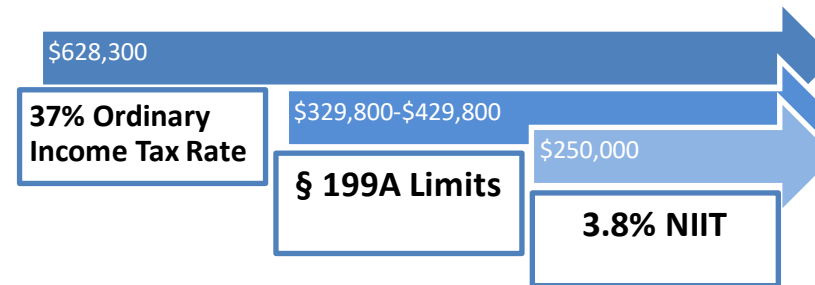


Robert S. Keebler, CPA/PFS, MST, AEP: Bracket Management

15 Impactful Bracket Management Ideas

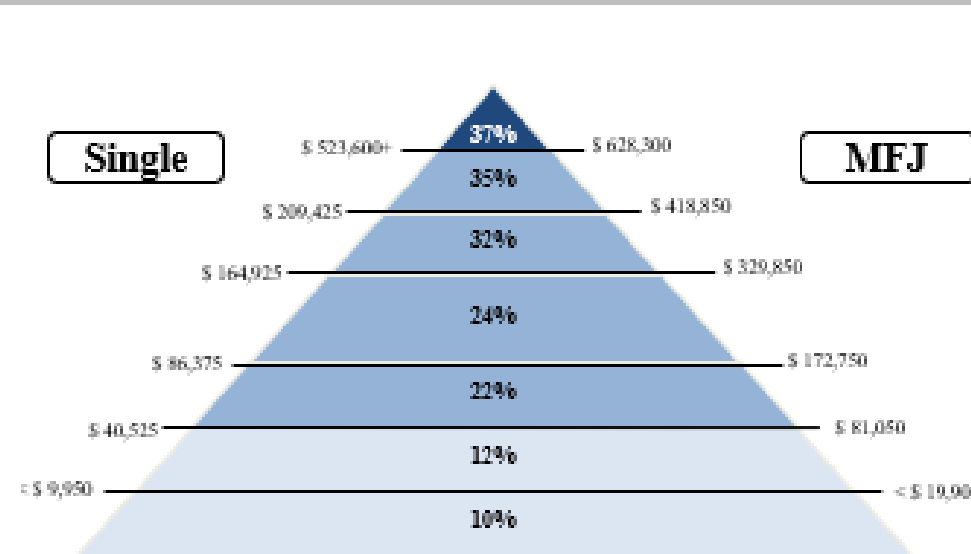
- Traditional IRA/401k Contributions:** Contribute to Traditional IRAs/401ks in high income years to reduce current income tax on wages and reduce investment taxation during accumulation years.
- Roth IRA/401k Contributions:** Contribute to Roth IRAs/401ks in low income years to reduce taxation during retirement years and reduce investment taxation during accumulation years.
- Roth IRA/401k Conversions:** Make Roth Conversions to the extent the current marginal rate is less than or equal to the projected average rate on distributions during retirement.
- Timing of Deductions:** Shift deductions to years in which provide the greatest tax benefit – note due to the phase-out of itemized deductions and the AMT this might not always be the year with the greatest income.
- Capital Loss Harvesting:** Harvest losses in high income years to offset capital gains.
- Capital Gain Harvesting:** Harvest gains in low income years to fill up the 0% bracket and evaluate gain harvesting which incurs taxation at lower rate in order to reduce future taxation at a higher rate.
- Control Investment Taxation:** Control taxes imposed on investment accounts by, for example, reducing ordinary income and turnover when it does not unduly sacrifice return.
- Asset Location:** Consider “locating” taxable bonds deemed necessary to prudent asset allocation to retirement accounts in order to reduce investment taxation and “locating” growth equity positions in taxable or Roth IRA accounts.
- Nonqualified Tax Deferred Annuities:** Nonqualified Tax Deferred Annuities can be used to smooth out income and thereby avoid higher tax brackets by shifting investment income from high income to low income years.
- Investment in Oil and Gas Partnerships:** Investments in certain oil and gas partnerships creates a large above-the-line “deduction” in the year of investment which can offset higher income. Moreover, depreciation and depletion shield a substantial portion of income from taxation.
- Life Insurance:** Life insurance death benefits grow free of income taxation and policy owners can borrow from the cash value in order to meet cash flow needs during high income tax years.
- IRC § 453 Installment Sale:** Sell assets on installment in order to spread income over several years and thereby avoid higher marginal rates.
- Charitable Contributions:** Make charitable contributions with appreciated assets when possible as it will generate increased income tax savings.
- Charitable Remainder Trusts:** Can smooth out income over a long period of time, defer income until after retirement, or shift income to family members in order to avoid higher tax brackets.
- Charitable Lead Trusts:** Used to smooth out income over a long period of time in order to keep the taxpayer out of the higher tax brackets.

