A RESOURCE FROM THE WEALTH GROUP

The 10 Most Commonly Overlooked Tax Strategies

The 10 Most Commonly Overlooked Tax Strategies

If you Google "how to save money on taxes", thousands of articles on tax deductions appear, but not much content surfaces on longer-range tax strategies.

And there is a difference between the two.

Here's a basic definition of a tax deduction:

> You pay out $10,000 to get a "rebate" of $3,000. You're still out $7,000 net. You may have saved $3,000 in taxes but you spent $10,000 to get it.

Typically, a tax deduction is geared to reduce your tax burden in the present tax year. This is often a good thing. But for many folks, little thought is given to tax strategies designed to reduce your taxes over the next 10 – 60 years.

Below are the 10 most overlooked tax strategies in personal finance today:

1. Inadequate Roth account funding.

Roth (1)	Pre-Tax (2)
No tax deduction today	**Tax deduction today**
Tax-free growth	**Tax-delayed growth**
Tax-free withdrawals	**Withdrawals taxed as income**

(1) Examples include: Roth IRA; Roth 401(k); Roth 403(b); etc.
(2) Examples include: Traditional IRA; pre-tax 401(k); pre-tax 403(b); etc.

For high-income earners, it's common for the bulk of their retirement nest egg to be socked away in pre-tax accounts. These accounts give a present-year tax deduction upon contributing to the account (which can save up to 40 or 50 cents on the dollar for high income earners in high income tax states), but those dollars are taxed as ordinary income when the time comes to withdraw from the account in retirement.

Most people are aware of Roth IRA contributions (which are subject to an income maximum that prevents many of our clients from contributing to a Roth IRA), but a smaller percentage of people pay close attention to other options for funding Roth accounts. The most common Roth option our clients have is Roth 401(k) (or 403(b)) contributions in their workplace retirement plan.

Some of our clients elect to have a smaller percentage of their 401(k) contributions go into the Roth bucket, such as 25% of their contributions to Roth and 75% to the pre-tax bucket.

2. Optimizing charitable giving.

When donating to charities, most folks give from their bank account (cash, check, or direct debit).

If you have a non-retirement investment account (a brokerage account or "after-tax" account), you can donate highly appreciated securities directly to the church or charity's investment account.

You still get the full tax deduction, you avoid capital gains on that investment, and the charity gets the full value of the holding. Because charities don't pay taxes, they can sell the investment holding (with no capital gains tax) and use the funds for their mission.

Then, you as the investor "backfill" your investment account with a transfer out of your bank account (this part is crucial).

For example, if you donate $10,000 of stock to your church, you then transfer $10,000 from your bank account to your investment account – and then purchase stocks again for that same amount. This is akin to "resetting" your cost basis, while still getting the tax deduction.

Other great charitable giving strategies include Donor Advised Funds (which we can setup for our clients) and "lumping" multiple years of giving into one year – to surpass the currently-high standard deduction.

3. Building non-retirement investment accounts.

Many Americans struggle to invest money beyond retirement accounts (401(k)s, Roth IRAs, and IRAs). Retirement accounts are great, but the "next level" is building an investment portfolio in a taxable brokerage account.

Our most successful clients often have a meaningful amount invested in taxable accounts. How do they do it? The first thing to do is start – don't delay for any reason. Open a joint investment account with your spouse and start investing $500 or $1,000 per month in that account. Even if it's just $50 a month, do something.

The most common path to building significant investment dollars in taxable accounts is getting your mortgage paid off. If you can be 100% debt-free by your late 40s or early 50s, you have a long runway to stockpile cash into your taxable brokerage.

If a client's mortgage payment (the principal and interest portion of the loan) had been $3,500 per month before paying it off, that $3,500 per month can be invested in a taxable brokerage account for 10 or 15 or more working years – leading to a large taxable account.

This taxable brokerage comes in handy during retirement in multiple ways.

