

MoneyWise Module 4

Tax and Long-term Planning: Key Issues


**Personal Finance Essentials:
8 Financial Priorities**


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Tax and Long-term Planning:
Key Issues

Module 4

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Discussion Topics

1. Perspectives: Planning
2. Taxes: Learn the tax rules
3. Credits: A social tool
4. Deductions: Second price
5. Shelters & Savings: Company and individual plans
6. Long-term Planning: Estates and Wills

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1. Financial Perspectives: Planning

President Ezra Taft Benson counseled:

Plan for your financial future. As you move through life toward retirement and the decades which follow, we invite all . . . to plan frugally for the years following full-time employment. Be even more cautious . . . about “get-rich” schemes, mortgaging homes, or investing in uncertain ventures. Proceed cautiously so that the planning of a lifetime is not disrupted by one or a series of poor financial decisions. *Plan your financial future early; then follow the plan.* (italics added, “To the Elderly in the Church,” *Ensign*, Nov. 1989, 4).

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Financial Perspectives: Planning

Elder Marvin J. Ashton stated:

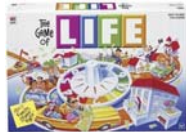
Some claim living within a budget takes the fun out of life and is too restrictive. But those who avoid the inconvenience of a budget must suffer the pains of living outside of it. The Church operates within a budget. Successful business functions within a budget. Families free of crushing debt have a budget. *Budget guidelines encourage better performance and management.* (italics added, Marvin J. Ashton, “It’s No Fun Being Poor,” *Ensign*, Sept. 1982, 72.)

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Taxes: Learn the Rules

- “Everybody talks about the weather, but nobody does anything about it.” - Charles Dudley Warner
 - Taxes are not like the weather, you *can* do something about it
- Tax planning is a year-round process
 - Tax filing is not optional if you have income



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Taxes: The Tax Process Simplified

