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Financial Briefs

JULY 2023

Tax Planning for Life's Major Events

As you go through life, the one thing you can count on is that Uncle Sam will always be with you. The following provides an overview of what you can expect regarding taxes as you hit the many milestones of your life.

First Job

Welcome to payroll taxes. The first thing you will need to do is determine how much to withhold from your pay. If you withhold too much, you will get a refund when you file your taxes, and while it can be nice to get that bonus, it may be better to have your money throughout the year as opposed to giving the IRS an interest-free loan. On the flip side, if you don't withhold enough, you may have a large tax bill and may also incur penalties for not withholding enough throughout the year. There are several good online calculators that can help you determine how much to withhold from your paycheck, and you can change your withholding as often as needed to get the tax amount correct.

Make sure you take advantage of any tax breaks your employer offers. If your employer offers health care coverage, that insurance may be a tax-free benefit to you. You may also have access to a flexible spending account (FSA), which allows you to save pretax dollars to pay for medical expenses that are not covered by your insurance. If your employer offers a tax-deferred retirement plan, such as a 401(k) plan, take full advantage of it because you are investing with pretax money. If your employer matches contributions, that is free money to you.

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Taxes and Your Investments

One of your portfolio's largest expenses is probably taxes. Ordinary income taxes on short-term capital gains and interest income can go as high as 37%, while long-term capital gains and dividend income are taxed at rates not exceeding 15% to 20% (0% if your income falls under certain limits). One way to help keep your portfolio growing is to invest in a tax-efficient manner. Some suggestions include:

- **Contribute to your 401(k) plan.** Contributions are made on a pretax basis, so you don't pay income taxes currently (Social Security and Medicare taxes are paid) and earnings grow on a tax-deferred basis until withdrawn. In 2023, you can contribute a maximum of $22,500 to a 401(k) plan, although plans typically limit your contributions to a certain percentage of your pay to ensure the plan complies with nondiscrimination rules. Individuals over age 50 may be able to make an additional catch-up contribution of $7,500 in 2023. Many employers also match your contribution, so you get additional funds at no cost to you.
- **Make contributions to an individual retirement account (IRA).** In 2023, you can contribute a maximum of $6,500, plus those over age 50 can make an additional $1,000 catch-up contribution. Investigate whether you're eligible to contribute to a traditional deductible IRA or a Roth IRA and then decide which option is best for you. While you can't deduct your contributions to a Roth IRA, your earnings grow tax free as long as you make qualified distributions from the IRA. With a traditional deductible IRA, your contribution is deductible on your current-year income tax return and earnings grow tax deferred until withdrawn.
- **Carefully decide which investments to hold in tax-advantaged**

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Tax Planning

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Getting Married

Typically, there are more advantages for married couples to file jointly, but you will want to do a thorough assessment of your newly combined income. You should reevaluate how much to withhold from both of your paychecks, just as you did when you got your job.

If both you and your spouse participate in an employer-sponsored retirement plan, you should carefully review and decide which plan offers the best benefits. The ideal situation would be to participate to the maximum in both plans, but if your cash flow won't allow that for a period of time, then determine which plan is the best for your retirement strategy. Your combined income could also affect your retirement contributions, because there are income limits that apply to different retirement accounts.

You can also make changes to FSA accounts to accommodate both of your medical expenses.

Having a Baby

A new baby comes with some tax benefits to help growing families. You will be able to claim your little one as an exemption in the year they are born until they are 19. If your child attends college, they may be claimed until they turn 24.

You may also be able to get a child tax credit for each child under the age of 17. The intent of the credit is to help families offset the cost of raising children. If you have a large family, you might be able to get money back from the IRS via the additional refundable child-tax credit. There is also a tax credit to cover some of the costs associated with adopting a child.

If you and your spouse work, parents can use the child- and dependent-care credit to pay for some of the costs of caring for their children while they are at work.

If you are planning to send your children to college, the tax code also offers several ways to save and pay for higher education costs, including 529 college savings plans and the Coverdell Education Savings Account.

Starting a Business

If you want to strike out on your own, make sure you review the tax code prior to starting your business. New businesses can deduct thousands of dollars in certain startup costs. As a sole proprietor, you will report your income as part of your annual individual tax filing by including Schedule C to your 1040. The schedule also offers opportunities to deduct business expenses, including setting up a home office, business use of a vehicle, health insurance premiums, and contributions to self-employed retirement plans. Typically, sole proprietors also make estimated tax payments four times per year.

As a sole proprietor, you will be responsible for paying self-employment taxes, which are comparable to the payroll taxes collected from wage-earning employees. And, as both the employer and employee, you will have to pay Social Security and Medicare taxes.

Buying a Home

There are many tax breaks for owning a home. The interest you pay on your mortgage is deductible as an itemized expense on up to $750,000 of debt ($1 million if the mortgage existed on December 15, 2017). There are also some home improvements that provide energy efficiency that will get you a tax credit to help offset the high cost of these improvements.

