2018 TAX LAW CHANGES: SEIZE THE OPPORTUNITY

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With more than 16 years of teaching taxes and tax planning, I strive to simplify the tax laws to make them very easy to understand and apply to financial planning. With that knowledge, I develop strategies to significantly improve clients' tax efficiency for investment planning, retirement planning, and estate planning.

Ask yourself this question. Do you think tax rates will go up in the future? The answer to that question should be a resounding yes. Let's look at the U.S. debt ($20 trillion) and our Federal budget ($4.5 trillion). We are currently borrowing (by issuing bonds and printing money) $800 billion per year to cover our expenses. Really? Do you run your household in a way that you must borrow 20% to cover your expenses? With 51% of those expenses being Social Security and Medicare, it seems that the only solution to close the annual deficit is to increase income (taxes) or decrease expenses. If 51% of our expenses are those social programs, then what do you think will happen to those benefits in the future?

Until 2018, I was preaching that the tax brackets were the lowest since World War II, and that because of the mounting Federal deficit, taxes could only go up. Wow, was I wrong. As a result of the Tax Cuts and Jobs Act of 2017, income taxes went down for nearly everyone, particularly those in the middle and upper middle class. These tax rates will end in 2025, or possibly sooner, pending the 2020 elections. This leaves a narrow window to seize this opportunity.

Baby boomers were trained to maximize their 401(k) and IRA contributions in order to get a tax deduction, and defer the taxes until retirement when income is lower. Well, I'm here to tell you that most middle and upper middle-class folks will actually be in a HIGHER marginal tax bracket in retirement than they are today. How could that be?

- Tax rates will almost certainly go up.
- Taxation of Social Security is dependent on other income. Thus, withdrawals from retirement plans can cause phantom taxation of Social Security.
- If one spouse dies, the surviving spouse will reach the higher tax brackets quicker.
- IRA/401(k) distributions in retirement could cause Medicare premiums to be higher.
- Social Security benefits may eventually be means-tested like Medicare premiums are now.

So what do you do? It is important to understand what your tax bracket is now—and whether it will be higher or lower in retirement. If you project a higher marginal tax bracket in retirement, then it's time to reduce the amount of assets in your tax-deferred bucket (401(k) and/or IRAs). To do so would require a combination of two things: reducing contributions to your tax-deferred bucket or moving assets from your tax-deferred bucket to a tax-free bucket. The tax-free buckets are the Roth 401(k) and Roth IRA.

The difference between the Traditional 401(k)/IRA and Roth 401(k)/IRA is that the Traditional account receives a tax deduction upon contribution but is taxable upon withdrawal. Roth contributions do not get a tax deduction but grow tax-deferred and tax-free (with certain restrictions). Plus, distributions from the Roth do NOT cause your Social Security income to become taxable.

To ascertain which plan is better is based on estimating the participant's tax bracket at the time of contribution versus at the time of withdrawal. I strongly encourage you to meet with your financial advisor to discuss an appropriate strategy for you. Or, feel free to register for the educational seminar to learn more about this topic.