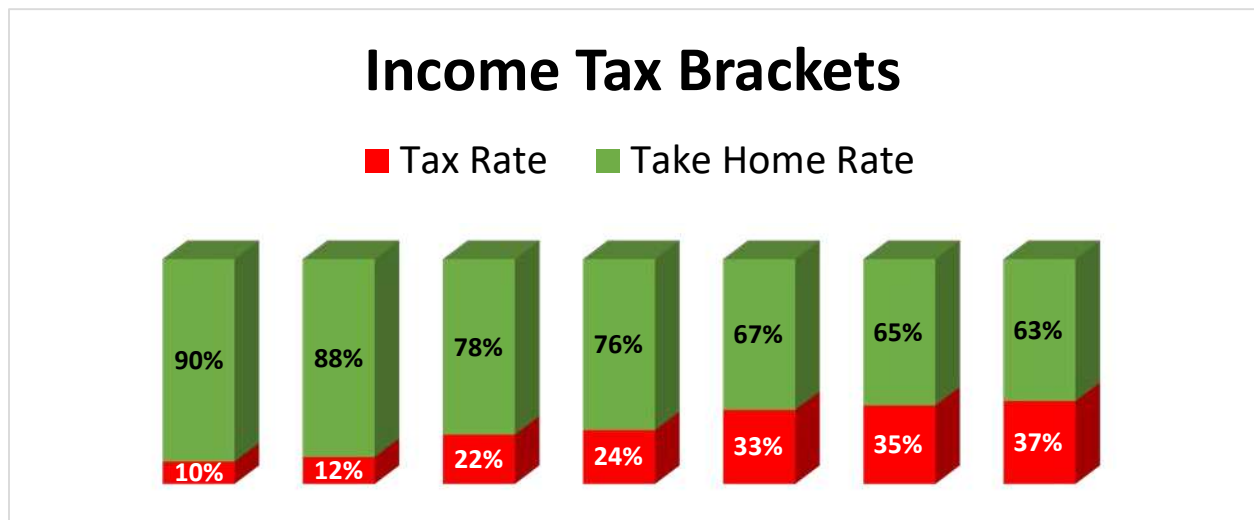


#1: Bracket Management

To begin with, there are a number of bracket management issues to consider:

- ❖ Capital gains tax rates
- ❖ Ordinary income tax rates
- ❖ Income should at least equal deductions
- ❖ Tax liability should at least equal tax credits available
- ❖ Non-refundable/non-carry forward credits
- ❖ Non-refundable carry forward credits
- ❖ Refundable credits

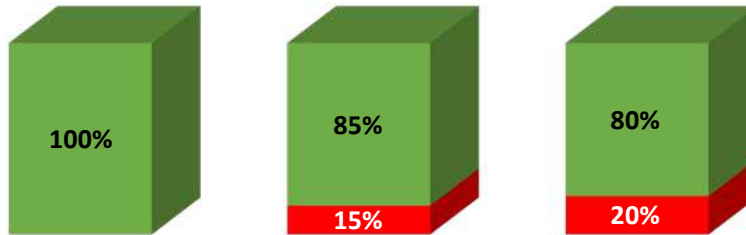
Following the 2017 Tax Cuts and Jobs Act, there are seven different ordinary income tax brackets – 10%, 12%, 22%, 24%, 32%, 35%, and 37% – and three different capital gains tax brackets – 0%, 15%, and 20%.¹ If you combine these tax brackets with the 3.8% net investment income tax (NIIT), there are even more possible tax brackets; i.e., high income taxpayers will be subject to a 40.8% tax rate on ordinary income and a 23.8% tax rate on long-term capital gains. The large number of tax brackets and the steep cliffs between some of them make tax deferral and income smoothing strategies a must.



