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INVESTMENTS & FINANCIAL PLANNING

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Tax Planning for Major Life 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 a 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 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 you have an employer match, that is free money to you.

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

Continued on page 2

Calculating Your Investment's Basis

Your capital gain or loss on the sale of an investment equals the proceeds from the sale less your basis. When you purchase an investment, your basis equals the price you paid plus any fees or commissions. Other factors can affect your basis calculations:

- ✔ Reinvested dividends are added to your basis at full market value plus any fees or commissions.
- ✔ The basis of any investment received as a gift is the donor's original basis plus any gift tax paid by the donor. However, if you then sell the investment at a loss, your basis is equal to the lesser of the donor's basis or the investment's fair market value on the date of the gift.
- ✔ For inherited investments, the basis is the market value on the date you inherited the investment, typically the date of the donor's death.
- ✔ Your basis in stock that has been split is the same as your basis before the stock split.
- ✔ When you exercise a stock option, your basis equals the price you paid for the shares plus any fees or commissions, which may be lower than market value. Shares must be retained for at least one year after purchase and for two years after receipt of the option, or any gains will be taxed as ordinary income. ❍❍❍

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Tax Planning

Continued from page 1

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 also 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 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 put in post-taxed money, but you can now take distributions that are tax free. The biggest drawback to a Roth IRA is that 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. ❍❍❍

The Basics of College Financing

Intimidated by the prospect of coming up with the money for your children to go to college? It's not surprising, since, along with buying a house and providing for your retirement, it's one of the most sizable financial transactions most people ever make.

Basically, there are three sources of college money: your own (or your child's), money that doesn't have to be repaid, and money you or your child have to pay back. If you need one or both of the latter, you're probably going to have to fill out an application or two and work with the college admissions office to finalize a financial aid package.

Grants

This is the free money — which doesn't have to be repaid — and it can come from three sources: the school itself, the federal or state government, and private sources. Most grants come from the first two sources. To get it from either the government or the school, your family has to complete a generic, government application form called the Free Application for Federal Student Aid, or FAFSA, for every year you have a student in college.

The FAFSA asks for your family's financial information, including annual income (based on your federal tax return), taxes paid, unpaid income, savings, and the like. Money in tax-advantaged retirement plans and annuities is excluded from the calculation. The FAFSA also asks for demographic information, including your family's size, how many students you have in college, and whether your child is attending college full- or part-time.

FAFSA administrators apply a formula that determines your Expected Family Contribution, or EFC, which is how much money you are reasonably expected to pay out of pocket for college bills. The gap between your EFC and those bills is considered your need for grants. Normally, this need-based financing comes from two or all three of the primary sources: the school's endowment, the federal government, and your state government.

Since grants are need-based, the greater your family income and the more savings you have, the higher your EFC and the less grant money your child will receive.

Scholarships

Scholarships are another form of free money for college. Unlike grants, however, they're usually not need-based, so your child may be eligible no matter how high your income. They're based on merit or special talents — like academic achievement, athletics, or musical skills — or characteristics, like your or your child's religion, national background, or your child's field of study. Some community organizations conduct essay or other contests to determine winners of scholarships they sponsor.

To find these opportunities, search the Internet or contact your student's high school guidance counselor, your church or synagogue, and your local community organizations. Few of these organizations offer scholarships to cover full tuition for four years, but for that very reason many families overlook this source of aid. You shouldn't.

Loans

Especially given the current job market, it makes sense to be prudent in taking on student debt, whether it's in your name or your child's. Still, loan financing can play an important role in your financial plan, especially since, in general, you can secure a college loan no matter what your income or financial assets. There are limits, however, to how much students are allowed to borrow per year and in the aggregate.

Most student loans are financed through banks, but are sponsored by the federal government, in accordance with its terms and rules. Student loans come in two forms: subsidized and unsubsidized. Their distinguishing characteristic is when the loan starts accruing interest, and whether there's an income limit for eligibility.

