# Tax Break: 10 Simple Tax Tricks that Could Save You Thousands

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**FROM THE DESK OF NICK CROW, CFA**
**PRESIDENT, MOTLEY FOOL WEALTH MANAGEMENT**

## Dear Fellow Fool,

While everybody rightly spends a good deal of time wondering "What if I were able to make more money?" or "What if I were able to spend *less* money?" there's also a third way to increase your savings (both pre- and post-retirement) that far too few people give enough time or thought to.

Tax planning.

Don't yawn. While I know it probably sounds boring at first blush, there are actually a good deal of helpful tricks that you can easily implement to decrease Uncle Sam's cut of your hard-earned income by tens of thousands of dollars (or more!).

And although most people seem to understand these income-saving devices are available, finding someone who actually employs all of them is pretty rare. I know, I know. Too complicated, too obscure, and too time-consuming to do on your own.

That's exactly why as we edge closer and closer to mid-April, I enlisted The Motley Fool LLC's resident tax expert, Robert Brokamp, CFP®, to isolate 10 quick and easy tax tricks that you may be able to take advantage of — both in the immediate term and over the course of the rest of your life.

It's called "**Tax Break: 10 Simple Tax Tricks That Could Save You Thousands**," and it's yours free simply as thanks for showing interest in Motley Fool Wealth Management.

And because everybody needs a *little* help when it comes to their finances and investments, after you peruse Robert's report, please feel free to check out the rest of our Motley Fool Wealth Management home page to see if you might be interested in taking advantage of the innovative money management solution my team and I have made available specifically for Fools who simply don't have the time, the energy, or the desire to constantly manage their own investment portfolios.

What's great about Motley Fool Wealth Management is that our team here can actually custom-build you a fully personalized portfolio directly tailored to your particular investment interests, financial goals, risk tolerance, and, of course, retirement status — whether you're three decades from retirement, are fast-approaching it, or have already punched that final, fateful time card years ago…

And we do all of that while still maintaining the same Foolish philosophy and approach to investing that you've come to know and love if you've been with The Motley Fool for a good deal of time.

We'll take care of all of the trades involved, including the buying, the selling, and any necessary rebalancing — as well as the hours of research that go into making a responsible decision on each front.

My team and I are so proud of what we've created here in Fool Wealth, and we'd be thrilled for you to be a part of it. So I hope to hear from you soon!

In the meantime, please enjoy Robert's article below, and Fool on.

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**Nick Crow, CFA — President, Motley Fool Wealth Management**

# Tax Break: 10 Simple Tax Tricks that Could Save You Thousands

BY ROBERT BROKAMP, CFP®

Have you ever dropped a note to a friend you haven't heard from in a while, just to make sure the friend is OK?

Probably.

And in such notes, have you ever suggested that the reason you haven't heard from the friend is that his or her head is being paraded around Paris on a pole?

Probably not… unless you're Benjamin Franklin.

In 1789, he sent a letter to Jean-Baptiste Leroy, a scientist whom Franklin befriended when living in Paris. Having not heard from Leroy in more than a year, Franklin sent him a letter expressing his hopes that Leroy had not lost his life in the nascent French Revolution. After offering his wishes that "it may all end well and happy, both for the King and the nation," Franklin passed along the news from America:

"Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes."

Thus was born perhaps the most famous quote about taxes. Other writers had previously expressed similar sentiments, but it's Franklin's that has endured. (Leroy, by the way, was alive and survived the Revolution. The king was not so lucky.)

While death and taxes often get lumped together, there are important differences.

The former is a bill you only have to pay once… but you don't know when. Filing a tax return, however, is an annual event.

Fortunately, this gives you the opportunity to make smart decisions that can lead to lower taxes — this year and for many years to come.

As such, here are 10 tips to help you put your tax bill to the guillotine.

## 1. Stop getting a refund.

If you are getting a refund you are paying Uncle Sam too much during the year. This is like a tax free loan to Uncle Sam. I know seeing that extra money show up in your bank account is more exciting than trying to make a pig's tail straight, but you are not optimizing your finances. If you need forced savings, just contribute more to a retirement plan. You will get compounded tax deferred growth at the very least.

