KEEN ON
RETIREMENT

Gearing Up for Tax Time:
Answering Listener Tax Questions

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Steve Sanduski:	Hey everybody, welcome back to Keen on Retirement, I'm your co-host Steven Sanduski and I am here with Bill Keen and Matt Wilson. Guys, how you doing today?
Bill Keen:	We're doing good down here Steve, how are you doing this tax season?
Steve Sanduski:	Doing well. Doing well. I haven't turned in all my papers yet to my tax person, but I am slowly but surely accumulating all the documents in my file and before long I'm gonna have to send that off and see how much I owe.
Bill Keen:	Oh yes. We're still early in the game in tax season here, aren't we, Steve? There's still an eternity until it's due.
Steve Sanduski:	Yeah. Not until middle of April.
Bill Keen:	That's right.
Matt Wilson:	Yeah and even then, you can extend it out till October.
Steve Sanduski:	You can.
Bill Keen:	Well you know, I know we keep suggesting that Steve is sitting on a big pile of Bitcoin that he's hoarding over there so, we're still not sure about that. He might have to extend his taxes to get all that figured out.
Matt Wilson:	Mm-hmm (affirmative).

Steve Sanduski: Yeah, well, you know, I think Bitcoin and these crypto currencies is starting to become a recurring theme in these episodes so ...

Matt Wilson: Mm-hmm (affirmative).

Bill Keen: We have to make sure that all this teasing Steve here, that our listeners aren't actually thinking that he actually does own a bunch of it.

Steve Sanduski: Well, maybe if we talk about it often enough that will actually will come true, that I didn't even know unconsciously I ended up buying a whole bunch of Bitcoin when it was $100.

Bill Keen: Right.

Steve Sanduski: And I am sitting on a gold mine.

Matt Wilson: You might be. Now, you might be a target then for hackers and for everybody else trying to steal your Bitcoin.

Steve Sanduski: Yeah. Yeah.

Bill Keen: Oh.

Steve Sanduski: And maybe I was smart enough to take it offline and write down my codes and put it in a safe deposit box. How's that?

Matt Wilson: Yeah.

Bill Keen: Now, that's a good piece of advice there.

Steve Sanduski: Alright, well, hey guys. I know we have a few listener questions that we're gonna go through today, I was looking at the list here, we've got some really good ones so, if you guys are ready, we'll just jump right into it.

Bill Keen: Let's do it.

Steve Sanduski: Alright. Well, the first one I'm looking at here says that, "I just inherited some money from my father who recently passed away. There is a life insurance policy that I am the beneficiary of and they say it's $200,000 and they have an IRA worth $37,000 and some after tax investments in stocks and mutual funds of about $300,000." And their question is, "Is all of this taxable?" What say you gentlemen?

Matt Wilson: Yeah that's a great question 'cause there are some different rules around the taxes with each one of those items, so, depending on when this person passed away, there could be some different rules now. Based on the values it won't really matter but what I'm referring to is the estate tax. So, it doesn't kick in if you passed away in 2018 till an individual has an estate worth more than $11.2 million. So, this person's under that threshold. Now if they passed away in 2017, the threshold was half that, so it was only $5.6 million so still not an issue but did have a little change there with the new tax laws that went into effect at the end of last year.

Bill Keen: We get this question a lot. When people inherit money like this and when they're asking are these taxable, I don't know that they know that they're asking this question but to Matt's point here, and I'll let him finish, is that there's different types of taxes that they need to be thinking about.

Matt Wilson: Yeah, most people, I think, when we get this question are referring to the estate tax, so they just want to know, will all of this money just be lumped together, and will I have to pay tax on it or will the estate have to be taxed on it? And the answer in this situation is no, no estate tax. The next piece then is okay, well, depending on how the account is held, what type of account it is, there's then some different tax ramifications. The first component there, I believe was the life insurance policy of $200,000 dollars.

Bill Keen: That's right.

Matt Wilson: There would be no tax on that.