With subsidized loans — which do have income eligibility restrictions — the federal government pays the interest charges while the student is studying at least half-time, for the first six or nine months after graduation, and during any period of declared hardship deferment. Unsubsidized loans — which have no income eligibility limitations — begin accruing interest from the date of disbursement. Required repayments can be suspended for financial hardship, but the interest continues to accrue.

Normally, your child's college financial aid office arranges for the loans — both the kind and the amount — based on your FAFSA calculations. If this package is still not enough, you can also apply for a Federal PLUS loan in your own name or directly to lenders in your child's name for supplemental private loans. Federally sponsored student loan rates are generally lower than those on private loans. ❍❍❍

How to Set Savings Goals

Setting clear, specific savings goals is one of the best ways to achieve your financial objectives, but it's a task many people struggle with. Below is a simple seven-step plan that you can use to set and reach your savings goals.

1. Select Goals —Your goals will be as unique as you are; the most important thing is that you select them and make them specific.

2. Determine How Much You Need to Save — Don't just pick a random number at this point — research how much you'll actually need.

3. Consider Your Timeline — Savings goals can generally be divided into three broad categories: short-term (those that you hope to reach in a year or less), mid-term (those that are roughly one to five years away) and long-term (goals you hope to achieve in five years or more). It's important to know your timeline, since it will have a direct impact on how aggressively you need to save to hit your target.

4. Determine How Much to Set Aside Each Week or Month — For short-term goals, this step is fairly simple. Determining how much you need to save to hit your long- and mid-term goals can be a bit more complicated, as you'll need to take into account the growth of your investments. Whatever the timeframe for your goals, making these calculations is important, because it allows you to adjust your savings as your budget allows.

5. Automate Your Savings If Possible — Once you know how much you need to save, you'll likely find it easier to stick to your plan if you can automate your savings. Adopt the pay yourself first principle and set up automatic transfers to your savings or investment accounts.

6. Choose the Right Way to Save — Depending on your goals and timeline, you have different options for savings. Traditional savings accounts are a good option for short-term goals, since your money will be safe, while investment accounts and retirement accounts, like a 401(k) plan or IRA, are good options for longer term goals, since you'll earn money as you save.

7. Watch Your Money Grow — Once you have your savings plan in place, keep an eye on how it is doing. You will need to periodically review your results and make adjustments as necessary. ❍❍❍

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Planning Year Round

Many people confuse tax planning with tax preparation and only think about the subject when preparing their annual tax return. However, if your goal is to reduce income taxes, you need to be aware of tax planning opportunities throughout the year.

Take time early in the year, perhaps as part of the tax preparation process, to assess your tax situation, looking for ways to reduce your tax bill. Consider a host of items, such as the types of debt you owe, how you're saving for retirement and college, which investments you own, and what tax-deductible expenses you incur.

During the year, consider the tax consequences before making important financial decisions. This will prevent you from finding out later that there was a better way to handle the transaction.

Look at your tax situation again in the fall, which gives you plenty of time before year-end to implement any additional tax planning strategies. At that point, you'll also have a better idea of your expected income and expenses for the year. You may then want to use strategies you hadn't considered earlier in the year. ❍❍❍

Financial Thoughts

The average age to start investing is 33.3 years old (Source: Personal Capital, 2022).

Two out of three households in the United States will fail to realize one or more of their major life goals because they have failed to develop a comprehensive financial plan (Source: Securities and Exchange Commission, 2022).

Approximately 60% of men and 56% of women in the United States own stocks (Source: Moneytransfers.com, 2022).

The median value of stocks owned by American families is $40,000. The average American investor holds on to a stock for 5.5 months before selling it. Almost 86% of home buyers believe that buying a house is a good investment (Source: Moneytransfers.com, 2022).

Women, on average, earn 80% of what men earn, resulting in an average $250,000 lifetime earnings differential (Source: SHRM, June 2022).

If you do not start saving until age 45, you will need to save three times as much as if you start at age 25 (Source: financiallysimple.com, 2022).

In just 30 years, 0.75% in investment fees equates to a 20% smaller nest egg (Source: financiallysimple.com, 2022). ❍❍❍