MSM FINANCIAL STRATEGIES
Creating Customized Strategies
For Achieving Your Financial Goals

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Tax Planning for Life's Major Events

As you go through life, the one thing you can count on is that Uncle Sam will always be with you. The following provides an overview of what you can expect regarding taxes as you hit the many milestones of your life.

First Job

The first thing you will need to do is determine how much to withhold from your pay. If you withhold too much, you will get a refund when you file your taxes, but it may be better to have your money throughout the year. On the flip side, if you don't withhold enough, you may have a large tax bill and may also incur penalties for not withholding enough throughout the year.

Make sure you take advantage of any tax breaks your employer offers. If your employer offers health care coverage, that insurance may be a tax-free benefit to you. You may also have access to a flexible spending account (FSA), which allows you to save pretax dollars to pay for medical expenses. If your employer offers a tax-deferred retirement plan, take full advantage of it because you are investing with pretax money. If your employer matches contributions, that is free money to you.

Getting Married

Typically, there are more advantages for married couples who file jointly, but you will want to do a thorough assessment of your newly combined income. You should reevaluate how much to withhold from both of your paychecks.

If both you and your spouse participate in an employer-sponsored retirement plan, you should carefully review and decide which plan offers the best benefits. The ideal situation would be to participate to the maximum in both plans, but if your cash flow won't allow that for a period of time, then determine which plan is the best.

You can also make changes to FSA accounts to accommodate both of your medical expenses.

Having a Baby

A new baby comes with some tax benefits to help growing

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Planning Year Round

Many people confuse tax planning with tax preparation and only think about the subject when preparing their annual tax return. If your goal is to reduce income taxes, you need to be aware of tax planning opportunities throughout the year.

Take time early in the year to assess your tax situation, looking for ways to reduce your tax bill. Consider a host of items, such as the types of debt you owe, how you're saving for retirement and college, which investments you own, and what tax-deductible expenses you incur.

During the year, consider the tax consequences before making important financial decisions. This will prevent you from finding out later that there was a better way to handle the transaction for tax purposes.

Look at your tax situation again in the fall, which gives you plenty of time before year-end to implement any additional tax planning strategies. At that point, you'll also have a better idea of your expected income and expenses for the year. You may then want to use strategies you hadn't considered earlier in the year, such as selling investments at a loss to offset capital gains. ❍❍❍

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Tax Planning

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families. You will be able to claim your little one as an exemption in the year they are born until they are 19. If your child attends college, they may be claimed until they turn 24.

You may also be able to get a child tax credit for each child under the age of 17. The intent of the credit is to help families offset the cost of raising children. If you have a large family, you might be able to get money back from the IRS via the additional refundable child-tax credit. There is also a tax credit to cover some of the costs associated with adopting a child.

If you and your spouse work, parents can use the child- and dependent-care credit to pay for some of the costs of caring for their children while they are at work.

If you are planning to send your children to college, the tax code also offers several ways to save and pay for higher education costs, including 529 college savings plans and the Coverdell Education Savings Account.

Starting a Business

If you want to strike out on your own, make sure you review the tax code prior to starting your business. New businesses can deduct thousands of dollars in certain startup costs. As a sole proprietor, you will report your income as part of your annual individual tax filing by including Schedule C with

your 1040. The schedule also offers opportunities to deduct business expenses, including setting up a home office, business use of a vehicle, health insurance premiums, and contributions to self-employed retirement plans. Typically, sole proprietors also make estimated tax payments four times per year.

As a sole proprietor, you will be responsible for paying self-employment taxes, which are comparable to the payroll taxes collected from wage-earning employees. And, as both the employer and employee, you will have to pay Social Security and Medicare taxes.

Buying a Home

There are many tax breaks for owning a home. The interest you pay on your mortgage is deductible as an itemized expense up to $750,000 ($1,000,000 if the home was purchased before December 16, 2017), and interest paid on a home equity loan or line of credit up to $100,000 is deductible. There are also some home improvements that provide energy efficiency that will get you a tax credit to help offset the high cost of these improvements.