## 2. Life changes are tax changes.

The following are just some of the life events that can result in a higher or lower tax bill:

- Getting married or divorced
- Having or adopting a baby
- A dependent leaving the home
- Changing or losing a job
- Retiring
- A dependent, your spouse, or you going to college
- Buying a house
- Getting a significant raise or bonus — or pay cut
- Moving
- A disability or death in the family

If any of these events should happen to you, consider a thorough examination of tax withholdings and/or quarterly payments, as well as your overall tax strategy.

# 3. Peer into the future.

Once you know what you're going to pay for 2015, you can begin to estimate what you'll pay for 2016 and beyond — and do something about it now. This includes factoring in any of the aforementioned life changes that you expect to occur in the next few years.

By estimating your taxes for this year (i.e., for the return you'll file by April 17, 2017) as well as contemplating your circumstances farther down the road, you'll be able to:

Know whether you should take a tax break or tax hit this year, or put it off to a future year.

Determine your eligibility for certain deductions, such as those that are deductible only to the extent that they exceed a certain percentage of your adjusted gross income, or AGI (more on this later).

Accurately assess the consequences of various financial decisions, such as selling an investment with a large taxable gain, paying off your mortgage, investing in tax-free municipal bonds versus taxable corporate bonds, or contributing to or converting to a Roth retirement account.

Estimate how retirement could affect your taxes, which is an important variable in determining your expenses after you stop working... which, in turn, is an important variable in determining whether you can stop working.

Explore ways to shield more of your Social Security from Uncle Sam, since it's only partially taxable, depending on the size and sources of your other income.

If your financial situation won't change much this year compared with last, then your tax bill likely won't change much, either. As of this writing, there are no major tax laws that are starting or ending in 2016. And most of the major tax-related numbers — such as brackets and retirement account limits — are little changed from 2015.

For technological help with estimating your taxes, as well as analyzing hypothetical scenarios, you can use these online calculators:

- TurboTax TaxCaster
- H&R Block Tax Calculator
- TaxAct Tax Calculator

It's also helpful to know your tax bracket... as long as you understand how the system works. Your bracket is determined by your *taxable* income — in other words, gross income minus all the exemptions, deductions, 401(k) contributions, etc.

Consider the following hypothetical married couple who in 2016 will earn $100,000 in annual gross income and contribute $15,000 to their 401(k)s.

| **Gross Income** | **$100,000** |
| --- | --- |
| Minus two exemptions ($4,050 each) | -$8,100 |
| Minus standard deduction | -$12,600 |
| Minus 401(k) contribution | -$15,000 |
| **Taxable Income** | **$64,300** |

If they looked up their *gross* income in the tax table for 2016 (which we conveniently provide below), they'd conclude that they're in the 25% bracket. But that's a mistake. They should instead look up their *taxable* income, and see that they're squarely in the 15% tax bracket.

Here are the tax brackets for 2016, which are approximately 0.5% higher than the 2015 brackets.

| Tax Bracket | Single Filers | Married Filing Jointly | Long-term Capital Gains and Qualified Dividends Rate |
|---|---|---|---|
| 10% | Up to $9,275 | Up to $18,550 | 0% |
| 15% | $9,276 to $37,650 | $18,551 to $75,300 | 0% |
| 25% | $37,651 to $91,150 | $75,301 to $151,900 | 15% |
| 28% | $91,151 to $190,150 | $151,901 to $231,450 | 15% |
| 33% | $190,151 to $413,350 | $231,451 to $413,350 | 15% |
| 35% | $413,351 to $415,050 | $413,351 to $466,950 | 15% |
| 39.6% | $415,051 or more | $466,951 or more | 20% |

## 4. Gather your deductions to take the most advantage of them.

If you don't get much bang for your itemized bucks — especially those deductions that must first exceed a percentage of your AGI to even count — consider bunching your itemized deductions into one year. You can take the standard deduction in the intervening years ($6,300 for single filers, $12,600 for married filers — in both 2015 and 2016).

