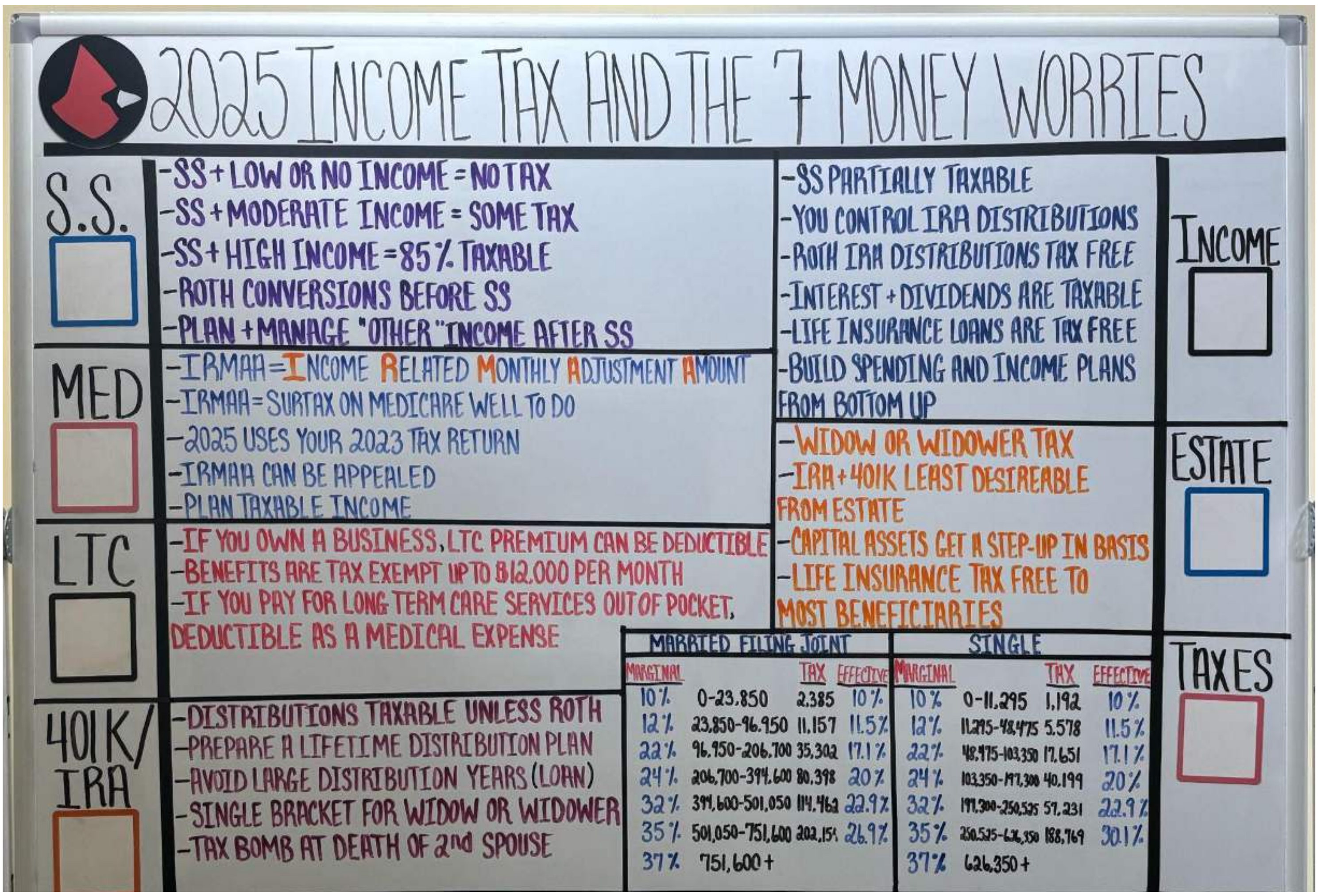
2025 Income Tax and the 7 Money Worries

Hans and Tom utilize several documents to discuss taxes in our video entitled "2025 Income Tax and the 7 Money Worries".



March 2025

Federal income taxes on Social Security benefits depend on your total income and filing status. Here's how it works:

1. **Calculate "Provisional Income"**:
   - Provisional income is your adjusted gross income (AGI) + nontaxable interest + half of your Social Security benefits.
2. **Determine Taxability Thresholds**:
   - **Single filers**:
     - If your provisional income is below $25,000, none of your Social Security benefits are taxed.
     - If it's between $25,000 and $34,000, up to 50% of your benefits may be taxable.
     - If it's above $34,000, up to 85% of your benefits may be taxable.
   - **Married filing jointly**:
     - If your provisional income is below $32,000, none of your benefits are taxed.
     - If it's between $32,000 and $44,000, up to 50% of your benefits may be taxable.
     - If it's above $44,000, up to 85% of your benefits may be taxable.
3. **Tax Rate**:
   - The taxable portion of your Social Security benefits is added to your other income and taxed at your marginal tax rate.

For retirees, managing income sources to control provisional income can help minimize Social Security taxation.