When you sell your home, up to $250,000 in sales gain ($500,000 for married joint filers) on your home is tax free. You are required, however, to have owned the property for two years and lived in it for two of the five years before the sale.

Divorce

There is nothing easy about a divorce and that includes the tax implications. Your filing status is determined on the last day of the tax year, so if your divorce is final on December 31, you are considered unmarried for the entire year.

Determining child custody is probably the most difficult part of divorce. From a tax perspective, the parent who has physical custody of the children for most of the year gets to claim them as dependents and also gets the child-tax credit and child-care tax credit savings. If there are multiple children and your custody time is relatively equal, you can also decide who gets to claim which child.

It may make the most sense for couples to sell their marital home prior to the divorce so they can split the tax-free profits. If one spouse is granted sole ownership of the family home, when they go to sell the property, the amount of profit exempt from capital gains is just $250,000 versus the $500,000 that married filing jointly homeowners can exclude.

When dividing other marital assets, both spouses should take into account the cash the recipient partners will net after taxes. Alimony is considered taxable income to the recipient and is a deduction for the spouse that is paying. Child support does not create any taxable event.

Retiring

Hopefully, you planned well for your golden years by taking advantage of the many tax breaks afforded by your retirement plan. While you will have to pay tax on the distributions from the account, remember all the years you were able to invest on a pretax basis.

If you have a Roth IRA, you deposit post-taxed money, but you can now take distributions that are tax free. The biggest drawback to a Roth IRA is that there are income limitations. However, regardless of your income, you can convert a traditional IRA to a Roth IRA.

Social Security benefits generally are tax free as long as you don't have a lot of other income. You will have to pay on portions of your benefit if you earn more than $25,000 as a single filer and $32,000 if married and filing jointly.

Please call if you'd like to discuss tax planning in more detail. ❍❍❍

Retirement Planning Assumptions

To enjoy your retirement without financial worries, make sure you have enough money saved when you retire. However, calculating how much you need can be a daunting task, since a variety of factors affect your answer and inaccurate estimates for any factor can leave you with way too little in savings. Some of the more significant factors include:

What percentage of your preretirement income will you need? You can find various rules of thumb indicating you need anywhere from 70% to over 100% of your preretirement income. On the surface, it seems like you should need less than 100% of your income. After all, you won't have any work-related expenses, such as clothing, lunch, or commuting costs. But look carefully at your current expenses and how you plan to spend your retirement before deciding how much you'll need. If you pay off your mortgage, stay in good health, live in a city with a low cost of living, and engage in inexpensive hobbies, then you might need less than 100% of your income. However, if you travel extensively, pay for health insurance, and maintain significant debt levels, even 100% of your income may not be enough.

When will you retire? Your retirement date determines how long you have to save and how long investment returns can compound. You want to make sure your retirement savings and other income sources, such as Social Security and pension benefits, will support you for what could be a very lengthy retirement. Even extending your retirement age by a couple of years can significantly effect the ultimate amount you need.

How long will you live? Today, the average life expectancy of a 65-year-old man is 81 and of a 65-year-old woman is 84 (Source: Social Security Administration). Most people look at average life expectancies when estimating this, but average life expectancy means you have a 50% chance of living beyond that age and a 50% chance of dying before that age. Since you can't be sure which will apply to you, it's typically better to assume you'll live at least a few years past that age. When deciding how many years to add, consider your health as well as how long other family members have lived.

What long-term rate of return do you expect to earn on investments? A few years ago, many retirement plans were calculated using fairly high rates of return. Those high returns don't look so assured now. At a minimum, make sure your expectations are based on average returns over a very long period. You might even want to be more conservative, assuming a rate of return lower than long-term averages suggest. Even a small difference in your estimated and actual rate of return can make a big difference in your ultimate savings.

Have you considered inflation? Even modest levels of inflation can significantly impact the purchasing power of your money over long time periods. For instance, after 30 years of just 2% inflation, your portfolio's purchasing power will decline by 45%. When estimating an inflation figure, don't just look at the historically low inflation rates of the recent past. Also consider long-term inflation rates, since your retirement could last for decades.

