IT'S TIME FOR THAT MIDYEAR TAX CHECK-UP

Most individual tax filers are in the middle of their tax year. That means there may be time to adjust strategies and have a lower tax bill at year-end.

A midyear tax check-up list can help a client change course and reduce his or her year-end tax bill. Evaluating current and expected income can allow a client to consider whether or not tax control (the preferred term for timing and control of recognition of gains via deferral, whether in qualified accounts or a non-qualified annuity) will allow for better planning. Following are some questions to ask your clients.

What is Your Expected Total Income for the Year?

Midyear is a good time to estimate expected income for the year. While final income may be higher or lower, the midyear evaluation creates a starting point for tax planning. It also gives a client time to consider whether or not tax deferral might be beneficial.

Expected income might include:

- W-2 income.
- Self-employment income.
- Income from nonqualified accounts, such as interest, dividends, and capital gains (remember certificates of deposit (CDs) coming due).
- Retirement plan distribution—including required minimum distributions (RMDs).
- Rents, royalties, and similar sources.

Is There a Risk of "Threshold Creep"?

The Internal Revenue Code (IRC) rules apply additional taxes on benefits or investment income if certain thresholds are met. Medicare can require higher premiums for Parts B and D. Some thresholds are hard-line numbers; that is, if you are over the income amount by even one dollar, you pay the higher premium.

Let's examine some common threshold-sensitive benefits and taxes.

Social Security. Social Security requires that higher income individuals include a portion of their Social Security benefit in their taxable income calculation. The income calculation means that 15% of a Social Security benefit will always be tax-free, but up to 85% may be included in taxable income. These are hard-line thresholds. Go over by one dollar and up to 85% of a client's Social Security benefit will be considered taxable income.

Social Security Benefit Taxation

100% Tax-Free	Up to 50% Tax-Free	Up to 15% Tax-Free
≤ $25,000 Individual	$25,001 – $34,000 Individual	≥ $34,001 Individual
≤ $32,000 Joint	$32,001 – $44,000 Joint	≥ $44,001 Joint

Adjusted Gross Income (AGI) | **Tax-Exempt** | **50% of Social Security Benefits** → **Combined Income**

Tested Annually

TIP: Remind clients to determine if their state imposes taxes on Social Security benefits. Many states exempt Social Security benefits from state income taxes!

Medicare. Medicare has the income-related monthly adjusted amount (IRMAA). This additional Medicare premium is required if income equals or exceeds the threshold amount. Remember that Medicare bases IRMAA on the tax return from two years ago. That is, 2022 premiums are based on 2020 income. If there has been a change in income, Medicare may adjust the premiums.

An example is a retiree who was working and had high income two years ago but is now fully retired.

So why plan midyear? If a retiree stays under the threshold, it means lower Medicare premiums down the road. Some retirees have had material changes in income that make them eligible for lower premiums.

2022 Parts B and D IRMAA

MAGI = AGI + Tax-Exempt Income Reported on Income-Tax Return from Two Years Ago

Modified Adjusted Gross Income (MAGI)		Monthly B Premium	IRMAA	Monthly D Premium
Individuals with a MAGI of	**Married Couples with a MAGI of**			
$91,000 or less	$182,000 or less	$170.10	$0.00	Plan premium
More than $91,000 up to $114,000	More than $182,000 up to $228,000	$238.10	$68.00	Plan premium + $12.40
More than $114,000 up to $142,000	More than $228,000 up to $284,000	$340.20	$170.10	Plan premium + $32.10
More than $142,000 up to $170,000	More than $284,000 up to $340,000	$442.30	$272.20	Plan premium + $51.70
More than $170,000 up to 500,000	More than $340,000 up to $750,000	$544.30	$374.20	Plan premium + $71.30
$500,000 or more	$750,000 or more	$578.30	$408.20	Plan premium + $77.90

Source: Centers for Medicare and Medicaid Services. *2022 Medicare Costs*. November 2021.

TIP: When the first person in a married couple passes away, the MAGI threshold drops by 50%. Planning now may allow the surviving spouse to better manage IRMAA.

Net Income Investment Tax (NIIT). The NIIT is an additional 3.8% tax that applies to individuals, estates, and trusts that have net investment income over certain threshold amounts. While the tax applies only to investment income, such as interest, dividends, distributions from annuities, and income from a passive investment, remember that earned income and qualified plan distributions can push income above the threshold amounts. In peak earning years especially, the ability to time and control the recognition of gain through qualified accounts and non-qualified annuities can help avoid the NIIT and keep more investment earnings growing for the future.

Net Investment Income Tax (NIIT) for Individuals

All NIIT come from investment assets, including credited interest and gains from annuities before taxes, and are subject to a 3.8% tax and applies to individuals with an NII and MAGI above certain thresholds.

Joint	All Other Cases	Estates and Trusts
The NIIT is 3.8% on the lesser of: • The net investment income or • the amount by which their adjusted gross income exceeds the statutory threshold amount of $200,000	The NIIT is 3.8% on the lesser of: • The net investment incomew or • the amount by which their adjusted gross income exceeds the statutory threshold amount of $250,000	• (A)The undistributed net investment income or • (B)The excess (if any) of: – the adjusted gross income over the dollar amount at which the highest tax bracket begins for an estate or trust for the tax year. (For estates and trusts, the 2022 threshold is $13,450)

TIP: Remember that RMDs are not subject to NIIT but do increase income. For a charitably inclined client, a qualified charitable distribution (QCD) is a good option for giving as these funds are not included in income!

What, If Any, Steps Should a Client Take Before Year-end?

This may be a good time for the client to consider whether or not tax control through deferral is a good addition to his or her investment plan.

Who might be most affected?

- **Two-income couples in their peak earning years.** A couple in their peak earning years may have much higher income than they will in retirement. That means there is a "tax target" on their backs during the years they are most able to save. If the couple does not need the investment income for current expenses, a nonqualified deferred annuity can allow more of each dollar gained to stay invested.
- **Higher-income retirees with traditional IRAs.** A traditional IRA is a live-on account. Starting at age 72, the IRS requires that the retiree take annual RMDs from the account. As noted above, a QCD is a good alternative to reduce, or even eliminate, RMDs from MAGI. If a retiree has concerns about income later in life, a qualified longevity annuity contract (QLAC) may be an option. If a retiree needs additional flexibility, a nonqualified, tax-deferred annuity may help reduce the effect of RMDs on total income by allowing the retiree to control the timing of taxable distributions.

Midyear is a great time to remind clients that tax planning is an ongoing process. A change in strategy today can mean a lower tax bill at year-end. Add value: reach out to clients today!

Additional Resources and Links

Tax-Deferred Annuities – Three Tips and a Trap

How Much of My Social Security Benefit May Be Taxed?

Federal Income Tax Estimator

For more information about retirement planning,
please contact our Retirement Strategies Group at
RSG@PacificLife.com or (800) 722-2333, ext. 3939.
PacificLife.com

Under current law, a nonqualified annuity that is owned by an individual is generally entitled to tax deferral. IRAs and qualified plans—such as 401(k)s and 403(b)s—are already tax-deferred. Therefore, a deferred annuity should be used only to fund an IRA or qualified plan to benefit from the annuity's features other than tax deferral. These features include lifetime income, death benefit options, and the ability to transfer among investment options without sales or withdrawal charges.

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