REVISED TAX LAW SPURS NEW INVESTMENT STRATEGIES

With the 2017 tax year officially behind us, many clients are asking about strategies for this year, considering the new Tax Cuts and Jobs Act of 2017. This new law has given us the lowest individual tax rates we have seen in decades, with a small caveat. They aren't quite permanent, as they have a "sunset" after the year 2025, when they revert to the 2017 tax rates. This act has many taxpayers wondering how it impacts them. While many articles dive into the net effects that the new tax law will have on us in the current calendar year, our clients have been finding the most insightful discussions around the impact on retirement planning.

For decades, traditional retirement planning thought has pointed to the idea of saving into a traditional IRA or 401(k). This is based on the premise that your marginal tax bracket while you are working should be higher than your marginal tax bracket during your retirement since many pre-retirement expenses will be reduced or eliminated. Between mortgages not being paid off, kids or even parents needing support, and the general desire to enjoy life, many find themselves spending significantly closer to their pre-retirement earnings.

Given that thought, let's examine some traditional retirement savings tools; the IRA/401(k) and their Roth counterparts. With a traditional IRA or 401(k), you make deductible contributions to the account, avoiding paying tax on the amount you contribute along with any earnings because traditional wisdom says your income should be higher while working. Then, in retirement, your withdrawals are subject to tax as ordinary income, when your income is expected to be lower. With the Roth versions, we can save with after-tax dollars, essentially paying tax today. At age 59 ½ and after a five-year holding period, you can take withdrawals, including earnings, tax-free. In a way, they work opposite one another. Many individuals elect traditional IRA contributions for the immediate tax-benefit today, coupled with the idea of lower taxes in retirement. But what if the tax rates today were incredibly low?

▸ PROFESSIONAL OPINION

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Enter the new Tax Cuts and Jobs Act of 2017. This new law has changed not only the amount of tax paid in each bracket, but also the size of the brackets. In 2017, a married couple filing jointly needed to earn between $75,901 and $153,100 of taxable income to find themselves in the 25% marginal tax bracket. That means that a family earning on the high-end of the bracket would need to reduce their income by more than half in retirement, to reduce their marginal tax bracket. With the new tax reform, the 25% marginal tax bracket has been reduced to 22%. The next bracket, covering from $165,001 to $315,000, is taxed at just 24%. To give some perspective, if a married couple earned $300,000 of taxable income in 2018, they would be in a 24% marginal tax bracket, which is a lower rate than if they earned $100,000 of taxable income in 2017. In this example, even if they spent less in retirement, they potentially wouldn't pay a lower rate than they are today. For many, this tax environment favors Roth-style funding over the traditional method.

You should be having these types of discussions with your advisor. Knowing the new tax rates aren't permanent, diversification across your retirement accounts from a tax standpoint, can be critical. This optionality allows you, your advisor, and your accountant to strategically plan for retirement. Whether taxes are higher or lower in the future, you have an option for either situation. While paying taxes is never fun, the new tax laws makes the notion of paying tax today dramatically more appealing than it ever has been.

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2017 INCOME TAX RATES

Taxable Income			Ordinary Income
Single	Married Filing Jointly	Trusts and Estates	
above $0	above $0	*Trusts and Estates have no 10% bracket*	10%
above $9,325	above $18,650	above $0	15%
above $37,950	above $75,900	above $2,550	25%
above $91,900	above $153,100	above $6,000	28%
above $191,650	above $233,350	above $9,150	33%
above $200,000 (AGI)	above $250,000 (AGI)	*Trusts and Estates have no 35% bracket*	
above $416,700	above $416,700		35%
above $418,400	above $470,700	above $12,500	39.6%

Income Tax rates were compiled by the advanced planning attorneys with Northwestern Mutual and should not be used as a basis for legal or tax advice.

2018 INCOME TAX RATES

Ordinary Income	Married Filing Jointly	Single	Trusts and Estates
10%	above $0	above $0	above $0
12%	above $19,050	above $9,525	
22%	above $77,400	above $38,700	
24%	above $165,000	above $82,500	above $2,550
32%	above $315,000	above $157,500	
35%	above $400,000	above $200,000	above $6,000
37%	above $600,000	above $500,000	above $9,150

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