Bill Keen: That's good news.

Matt Wilson: Yep that is distributed tax free to the beneficiary so that is good. There's an IRA worth $37,000. So, the answer on that is it transfers to the beneficiary tax-free, but the beneficiary is now responsible for all of the deferred tax that's within that IRA.

Bill Keen: We have a lot of these don't we Matt? Our clients, even in their 50's and 60's, are now inheriting these IRA accounts, so we have quite a few of these inherited IRA's that he's talking about here.

Matt Wilson: We do. And the balances are kinda in that range, I mean none of 'em are any huge amounts of money where I would say their north of a million dollars or anything like that, but I think we'll start to see more and more of that as time goes. The way the rule works, says the IRS, is, yes, it passes to the next generation or to the beneficiary, but that beneficiary has to take out a minimum amount based on their life expectancy.

Bill Keen: A lot like the required minimum distribution rules.

Matt Wilson: Exactly like that. They call it a required minimum distribution for an inherited IRA. So, the IRS basically says, "Well, this money's been sitting in this account, tax deferred, for however many years and this person that owned it might have already been taking required minimum distributions but the next generation they have to continue taking required minium distributions but it's just based on their age." So, the amount they have to take out is different, it's not based on the person who passed away.

Bill Keen: That's right.

Matt Wilson: Now there is one caveat to this, is that if you forget to take it in that first year, then you have a five year window to take the entire account out. You have to take the balance to zero.

Bill Keen: So, in this case that's probably not going to be a big deal and we might even recommend, depending on this listener's tax situation, that they take the whole thing out anyway as part of their, maybe, next year's income. It just totally depends on whether or not they're retired, they need the money or not.

Matt Wilson: That's right.

Bill Keen: I think when our clients start to pass away, the ones that we're working with, where the IRA's are seven figures plus, now this is gonna be a much different situation for their kid's inheriting and not being forced to take that out over the course of five years.

Matt Wilson: That's right.

Steve Sanduski: Hey Matt, I got a question if I could. So, let's say this was maybe one of those million dollar IRA's, could it be set up so that there are three beneficiaries of this? And each one gets a third, a third, a third and if so, mechanically how does that work? Are they taking this million dollars and let's say it's invested in a lot of different things, how do they know which third goes to each of the people? And are they setting up three new accounts? How does that all work?

Matt Wilson: What happens when you have multiple beneficiaries, which is very common, is, the custodian will set up inherited IRA's for each of the beneficiaries based on the percentages that was predetermined by the owner of the account. So, in your example Steve, yes, a third, a third, a third. Now, you have to equal 100% so, someone might be getting a little bit more in that case, but it is predetermined. In other cases, you might have three beneficiaries but it's 75% to one, 20% to another and 5% to the third so that it doesn't have to be equal at all. And the other thing to remember with this too is, it doesn't matter what any of your estate planning documents say. So, if you've created a will or a trust, if you didn't update your beneficiaries, it doesn't matter. It goes by whatever it says on that IRA that's one of our checklist items is just reviewing beneficiaries on an ongoing basis because sometimes things do change.

Each owner of the inherited IRA now has their own tax ramifications for whatever decision they make. So, if one of the individuals inheriting the funds decides to just take it all out and pay all the income tax, that doesn't impact any of the other beneficiaries.

Steve Sanduski: Okay. That makes sense.

Matt Wilson: They're very tax friendly, that's right.

Steve Sanduski: Okay.

Bill Keen: One thing we have to do Steve and this question has kind of opened up a lot of different scenarios here is, educate the kids. We want to try to do the best we can to let them know about the Stretch IRA, which allows these accounts to be taken out over the course of a lifetime and not all consumed in the first year or the first five years, like Matt mentioned, and in some cases, you can educate all you want but there's going to be the kid, if you will, that's not going to care about the Stretch IRA and that's gonna want the money now as soon as possible. So, we do try to educate the kids and let them understand. This truly could be a retirement account for you over the course of your lifetime. Yes, taking small distributions is required over the course of your life but not taking it all out all at once.