“Flying Below the Radar”

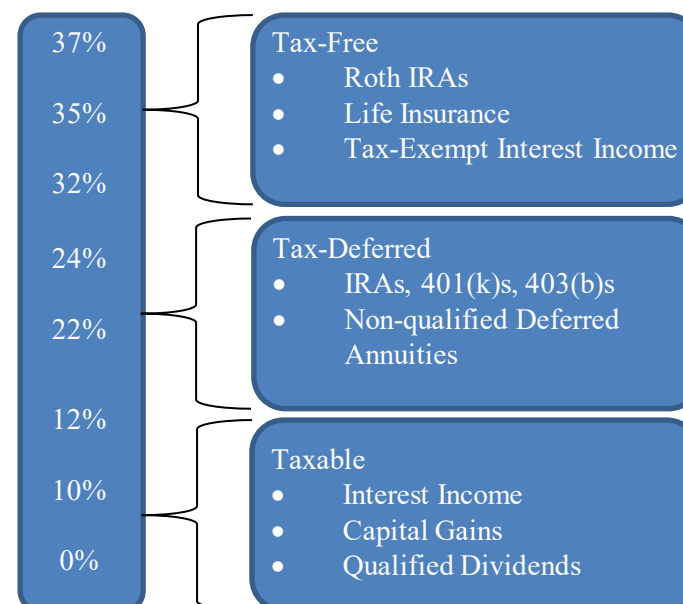


Thresholds for married filing jointly.

2021 Federal Income Tax Brackets



Tax Rate Asset Allocation



Bracket Management Checklist

- ✓ Determine the client’s current tax bracket.
- ✓ Project the client’s future tax brackets.
- ✓ Determine if and when the NIIT, AMT, § 199A Limits, and higher brackets will apply.
- ✓ Use the projections to build the client’s portfolio according to the Tax Rate Asset Allocation chart.
- ✓ Build the portfolio with an understanding of the Taxation of Retirement Distributions.
- ✓ Consider Impactful Bracket Management Ideas 1-8 for all clients.
- ✓ Consider Impactful Bracket Management Ideas 9-15 for all clients, but especially those not “Flying Below the Radar.”

Taxation of Retirement Distributions

	Basis	Tax-Free Loans	Earnings
IRA ⁽¹⁾	Pro rata Method	N/A	Pro rata Method
ERISA Plan	Pro rata Method	N/A	Pro rata Method
Roth IRA ⁽²⁾	Basis First	N/A	Earnings Follow
Non-qualified Annuity	Basis Follows	N/A	Earnings First
Life Insurance ⁽³⁾ Non-Modified Endowment Contract	Basis First	Available	Earnings Follow
Life Insurance ⁽⁴⁾ Modified Endowment Contract	Earnings First	N/A	Basis Follows

- All IRAs are combined for the distribution computation
- All Roth IRAs are combined for the distribution computation
- Loans available, with interest to the extent of cash surrender
- Each contract is treated separately for distribution purposes

