TAX TIPS EVERY INVESTOR SHOULD KNOW

Wealth Legacy Institute

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Introduction

"This is a question too difficult to answer for a mathematician. It should be asked of a philosopher."
- Albert Einstein when asked about completing his income taxes.

Let’s face it, nobody wants to pay more in taxes than they have to. It’s so easy to delay until the last moment and then scramble to pull documents together. That avoidance can cost you!

It’s important to monitor your tax situation throughout the year to make sure you are maximizing the opportunities available to you. The common reason we avoid taxes is complexity - even Albert Einstein had trouble completing his taxes!

Tax Tips Every Investor Should Know outlines what to look for when reviewing your tax return along with actionable tips to help lower your tax bill now and in the future.

Know Your Numbers

The first step in lowering your taxes is understanding your numbers! Unfortunately, tax returns can be hundreds of pages long and that's a lot of numbers. The good news is you can learn a lot by looking at 5 key numbers.

1. **Total Income:** This is all of the income you earned throughout the year. It includes wages, dividends and interest, capital gains, retirement distributions, social security benefits, and any other source of income.

2. **Adjusted Gross Income (AGI):** Your AGI is one of the most important numbers to understand. It is the starting point for calculating your taxes each year and often determines what tax credits and deductions you are eligible to receive.

3. **Deductions:** This is the amount you get to subtract from your AGI. You will have the option to take a standard deduction or itemized deduction.

4. **Taxable Income:** This number is used to calculate how much you owe in taxes each year. It is calculated by taking your AGI minus your itemized (or standard) deduction.

5. **Total Taxes, Payments, and Refunds:** You may already know these numbers because it determines if you owe money or get a refund. But don't just skim by this because it will help you with making adjustments for the next tax year.

Search for Tax Credits & Deductions

Tax Credits directly offset your tax liability and often have income limits. Deductions, on the other hand, only reduce your taxable income and most often only qualify when you itemize.

1. **Fees for Tax Preparation:** It doesn't matter if you paid someone to do your taxes or filed them on your own, any fees you pay can be a personal tax write-off. The caveat, the fees must be greater than 2% of your Adjusted Gross Income (AGI) to qualify.

2. **Medical and Dental Expenses:** Medical or dental costs incurred by you, your spouse, or dependents can qualify for a tax deduction if the expenses are beyond 10% of your AGI.

3. **Home Renovations for Medical Reasons:** Your home renovation costs normally will not qualify for a write-off, but if the home renovation was used to improve accessibility for disabled individuals (ex. adding a wheelchair ramp can be included in the deduction for medical expenses).

4. **Mortgage-Interest Deduction:** You can include interest you pay on your mortgage in your itemized deductions. But be careful because there are limits on the amount you can claim!

5. **State and Local Property Taxes:** Up to $10,000 of state and local taxes can be deducted on your tax return

6. **Primary Home Capital Gains Exemption:** In most situations, when you sell an asset for a gain, you have to pay taxes. However, if you sell your primary residence for a gain, you may be able to exclude that gain from your taxes. To qualify, you must have lived in the home for at least 2 out of the last 5 years and have not used the capital gains exemption in the last two years.

8. **Donations of cash, stock, or property:** If you donated an asset to a charitable organization, you may be able to deduct it from your taxes if you itemize. There are specific rules for the type of asset donated so you may want to consider speaking with an accountant or lawyer before gifting.

9. **Legal Fees:** If you had to hire an attorney to keep your job (or address job related issues), this qualifies as a tax deduction. Legal fees for alimony disputes and title disputes also qualify.

10. **Casualty, Disaster, and Theft Losses:** If your home was destroyed due to a natural disaster - flood, hurricane, tornado, etc. - you can claim a deduction for your loss. This rarely used deduction is very valuable, but be careful as there are some additional requirements to qualify.

Take Advantage of your Employer's Benefits

You can lower your tax bill now (or in the future) depending on what type of elections you make as it relates to your employer's benefits. The decision to make a pre/post-tax deduction often comes down to your personal situation and circumstances.

1. **Pre-Tax Deductions:** Allows you to pay less taxes now, but you may owe taxes on the money in the future. Some common pre-tax deductions are contributions to a traditional retirement plan, life insurance premiums, health insurance, health savings accounts (HSA), flexible spending accounts (FSA) and transportation programs.

2. **Post-Tax Deductions:** Will not lower your current taxable income, but you will not owe taxes on the withheld money in the future. Some common post-tax deductions include contributions to Roth retirement plans, disability insurance, life insurance, and union dues.