Steve Sanduski: So, how about the other part of this question where they said they also have some after tax investments in stocks and mutual funds of about $300,000. How is that taxed or not taxed?

Matt Wilson: We call this a "step up in cost basis". It doesn't matter what the person who passed away, what they paid for the investments. What the IRS says is at the date of death, whatever the value of everything is at that time, your basis resets to that new value.

Bill Keen: That's quite a gift isn't it?

Matt Wilson: It is. Let's just say for example this person paid $100,000 dollars for these investments, they're now worth $300,000 dollars, if they sold those while they were living, they're gonna have a capital gain on $200,000 dollars and they're going to pay tax on that because they passed away and left this on without triggering that sale, that $200,000 dollar capital gain gets basically wiped out by the IRS and the beneficiary gets to decide. Now they don't have to sell anything.

They can do whatever they want with those funds and just hold onto the stocks and mutual funds but if they choose to sell 'em, then if they sell 'em, essentially, at the date of death or real near that, there would be very minimal gain or loss, of course depending on what the investments are doing but they don't have to worry about going back and figuring out all the old cost basis records.

Bill Keen: Now, it's enough just to talk about what the actual tax bill is that passed so it's maybe unnecessary to go back and talk about prior versions that didn't pass but, Steve, they were talking about eliminating that step up in basis that Matt just described and that had a lot of people up in arms.

Matt Wilson: Yeah.

Bill Keen: 'Cause this is a big deal for after tax investments. Things like family farms, right?

Matt Wilson: Yeah. Oh yeah.

Bill Keen: Family farms ...

Matt Wilson: Real estate.

Bill Keen: Yeah.

Matt Wilson: Yeah.

Bill Keen: Oh yeah.

Matt Wilson: Real common with stocks and bonds and mutual funds and those types of investments but, yeah, anything that is invested in after tax dollars, that capital gain goes away. One of the proposals was get rid of the estate tax completely, but there would be a capital gains, the step up in basis would be eliminated as well. So, in that case, a lot more people would be subject to that step up in basis situation.

Bill Keen: Oh yeah. So, by raising the estate tax limits now to, would you say, 11-2 per person, right?

Matt Wilson: Per person, yeah.

Bill Keen: That's 22-4, it essentially eliminates mathematically everyone.

Matt Wilson: Yeah.

Bill Keen: I mean, there's very few people who will get hit by that, not quite everybody will be eliminated but mathematically most. And then the quote "normal" people got to retain the step-up basis so, we appreciated that working out the way it did. So, to answer this listener's question, if you look at this, they just inherited over $500,000 dollars. And they're going to only owe income tax on the $37,000 in the IRA of which a very small portion even that needs to be brought out under the RND rules. So, good news for this listener and others out there listening to us today, we get this question a lot in this firm. I mean, probably once or twice a month folks are going through this and they're just certain that there's going to be at least a good chunk coming out of something like this. And in most cases, there's not.

Steve Sanduski: So, I think the moral of the story is, it's good to inherit money.

Bill Keen: Yeah, we'd have to do some calculating.

Steve Sanduski: That's a strategy we recommend.

Bill Keen: Yes, exactly.

Steve Sanduski: Hey, let's take a look here at the second question that we've got and the question is, they say, "I had a zero tax year last year due to a tax deduction. I realize now that I could have converted part of my IRA to a Roth IRA and had virtually a non-taxable event, can I still do this now in 2018 for 2017 tax year?"

Bill Keen: Oh.

Matt Wilson: Yeah, unfortunately not.

Bill Keen: Yeah, there's a lot of things that we talk about in being proactive in your tax thinking and planning, so there's a checklist that we go through every year so that we're not doing exactly this and that's looking back at history and saying, What could we have done? Unfortunately with these Roth conversions, they have to happen in the tax year that you want to make that transaction occur, unlike making a Roth contribution or an IRA contribution now, we have until you file your taxes to do that. Like right now, someone could make contributions for 2017 still. The Roth conversion has to happen by December 31st of the year.