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graph TD
    A["1. Start with Gross Income from all sources (wages, interest) less exclusions and deferrals = Gross Income"] --> B["2. Subtract adjustments to Gross Income = Adjusted Gross Income (AGI)"]
    B --> C["3. Subtract the greater of Standard or Itemized Deductions"]
    C --> D["4. Minus Exemptions = Taxable Income"]
    D --> E["5. Look up tax on tax table = Tentative Tax"]
    E --> F["6. Minus Credits = Total Tax Owed"]
    F --> G["7. Minus Taxes already Paid = Balance Due or Amount of Refund"]
  
```


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Taxes: Simplified Tax Format



Gross Income (Wages, interest, etc.)
 Minus: "Above the line" Adjustments
 = **Adjusted Gross Income (AGI)**
 Minus: Itemized or Standard Deductions
 Minus: Personal Exemptions (\$4,000/each in 2015)
 = **Taxable Income**
 Times: Tax Rate (10% / 15% / 25% / 28%/ 33%/ 35%)
 = **Tax Owed**
 Minus: Credits
 Minus: Taxes Withheld from Wages/Prepaid
 = **Refund/Amount Owed**

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Taxes: Taxing Terms

- Tax deductible: Subtracted from your income on your tax return before calculating taxes
- Pretax: Subtracted from your income before the amount reported on your tax return
- Tax deferred: Taxed later rather than right now
- Tax credit: A dollar for dollar reduction of your taxes
- After tax: Subtracted from income after calculating taxes
- Tax free: Not taxed at all

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Taxes: Uncle Sam's Big Plans for You



The U.S. tax system isn't just for generating revenue

- Tax incentives drive social objectives
 - Home ownership
 - Education
 - Charity
 - Retirement savings
 - Welfare

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Taxes: Tax Withholding

- The IRS requires employers to "withhold" taxes
 - Social Security, Federal Income Tax, State Income Tax
- Withholding federal and state taxes **prepays** any amount you would owe April 15th
- Employees decide how much to have withheld
 - Form W-4 is completed when hired
 - W-4 can be updated at any time
 - The more exemptions you claim, the less tax is withheld
- Tip: Have just enough withheld to cover taxes owed
- See IRS Withholding Calculator at <http://www.irs.gov/individuals/article/0,,id=96196,00.html>

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Taxes: Tax Deduction versus Tax Credit in 2015

	Jack Deduction	Jill Credit
Income	\$35,000	\$35,000
Minus: Adjustments	1,000	0
= Adjusted Gross Income (AGI)	\$34,000	\$35,000
Minus: Standard Deductions	12,600	12,600
Minus: Personal Exemptions (2)	8,000	8,000
= Taxable Income	\$13,400	\$14,400
Times: Tax Rate (10%)	x 10%	x 10%
= Tax Owed	\$1,340	\$1,440
Minus: Credits	0	1,000
Minus: Taxes Withheld	\$1,500	\$1,500
= Refund	\$160	\$1,060

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3. Credits: A Social Tool



- Credits help support the governments social agenda. There are credits for:
 - Education
 - Savers
 - Children
 - Dependent care
 - Earned income

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Slide 11

CN1 I moved this slide (ded'n vs credit) to be slide #11, after Tax Withholding and before Credits.
Christie Norris, 10/20/2015

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Credits: Education (AOC and LLC)

- American Opportunity Credit (AOC)
 - First four years of post-secondary education
 - Qualified expenses include tuition, fees, and other "course materials" (i.e., books, supplies and equipment)
 - \$2,500 maximum per student, 100% of first \$2,000 and 25% of the next \$2,000
 - Payments made with loans qualify, but not with scholarships or Pell grants
 - 40% of credit is refundable (can receive up to \$1,000 even if owe no taxes)
- Lifetime Learning Credit (LLC)
 - Must choose either AOC or LLC, not both
 - 20% of first \$10,000 per family


See IRS Publication 970, <http://www.irs.gov/publications/p970/index.html>

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Credits: Education Incentives

- Education expense deduction
 - Above-the-line adjustment up to \$4,000
 - Can't claim with education credits
- Student loan interest deduction
 - More liberal definition of qualified expenses
 - Tuition and fees
 - Room and board (generally)
 - Books, supplies, and equipment, transportation
 - Up to \$2,500 in interest
 - Above-the-line adjustment to income
 - Phased out for MAGI income from \$130,000-\$160,000 in 2015




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Credits: Savers Credit

- Nonrefundable credit, percentage based on AGI (2015)
- Full-time students ineligible, but spouses eligible
- Credit is 10–50% of first \$2,000 contributed to 401(k), IRA, or Roth IRA
 - Percentage depends on AGI

Credit Rate	Joint Filers AGI
50%	\$0 - \$36,500
20%	\$36,501 - \$39,500
10%	\$39,501 - \$61,000
0%	\$61,001 +



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Credits: More credits

- Child tax credit
 - \$1,000 per child under age 17
- Dependent care credit
 - Up to \$3,000 of qualifying expenses per child under age 13
 - Max of \$6,000
 - Credit is 20–35% of expenses depending on income
 - Day care must be so both spouses can work
 - Exception if spouse is full-time student

See IRS Publication 503, <http://www.irs.gov/pub/irs-pdf/p503.pdf>

- Adoption credit
- Residential energy credit



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Credits: Earned Income Credit

- Based on 2015 earned income, number of children and married filing jointly (MFJ)
 - >2 children and earned less than \$53,267 (Max \$6,242)
 - 2 children and earned less than \$49,974 (Max \$5,548)
 - 1 child and earned less than \$44,651 (Max \$3,359)
 - No child and earned less than \$20,330 (Max \$503)
- Investment income of \$3,400 or less
