $4,240 in property taxes. By moving to Washington, her SALT taxes decrease by $13,680.

It's important that Carla considers other factors, such as cost of living, sales tax, real estate prices, whether or not she'd actually enjoy living in the state, etc.

** Based on 2021 tax brackets. Tax rates can – and do – change, so we recommend consulting IRS.gov or your financial professional for your current tax bracket and rates.*

OUTLOOK
WEALTH ADVISORS, LLC

www.outlookwealth.com | 281.872.1515

The tax planning strategies discussed in this whitepaper should not be construed as personal tax advice. Before implementing a tax strategy, consult with a licensed and professional tax advisor.