We've seen this, haven't we? Several clients that have had big tax deductions, we have several that have businesses that have different accounting methodologies that every so often they'll buy some capital equipment, or they'll have something that comes up that they're in a zero tax, there's not any taxes due for them that year and those are years just like this listener asked. Yes, if you have money in IRA's you can make a conversion over to a Roth and take advantage of that. We had at one point, a client bought into a long-term facility, it wasn't a nursing home, although it had that level of care, it was an independent living but then you basically sell your home and make a large contribution. I think it was several hundred thousand into this facility and then you're there, you can stay there the rest of your life.

Good portion of that was considered a qualified medical expense and above the floor that year they had a nice deduction that we were able to convert a Roth IRA to a Roth to take advantage of that deduction in that year. Had we not done that, been aware of it and had been looking back at it like this listener is, client would have missed it. So unfortunately, this answer isn't as positive as probably the one that we had to listener question number one. If you missed it, you missed it unfortunately.

Matt Wilson: Yeah, that's why it's important to just sit down in the fourth quarter of every year and really just get conscious of where you're at income wise and what some of your expenses have been and kinda run through a mock tax return just to see, okay, is there any potential strategies that I can utilize before the end of the year? 'Cause that is the key to this on some of these strategies. These conversions specifically though, you've got to do 'em in the tax year.

Steve Sanduski: One thing I wanted to add here Bill is, I've heard you use the word checklist a couple of times and I know we've done previous episodes and some blog posts on checklists and how you guys are using that in the practice there at Keen Wealth Advisors and so I would just say, anyone listening to this, if you're working with a financial professional and they're not using checklists or they don't have some method and process whereby they are able to go through a list of all these different things that they should be talking to you about to make sure that nothing falls through the cracks and that they don't miss anything, just like in this example here with the Roth IRA needing to be able to do that during the current tax year to take advantage of it. So, if you are working with someone doesn't have a checklist or some kind of process like that then you might want to think twice about that.

Bill Keen: Well, for sure, and I always say make sure you're working with people who are keeping their checklist updated as well.

Steve Sanduski: Yeah.

Bill Keen: You know Steve, I'm a pilot, and we talk about that a little bit over the course of our episodes and sometimes I get a hard time from people. My friends and relatives and others, they say, "Oh Bill, you're so obsessive. You and your checklists," or they look our blogs we put out and we always have a nice checklist about hey here's the things, the actionable items that can make a difference to look at and then now we're talking about checklists today in the Keen Wealth for our clients and I would simply say, if you're a passenger in my airplane, you're gonna be grateful that I'm a quote "checklist guy".

Steve Sanduski: For sure.

Bill Keen: And if you're a client of Keen Wealth, you're gonna be grateful that we are checklist people here and that we keep our checklists up to date.

Steve Sanduski: Yeah and I can attest to that Bill, 'cause I have been a passenger when you've been at the controls of your plane and I am grateful that you definitely go through the checklist and you're very focused on that. So yeah. It's so easy to forget things and we get hundreds or thousands of flying hours and still even with that, you still go through the checklist on the very basic things because it's so simple. All it takes is just one missed flip of a switch and that could be the difference between life and death.

Matt Wilson: Mm-hmm (affirmative).

Bill Keen: That's right. That's right.

Steve Sanduski: Alright, let's take a look at the third question here. And this listener asks, "It looks like now that I will be taking the standard deduction due to the higher deduction numbers," and I think they're referencing the new tax bill and they say, "Is there any strategy left to take advantage of deductions?"

Bill Keen: Yeah, we've been looking at this pretty hard.

