Rochester
Wealth Strategies

439 S Main St, Suite 250
Rochester, MI 48307
(248) 434-6550

Thinking Ahead When It Comes to Taxes

by Xenia Woltmann

In recent years, nearly everyone has been able to take advantage of favorable tax rates. Perhaps you have also found value in the increased standard deduction, the sizeable estate tax exemption, or the larger child tax credit. These are just a few of the 23 tax cuts that are set to expire in 2025.

Today, if you are making $250,000 (married filing jointly), you would be in the 24% tax bracket. In 2017, this same income would have put you in the 33% tax bracket. More alarming is when you take a closer look at history; America has spent nearly half a century with a top marginal rate over 70%. Since taxes are so low relative to historical standards, coupled with the dramatic growth of our government deficit, an increase in taxes could be expected regardless of your income level.

Most people have contributed to their retirement accounts on a pre-tax basis with the assumption that their tax bracket may be lower in retirement. Although this may still be the case for some, many will be surprised to see their tax bracket jump back up when they start taking required minimum distributions from their IRA at the age of 72. The short time frame between age 59 ½ and 72 will now become the most crucial planning years to create tax efficiency for the duration of one's life and legacy.

A Roth conversion may be one solution. This allows an individual to transfer tax-deferred retirement assets, such as a Traditional IRA, SEP, or SIMPLE IRA into a Roth IRA. Some employer plans, such as a 401(k), 403(b), or 457 may also allow for in-plan conversions. Note that these conversions will be considered a taxable event as contributions made to the deferred accounts were deductible when the contribution was initially made. Another important note is to utilize savings or taxable accounts to cover the tax liability; it rarely makes sense to pay the taxes from the IRA itself. Lastly, be cognizant of how this may affect other tax aspects. For example, a conversion could have the potential to bump up your current tax bracket, incur an additional 3.8% surtax, and/or raise your Medicare premiums. Once in a Roth account, the money can grow tax free for both you and your heirs. Ultimately, the objective is to pay taxes now to avoid the likelihood of higher taxes down the road.

Another important consideration is the estate tax, or what some may call the "inheritance tax." Since the estate tax exemption was raised to $11,700,000, very few people have had to worry about taxes affecting their estate. When the current tax provisions expire, this amount will drop to around $6,000,000 (adjusted for inflation). Moreover, the current administration has proposed lowering this further to $3,500,000. Any portion of your estate over these amounts may be hit with a 40-45% tax. If your retirement plan has your assets projected to go beyond these figures, then it may be time to start considering more specialized estate planning techniques such as credit shelter trusts, ILITs, qualified charitable distributions, donor-advised funds, family gifting, etc.

There is no one-size-fits-all solution. While many options exist, the goal is simply to be proactive and take advantage of current circumstances before it is too late.

Xenia Woltmann is Vice President of Rochester Wealth Strategies LLC, an Independent Registered Investment Adviser located in Downtown Rochester. RWS is a Fiduciary and Fee-Only financial advisory firm. (248) 434-6550

Contact us: info@RochesterWealthStrategies.com   www.RochesterWealthStrategies.com