TAX OPTIMIZATION STRATEGIES

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For Individuals and Families: Navigating taxes regardless of who wins the election

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Tax optimization is a crucial aspect of financial planning, enabling individuals and families to maximize their wealth while minimizing their tax liabilities. With the expiration of the Tax Cuts and Jobs Act (TCJA) set for the end of 2025, it's essential to consider how current tax laws may change and what strategies can be employed now to protect and grow wealth in the face of these potential changes.

1. UNDERSTANDING THE CURRENT TAX LANDSCAPE

The TCJA, also known as the "Trump tax cuts", enacted in December 2017, brought significant changes to the U.S. tax code, impacting both individuals and businesses. Key provisions of the TCJA that affect individual taxpayers include:

- **Lower Marginal Tax Rates:** The TCJA reduced the marginal tax rates for most income brackets, with the top rate dropping from 39.6% to 37%.
- **Increased Standard Deduction:** The standard deduction was nearly doubled, reducing the number of taxpayers who itemize deductions.
- **Elimination of Personal Exemptions:** Personal exemptions were eliminated, which previously allowed taxpayers to reduce their taxable income for each dependent.
- **Cap on State and Local Taxes (SALT) Deduction:** The TCJA capped the deduction for state and local taxes at $10,000, impacting taxpayers in high-tax states.
- **Increased Child Tax Credit:** The child tax credit was increased to $2,000 per qualifying child, with a higher phase-out threshold.

The provisions of the TCJA are set to expire at the end of 2025 unless extended or modified by Congress.. Now that our next presidential election race is heating up, clients and families should begin contemplating proactive steps to optimize their tax situation both now and in the future.

2. TAX OPTIMIZATION STRATEGIES BEFORE THE TCJA EXPIRES

1. Maximize Contributions to Tax-Advantaged Accounts

a. **401(k) and IRA Contributions:** Contributing to retirement accounts like 401(k)s and IRAs is a key tax optimization strategy. These accounts offer tax-deferred growth, meaning you won't pay taxes on the money until it's withdrawn in retirement. Whether tax rates remain the same or increase from current levels, it's still advantageous to contribute as much as possible to these accounts.
b. **Health Savings Accounts (HSAs):** HSAs offer triple tax benefits: contributions are tax-deductible, earnings grow tax-free, and withdrawals for qualified medical expenses are tax-free. Maximize contributions to your HSA to reduce taxable income.

2. Roth Conversions

a. **Converting Traditional IRAs to Roth IRAs:** With the possibility of higher tax rates after 2025, converting traditional IRAs to Roth IRAs may be a smart move. While you'll pay taxes on the converted amount at current rates, future withdrawals from Roth IRAs are tax-free, providing a hedge against potential tax increases.

3. Accelerate Income and Defer Deductions

a. **Accelerate Income:** If you expect to be in a higher tax bracket after 2025, consider accelerating income into the current tax years. This could include exercising stock options, taking bonuses, or realizing capital gains.
b. **Defer Deductions:** If possible, defer deductions (such as charitable contributions) to future years when tax rates may be higher, making the deductions more valuable.

4. Leverage the Increased Gift and Estate Tax Exemption

a. **Utilize the Current Gift Tax Exemption:** The TCJA doubled the gift and estate tax exemption to $12.92 million per individual in 2023. This exemption is set to revert to pre-TCJA levels (approximately $5 million adjusted for inflation) in 2026. High-net-worth individuals should consider making substantial gifts before the exemption is reduced.
b. **Establish Trusts:** Creating irrevocable trusts can help reduce the size of your taxable estate, ensuring that more of your wealth is passed on to heirs rather than being lost to estate taxes.

5. Review and Update Estate Plans

a. **Revise Estate Planning Documents:** Given the potential changes in tax law, it's crucial to review and update estate planning documents, including wills, trusts, and powers of attorney. Ensure that these documents reflect your current wishes and take advantage of the current tax environment.
b. **Incorporate Tax-Efficient Wealth Transfer Strategies:** Consider strategies such as grantor retained annuity trusts (GRATs) or charitable remainder trusts (CRTs) to minimize estate taxes while transferring wealth to heirs.

6. Consider the Impact of State Taxes

a. **Evaluate State Tax Implications:** The $10,000 cap on the SALT deduction remains a significant issue for taxpayers in high-tax states. Consider the impact of state taxes on your overall tax strategy, and explore opportunities to mitigate this burden, such as relocating to a lower-tax state or investing in tax-efficient assets.

3. PREPARING FOR THE POST-TCJA TAX ENVIRONMENT

While it's impossible to predict exactly what will happen to tax laws after 2025, there are steps you can take now to prepare for a potentially less favorable tax environment:

1. **Scenario Planning**
    a. **Run Projections:** Work with us to run projections under different tax scenarios. This can help you understand the potential impact of higher tax rates and identify strategies to mitigate these effects.
    b. **Stress Test Your Financial Plan:** Ensure that your financial plan is robust enough to handle potential tax changes. This includes reviewing your investment strategy, retirement plans, and estate plans.

2. **Diversify Tax Exposure**
    a. **Build Taxable, Tax-Deferred, and Tax-Free Buckets:** Diversifying your assets across taxable, tax-deferred, and tax-free accounts can provide flexibility in managing your tax liability in retirement. This strategy allows you to withdraw funds in a way that minimizes taxes, regardless of future tax rates.
    b. **Consider Municipal Bonds:** Municipal bonds are generally exempt from federal income tax and, in some cases, state and local taxes as well. They can be an attractive investment for tax-conscious investors, especially if tax rates increase.

3. **Optimize Charitable Giving**
    a. **Donor-Advised Funds (DAFs):** A DAF allows you to make a charitable contribution, receive an immediate tax deduction, and then recommend grants from the fund over time. This can be particularly advantageous if tax rates rise, as you can time the grants to maximize their impact.
    b. **Qualified Charitable Distributions (QCDs):** If you're over age 70½, consider making charitable donations directly from your IRA through a QCD. This strategy allows you to satisfy your required minimum distribution (RMD) while excluding the distribution from taxable income.

Tax optimization is an ongoing process that requires careful planning and consideration of both current and future tax laws. With the potential expiration of the TCJA on the horizon, individuals and families must take proactive steps to protect and grow their wealth. By maximizing contributions to tax-advantaged accounts, considering Roth conversions, leveraging the current gift and estate tax exemption, and preparing for a potentially less favorable tax environment, you can position yourself to navigate the changing tax landscape with confidence.

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Cetera does not offer direct investments in gold/silver or other commodities. Commodities are volatile investments and may not be suitable for all investors.

A diversified portfolio does not assure a profit or protect against loss in a declining market.

Some IRAs have contribution limitations and tax consequences for early withdrawals. For complete details, consult your tax advisor or attorney.

Distributions from traditional IRAs and employer sponsored retirement plans are taxed as ordinary income and, if taken prior to reaching age 59 1/2, may be subject to an additional 10% IRS tax penalty.

A Roth IRA offers tax-free withdrawals on taxable contributions.

To qualify for the tax-free and penalty-free withdrawal of earnings, a Roth IRA must be in place for at least five tax years, and the distribution must take place after age 59 1/2 or due to death, disability, or a first-time home purchase (up to a $10,000 lifetime maximum). Depending on state law, Roth IRA distributions may be subject to state taxes.

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