3. **Employer's Retirement Plan:** Maximize your company's 401(k) match, if there is one. You do not want to miss the opportunity to put your money in this tax-advantaged retirement account. Not only are your contributions tax-deductible, but many employers will match contributions. Otherwise, you are turning down free money.

4. Health Savings Accounts (HSAs)
HSAs offer tax benefits unlike any other investment account. When you make a contribution to an HSA you receive a tax deduction in the current year and can invest those assets and most HSA plans allow you to invest any contributions you didn't use for medical expenses. You are not taxed on the growth as long as the distributions are used for Qualified Medical Expenses (QME). This is known as a triple tax benefit - you get a deduction when funds go in, investments grow-tax free, and distributions are tax-free, if used for QME.

It’s also important to note that HSAs are one of the only deductions available to anyone enrolled in a High Deductible Health Insurance plan up to age 65, regardless of income. So it can be a powerful savings tool for high-income earners

5. Required Minimum Distributions (RMD) The IRS requires investors to begin withdrawing funds from their tax-deferred retirement accounts. While taking an RMD won’t lower your taxable income - the RMD rule is actually designed to increase your taxable income - missing a distribution can come at a steep cost. When you fail to take an RMD, the amount you were required to take is subject to 50%. You are also still required to take a distribution. This means that a missed RMD = 50% penalty on the distribution amount + income taxes on the distribution. Depending on the size of your retirement assets, this can be a big tax hit!

Your Portfolio can Lower Your Tax Bill

Efficient investing is one of the key ways to lower your tax bill. Investors often don't pay enough attention to how much their portfolio impacts their tax bill and what they can do to change that.

1. **Tax-Loss Harvesting:** This allows you to lower your tax bill by selling investments at a loss so you can offset capital gains.

2. **Asset Location:** Not all investments are taxed the same. You can often lower future tax bills by determining what investments need to be held in tax-deferred accounts and taxable accounts.

3. **Active Mutual Funds:** If you own actively managed mutual funds, be aware that portfolio turnover and trading volume can create more capital gains taxes than index funds.

4. **Dividend Reinvestment:** Electing to have your dividends reinvested vs. paid out in cash can also lower your tax bill because it reduces the number of trades you have to make to keep the portfolio in balance.

5. **Converting your IRA to a Roth IRA:** A Roth Conversion is where you move funds from your Traditional IRA to a Roth IRA. Doing this will increase your current tax bill but may lower your taxes in the future. This is often done when you believe your current tax rate is less than your future tax rate.

Optimize Your Charitable Donations to Supercharge Tax Savings

Setting up automatic donations or simply writing a check may feel natural if you are someone who makes charitable giving a regular practice. At Wealth Legacy Institute, we are big believers in supporting the community and paying it forward. How can you make your gift as tax-efficient as possible while ultimately making an impact on causes you care about? Below are some great tips to consider!

1. **Gift Appreciated Stock:** Before making a cash donation to a charity, consider gifting appreciated stock instead. Gifting appreciated stock allows you to avoid paying taxes on the gains. You can then buy the stock back with the cash you were going to give, which resets your cost basis. You generally want to give shares of appreciated stock that have *long-term capital gains* - meaning you owned the stock for 365 days or more - to make the most benefit.

2. **Open a Donor Advised Fund (DAF):** DAFs are a tax-smart investment solution for giving. There are two main benefits 1) Donations to a DAF are tax deductible in the year you make the contribution to the fund, even if you don’t give the funds directly to a charitable organization 2) Funds that you don’t distribute can be invested and the growth is tax-free. DAFs can be a powerful tool for business owners who are selling their businesses and are looking for ways to lower their tax burden. The one caveat is that donations to a DAF are irrevocable, meaning they can only be donated to qualified charitable organizations.

3. Make Qualified Charitable Distributions (QCD): QCDs are one of the most efficient ways for retirees to give to charities. The biggest benefit with a QCDs is that retirees do not have to include that income anywhere on their tax return. It's also important to note that QCDs count towards your Required Minimum Distribution for the year. This can lead to big savings because it can lower the portion of Social Security benefits that are taxable as well as prevent from paying increased medicare premiums (also known as IERMA).

4. "Double Up" Donations: This strategy is primarily designed for someone who has personal deductions - mortgage interest, property taxes, etc - but still takes the standard deduction. The goal of doubling up is to increase personal deductions so they are greater than the standard deduction amount. Towards the end of the year, if your personal deductions aren't above the standard deduction then you may consider doubling up your donations (this year's and NEXT year's donation) - so your personal deductions are greater than the standard deduction. This strategy works well with making the contribution to a donor-advised fund because you may not want to give all that money to charity at once, but would still like to receive a tax deduction for the donation.