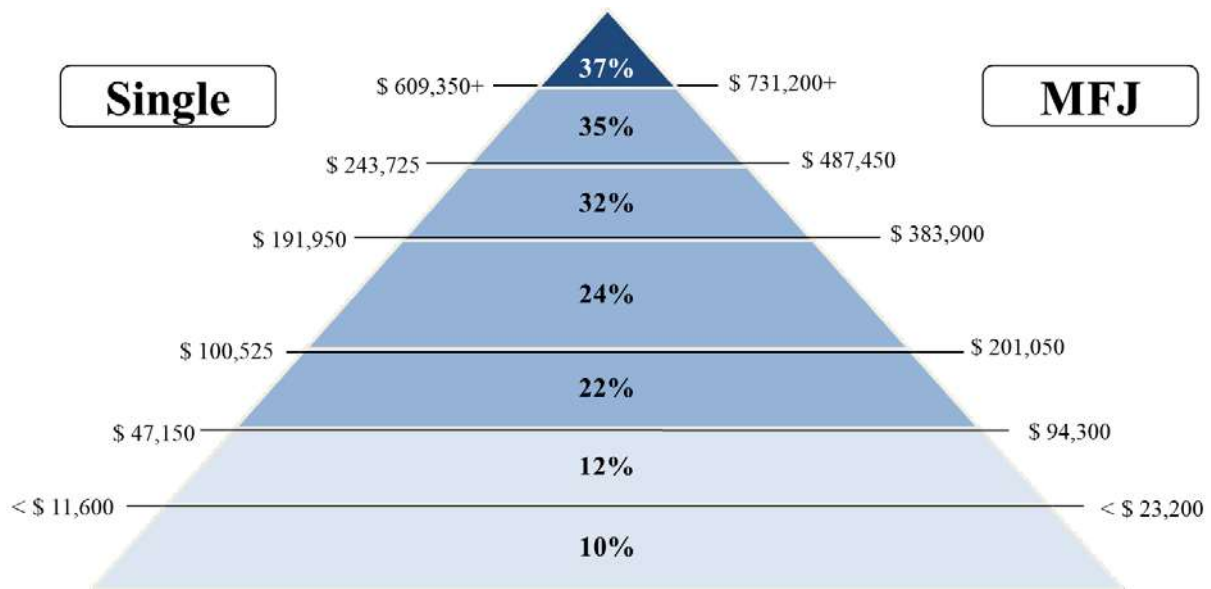
¹ Note that there are two additional tax brackets for special income - a 25% bracket for unrecaptured IRC §1250 gain and a 28% bracket for collectibles gain.

Capital Gain Brackets

■ Tax Rate ■ Take Home Rate



2024 Federal Income Tax Rates and Brackets



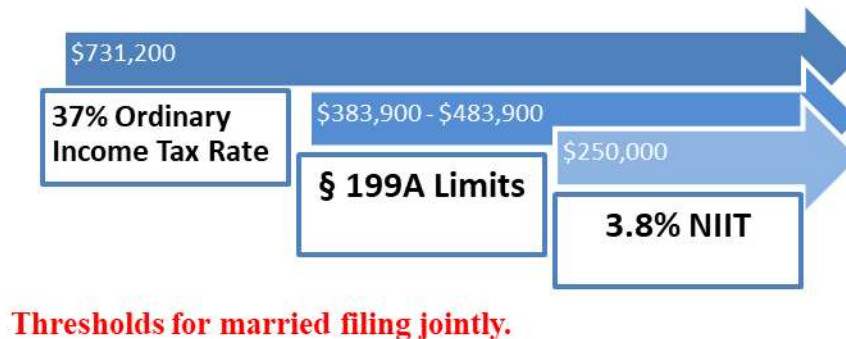
The first step in tax planning is to estimate the amount of taxable income over a five to fifteen year horizon. Once the amount of taxable income is estimated, planning to avoid the higher tax brackets and the NIIT can begin. There are many different specific tax planning strategies that can be implemented depending on the situation. Some of these include:

- (1) Harvesting losses in high income years;
- (2) Harvesting gains in low income years;
- (3) Contributing to traditional IRAs in high income years;
- (4) Contributing to Roth IRAs in low income years;
- (5) Investing in tax deferred annuities;
- (6) Creating different types of charitable remainder trusts;
- (7) Creating charitable lead trusts;

- (8) Engaging in installment sales;
- (9) Engaging in life insurance strategies;
- (10) Implementing Roth IRA conversions; and
- (11) Creating family trusts.

