HBKS®
Wealth Advisors

Using the Tax Return to Increase Income

A first in a series we hope you find useful in helping maximize current and future incomes.

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Along with having his own financial advisory practice, he works with the firm's co-founder, Gregory Sorce. Mr. Rinn has experience in comprehensive financial planning, retirement planning, insurance and asset management.

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Brief #1: The annual IRA contribution

As a financial advisor, I find the tax return one of the most revealing and useful tools for helping my clients. It will always be among one of the first items I ask new clients to provide.

CFPs and CPAs can collaborate to help maximize a client's after-tax rate of return. Given the current market conditions of low bond yields and volatile equity markets, advisors should consider other ways to add value. For this, we look to the tax return.

As we look to increase after-tax returns, review of clients' tax rates, the impact of taxable versus tax-free interest, active versus passive management, and capital gains distributions/sales planning are important considerations. An often overlooked strategy for clients is the IRA deduction, which will be the focus of this article.

Consider line 32, the IRA deduction.

There are few accounts that can help salaried employees save for retirement better than their company-sponsored retirement programs. Salaried employees should contribute to these programs at least up to their company match, and perhaps even more considering their current tax bracket, future tax bracket and age. Once the decision is made as to how much to contribute to a company retirement program, individuals should look for ways to maximize their tax efficiency outside of their company plan. (See IRS form 1040, line 32.)

More often than not, I find new clients may have their company-sponsored retirement plan, an IRA from a previous employer as well as some after-tax savings. What is often forgotten by their "money manager," who may not be reviewing the tax return and can be uncovered by their CPA and CFP, is the relationship between after-tax and tax-deductible savings each year. Clients may feel they do not have enough current income to make additional tax deferred savings, although they often overlook the transfer from after-tax assets to their deductible IRA each year. This can be a "cashless" transfer, decreasing your federal tax bill and increasing your refund amount, cash in hand.

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This strategy of managing the relationship between tax-deductible savings and after-tax savings is especially powerful for people who are close to retirement. More often than not, retirement-age individuals are at their peak earnings and highest tax rate. Where the IRA limits allow, taking advantage of the current tax deduction then spending the funds in retirement at a potentially lower rate provides an increased after-tax return on savings.

It is important to consider the use of the Roth IRA when managing after-tax and tax-deferred savings as well. For example, younger individuals without a large change in their tax bracket may benefit from transferring the after-tax dollars to a Roth IRA, making all future earnings tax free. Keep current liquidity in mind when considering the use of these strategies. You may be committing to a longer term investment strategy given the five-year rule for Roth IRAs. Also keep in mind the IRS age limit for IRA withdrawals—59 and a half—to avoid the penalty.

Advisors should carefully review client tax returns throughout the year. The tax return has the potential to uncover planning opportunities to increase longer term rates of return on net worth. This tax season, be sure to review your relationship between tax deferred and taxable savings to maximize tax efficiency and add value to your bottom line. ☐

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