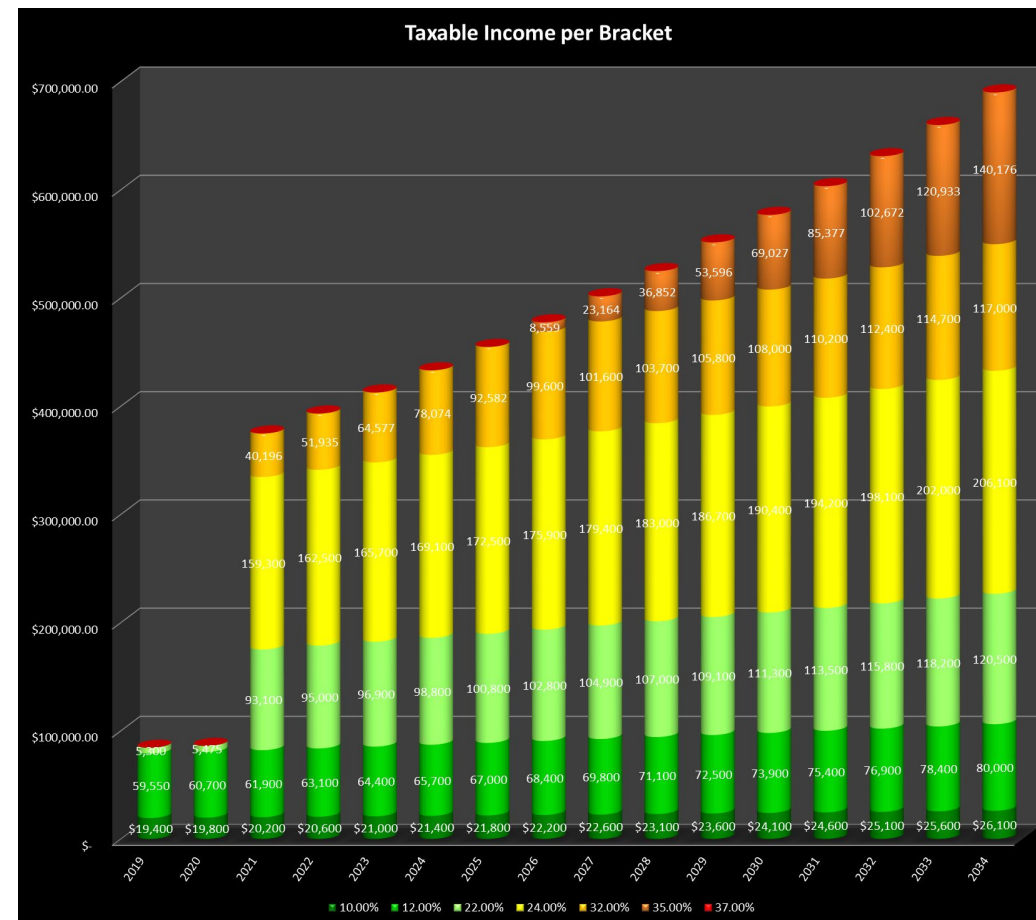
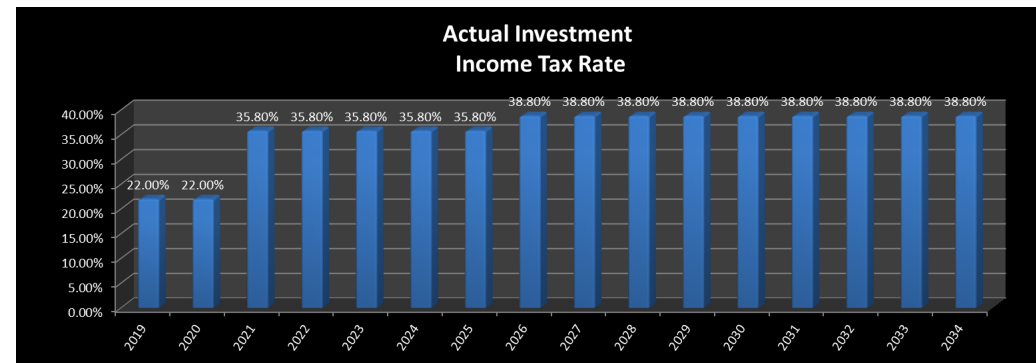
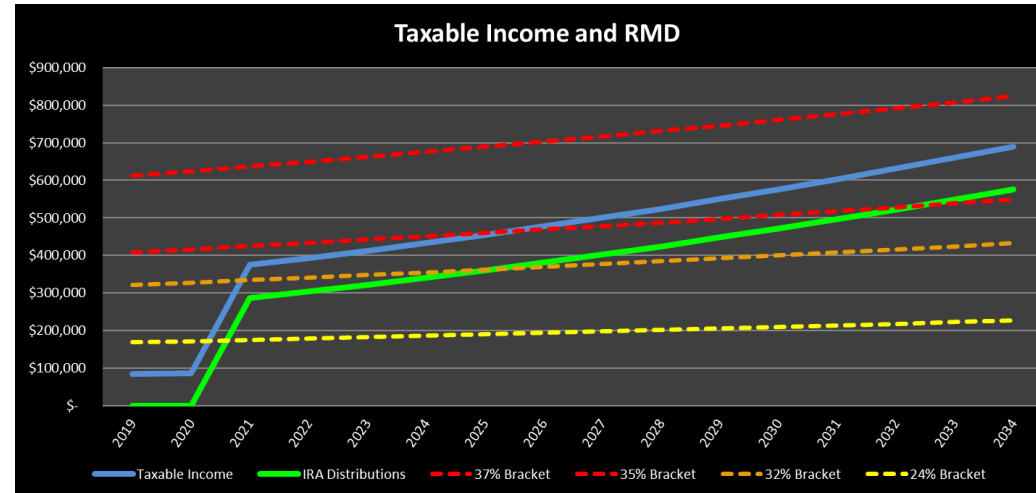
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Illustration: Poor Bracket Management Strategic Income Tax Diagnostics

