7 Easy Ways to Reduce Your Tax Bill

DuPageTaxGroup.com

630-839-9326

Navi@DuPageTaxGroup.com

7 Easy Ways to Reduce Your Tax Bill - 2018 Edition

Introduction - Small Life Changes Make a Big Difference

The first tip to reduce your income tax bill is this: Realize that the IRS changes the tax code often and has rules that “phase in” or “phase out”. Often, the IRS has specials, almost like the special of the day at your favorite diner, which are temporary and have an expiration date. They also, as needed, amend the tax code and change it mid-year, depending on the economic circumstances that are driving the need.

For instance, in 2008, the mileage allowance for reimbursement was 50.5 cents per mile from January 1, 2008 to June 30, 2008, but as gas prices skyrocketed, they changed it to 58.5 cents per mile from July 1, 2008 through December 31, 2008. Why is it important to understand this? People tend to think of their past experiences as a permanent condition. They also view things that have happened to their siblings or parents, in regard to income taxes, as permanent. However, the tax code is a moving, changing document. Many people think, “Well, I've never had enough expenses to itemize, so I'll just take the standard deduction again this year.” Because of that mind set, they may forget some of the components that go into the calculation and not realize that they could get extra tax savings because of a single event, or a number of small events.

Tax Tip #1

Remember, the tax code constantly changes, so you can't compare one year to the next. Always look at the coming tax year as a new episode, or a new chapter in a book, and greet it with an open mind. Those changes may represent an opportunity to reduce your tax bill. It is imperative to work with a financial advisor who takes a proactive approach to tax planning, rather than allowing the tax piece of the financial plan to be prepared elsewhere. Indeed, your tax preparation should be a part of your overall financial plan. A good financial advisor, aware of all the year-to-year changes to the tax code, can be your best resource, especially if that advisor offers professional tax preparation.

Tax Tip #2

CD interest penalties are **deductible**. That's right. If you have been working with a financial advisor and have decided on employment of a tax-advantaged investment strategy, such as tax-free municipal bonds or tax deferrals in annuities or life insurance products, you may be contemplating moving money from a certificate of deposit or other savings accounts. Often, people delay changing the way their dollars are invested or stored because there would be a penalty for early withdrawal. They don't realize that part of that penalty would actually lower their income tax bill on the adjusted gross income, line 30, penalty for early withdrawal.

Tax Tip #3

It is not uncommon for some taxpayers to not be in a tax bracket at all, because they have money in tax-free or tax-deferred vehicles, collect Social Security, and have low fixed expenses. Yet, those people often still have some IRA monies. People who under the age of 70 and not required to take their RMDs are allowed to leave money in IRAs and simply enjoy being at the zero bracket.

Those people, however, often could have taken hundreds, even thousands of dollars out of their IRAs or deferred accounts and continued to pay zero tax. If you're working with a proactive financial advisor, they may suggest a “what if” tax return in the month of December to estimate how much actual income you are going to be reporting. If there are a few hundred dollars or more left that you could earn and still pay zero tax, it makes sense to take those dollars from IRA and either roll them into a Roth IRA, or simply re-categorize those assets, expose them to the possibility of taxation, avoid paying the tax (0% tax bracket), and restore them in any non-IRA.

Tax Tip #4

Many people with capital gains from sales of stock or from mutual fund distributions know that they can offset those gains with a loss, but few actually sit down and do the annual exercise. It is a good idea to meet with a financial advisor or broker to look at your losses. By selling those losing assets you can offset your other investment gains and end up with an equivalent of no capital gains. Many people would rather not sell their underperforming assets because they believe they’re about to "come back" and wouldn’t dare wait the 31-day waiting period to repurchase the same asset as an allowable purchase.

However, many people don’t realize that an ETF (Exchanged Traded Fund) is in a different asset class than a mutual fund, and many ETFs are comprised of many of the same assets as their mutual fund counterparts. For instance, someone invested in the Vanguard S&P 500 mutual fund could sell that fund at a loss and buy the Vanguard S&P 500 ETF the next day without violating the 31-day rule. There are other nuances to changing asset classes that must be considered, but the point is clear. In December, compare your investment winners and losers and plan accordingly.

Tax Tip #5

Another special tax deduction that has been extended for the lower brackets is the **Capital Gains Tax**. Many people believe that the Capital Gains Tax Rate is 15% because that's what they paid the last time they sold an investment at a gain. For instance, if Mary sold stock in 1998, she may have paid 15% capital gains on the federal level and then an additional tax on the state level making it unattractive to sell other stocks with large gains. However, the Capital Gains Tax Rate is not 15% for everyone. It is on a sliding scale based on what your actual personal tax rate is.

In 2018, if you are in the 10% or 12% tax bracket, then you might be able to sell a stock or other appreciated asset that you have held for more than one year and pay 0% capital gain. That's right. For many tax brackets the minimum Capital Gains Tax Rate for 2018 is still zero! For many people who primarily have Social Security income, which is not taxable up to a certain income limit, and perhaps a small pension or IRA income stream, it is not uncommon for them to be in the 10% or 12% tax bracket. Those people could sell highly appreciated assets this year and pay no capital gains tax whatsoever. Also, don't forget that if you sell a stock at a gain there is **NO 30-DAY RULE**! You could repurchase the same stock the next day. The 30-day rule is if you take tax losses, **NOT** profits! Selling at a profit but still paying no tax means a free step up in cost basis. After 2018, it's not likely there will be a 0% capital gains rate again. **Carpe Diem!!**

Tax Tip #6

When you find an error in your tax work for a particular tax year, you may have more than just that year to worry about. If an error was made, it is often carried forward from previous years, so look at the previous year's return as well. Even if there's an error in your favor, amend those returns. Form 1040X can be used to go back up to three years. Many people are afraid to ask for errors to be corrected.

Many taxpayers believe, irrationally, that the IRS will look for other things "to get even" for filing for an additional refund. This is simply not the case. If you underreported deductions, or over reported income and subsequently paid too much tax, the IRS is happy to refund from prior years.

Tax Tip #7

There is one thing that almost everyone you speak to agrees on. The fact is that in the future, as in the past, tax brackets, tax rules and laws will change. If your financial planner, insurance agent or other trusted advice giver is not giving you advice from a **tax perspective**, then you may want to reconsider your choices. Also, IRS **"letter audits"** are on the rise and the U.S. is still in financial trouble, so there will always be pressure on the government to find ways to collect more taxes. If your current advisor says, "Don't let the tax tail wag the dog" as a response to your tax planning questions, **fire them**! They are side stepping a major factor in your future financial security!

7 Easy Ways to Reduce

Your Tax Bill

DuPageTaxGroup.com

630-839-9326

Navi@DuPageTaxGroup.com