4. Holding tax-inefficient mutual funds in non-retirement accounts.

As you build your taxable brokerage account, you want to hold tax-efficient index funds in those accounts. Avoid actively-managed mutual funds in such accounts, as these funds sometimes pay out unwanted year-end capital gain distributions.

Even within the world of index funds (which we love), the tax efficiency can vary based on the amount of annual income being paid out from the underlying holdings and the annual turnover (trading) within the fund.

5. Thinking that a tax deduction is always a good thing.

You want to keep as much of your money as possible. Sometimes, people buy a depreciating asset to lower their tax burden. For example, a business owner buys an expensive truck (because it's a write-off), or a farmer buys new equipment (to save on taxes).

If you buy a $80,000 truck to save $36,000 on taxes (35% Federal and 9.85% Minnesota), you're still out $44,000 net of the tax savings. If you needed a new truck for your business, maybe this purchase was a decent deal. But imagine if you bit the bullet and paid the taxes – and then took that after-tax income and invested it in a brokerage account.

6. Tax-loss harvesting during down markets.

Since the end of WWII, bear markets (defined as a stock market decline of 20% or more) have occurred [on average] once every 6 years. That's 13 bear markets in ~ 79 years.

When stocks decline meaningfully, our team reviews all clients' taxable investment accounts for opportunities to harvest capital losses. Here's how this works:

- Sell holding XYZ to realize a $25,000 capital loss.
- Immediately reinvest those sale proceeds into holding ABC – thereby always maintaining stock market exposure.
- The $25,000 capital loss can be used to offset other capital gains realized that year – and the unused loss can be carried forward indefinitely. The loss can also be used to deduct up to $3,000 per year from ordinary income and it can also be used to offset future capital gains.

We have saved clients hundreds of thousands of tax dollars from this disciplined strategy.

7. Roth Conversions.

Converting dollars from pre-tax accounts into Roth IRA (tax-free) dollars often makes sense at specific stages of an investor's life. We essentially want to "fill up" (or "utilize") all the lowest Federal tax brackets (10% and 12% tax rates) every year.

Examples of those life stages include:

- A client who retires some years before drawing on Social Security, while simultaneously having taxable investments upon which to draw for lifestyle needs.
    - We have helped some clients convert several hundred thousand dollars from IRAs into Roth IRAs while in their late 50s or early 60s.
- A sales professional has a down year (or a break between jobs), thus bringing in a much smaller income than usual. This lower income year can provide an opportunity for Roth Conversions at a relatively low tax rate.
- A client is making a six-figure charitable gift, bringing a huge tax deduction that year.

8. Insufficient tax withholding on bonuses and stock vests.

In calculating income taxes owed, all earned income sources are treated the same – as ordinary income. That is, it doesn't matter whether the income is your salary or a bonus or a stock vest (e.g., an RSU) – the income all goes into one pot of "ordinary income" for the purpose of tax computation.

However, from a payroll perspective, it may be that your company automatically elects a "special income" withholding rate at a flat 22% Federal tax for Restricted Stock Unit vesting or for bonuses.

For many of our clients, a 22% flat Federal withholding rate is insufficient. You can work with your company's benefits or payroll contact to increase the withholding rate for significant bonuses and stock vests.

9. Missing out on the Backdoor Roth IRA and the Mega Backdoor Roth IRA.

The Backdoor Roth IRA allows an individual to legally circumvent the income cap on a Roth IRA contribution. This strategy only works well for folks who don't have an existing Traditional IRA account.

The mechanics are as follows:

- Make a non-deductible IRA contribution for the max dollar amount (e.g., $7,000 in 2024 for a person under age 50).
- Immediately complete a Roth Conversion to convert/transfer that $7,000 into a Roth IRA.
- Report the Conversion on your taxes as a tax-free conversion (since no deduction was taken on the IRA contribution).