A very common, and illustrative, bracket management issue occurs when retirement savers reach their required beginning date. This is because required minimum distributions can be quite large and “catapult” taxpayers to a much higher average tax rate. The tax rate is higher due to a number of factors including: (1) a greater portion of social security is taxed; (2) the § 199A limits apply; (3) higher ordinary income tax brackets apply; (4) higher capital gain tax brackets apply; (5) the AMT can apply; (6) the NIIT applies.

Example. Consider a taxpayer who files single, has \$6,000,000 in his 401k and begins RMDs in two years. Assume inflation of 2%, asset growth of 7% and that the taxpayer is limited to the standard deduction.

Illustration: Poor Bracket Management Graphical Strategic Income Tax Diagnostics



2021 Bracket, Threshold and Limitation Detail

TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10%	\$ 9,950	\$ 19,900	\$ 9,950	\$ 14,200	\$ 2,650
12%	\$ 40,525	\$ 81,050	\$ 40,125	\$ 54,200	-
22%	\$ 86,375	\$ 172,750	\$ 86,375	\$ 86,350	-
24%	\$ 164,925	\$ 329,850	\$ 164,925	\$ 164,900	\$ 9,550
32%	\$ 209,425	\$ 418,850	\$ 209,425	\$ 209,400	-
35%	\$ 523,600	\$ 628,300	\$ 314,150	\$ 523,600	\$ 13,050
37%					

TOP OF EACH CAPITAL GAINS BRACKET

	S	MFJ/QW	MFS	HOH	T&E
0%	\$ 40,400	\$ 80,800	\$ 40,400	\$ 54,100	\$ 2,650
15%	\$ 445,850	\$ 501,600	\$ 250,800	\$ 473,750	\$ 13,150
20%					

AMT

	2020	2021
Single or Head of Household	\$72,900	\$73,600
Married Filing Jointly	\$113,400	\$114,600
Begin of Phaseout, Single or HoH	\$518,400	\$523,600
Begin of Phaseout, MFJ	\$1,036,800	\$1,047,200