This is especially powerful if your annual income varies so much that some years leave you more exposed to the Alternative Minimum Tax (very generally, those with annual incomes above $200,000) or your ability to itemize deductions is limited (in 2016, single filers with an AGI of $259,400, married couples filing jointly with an AGI of $311,300).

Here are the two big categories of AGI-dependent deductions:

### A) MISCELLANEOUS ITEMIZED DEDUCTIONS

Deductible to the extent they exceed 2% of your AGI (you can find your AGI at the bottom of the first page of your tax return if you file Form 1040). Let's say your AGI is $100,000; in this case, miscellaneous deductions above $2,000 are deductible.

Generally, these deductible items are related to producing income. Many come under the umbrella of unreimbursed job-related expenses such as uniforms, some types of insurance, dues to professional societies, subscriptions to trade journals, travel expenses, and work-related education.

You can also deduct tax planning and investment expenses. This includes fees to financial pros, subscriptions to investing-related publications, and software or online services used to manage your investments. You can also deduct margin interest up to the value of your net interest income (e.g., interest, dividends, capital gains) minus whatever investment expenses you were able to deduct.

For the full list of miscellaneous deductions, consult IRS Publication 529.

### B) UNREIMBURSED MEDICAL AND DENTAL EXPENSES

Deductible to the extent they exceed 10% of AGI (7.5% for those age 65 and older, but increases to 10% in 2017). That may be a high hurdle, but those expenses can include health care and long-term care insurance premiums (including Medicare premiums if paid with after-tax dollars), eyeglasses, contact lenses, prescribed medicines, some preventive care, and a range of programs — and even home modifications — if prescribed by a doctor (e.g., weight loss or smoking cessation). See IRS Publication 502 for a comprehensive list.

## 5. Uncle Sam might be co-owning your funds.

If you're holding a mutual fund or ETF outside your tax-advantaged retirement accounts, you'll likely be sharing a good bit of gains and distributions with the IRS — even if you haven't yet sold the investment!

That's why it's important to compare a fund's after-tax returns with those of other funds in its category.

Enter the fund's ticker on Morningstar.com, then click on "Tax" in the gray area under the fund's name and ticker. You'll see an estimate of how much of the return was handed over to Uncle Sam and Sister State.

This is especially important if your fund is barely beating a comparable index fund, because index funds tend to result in tax bills that are just one-fourth to one-half those of similarly invested actively managed funds.

## 6. Turbocharge your tax savings by donating appreciated investments.

Have stock, artwork, or another asset that has appreciated significantly in value, and you don't want to pay the capital gains taxes? Do you have some altruistic bones in your body? Then donate the investment to a qualified charity. You get a deduction (the fair market value of the asset, up to 30% of your AGI, with any excess carried forward for the next five years) and you avoid paying the capital gains taxes.

Let's say you're in the 28% tax bracket and own $50,000 worth of stock that you bought many years ago for $2,000. If you sold the stock, you'd pay $6,000 in capital gains taxes. That would leave just $44,000 left over to donate to your favorite cause. Fortunately, you can deduct the contribution, which reduces your tax bill by $12,320 (28% of $44,000). So your total tax savings are $6,320 ($12,320 minus $6,000).

However, if you instead donated the stock directly, you wouldn't have to pay that $6,000 in capital gains taxes. The charity gets the entire $50,000, which it could sell (with no tax consequences, since it's a tax-exempt organization). Plus, you get to deduct the full $50,000. Going this route, your total tax savings is $14,000 (28% of $50,000) — more than twice the benefit you'd have received if you first sold the stock and then donated the cash proceeds.

In fact, before you make a cash contribution to a charity, you should consider whether you should instead donate investments with large embedded capital gains, even if you still think it's a great investment.