When you sell your home, up to $250,000 in sales gain ($500,000 for married joint filers) on your home is tax free. You are required, however, to have owned the property for two years and lived in it for two of the five years before the sale.

Divorce

There is nothing easy about a divorce and that includes the tax implications. Your filing status is determined on the last day of the tax year, so if your divorce is final on December 31, you are considered unmarried for the entire year.

Determining child custody is probably the most difficult part of divorce. From a tax perspective, the parent who has physical custody of the children for most of the year gets to claim them as dependents and also gets the child-tax credit and child-care tax credit savings. If there are multiple children and your custody time is relatively equal, you can decide who gets to claim which child.

It may make the most sense for couples to sell their marital home prior to the divorce so that they can split the tax-free profits. If one spouse is granted sole ownership of the family home, when they go to sell the property, the amount of profit exempt from capital gains is just $250,000 versus the $500,000 that married filing jointly homeowners can exclude.

When dividing other marital assets, both spouses should take into account the cash the recipient partners will net after taxes. Alimony is considered taxable income to the recipient and is a deduction for the spouse that is paying. Child support does not create any taxable event.

Retiring

Hopefully, you planned well for your golden years by taking advantage of the many tax breaks afforded by your retirement plan. While you will have to pay tax on the distributions from the account, remember all the years you were able to invest on a pretax basis.

If you have a Roth IRA, you deposit post-taxed money, but you can now take distributions that are tax free. The biggest drawback to a Roth IRA is there are income limitations. However, regardless of your income, you can convert a traditional IRA to a Roth IRA.

Social Security benefits generally are tax free as long as you don't have a lot of other income. You will have to pay on portions of your benefit if you earn more than $25,000 as a single filer and $32,000 if married and filing jointly.

Please call if you'd like to discuss tax planning in more detail.

Your Investments

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and taxable accounts. Gains from investments held in retirement accounts, such as 401(k) plans and traditional IRAs, are taxed at ordinary income tax rates when withdrawn, rather than the lower capital gains tax rates. While it may make sense to hold investments that produce ordinary income or that you want to trade frequently in retirement accounts and investments that generate capital gains in taxable accounts, factors such as your investment period should also be considered.

- **Analyze the tax consequences before rebalancing your portfolio.** Portfolio rebalancing is a taxable event that may result in a taxable gain or loss. In general, avoid selling investments from your taxable portfolio for reasons other than poor performance. Bring your asset allocation in line through other methods. For instance, when purchasing new investments, select ones from underweighted categories. Or rebalance through your tax-deferred accounts.
- **Consider municipal bonds or stocks generating dividend income if you are in a high tax bracket.** Since municipal bond interest is exempt from federal, and sometimes state and local, income taxes, your marginal tax bracket is a major factor when deciding whether to include municipal bonds in your portfolio. Thus, you should determine how a muni bond's yield compares to the after-tax yield of a comparable taxable bond. Since dividend income is taxed at rates not exceeding 15% to 20%, stocks that generate significant dividend income may be a good choice.
- **Look into tax-advantaged ways to save for college.** If you are saving for college, look at education savings accounts (ESAs) and Section 529 plans. The annual contribution limit to ESAs is $2,000. While you can't deduct the contribution on your tax return, earnings grow tax free as long as funds are used for qualified education expenses. With Section 529 plans, you can contribute up to $85,000 to a qualified plan ($170,000 if the gift is split with your spouse) in one year and count it as your annual $17,000 tax-free gift for five years. However, if you die within the five-year period, a pro-rata share returns to your estate. Distributions from 529 plans to pay qualified higher-education expenses are excluded from income.
- **Consider owning a home.** Owning a home has significant tax advantages. Mortgage interest and property taxes can be deducted on your tax return. Mortgage interest is deductible on up to $750,000 of home debt ($1,000,000 if the mortgage existed on December 15, 2017). When you sell your home, you can exclude up to $250,000 of gain if you are a single taxpayer and up to $500,000 of gain if you are married filing jointly, provided the home was your primary residence in at least two of the preceding five years. You no longer have to purchase another home for the exclusion.

If you'd like to review other options, please call.

Why Tax Planning Matters

Generally attributed to Benjamin Franklin, one quote that still rings true today is "…in this world nothing can be said to be certain, except death and taxes." When people neglect to plan for taxes over the course of their lifetimes, they end up facing another, also depressing certainty: paying more than necessary. Taking the time and effort to plan for taxes saves you money in the short term, long term, and can make all the difference for your retirement and legacy.

Short Term

Making a tax plan at the beginning of the year can help lower your tax bill by ensuring you are taking advantage of as many tax strategies as possible. The best way to make sure you haven't missed anything is by going over your tax situation and strategies with an accountant or advisor.

