THE NEWS TRIBUNE

Part of the McClatchy Media Network

BUSINESS COLUMNS & BLOGS

Here are some ways to be more strategic about income when federal tax time rolls around

BY GARY BROOKS *CONTRIBUTING WRITER*

MARCH 06, 2023 5:00 AM

This time of year, when you willingly endure a headache gathering documents for your tax return, also keep an eye out for opportunities to be more tax efficient.

The tax return can identify tactics that might allow you to tighten the gap between the gross-of-tax dollars that you earn and the net-of-tax dollars that you keep.

As with most topics in financial planning, this is not a one-size-fits-all exercise. However, there are several ways, including some beyond those mentioned here, to increase your after-tax income and investment returns.

BUNCH YOUR CHARITABLE GIVING

Many people make charitable gifts annually but earn no tax benefit from them because the total amount of itemized deductions on their tax return is less than the standard deduction. You likely don't make donations solely for tax benefits, but if there are ways to address your philanthropic motivations and save some tax dollars, that shouldn't be ignored.

Assume you planned to donate $4,000 per year for the next five years but doing so would leave you below the standard deduction annually. Instead, pick one year to donate $20,000 instead. That would allow you to itemize your deductions for the tax year of the donation and improve your after-tax income.

Keep in mind that donating property or investment securities can lead to more tax savings than cash donations.

KNOW YOUR BRACKETS

Especially for retirees who have not reached the age at which they need to start making required withdrawals from pre-tax accounts (IRAs, 401ks and their relatives), it might be helpful to fully utilize lower tax brackets. You might have a window of time to purposefully withdraw money from IRAs/401ks before you are required to but while the tax cost will be less than if you wait until the required age (currently 72 but rising to 75).

For instance, you might have room in the 22 percent or 24 percent tax bracket, but once you start required IRA withdrawals, your income is projected to reach the 32 percent tax bracket. You could take some money out now while it is taxed at a lower rate. If you don't need the money to fund your current budget, you could simply reinvest it in a non-retirement account. Or, a wise way to increase your long-term financial security could be to use IRA withdrawals to allow you to postpone starting Social Security benefits. That way, you earn valuable inflation-adjusted guaranteed increases in income for waiting past age 62 (possibly all the way to age 70) to start Social Security.

Understanding the gap you have in your tax brackets could also inform whether a Roth IRA conversion would be useful as a long-term tax-efficient strategy.

WATCH OUT FOR IRMAA

When strategizing how much income to realize, remember that Medicare insurance premiums for people over 65 are tied to income. Medicare's income-related monthly adjustment amount (IRMAA) increases premiums over four income tiers. This happens with a two-year look-back. Your 2023 Medicare premiums are based on your 2021 income. If you were to purposefully add to your income with IRA withdrawals or a Roth IRA conversion, test first whether the benefits of that activity outweigh possible increases in the cost of your Medicare premiums. Alternatively, it might offer an opportunity to combine the donation bunching with realizing more income in low brackets to allow for both without increasing Medicare premiums. There are options to get creative with the several thousand pages of tax code.

KEEP INVESTMENT INCOME IN TAX-DEFERRED ACCOUNTS

If you notice in your tax return that you are being pushed into higher tax brackets by the amount of investment income you earn, you might be able to make better use of different investment types or better locations for your investments. In taxable brokerage accounts, it's often better to use index funds or exchange-traded funds that don't make capital gains distributions or large dividend payments. It's also wise not to hold REITS (commercial real estate funds) or other high-income funds in a brokerage account. To the extent that you can, hold income-producing investments in IRAs or 401ks for better overall tax treatment.

MAKE YOUR LOSSES USEFUL

The past year offered a surge of opportunities to sell investments in non-retirement accounts that had declined in value. Those realized capital losses could be used to offset capital gains and some ordinary income. For the 2022 tax return, it would be common for there to be tax-loss carry-forward, meaning there were more losses than available gains to offset them. This creates an opportunity to think about how to use those realized losses to offset capital gains and ordinary income going forward.

As usual, confirming tax tactics with your accountant is a good idea, preferably proactively for the current year, not just with last year's return in mind.

Gary Brooks is a certified financial planner and the president of BHJ Wealth Advisors, a registered investment adviser in Gig Harbor.