Using the example above, let's say you also had $50,000 in cash in the bank that you could donate. But rather than writing the charity a check, you donate that $50,000 worth of stock and get the aforementioned $14,000 in tax benefits. Then, you use the $50,000 of cash in the bank to buy back the stock. You now have a new and higher cost basis, have avoided paying capital gains taxes on the growth from $10,000 to $50,000, and gained good karma by helping a worthy cause.

Make sure you do your research before making a donation, because there are plenty of rules and limitations, starting with you have to itemize in order to take this type of deduction, and the contribution must be made to an organization that is qualified in the eyes of the IRS. So check out IRS Publication 526: Charitable Contributions (didn't you always want to learn about the rules governing the donations to whaling captains?), contact your personal tax pro, or reach out to the organizations to which you want to make a donation (as they might have experts on staff).

## 7. Engage in tax-*gain* harvesting.

You may have heard of tax-*loss* harvesting, which involves selling underwater investments and deducting the capital loss. However, if you're in the 10% or 15% tax bracket, you should also consider tax-*gain* harvesting. As you can see in the table of 2016 tax brackets above, you'll pay no taxes — zero, zilch, nada — on long-term capital gains.

There's really no reason not to sell an investment and take the profit. You can even immediately buy the investment back; the 30-day wash-sale rule that governs tax-loss selling doesn't apply to gains. This will give you a tax-free stepped-up cost basis, which you'll appreciate if you're in a higher tax bracket or if capital gains tax rates are higher when you sell in the future.

Just know that the capital gains themselves will increase your taxable income, which could tip you into the next tax bracket. But that's not as bad as it may sound. The long-term gains up to that point still enjoy the 0% tax rate; only the long-term gains that crept into the next tax bracket will be taxed at 15%.

## 8. Make the best of a bad (or no longer needed) annuity or insurance policy.

Withdrawing money from an insurance policy or annuity can lead to taxes, penalties, and fees, depending on your age and the terms of the policy. But if you have an insurance product that no longer suits your circumstances, you might be able to swap it for another with no tax consequences. Here are a few examples:

- Exchange a high-cost, low-performing annuity with one that has lower costs, higher returns, and/or better guarantees.
- Use an annuity outside of a retirement account or the cash value in an insurance policy to pay premiums for long-term care insurance.
- Exchange a life insurance policy for a new one that better suits your current circumstances in terms of death benefit, premiums, or other previous.
- Exchange a life insurance policy for an annuity.

Obviously, not all these options are available for all types of policies and annuities. Plus, for the swapping of one product for another to be tax-free, the insurance companies must do the exchange directly with each other; don't ask for a check from one insurer and then use the money to buy a new policy.

It's also important to know that each individual insurance product has its own features, provisions, guarantees, and costs, including fees for moving money within a certain number of years after purchasing. You most definitely should talk to a qualified insurance expert so you know exactly what you'll be giving up and what you'll be getting via the exchange.

## 9. Don't look a gift tax in the mouth.

Many people are at least vaguely aware of the annual gift tax exclusion, which in 2016 is $14,000 per recipient; a donor can give $14,000 to as many people as he or she wants without worrying about taxes (which are always the responsibility of the giver, not the givee).

However, many people also think gifts worth more than $14,000 are taxable — but that's not true. Gifts beyond that amount begin to use up the $5.45 million (in 2016) unified gift and estate tax lifetime exclusion. That's the amount an individual can give away or leave to heirs tax-free. Since it's an individual limit, married couples can leave twice as much. Giving away more than that $14,000 annual limit will require filing Form 709 come tax time, but it won't add to your tax bill unless you've already used up the lifetime gift and estate exclusion.

For some gifts, you don't even have to worry about that annual exclusion. When you cover the tuition or qualified medical expenses incurred by someone else, those are not considered gifts as long as the money is sent directly to the institution providing the service. For instance, if you have a grandson in college, you could pay his tuition (directly to the college) without it counting as a gift. You could also pay the medical bills he incurred after he tried to scale the walls of the women's dorm — so long as you pay the hospital yourself.

## 10. Finally, there's death.

We couldn't begin with Ben Franklin's famous quote and only discuss taxes.