10. Building a massive HSA (Health Savings Account) during your decades-long working career.

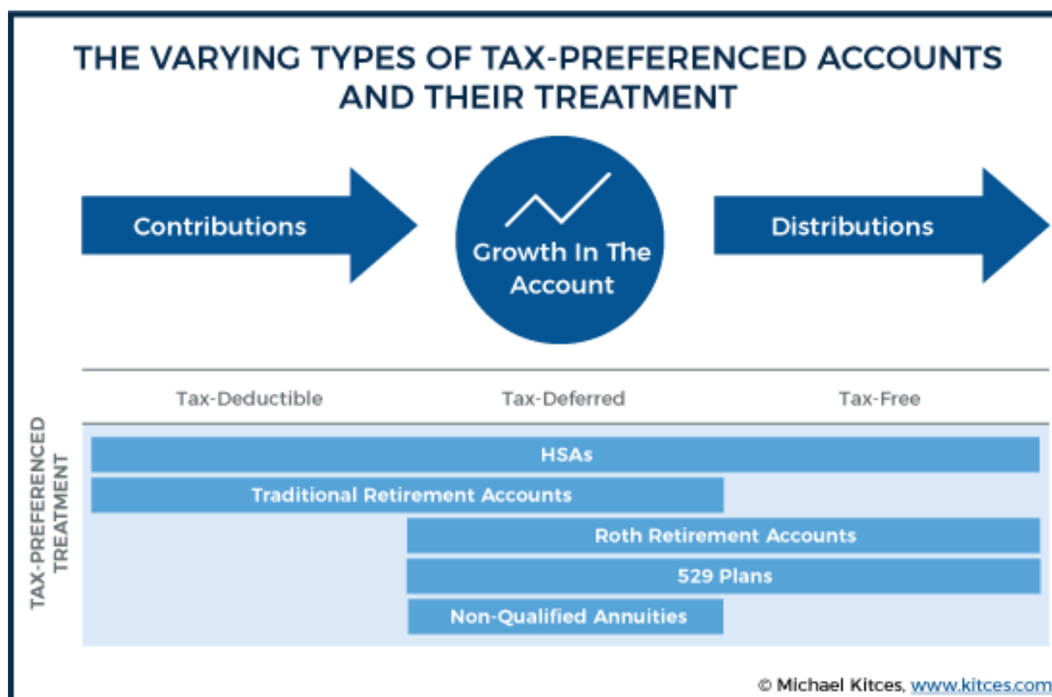
The Health Savings Account (HSA) is the only investment vehicle that offers the trifecta of:

- tax deduction on the front end (for contributions to the account).
- tax-free growth in the account.
- tax-free withdrawals (for qualified medical expenses).

Most HSA plans have great investment options, including a range of stocks, bonds, and balanced funds. You are typically required to always leave a small amount of money in cash (around $2,000) – but the rest can be invested.

The list of eligible medical expenses for tax-free withdrawals is long, so it's not difficult to deplete the account later. In retirement, even Medicare premiums are eligible for payment out of an HSA.

You can also reimburse yourself for decades-old medical expenses. For example, if you have a surgery at age 50 that costs you $7,000 out of pocket, you can reimburse yourself decades later with your HSA (you are technically required to retain a record of the expense).



Your Partners in Wealth Management

Reach out to our team today to learn more about partnering together.

MINNESOTA
14850 Scenic Heights Rd Ste 100
Eden Prairie, MN 55344
(952) 937-9423

TENNESSEE
725 Cool Springs Blvd Ste 445
Franklin, TN 37067
(615) 395-8600

VIRTUAL OFFICE NATIONALLY VIA ZOOM

thewealthgroup.com

The Wealth Group – Austin B. Colby & Associates is a Securities and Exchange Commission registered investment advisor. Information presented is for educational purposes only and does not intend to make an offer or solicitation for the sale or purchase of any securities, and past performance is not indicative of future results. Investments involve risk and are not guaranteed. Be sure to first consult with a qualified financial adviser and/or tax professional before implementing any strategy discussed here.