5 TIPS TO AVOID THE TICKING TAX BOMB

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HAVE YOU EVER WISHED YOU COULD **PREDICT THE FUTURE?**

Well, let's imagine for a minute that you can! Now that you have this superpower, how will you use it? Before you buy those stocks or that lottery ticket, let's focus on something closer to home – taxes.

Before you see this as the most boring way to use your new power, let's explore a few questions:

- Will tax rates go up, or come down in the future?
- Do you think higher taxes will have a greater effect on retirement savings?
- Do you want to reduce your tax liability while increasing your retirement income?

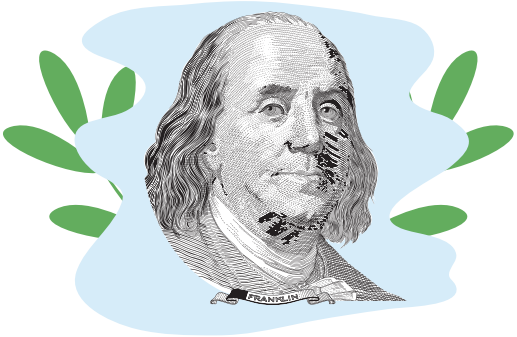
If you answered yes to these questions, your super-powers are much stronger than you think.

Want to know how to take control over your tax future?

Read on …

The Tax Cuts and Jobs Act was passed in 2017 and has an expiration date of December 31, 2025. In 2026 it is likely that taxes will increase. Let us first look at the reasons why they may increase, and then what you can do to take control over how much you will pay in taxes in the future.

For more information on the Tax Cuts and Jobs Act, visit https://www.irs.gov/
For current information on the US Deficit visit https://www.usdebtclock.org/.



"Nothing is certain except for death and taxes."
- Benjamin Franklin

A BRIEF TAX HISTORY

In 1913, the 16th Amendment was passed to begin taxing US citizens. In 1914, the highest tax bracket was only 7%. Within four years, in 1918, the top tax rate had risen to a staggering 77%. At the end of WWII, from 1944-1945, Americans witnessed the highest tax bracket ever yet recorded, an astronomical high of 94% for anyone making anything above $200,000. After WWII, taxes dropped back down, and then again in the 1970s the high jumped up to 70%.

Now, let us take a deeper look at the current state of our economy -- our national deficit/debt vs. the Gross Domestic Product (GDP). The growth and productivity rate of our country is stagnant and even decreasing during challenging quarters and our labor force is aging. Unfortunately, there has also been significant increase in government spending.

Since the 2017 Tax Cuts and Jobs Act, we have basically seen taxes "On Sale", meaning they are at a historical low and we actually have a good idea when they may move up. Currently the highest tax bracket is a mere 37%. However, as mentioned previously, this Act is set to expire at the end of 2025. With a current national debt of $26 Trillion and counting, and national programs like Social Security, Medicare and Medicaid running out of funds, how will we solve this crisis? The answer, quite possibly, will be to increase taxes.

Now that we have a snapshot history of taxes, the current U.S. economic situation, and the fact that taxes may very well go up in the future, here are 5 tax smart planning tips to help you stay in control of your taxes.

1. **Working with Financial and Tax Planner Professionals:**
One of the most important steps you can take in your retirement planning is to begin planning and saving as soon as possible. The second most important decision is to work with, not just a tax preparer, but a tax planner. Planning and investment decisions should be made from a savvy, tax-smart approach. For example, you wouldn't want $10 in excess Capital Gains income to cost you upwards of $1,000 in unnecessary tax liability. One small decision could cause a domino effect that could cost you additional tax, unknowingly and unnecessarily. If your financial planner does not offer tax planning advice, find a tax planner who can assist your financial planner in making the right choices with your tax goals in mind.

2. **Balance the 3 Tax Funnels:** Income and Investments are taxed in one of 3 categories. We call these categories Tax Funnels. It's important to understand each funnel. Developing a tax efficient funnel plan can maximize your income and decrease tax liability. Here is an example of how accounts can be set up from a tax perspective.