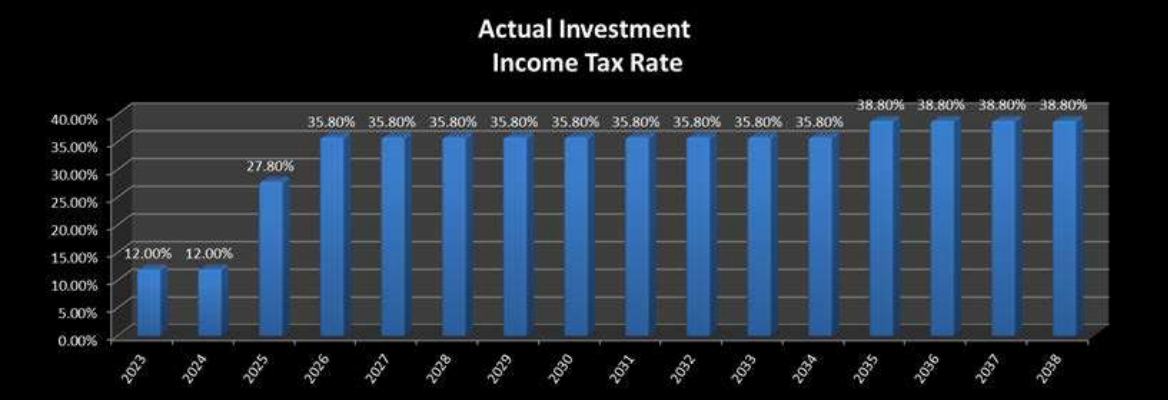
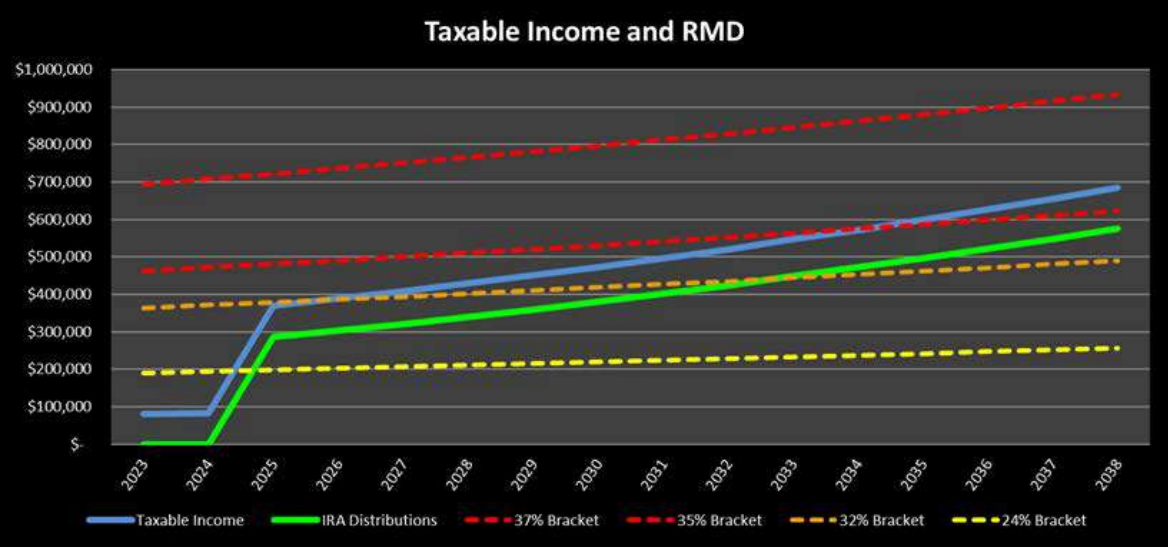
These strategies, and more, are covered in detail in other sections of the series.

While some of those tax planning strategies may be quite complicated, the basic idea is simple – use income smoothing to obtain the maximum benefit of tax rate arbitrage. Basically, income smoothing strategies involve: (1) reducing taxable income in high income years by maximizing deductions and shifting income to lower income years; and (2) increasing income in low income years by deferring deductions and increasing taxable income to fill-up the lower tax brackets. Put another way, the idea is to keep taxable income below the highest tax rates and thresholds at which the effective tax rate increases.