Matt Wilson: This new tax law increased the standard deduction to a point to where most individuals, and this is data that is coming in from several different sources, 95% of tax filers will file the standard deduction. 2017 and in previous years, it's about 70% would file the standard deduction. So, most people still file the standard but now this is gonna hit more and more people to where the itemized deductions just don't make sense or don't add up too enough there's definitely two strategies that come to mind. The first one is all about charitable contributions and being over 70 and a half.

Bill Keen: That's right.

Matt Wilson: So, what we call that is a "qualified charitable distribution", a QCD, when you take out money directly from your IRA, and pay it to this qualified charity and it counts towards your requirement minimum distribution but it doesn't show up on your tax return as a distribution.

Bill Keen: So, as an example for a married couple the new standard deduction is $24,000 so you got a lot of people that we work with in the firm here don't have any mortgage interest to deduct anymore, their state income if they're retired isn't too awfully bad. So, some of the deductions, really, it was the charitable that was making up a good portion of it and property taxes but like Matt said, 95% of the folks in the U.S. won't have enough of those combined to get over the $24,000 so, it doesn't make sense for them to itemize. They would just simply take the standard deduction.

Matt Wilson: Mm-hmm (affirmative).

Bill Keen: So, in his example there, you take the standard, you get the full $24,000, you write that off and then on the RMD you were forced to take because you have to, based on the rules, that you direct it right over to your charity that you would have been making anyway and it's a non-taxable event.

Steve Sanduski: Well, let me throw this side to you. This is something I've been reading about as well. So, talking about these charitable contributions, let's say that you're under 70 and half and let's say that maybe you typically make, I'm just gonna pick a number, $15,000 a year of charitable contributions, well even with your $15,000 charitable contributions and make a few thousand of state tax, let's say you're still under the $24,000 ...

Matt Wilson: Mm-hmm (affirmative).

Bill Keen: Yeah.

Steve Sanduski: Okay. So, some people are now saying that you bunch your charitable contributions and you take 'em all, like once every two years. So, if you're going to make $15,000 per year than what you do is, in one year you contribute $30,000 and then the next year zero and then next year $30,000 so that way by doubling them, you're now over your $24,000 and you might be able to have a higher deduction in those years when you've doubled your contributions. Is that a valid strategy?

Matt Wilson: It is. And that's actually one of the other strategies that we're talking to folks about is that, essentially, and there's a couple of different ways to go about it, you can bunch them to where if you have a charity that you've been pretty consistent with giving funds to, just let 'em know hey this is what I'm going to give you for the next two years so you just bunch them all into one year so you're able to claim the itemized deduction.

Bill Keen: Course they forget that, by the way. By the next year they forget that you said that was for two years.

Matt Wilson: Charities but yeah …

Bill Keen: That's a whole other ...

Matt Wilson: They always kind of remind everybody. Now, another strategy with that is to use what is called a donor advised fund.

Bill Keen: Mm-hmm (affirmative).

Matt Wilson: We customize our client assets at Charles Schwab and Charles Schwab has donor advised funds here the client can deposit any dollar amount. Now, this is with after tax money so it's not IRA money it's after taxes. And they can put in, in this example Steve, they can put in two years' worth, $30,000 dollars, they could put in four years' worth, $60,000 dollars, assuming they had the cash to do so and then claim a deduction for that contribution or the donor advised fund in the year that they made that contribution. And then you can control how it's invested.

So, you can determine what level of stocks and bonds that you want in there and then too, you also control when the money is distributed. So, you don't have to just decide upfront who it goes to and what dollar amount while it's inside this donor advised fund, you can make that choice. So, if you were donating a thousand bucks a month to a specific charity, you can set that up directly from this donor advised fund as well so you're not having to have this conversation that we're gonna give you a lump sum every couple of years and then reset that every so often. And you can change your mind too, so if you felt like, well, hey, I had this charity in mind but I'm gonna maybe split this up in a couple of different ways, you can change it at any time as well so, a lot of flexibility with these donor advised funds and I think we'll see a lot more of that come into the planning realm.