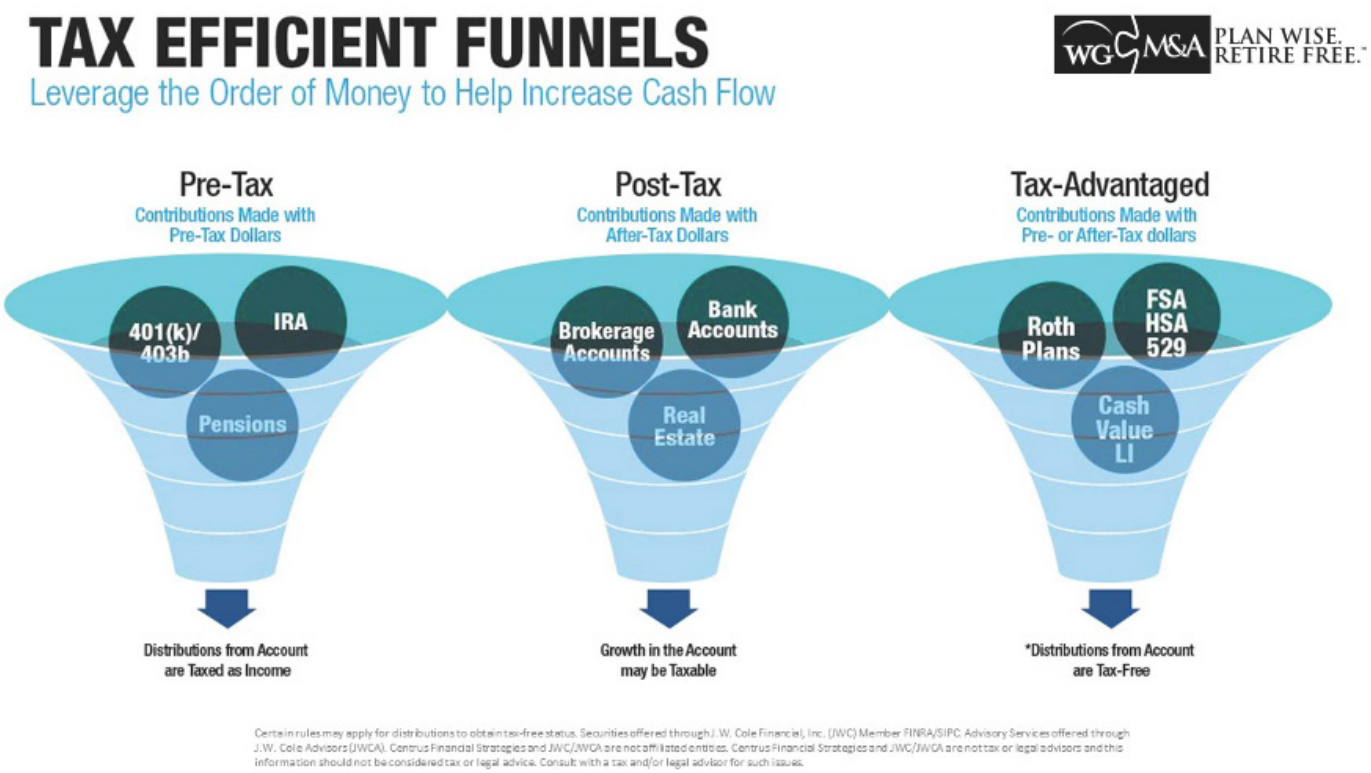
   - **Tax Deferred/Pre-Tax:** These types of accounts include 401K IRA, 403B, and Pensions. Funds are placed here during your working years. Assets enter this funnel pre-tax; therefore, you get a tax deduction each year for the contributions made into these accounts. These accounts grow with interest over time. The media and many financial advisors often suggest you should contribute the maximum to these Tax Deferred vehicles. But this blanket advice doesn't fit everyone.

