Sampleton Family 20XX Personalized Tax Advice

Introduction:

Tax season is over. It's a great chance to reflect on what's happened and fix what's not working. Based on our work so far, I'm excited to share what I see as 20XX's wins, losses, future opportunities, and next steps.

This is not intended to be a prescriptive list of to-do's. It's intended to be a guide to quick-wins and further conversation. I have highlighted some recommendations in green. They will be the most straightforward to implement.

Goals:

Minimize lifetime tax burden.
*Note: If you have other goals in mind, I will accommodate them.

20XX Summary

	Last Year	**This Year**	**Difference**
Total Income	$565,539	$739,378	**$173,839**
Adjusted Gross Income	$557,095	$698,578	**$141,483**
Deductions	$42,372	$72,805	**$30,433**
Total Fed Tax	$122,912	$166,889	**$43,977**
Total State Tax	$25,660	$32,271	**$6,611**
Total Tax	$148,572	$199,160	**$50,588**
Total Tax Rate*	26.27%	26.94%	**0.67%**

*Total Tax Rate is taxes paid/total income. I think it's a clearer measure of tax-savvy. It's better than the effective rate used in tax software. This metric includes income you made tax-free.

Misses:

1. No tax planning last year. This would have alerted us to withholding issues well in advance. In hindsight, the tail end of 20XX was a difficult time but we can do better this coming October/November.
2. Retirement contributions. At a 39.65% marginal tax rate, you will likely keep more by contributing only to traditional 401(k).

Wins:

1. Your rental is generating 100% tax-free income.
2. Your total income jumped Y/Y by 31%! That's extraordinary.

Opportunities:

1. **Explore other benefits available through work.** You had to include $2,000 worth of your dependent care benefit in your taxable income. The maximum benefit is $5,000 total. There may be other tax-free benefits, like a flexible savings account (FSA). $2,000 would be better directed to them.
2. **Adjust your tax withholding.** You should see 30% of your paychecks going to taxes. If it's less than that, you could see penalties from the IRS. Increasing your total tax rate higher than necessary.
3. **Consider the possibility of one of you becoming an independent contractor. First, think about how you will make the change pay off.** This will **not** save you money, in fact, it will cost more (+$15k) UNLESS you plan to maximize deductions. A powerful structure is to have 1 spouse as W2, paying for the necessities of daily life. The other spouse is an independent contractor. They focus on expenses you would pay anyway but are deductible and on long term savings. Examples include:
    a. Set up a solo 401(k) for both you and your spouse. This allows you to contribute $66,000 for the independent spouse. You can also contribute 25% of the non-independent contractor spouse's pay. All contributions are a deduction to the business.
    b. Instead of a 401(k) you may consider a deferred compensation plan. This would allow you to save over six-figures for retirement. All contributions are deductible.
    c. Establish a section 125 cafeteria plan to offer benefits. These include life, health, and disability. All expenses are a deduction for the business.
        i. The most basic way to view what is deductible, is to review the form Schedule C part 2.

    ii. For knowledge workers, the biggest source of deductible expenses are typically retirement plans.

4. **Reorganize your balance sheet, if possible**. You could not deduct $782,000 of your interest bearing debt. You have a total limit of $1,000,000. This will probably resolve itself naturally. Once the Colorado house is done, we can assign the loan to it. Then, interest can be deducted against rental income. This will improve your after-tax cash flow next year.
5. **Passive Losses banked for the future.** You have $31,967 in "passive activity losses". They are being carried forward to offset income from passive sources, like real estate rentals. Ensuring your rental income will continue to be tax-free.
6. **Child Tax Credit** is $2,000 (Equal to deducting ~$6,000 of income). If total adjusted gross income ever falls below $400,000, you will qualify for this credit.
7. Look for **investments with favorable tax attributes** for your brokerage account and extra savings. Here are 3 powerful types you may consider:
    a. **Real Estate Private Placements**. These private real estate-based securities allow expenses to be passed through. Making income more tax-efficient than regular REIT securities. Also, if AGI ever falls below $364,000 (for 2024), you can also deduct 20% of your net profit on these investments. Making income received even tax efficient than ordinary income.
    b. **Municipal Bonds & Qualified Dividends**. If you have extra cash, switch from high yield savings to municipal bonds or dividend funds. Municipal bonds are tax-free. Qualified dividends are taxed 19.65% less than ordinary income (20% instead of 39.65%). If you choose a fund structure, make sure it has a low turnover ratio.
    c. **Oil & Gas Partnerships.** These investments offer 3 specific tax benefits: depreciation, depletion, and intangible drilling costs. Most tax benefits come in the first 2 years. Unlike most investments, losses can reduce taxes on your W2 income!
8. **Contributions to 401(k) and Roth 401(k).** The math about which is best depends on what your tax rate will be when you withdraw this money. You are in a 39.65% tax bracket. I recommend deferring those tax payments down the road. Do this by switching all 401(k) contributions to a regular 401(k).
9. **Mega-Backdoor Roth 401(k).** These may or may not be available, depending on your employers' retirement plan rules. To make use of this, first max out your regular 401(k) contributions, then move onto the mega-backdoor Roth 401(k). These won't reduce your tax this year. But, they will grow tax free for decades. This will greatly cut your lifetime tax bill.

10. Consider **strategic "Roth conversions"** in years when your earnings drop for any reason. For example, a layoff or one spouse stops working for any reason. This is a prime moment to use a Roth conversion.
11. **401(k) Loans.** Get a loan from yourself via your 401(k). Instead of paying interest to the bank you pay interest to yourself. This can be a good option if the need for money is infrequent. 401(k) loans will have minimums and may have costs to withdraw money but could be a good strategic option to be aware of.
12. Continue to **keep good records** of expenses related to your rental. For guidance on what to record, look at Schedule E. A good way to go is to log expenses and income in a spreadsheet.
13. **When you consider selling your property in Colorado, have a tax analysis performed**. When a rental is sold, all past depreciation is "recaptured." It is added to your taxable income in a single year. Property appreciation is considered capital gain. If unexpected, this blow can be devastating. There are options. One of them is a 1031 exchange. Please consult me to get crystal clear about the rules.

Next steps: when you're ready to explore these ideas in greater detail, please grab some time on my calendar using this link. Now that I've done your taxes I can provide custom modeling & advice during the year as needed.

Respectfully,

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