Bill Keen: Yeah, Matt mentioned $30,000 or $60,000, as an example, the reality is, and I think he mentioned it too, but just to reiterate, any amount can go into a donor advised fund and get that tax deduction in the current year. Now if I say that though, now I gotta go talk about the percentage of you can only deduct up to 60% now of your adjusted gross income in any given year. It was 50% under the old tax rules and now it's up to 60 so here's an example. If you made $100,000 adjusted gross income, they will only allow you to deduct $60,000 now in '18 and goin forward in that year so there is a limitation to your deduction there based on adjusted gross income.

Matt Wilson: That's right. Yeah. And again, these are all for charitable contributions so, you can't set up a donor advised fund for your child.

Bill Keen: Well, the kids would sure like that. I think I already have though.

Matt Wilson: You just don't get the tax deduction.

Bill Keen: I mean not technically ... Right, right. Yeah.

Steve Sanduski: Yeah.

Matt Wilson: Another, so this can even be coupled with this donor advised fund or this charitable bunching, is making two property tax, state income tax, making two years' worth of payments in one year. Now this gets a little bit more technical, in terms of how you do that and what are the penalties associated with it. If we combined a donor advised fund with some charitable bunching with this property tax strategy, we can somebody's itemized deductions up there in every few years.

Bill Keen: Right, so, take the standard every two, three years and then you have an off year or an odd ball year where you have these higher deductions all pushed into one.

Steve Sanduski: Excellent guys. Well, I see one more question here, and the question is, "I saw in the tax bill that the step up in cost basis was repealed. What does this mean?" Now, I know we talked a little bit ago about a step up in basis, so what's going on here with what they're asking?

Bill Keen: Sounds like they read an old version of the bill doesn't it?

Matt Wilson: Yeah.

Bill Keen: We got ahead of that question, didn't we?

Matt Wilson: That one ... It was bantered about but never put in the law.

Steve Sanduski: Okay. Alright. So, we've already answered that one then.

Matt Wilson: Yeah. And there's another question that we've been getting a lot lately too is around 529's.

Bill Keen: Uh-huh (affirmative).

Matt Wilson: Because that was another big change that I think, applies to a lot of folks that we work with is, how 529's are now used going forward. So, what the tax cuts and job act of 2017 now allows is for 529 accounts to be used for education expenses from grades K through 12. Now that is subject to a $10,000 cap per beneficiary on grades K through 12 and then any dollar amount for any college expenses.

Prior to this year, it was just for college expenses and so, you think about saving for 18 years, yeah, you could have nice account there, there's just a big unknown around, well, is my child going to go to college or not? And am I going to have this big chunk of money in this 529 account that I can't necessarily access for other purposes if you didn't use 'em for qualified education expenses, it was taxed, the gain, the gain was taxed and penalized at a 10% rate. So, there were some restrictions around that. What we're seeing from a planning standpoint is individuals who are already making education expenses for grades K through 12, now running those through a 529 account and the reason they would do that is because they would get a state tax deduction for those contributions.

In Missouri you can deduct up to $8,000 dollars if you're single, $16,000 if you're married, off your Missouri taxes. Kansas is $6,000 per beneficiary if you're married filing jointly.

Bill Keen: So, some of these strategies we've talked about today Steve, they're all about thinking ahead. Being smart, being prudent and saying, is it worth it to pivot to understand the rules, to do a little bit of work upfront to take advantage of some of the new legislation? For some people the answer will be yes, for other people it will be, keep it simple these are all things though that I think as we continue to get questions and think about how these things play out, we'll continue to bring those to the show.

Steve Sanduski: Well, guys, I think we'll wrap it up there so, some great questions and some very important and insightful answers from you guys. So, I appreciate that, lots of good wisdom here that we talked about today and some ways for people to save some money on taxes with the new tax bill. So, again, guys, thank you and we'll look forward to the next episode of Keen on Retirement.

Bill Keen: Alright. Thanks Steve. Thanks Matt.

Matt Wilson: Thanks.