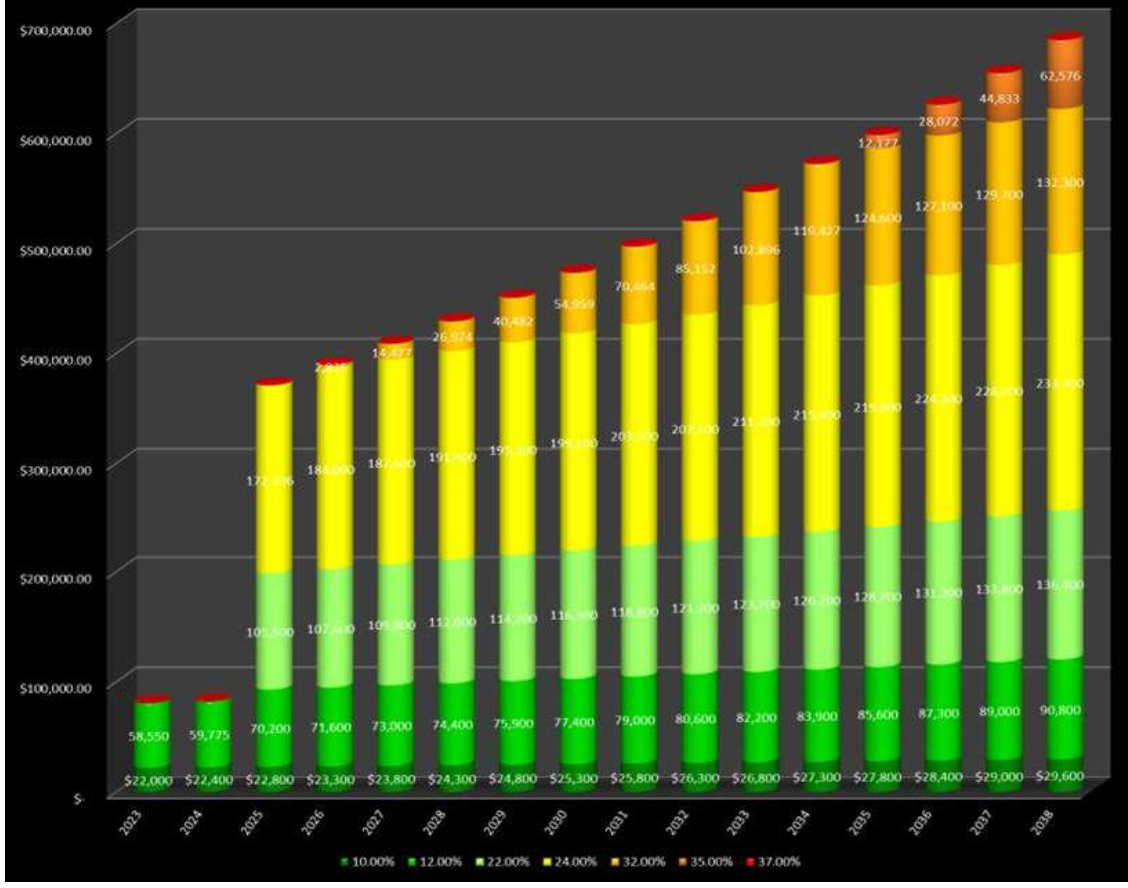


Below are some illustrations of poor bracket management: Suppose that your client’s current taxable income is about \$100,000 per year. He and his wife are recently retired and think they are doing extremely well managing their tax obligations. However, you point out that soon they soon must take Required Minimum Distributions (RMDs).² Without proper bracket management, their taxable income spikes by nearly \$300,000 and only grows thereafter:

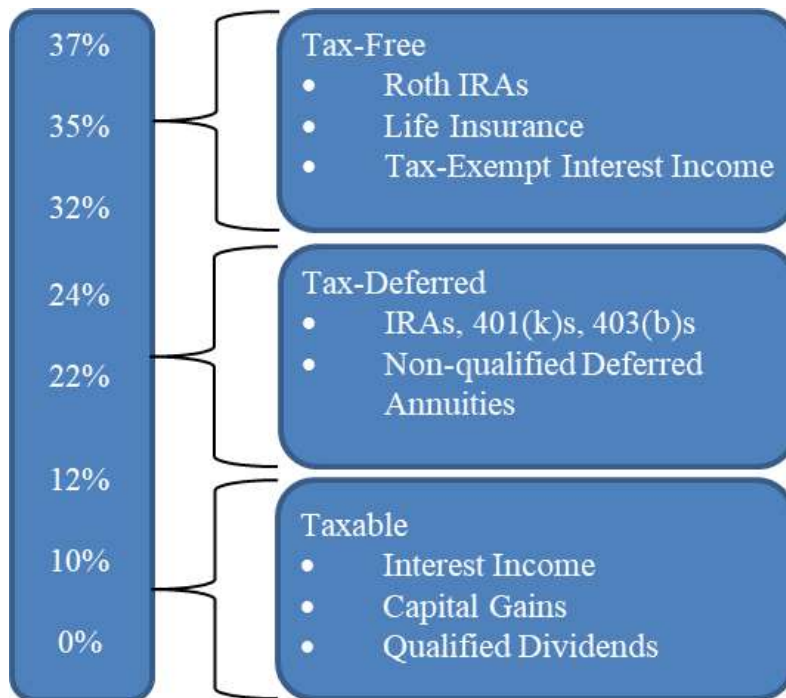
² The SECURE Act changed required beginning date for RMDs from age 70 ½ to age 72. “SECURE 2.0” (the EARN Act) further increased the age to 73 for 2023.