- Must be age 25 or have a child

See IRS Publication 596 <http://www.irs.gov/publications/p596/index.html>

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Credits: Premium Tax Credit

- If purchased health insurance coverage through the Marketplace, you may be eligible
- Amount is based on household income and size
- If you received advance payment credits, you may get an additional credit, or have to repay the amount
 - Based on estimate entered when applying for insurance
 - Be sure to report changes in circumstances
- You may qualify for coverage ^{CN2} exemptions or you may owe an individual shared responsibility payment

See IRS website for assistance <https://www.irs.gov/uac/Affordable-Care-Act-1>

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Slide 18


CN2 I added this slide (#17) on the Premium Tax Credit after Earned Income Credit.
Christie Norris, 10/20/2015

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4. Deductions: Second Prize




- Deductions only benefit you to the extent they exceed the standard deduction
 - The standard deduction in 2015 is \$12,600 MFJ
 - Take the higher of your itemized versus standard
- Major deductions include:
 - Mortgage and home equity loan interest
 - Charitable contributions (tithing, DI, etc.)
 - Property and state taxes
 - Excessive medical expenses (amount over 7.5% of income)

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5. Shelters and Savings: Company and Individual Plans



- Best way to beat the tax game!
 - Understand the traditional and Roth difference
 - Contribute enough to get the full employer match
 - You can't beat a 100%, risk-free, instant return
 - Contribute more if you prefer the traditional vehicles:
 - Contribute to your traditional 401k
 - The only way you ever save is through payroll deduction
 - If you prefer Roth vehicles:
 - Contribute to your Roth IRAs, with additional in the traditional vehicles
 - You can contribute up to \$5,500 in either an IRA or Roth IRA
 - You can contribute up to \$18,000 in a Roth or traditional 401k/403b

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Shelters and Savings: College Savings Plans

- The decision to contribute to your children's education is your decision
 - You're not a bad parent if you're not saving to put your kids through law school
 - Prioritize this somewhere after your own retirement planning and debt elimination (including mortgage)
 - Retirement for parents is a higher priority than the children's education savings
- Talk to your kids about what they can expect
 - Let them know early if they will need a scholarship or loans to afford school

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Shelters and Savings: Tax-favored Education Savings Options




- 529 plans
 - Each state has teamed up with an investment company to create their own plan
 - You can choose any state's
 - Utah's is highly rated (www.uesp.org)
 - State income tax credit of 5% for contributions up to \$3,800 per beneficiary in 2015 (MFJ)
- Coverdell ESA ("Education IRAs")
 - Up to \$2,000 per year, non-deductible
 - Can be used for qualified elementary, secondary, p
- 529 Prepaid tuition programs
 - An OK idea if you can find one

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6. Long-term Planning: Estates and Wills



- Children's custody is your primary concern
 - Without a valid will, courts must decide on guardian for your children
- Dividing your assets is a secondary concern
 - Most assets don't fall under the will
 - Retirement accounts and insurance policies have named beneficiaries and contingents
 - Homes, vehicles, and joint accounts transfer to the surviving owner ("joint tenancy with right of survivorship")

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Estate Planning and Wills: A Simple Will

- Three alternatives
 - Holographic will for students with simple wills
 - Biggest advantage is you can do it *right now!*
 - Handwritten wills don't need witness signatures
 - State that you intend this to be your will
 - Name a guardian for children if you and spouse should die
 - List any specific bequests, with remainder to spouse
 - Will preparation software
 - Appropriate if situation is uncomplicated
 - Recommendations in *Personal Finance for Dummies*
 - Can also help with power of attorney and health care directives
 - Attorney
 - Wills, trusts, individually titled assets, own business, divorce

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Tax Planning Take Aways

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25

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FHE Suggestions

- Review list of tax credits and deductions and discuss whether you're taking full advantage of "the tax game"
- Discuss whether you need to change your withholdings to help with budgeting
- Get two sheets of notebook paper and have each spouse write a holographic will, sign and date it
- Decide whether you need an attorney or can use will preparation software to create a more permanent will

26

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Resources

***All Resources are Online at <http://personalfinance.byu.edu>

Readings

- Reading 4.1 Steven J. Dixon, "Planning Ahead: The Importance of Wills and Trusts," *Ensign*, June 1983, 28.
- Reading 4.2 Dellwyn R. Call "Tax Planning", *Marriott School Magazine*, Fall 2004, pp. 16-21. (The numbers are outdated but the principles are still sound and useful.)
- MoneyWise Reference Manual 2015-2016 (online)

Websites

- BYU Personal Finance Website: <http://personalfinance.byu.edu>
 - Advanced Lessons: 4. Tax Planning, 33. Financing Education
- Free income tax help: <http://vita.byu.edu>
- IRS website is very user friendly and helpful: www.irs.gov

27

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