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Top Things Taxpayers Get Wrong

Assuming taxes will be less during retirement years.

Case Study- Robert and Jennifer earn $270,000 in 2014. Given deductions for their house and kids, their effective tax rate was 17.4%. When they retire, their effective tax rate will be over 22%. And Yes, their marginal tax rate will be higher too. Robert and Jennifer have $900,000 of pre-tax retirement savings. When they retire, they will actually pay more in taxes than they saved. A lot of retirees are finding this out the hard way since tax deductions are down and income is similar to wage earning years.

Not knowing the tax burden during retirement or how to pay for it.

Paying taxes during retirement is tough. They usually are paid from savings. New car? Used car? Big vacation? Modeling your income tax obligation today, and when you retire will help manage your expectations.

Thinking that reducing taxes thru 401ks and IRAs is a tax savings.

Using these tools is a tax deferral not a tax reduction (or savings). A 401k or IRA contribution is basically an IUO to the IRS When you pull that money out through required minimum distributions (RMDs), you will pay taxes. But the question you must ask is, at what rate? Reducing taxes by deferring them until later is not the same as saving taxes.

Not considering after-tax investments as viable options to saving taxes during retirement.

A Roth IRA is one of the best choices for after-tax investments. Grows tax free. But few people know about a Roth 401k- most employers have been offering this since 2005, and they have huge contribution limits ($18,000 + $6,000) or NO income phaseouts or limitations! Paying taxes during your working years might be a good idea.

Not converting traditional IRAs into Roth IRAs or doing too much too soon.

Roth IRAs have income phaseouts and low contribution limits. The solution is to convert traditional IRAs into Roth IRAs, pay taxes today, and avoid taxes during retirement. The problem is either a) not doing this, or b) not doing it correctly. Case Study- Mike and Nancy did not use a financial advisor, and converted over $300,000 in IRAs in one year and created an unnecessary tax burden. Had they structured it over a few years under our advice, they would have saved $20,000 in taxes.

Not using asset protection to prevent huge tax bills during a crisis.

Case Study- Brenda and Ross had a problem. She had to liquidate an IRA to pay for her husband's long-term care. Because of improper asset protection, she unnecessarily had to pay over $65,000 in taxes. And while she can point to the entry in her checkbook and pinpoint the cost in dollars, it is hard to approximate the emotional cost. Had they come to the Watson CPA Group a few years ago, we could have implemented a plan to avoid these burdens.

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Not doing end of year tax planning.

It might be too late for some year-end tax planning for 2017, but these things should be considered for 2018 today! Buying a car? Pre-paying property taxes or rent? Harvesting your profits? Check out of our end of year tax planning webpage-

www.watsoncpagroup.com/eoy

Using a self-directed IRA to buy a rental without fully knowing the issues.

If you have $100,000 in your IRA and you earn 6%, how much to you make? $6,000. But if you take this same $100,000 and buy a $300,000 rental property that has an overall rate of return of 6%, you earn $18,000. You have additional income solely based on leveraged financing that a normal IRA buying stocks and bonds cannot achieve. Therefore the $12,000 ($18,000 minus $6,000) is considered unrelated debt financed income (UDFI) under IRC Section 514. Yes, your self-directed IRA needs to file a Form 990-T. Yes, it is taxable. Yes, it can be a mess. Read more at

www.watsoncpagroup.com/SDIRA

Using only 529 plans for college savings.

529 plans offer excellent tan benefits, no doubt. But at what cost? The money is captive. So what happens if Junior doesn’t go to school? Another option is to the layer education savings with 529 plans, plus Roth IRAs, plus life insurance, plus good ol’ fashioned savings. From there having a bright line in the sand as to what Mom and Dad will pay for, and what Junior is responsible for, must be established. Parental guilt is a powerful emotion and too many taxpayers get caught up in it. Read more at

www.watsoncpagroup.com/529

Thinking a financial plan is not necessary for retirement success.

Financial planning is much more than plugging a few numbers into a financial calculator or website and getting “your number.” A retirement checklist is nice, but it is only a tool in the financial planning toolbox. Anyone can throw some money at the latest mutual fund, but retirement and financial planning is a comprehensive, on-going process that encompasses so much more than investments. For more information read-

www.watsoncpagroup.com/FP

People don’t plan to fail, but most fail to plan