Taxable Income per Bracket



Depending on the tax bracket one falls into, the strategy will be different.



Some of the top tax planning ideas include:

1. “Filling-up” the 10% or 12% bracket;
2. Doing Roth conversions by asset class and Roth conversions to manage tax brackets;
3. Spending from the “outside non-qualified” portfolio first once you have “filled-up” the 12% bracket;
4. Positioning bonds in IRAs because of the annual tax burden; and
5. Using life insurance as a supplement to existing pensions.

Furthermore, the appropriate strategies to use are different for different stages in a taxpayer’s life, as shown in the following charts:

Early Accumulation Years (Ages 25-45)

- ❖ Maximize qualified retirement savings
- ❖ Maximize IRAs
- ❖ Position some funding in Roth IRAs or Roth 401(k)s
- ❖ Deferral via annuities
- ❖ Low-risk oil & gas transactions
- ❖ Low-risk real estate transactions
- ❖ Focus on low-return strategies

Core Accumulations Years (Age 46-Retirement)

- ❖ Continue to apply key concepts from early accumulation years

- ❖ Aggressively manage taxation of wage earnings
 - Retirement plans
 - Deferred compensation
- ❖ Aggressively manage taxation of investments

At Retirement

- ❖ Evaluate rollover of pensions and profit sharing plan
- ❖ Evaluate asset protection issues
- ❖ Manage net unrealized appreciation (NUA) opportunities
- ❖ Monitor the 10% IRC § 72(t) penalty
- ❖ Manage basis in both IRAs and qualified plans
- ❖ Manage qualified Roth distributions

Early Retirement Years (Retirement-Age 70)

- ❖ Manage the 10% and 12% tax brackets
- ❖ Generally defer IRA distributions taxed at 22% or greater
- ❖ Draw upon “outside non-qualified” assets and deferred compensation first
- ❖ Draw upon traditional IRA assets second
- ❖ Draw upon Roth IRA assets last
- ❖ Review Roth conversions to manage tax brackets

Later Retirement Years (After Age 70)

- ❖ Manage the 10% and 12% tax brackets
- ❖ Take all Required Minimum Distributions (RMDs)
- ❖ Spend down high basis outside assets
- ❖ Draw additional funds from IRA to manage tax brackets
- ❖ Update estate planning

Many of the income smoothing strategies above not only produce tax rate arbitrage, but also create tax deferral. The longer the period of time that tax can be deferred, the smaller the present value of the tax owed. Below is a chart showing the present value of a dollar of tax paid for various deferral periods, assuming a discount rate of 5%:

Yrs. Deferred	Discount Rate	Present Value Dollar
0 years	5%	\$1.00
1 year	5%	\$0.9524
5 years	5%	\$0.7835
10 years	5%	\$0.6139
15 years	5%	\$0.4180
20 years	5%	\$0.3769

Unfortunately, deferring the entire amount of tax for a certain period of years as shown in the chart above may not be possible. Even if the full amount of tax payable cannot be deferred until the end of the period, impressive tax savings can still be achieved by spreading the payments out over the applicable time period rather than paying all the tax at the beginning of the period. To illustrate, suppose at the end of the tax year \$100,000 in tax is owed because there was no tax planning. In

the alternative, assume there was good tax planning and the same \$100,000 in taxes owed is spread out over five, ten, fifteen, or twenty years. For example, if the tax payable is spread out over 5 years, \$20,000 is paid each year and if the tax payable is spread out over 10 years, the tax payable each year is \$10,000 per year. Below is a chart showing the present value of the \$100,000 paid over the different time periods assuming different discount rates:

5 Years:

Discount Rate	Present Value
0%	\$100,000
4%	\$89,036
6%	\$84,247
8%	\$79,854

10 Years:

Discount Rate	Present Value
0%	\$100,000
4%	\$81,109
6%	\$73,601
8%	\$67,101

15 Years:

Discount Rate	Present Value
0%	\$100,000
4%	\$74,126
6%	\$64,752
8%	\$57,066

20 Years:

Discount Rate	Present Value
0%	\$100,000
4%	\$67,952
6%	\$57,350
8%	\$49,091

As shown above, with effective bracket management, tax savings are significant. While there are many ways to achieve good bracket management, the most important thing to recognize is that because of the new NIIT and higher tax brackets, bracket management is more important than ever, and, therefore, it is a must do tax planning strategy.

Disclosures

NOT FOR REDISTRIBUTION

<https://www.bloomwoodcapital.com/smdisclosures>