As previously mentioned, each American can give away or bequeath $5.45 million (known as the unified gift and estate tax exclusion) before having to worry about paying federal estate taxes, and that number increases each year along with inflation. Married couples can give away or bequeath twice that amount to other people; they can be as generous as they'd like with each other since gifts and inheritances between spouses are not subject to federal estate or gift taxes.

Since that exclusion amount is so high, far more people worry about federal estate taxes than actually pay them. An investigation last year by the House Ways and Means Committee found that in 2013 only 0.2% of deaths in America necessitated the filing of an estate tax return, compared with more than 6% in the mid-1970s. Still, there are reasons why your heirs may find themselves sharing their inheritances with the tax collector:

1. **You own all kinds of stuff.** Determining the value of your estate is the job of your executor, who will tally up the value of just about everything you own, including your home (minus mortgage), your portfolio, your business interests, all your "stuff" (e.g., cars, boats, furniture, collectibles), and life insurance policies that you own. Add it all up, and your estate may be worth more than you initially think.

2. **State taxes.** Several states have a separate estate tax with exclusion amounts much lower than the $5.45 million federal amount. A few states charge an inheritance tax, with the rate dependent on the relationship between the inheritor and the person who passed away. What's the difference? An estate tax is paid when the executor files the return, using assets once owned by the person who died, and is determined by where the decedent lived; an inheritance tax is paid by the people who receive the assets and is determined by where they live.

3. **The laws can change.** Over the past 40 years, the federal estate exclusion has been as high as $10 million and as low as $2 million. A future Congress can change the amount, as well as any of the myriad rules that govern the transfer of property from one person to another.

This all can get very complicated. We strongly suggest that you see a qualified attorney to create your estate plan, whether you expect to be subject to taxes or not.

But we do have some parting advice for the eventually departed: Once you reach a point in life when you're looking to pass wealth on to others, keep these differences between gifts and inheritances in mind:

- Generally speaking, a gifted asset retains its original cost basis and holding period when it changes hands. So if give your daughter $10,000 worth of stock for which you paid $2,000 several years ago, her cost basis will also be $2,000. If she sold the asset immediately, she'd have a taxable $8,000 long-term capital gain.

- The cost basis of inherited property is the value of the asset as of the date of death. Furthermore, the holding period is always considered long term. So let's say you bequeathed to your daughter stock that was worth $10,000 on the day you died. It increased to $10,250 by the time she took possession of the stock, at which point she immediately sold it. She'd pay taxes on a $250 long-term capital gain. (Note: In limited circumstances, an estate will use an alternative valuation date of six months after the date of death.)

So, all other things being equal, it might make sense for older investors to gift stocks with moderate capital gains but hold on to stocks with large capital gains because their heirs will receive a "stepped-up" cost basis. As for investments that are worth less than what you paid, it might be better for you to sell those money-losing shares and take the capital loss (which reduces your tax bill), and then gift the cash.

## THE FOOLISH BOTTOM LINE — AKA LINE 78 ON FORM 1040

Taxes account for one of the biggest bites out of your budget. But the more you plan, the less you pay. And keep in mind that you're not just paying less in any given year; you will also have more money to invest. Your tax savings today could result in a future benefit worth many times more than that lower number at the bottom of your tax return.

For example, if you save $5,000 one year and invest that savings, you'll have almost $11,000 after 10 years, and almost $25,000 after 20 years, assuming an 8% average annual return. That's a solid long-term return on spending some time today planning your future tax returns.

And as a client of ours here in Motley Fool Wealth Management, you'd be among a very small and select group of Fools who will actually have the opportunity to put our highly trained in-house team of Certified Financial Planners to work for you at incredibly affordable rates (full details on the entire list of financial planning services we can provide can be found immediately after you join us).

As you've also likely heard by now, not only would you have a dedicated team of portfolio managers (all of whom cut their teeth coming up through the investing ranks of The Motley Fool LLC before moving on to work for Motley Fool Wealth Management) managing your portfolio for you, including what you hold, buy, and sell...

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