Long Term

Most people do not make enough money in a single year to fund their long-term goals, like paying for their children's college, purchasing a house, or paying off all of their student loan debt. Therefore, some long-term tax planning is in order. For example, the money you put away in a tax-advantaged 529 account for college education grows tax free and can be withdrawn tax free when used to pay educational expenses. Overall, the more you save on taxes, the more you have to put toward your financial goals.

Retirement

As you plan for your retirement and continue to contribute to your 401(k) plan or IRA, it is helpful to know that the amount you contribute can be deducted from your taxes. Even if you utilize a Roth IRA and cannot deduct the contributions today, you can access those funds tax free in retirement. It takes a lot of money and careful planning to retire comfortably, and a tax plan is an essential part of the process.

Legacy

When you think about what you hope to leave behind for your heirs or your favorite charity, you might not initially consider the tax ramifications. Consider setting up part of your estate plan in a Roth IRA so your children can draw tax-free income from the account. You can also take advantage of the annual gift tax exclusion by transferring funds to your heirs while you are still alive. Donor-advised funds, life insurance, and various types of trusts can all offer other solutions to the tax aspect of your legacy.

News and Announcements

From The Alexander Household

I love discovering hidden gems. Thanks to the Celedonio Romero Guitar Institute, we enjoyed exceptional classical guitar concerts, one of which featured Romero's children and grandchildren playing with Institute students.

In 2008, this Institute was created by the Romero family to honor the life and legacy of Celedonio Romero. Students and professionals gather from around the world to spend a week learning from the Romeros in one-on-one lessons, masterclasses, and ensemble coaching. Through an apprentice program, local students can participate and our son, Luke, was one of the fortunate ones. Matthew Denman, who has been nominated for a 2024 Music Educator Grammy, is the Institute director. www.Romero-Institute.com

Celedonio Romero began playing the guitar at the age of 5, and eventually studied music in Málaga and at the Madrid Royal Conservatory. He made his concert debut at 22 and was well-known in Spain, but the Franco government did not allow him to give concerts abroad. After secretly obtaining an American visa, in 1957 the family was granted permission to visit an ailing relative in Portugal. Rather than return to Spain, the family settled in Southern California. Celedonio and his three sons Celin, Pepe, and Angel started The Romeros guitar quartet in 1960. They became known as "The Royal Family of the Guitar." Celedonio died of lung cancer in 1996 at the age of 83.

I am grateful to the Romero family, the Romero Guitar Institute and OCU for bringing classical guitar education and performances of this caliber to Oklahoma.

Carol Ringrose Alexander, CFP®
AIF®, CEPS, RLP®, CDFA™
Executive Vice President

From the Rudy Household

In 2020, it must have been cabin fever that led us to purchase something that I had repeatedly stated that I would never buy. We bought a boat! After renting boats frequently, the family was excited to take this step. I did pause to wonder if we would enjoy boat life enough for this purchase to make sense. We are in our fourth summer of boating, and I am happy to share that we love it more than ever.

With two daughters in college and one halfway through high school, I am pleased with how often we all spend time together on the boat. The girls also invite friends to the lake where they do everything from tubing to soaking in the sun, to simply floating and swimming in the water. It's great to be able to take a break from our daily lives and enjoy nature.

Some days my wife Amy and I go out to the boat in the morning with our coffee. Some days we stay late and watch the sunset. I am most surprised about how much we love boat rides all year long. If it's a sunny 50-degree February day, we just bundle up. There's always something to enjoy on the boat.

The saying goes, the two happiest days of boat ownership are the day you buy your boat, and the day you sell your boat. So far, we have defied that saying and hope to have many more happy boating days spent with friends and family!

Chad A. Rudy, CFP®
Executive Vice President - TX

From the Bolander Household

Summertime is family time. We've planned some weekend getaways with different family members, and on one of the longer weekends, we'll be traveling to visit John's extended family in Ohio. We try to go every few years, and this reunion in late July marks the 75th anniversary of the Bolander's official summer meeting. There are plenty of fun and games for everyone, from horseshoes to egg toss, tug-of-war, and others. It's a great time to rekindle family rivalries and start new friendships as the family continues to grow. We're looking forward to seeing all the folks in Ohio!

My family reunion was held in June at the Wintersmith Park Lodge in Ada, Okla. We're mostly the eat-and-visit kind of people, but the kids get outside for some fun in the park. According to the travelok.com website, Wintersmith Park was constructed by the Civilian Conservation Corps in the 1930s and is listed in the National Register of Historic Places. The park includes a lake, stone bridges, trails, a small zoo, and a public amphitheater within its 150 acres. It also has a great public swimming pool and areas for basketball, softball, volleyball, and horseshoes, but the kids like to feed the ducks. This year was especially pleasant as both the temperature and the humidity were low.

Have a great summer!

Brenda C. Bolander, CFP®
CPA/PFS
Executive Vice President