What tax rate do you expect to pay during retirement? Especially if you save significant amounts in tax-deferred investments that will be taxable when withdrawn, your tax rate can significantly affect the amount you'll have available for spending. You may find your tax rate is the same or higher after retirement.

Once you've estimated these factors, you can calculate how much you'll need for retirement. Please call if you'd like help with this calculation. ❍❍❍

Tax-Efficient Investment Strategies

During periods of uncertain returns, it becomes even more important to consider other ways to increase your portfolio's value. Using strategies that defer the payment of taxes for as long as possible can make a substantial difference in your portfolio's ultimate size. Consider the following tax-efficient strategies:

✔ **Minimize portfolio turnover.** Carefully evaluate your investment choices, selecting those you'll be comfortable owning for years. That way, you can let any realized capital gains grow for a long time.

✔ **Place investments that generate ordinary income or that you want to trade frequently in your tax-deferred accounts.** Since income and realized capital gains inside tax-deferred accounts aren't taxed until withdrawn, you defer paying taxes on that income. Keep in mind that withdrawals may be subject to a 10% federal penalty if made prior to age 59 1/2.

✔ **Analyze the tax consequences before rebalancing your portfolio.** Portfolio rebalancing is a taxable event that may result in a taxable gain or loss. You should generally avoid selling investments for reasons other than poor performance. You can bring your asset allocation back in line through other means. For instance, when choosing investments, only purchase those that are underweighted in your portfolio. Reinvest interest, dividends, and capital gains in investments that are underweighted. Any withdrawals can be made from overweighted investments. Or rebalance through your tax-deferred accounts, which typically won't result in current tax liabilities.

✔ **Utilize losses to offset capital gains.** Selling investments at a loss can offset capital gains for that year, reducing your total tax liability. Excess losses may be used to offset up to $3,000 of ordinary income and the unused portion may be carried forward indefinitely. If you still want to own that investment, you can purchase it 30 days before or after selling it. That way, you will not be subject to the wash sale rules, so your loss will be tax deductible.

Please call if you'd like to discuss how to structure your portfolio in a more tax-efficient manner. ❍❍❍

Calculating Basis

When you purchase an investment, your basis equals the price you paid plus any fees or commissions. While the calculation is fairly straightforward, other factors can affect your basis calculations:

✔ Reinvested dividends are added to your basis at full market value plus any fees.

✔ The basis of any investment received as a gift is the donor's original basis plus any gift tax paid by the donor.

✔ For inherited investments, the basis is the market value on the date you inherited the investment.

✔ Your basis in stock that has been split is the same as your basis before the stock split. Your per share basis, however, will now equal your total basis divided by the number of shares you own after the split.

✔ When you exercise a stock option, your basis equals the price you paid for the shares plus any fees or commissions, which may be lower than market value. Shares must be retained for at least one year after purchase and for two years after receipt of the option, or any gains will be taxed as ordinary income. ❍❍❍

Financial Thoughts

Data released by the National Assessment of Educational Progress, aka the "Nation's Report Card," revealed that just 67% of eighth-graders and 60% of fourth-graders scored at a basic or better reading level. Average reading scores in the U.S. have been declining since 2017. Societal trends, such as the rise in reading on devices and kids watching screens at home rather than reading for pleasure, contributed to the decline in reading ability. There's a relationship between test scores and wages, meaning that the low literacy levels will likely lead to trillions of dollars in lost earnings over time and damage the economy.

A recent Pew Research Center survey found that 75% of U.S. adults are working remotely at least some of the time, and 46% of those workers said they would be unlikely to stay at their jobs if they couldn't work from home.

In a survey conducted by Randstad, a global human-resources consultancy, a whopping 42% of respondents in the United States said they don't want a promotion because they're happy where they are.

Child-free couples living together earn an average of $138,000 per year, which is $9,000 more than couples with kids, per Federal Reserve data analyzed by Rocket Mortgage. ❍❍❍