3.8% NIIT THRESHOLDS

S	MFJ/QW	MFS	HOH
\$ 200,000	\$ 250,000	\$ 125,000	\$ 200,000

DEFINED CONTRIBUTION PLAN LIMITS

IRA / ROTH IRA CONTRIBUTION LIMIT	\$ 6,000
IRA / ROTH IRA "CATCH UP"	\$ 1,000
401k ELECTIVE DEFERRAL	\$ 19,500
401k ELECTIVE DEFERRAL "CATCH UP"	\$ 6,500
SIMPLE IRA CONTRIBUTION LIMIT	\$ 13,500
SIMPLE IRA "CATCH UP"	\$ 3,000
SEP IRA EMPLOYEE PERCENTAGE MATCH LIMIT	25%
SEP IRA SELF-EMPLOYED PERCENTAGE MATCH LIMIT	20%
OVERALL LIMIT ON CONTRIBUTIONS TO DCPs	\$ 57,000

INCOME	2019	2020	2021	2022	2023	2024
Wages	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Taxable Interest Income	50,000	51,000	52,020	53,060	54,122	55,204
Non-Qualified Dividends	-	-	-	-	-	-
Qualified Dividends	20,000	20,400	20,808	21,224	21,649	22,082
Short-Term Capital Gains	-	-	-	-	-	-
Long-Term Capital Gains	50,000	51,000	52,020	53,060	54,122	55,204
IRA Distributions	-	-	287,051	303,776	321,457	340,145
Roth IRA Conversions	-	-	-	-	-	-
Pension & Annuity Distributions	-	-	-	-	-	-
Social Security (Gross)	25,000	25,500	26,010	26,530	27,061	27,602
Less: Social Security (Non-Taxable Portion)	(3,750)	(3,825)	(3,902)	(3,980)	(4,059)	(4,140)
Other Income	40,000	40,800	41,616	42,448	43,297	44,163
Subtotal	\$ 181,250	\$ 184,875	\$ 475,624	\$ 496,120	\$ 517,647	\$ 540,260
Less: Adjustments	-	-	-	-	-	-
Adjusted Gross Income (AGI)	\$ 181,250	\$ 184,875	\$ 475,624	\$ 496,120	\$ 517,647	\$ 540,260
Itemized Deductions/Standard Deduction	\$ 27,000	\$ 27,500	\$ 28,100	\$ 28,700	\$ 29,300	\$ 29,900
Total Deductions	\$ 27,000	\$ 27,500	\$ 28,100	\$ 28,700	\$ 29,300	\$ 29,900
Taxable Income	\$ 154,250	\$ 157,375	\$ 447,524	\$ 467,420	\$ 488,347	\$ 510,360

Note the effects of the RMD income “spike” below and in the graphs to the right. It’s very possible that with better bracket management during, and especially before, retirement the taxpayer might lose far less of their wealth to taxation.

	2019	2020	2021	2022	2023	2024
MARGINAL INCOME TAX RATE	22.00%	22.00%	32.00%	32.00%	32.00%	32.00%
MARGINAL CAPITAL GAINS RATE	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
CURRENTLY SUBJECT TO NIIT	No	No	Yes	Yes	Yes	Yes
MARGINAL INCOME TAX RATE w/NI	22.00%	22.00%	35.80%	35.80%	35.80%	35.80%
MARGINAL CAPITAL GAIN RATE w/N	15.00%	15.00%	18.80%	18.80%	18.80%	18.80%
AVERAGE RATE	11.45%	11.46%	20.33%	20.59%	20.84%	21.09%
DISTANCE TO PREVIOUS BRACKET \$	(5,300)	(5,475)	(40,196)	(51,935)	(64,577)	(78,074)
DISTANCE TO NEXT BRACKET \$	84,150	85,825	50,004	40,065	29,323	17,626
DISTANCE TO FOLLOWING BRACKET \$	237,200	241,925	262,404	256,665	250,223	243,026
AMOUNT ABOVE 37% BRACKET	-	-	-	-	-	-
MAGI LESS THRESHOLD (A) \$	-	-	\$ 225,624	\$ 246,120	\$ 267,647	\$ 290,260
NET INVESTMENT INCOME (B)	120,000	122,400	124,848	127,345	129,892	132,490
LESSOR OF A OR B	\$ -	\$ -	\$ 124,848	\$ 127,345	\$ 129,892	\$ 132,490
NIIT @ 3.8%	\$ -	\$ -	\$ 4,744	\$ 4,839	\$ 4,936	\$ 5,035