     These accounts can be a hidden tax bomb waiting to go off in retirement. These withdrawals could be taxed at a much higher rate in the future and create an unwelcomed tax liability. Once in retirement, at age 72 1/2 you are required to withdraw funds from traditional IRA's, these withdrawals are called RMD's (Required Minimum Distributions). This is when the taxes are applied to the withdrawal amount each year. Not only is the withdrawn amount taxable, but the income is considered Provisional Income, which is part of a calculation that could also affect your Social Security benefit being taxed. Now the question is, at what tax rate? Do you know what your tax bracket will be when you retire? This is the downside to these types of accounts.

   - **Taxable/Post Tax:** The funds going into this funnel are typically from income you've earned and have already been taxed. The interest earnings from these assets will also be taxable each year. Depending on how the returns on these investments are classified (capitals gain, dividends, interest) they will be taxed at either income or investment tax rates.

   - **Tax Advantaged:** The funds that go into this funnel are free from Federal & State Tax and Capital Gains Tax during distribution. Funds come from your earnings which have already been taxed prior to contributing to these accounts, therefore withdrawals later are tax free. Examples: Roth IRA, FSA, HAS, 529 Plan & Cash Value Life Insurance Plan. Roth IRA withdrawals don't count as Provisional Income and therefore do not affect Social Security.

The diagram below shows examples of the three tax funnels.



3. Know Your Tax Bracket:

Working with your financial planner and tax professional will help you to understand your income, your tax bracket and what you can do to maximize your income while keeping within or even reducing your tax bracket. Trying to get into the lowest or zero tax bracket possible should be an important part of your retirement plan. After all, if you are in the 0% tax bracket in retirement, and taxes go up 2X... Two times Zero is still zero.

Tax Brackets & Tax Rates For 2019

SINGLE	MARRIED FILING SEPARATELY	MARRIED FILING JOINTLY	HEAD OF HOUSEHOLD	TAX RATE
$0 - $9,700	$0 - $9,700	$0 - $19,400	$0 - $13,850	10%
$9,701 - $39,475	$9,701 - $39,475	$19,401 - $78,950	$13,851 - $52,850	12%
$39,476 - $84,200	$39,476 - $84,200	$78,951 - $168,400	$52,851 - $84,200	22%
$84,201 - $160,725	$84,201 - $160,725	$168,401 - $321,450	$84,201 - $160,700	24%
$160,726 - $204,100	$160,726 - $204,100	$321,451 - $408,200	$160,701 - $204,100	32%
$204,101 - $510,300	$204,101 - $306,175	$408,201 - $612,350	$204,101 - $510,300	35%
Over $510,300	Over $306,175	Over $612,350	Over $510,300	37%

4. **Cash Value Life Insurance Policy:**
   Purchasing a Permanent Life Insurance Plan policy early can provide tax free cash withdrawals later when tax rates may be much higher. A permanent life insurance policy typically has a high dollar premium payment and provides coverage for life. A portion of the premium is deposited into a cash value account where it will grow over time with interest. The interest earned on this account is taxable, but the principal is not. Examples are Whole Life, Variable Life and Universal Life Insurance Policies.

5. **Roth IRA Conversion:**
   As mentioned briefly above, Roth IRA accounts are funded with income which has already been taxed and can be withdrawn penalty and tax free once the account has been established for more than 5 years and the owner is 59 ½ years of age or older. A Roth IRA does grow with interest and a Roth is not subject to the rules of RMDs. An individual, working with their financial planner and tax professional, can strategically, over time, withdraw funds from other types of retirement accounts, pay the taxes now, while tax brackets are low, and place those funds into Roth IRAs for future tax-free retirement use.

ABOUT US

Mott & Associates and Wilson Group Financial is a financial services firm that takes a tax-smart approach to designing financial plans that meets clients where they are and works with them to achieve their retirement dreams.

We work each day to achieve and sustain a trusted advisor relationship with our clients. We look to both our people and proven processes to get the job done. In this capacity, we have the wisdom and the tools to take our clients to their desired destination. We can guide, direct, inform and counsel our clients so that they can achieve their best life.

To schedule a 15-minute consultation, call us at 888-534-9994. We look forward to speaking with you.