5. Understand the Rules: The IRS has some specific rules regarding the ability to deduct charitable donations, so we recommend speaking with an accountant or attorney before making any gifting decisions. But at a high level, here are a few things to be aware of: the type of asset you are donating, whether you will itemize on your tax return, as well as your current and future tax rates.

Leverage your Business or Side Hustle

Entrepreneurs have to wear many hats while running a successful business. And let's face it, tax planning normally falls to the bottom of the to-do list. While a good accountant is critical for a small business owner, it's important to be proactive and possibly lower your tax bill by leveraging these tips.

1. **Set up a Retirement Plan:** You get a tax benefit when making a contribution to a retirement plan. Retirement plans can also lower your payroll tax expenses because it lowers employee wages subject to the Federal Unemployment Tax Act (FUTA). Common retirement plans for small businesses are SEP-IRA, 401(k), and Simple IRA. Solopreneurs have the ability to open a Solo 401(k), which can have tremendous tax advantages.

2. **Keep Track of your Losses:** New businesses usually don’t make a profit in the first few years. While losses are never fun, there is a silver lining. If your business ends the year with a loss, that loss can be used in future years to offset gains. This is known as a carryover loss. Keeping track of your losses is important because it could potentially eliminate your tax bill in years you make a profit.

3. **Research Small Business Tax Credits:** Tax credits are almost free money because it directly reduces the amount of taxes you owe. The best place to find tax credits for your business is by looking at the IRS.gov website. You may be surprised at what is available to you!

4. Take Advantage of the Home Office Deduction: If you work from home, then you may be able to get a deduction for your office space. This is an easy deduction to overlook when completing your taxes, especially for new entrepreneurs. The deduction amount varies based on the formula you use and the size of your office. To qualify for the home office deduction, you cannot use the space for any other purpose. Because there are some specifics on the home office deduction, we suggest that you read the IRS rules before claiming the deduction.

5. Hire a Professional: As we said at the beginning, a good accountant is critical for a small business owner. You may not be at a place in your business where you can afford someone to help, and that's okay. But if you are an established business, a good accountant is a no-brainer. This can save you time (your most critical resource) and money because they are experts at lowering your tax bill.

Special note on accountants:
We often see clients who have a bad experience with an accountant and either 1) continue to work with them and just accept it or 2) stop working with an accountant altogether. This is a big mistake. Just like finding a financial advisor, you may need to interview multiple accountants. It can be a lot of work, so here are a few tips for finding the right fit:

- *Do your research* - in almost all cases it is best to work with firms that have a CPA vs. just a tax preparer. Also look for firms that specialize in your specific business.
- *Prepare a list of questions* - have 3 to 5 standard questions you can ask each firm.
- *Ask around* - use your network to see who they work with, you may find that one particular company keeps coming up and that's a good place to start.

You Don't Have to Figure this Out on Your Own

The points outlined are intended to help you know "what" to look for when reviewing your taxes. It was created so you can understand your tax situation and stay in control.

The IRS tax code is +2,000 pages, with almost endless complexity. Depending on your situation, it may make sense to engage with a professional for tax planning. Tax professionals can help you gain an even deeper understanding of your personal tax situation and can uncover even more tax-saving opportunities. A tax professional in conjunction with a financial advisor can provide a more comprehensive, holistic perspective to your overall financial objectives.

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Meet Kim Curtis

I'm Kim Curtis, CFP®, ChFC, CLU, CAP, AEP, MSFS, founder and CEO of Wealth Legacy Institute. I am a bestselling author of *Money Secrets: Keys to Smart Investing* and *Retirement Secrets: Keys to Retiring Happy, Healthy and Free* published by Financial Literacy Press. I have been fortunate to have the opportunity to be profiled on NBC, CBS, ABC, FOX, CW as well as Forbes and the Wall Street Journal.

The origins of Wealth Legacy Institute began as a response to shady practices of many financial brokerage firms, such as hiding fees and commissions within long and intentionally complicated fine print. It became clear to me that employees in big brokerage firms were simply salespeople working towards the interests of the brokerage firm, not necessarily the client.

At WLI, we are an independent, Registered Investment Advisory (RIA) firm filled with humanity that puts clients first, not last. We focus on a highly personal client-centric planning model which has been recognized in the Journal of Practical Estate Planning, winning the Editor's Choice award. This model is the cornerstone of our firm's holistic and highly successful approach to integrated wealth management, The Planning for LIFE Experience™.