Approximately 50% of Social Security beneficiaries do not pay federal income tax on their benefits. This is because their combined income falls below the thresholds that subject benefits to taxation.

The taxation of Social Security benefits is determined by your combined income, which includes your adjusted gross income, nontaxable interest, and half of your Social Security benefits. If your combined income exceeds certain thresholds—$25,000 for single filers and $32,000 for married couples filing jointly—a portion of your benefits becomes taxable.

Since these income thresholds are not indexed for inflation, over time, more beneficiaries may find their benefits subject to taxation. Projections indicate that the proportion of beneficiary families owing federal income tax on their benefits could rise to about 56% between 2015 and 2050.

As of November 2024, nine states tax Social Security benefits to varying extents:

1. **Colorado**: Allows taxpayers aged 65 and older to deduct all federally taxed Social Security benefits from their state taxable income. Retirees aged 55 to 64 can deduct up to $20,000.

2. **Connecticut**: Exempts Social Security benefits from state income tax for single filers with an adjusted gross income (AGI) under $75,000 and joint filers under $100,000. Above these thresholds, up to 25% of benefits may be taxed.

3. **Minnesota**: Taxes Social Security income but offers a subtraction for certain income levels. For tax year 2024, the maximum subtraction is $5,840 for married joint filers, $2,725 for married separate filers, and

$4,560 for single and head-of-household filers. The subtraction decreases as income increases.

4. **Montana**: Follows federal rules for taxing Social Security benefits. Single filers with incomes under $25,000 and joint filers under $32,000 are exempt. Above these thresholds, a portion of benefits may be taxable.

5. **New Mexico**: Exempts Social Security benefits from state tax for single filers with AGIs up to $100,000 and joint filers up to $150,000. Above these thresholds, benefits are taxable.

6. **Rhode Island**: Exempts Social Security benefits for individuals who have reached full retirement age and have AGIs below $95,800 (single filers) or $119,750 (joint filers). Above these thresholds, benefits are taxable.

7. **Utah**: Taxes Social Security benefits but offers a nonrefundable tax credit to offset the tax for certain income levels. The credit phases out as income increases.

8. **Vermont**: Exempts Social Security benefits for single filers with AGIs up to $50,000 and joint filers up to $65,000. Partial exemptions apply for incomes slightly above these thresholds.

9. **West Virginia**: Is phasing out its tax on Social Security benefits. By 2026, benefits will be fully exempt from state taxation.

Each state's approach varies, often including income thresholds and age considerations. It's advisable to consult the specific state's tax authority or a tax professional for detailed information.

In 2023, the federal government collected $50.7 billion in federal income tax on Social Security. The $50.7 billion went right back into the Social Security trust fund to pay future Social Security checks.

2025 Medicare Income Planning

Part B and D Charges

The Medicare health care system is largely government funded, but individuals pay premiums to participate in two portions of it.

Medicare charges premiums to participants in Medicare Part B, covering doctor visits, and Part D, the prescription drug benefit. In 2025 the basic premium for Part B is $185.00 per month. The premium for Part D varies by plan.

The standard premiums for these are increased by surcharges imposed on upper-income individuals, those with **Modified Adjusted Gross Income (MAGI)** exceeding $106,000 on an individual return or $212,000 on a joint return.

In 2025, the largest premium surcharges apply to persons with MAGI of $500,000 or over on a single return or $750,000 or over filing jointly.

The extra amount that higher-income individuals must pay is called an **Income Related Monthly Adjustment Amount (IRMAA)**. The first five IRMAA tiers for Medicare premium surcharges are adjusted for inflation each year. This could result in reduced Medicare premiums for some. The IRMAA tier for individuals earning $500,000 or more (or married couples with MAGI of $750,000 or more) will not be adjusted until 2028.

Combination Chart - Parts B and D

2025 IRMAA *MONTHLY* SURCHARGES FOR MEDICARE PART B AND PART D (Based on 2023 MAGI)

Filing Single	Married filing joint	IRMAA Surcharge Part B	Total Premium Part B	IRMAA Surcharge Part D	Total of surcharges Part B & D
$106,000 or less	$212,000 or less	$0.00	$185.00	$0.00	$0.00
Over $106,000 to $133,000	Over $212,000 to $266,000	$74.00	$259.00	$13.70	$87.70
Over $133,000 to $167,000	Over $266,000 to $334,000	$185.00	$370.00	$35.30	$220.30
Over $167,000 to $200,000	Over $334,000 to $400,000	$295.90	$480.90	$57.00	$352.90
Over $200,000 to less than $500,000	Over $400,000 to less than $750,000	$406.90	$591.90	$78.60	$485.50
$500,000 and above	$750,000 and above	$443.90	$628.90	$85.80	$529.70

IRMAA surcharges apply on a “cliff” basis. Reaching the first dollar of an IRMAA income level causes the full corresponding surcharge to apply to all premiums paid for the year.

Example:
If Bob has MAGI of as much as $106,000 on his single return, he’ll owe no surcharge. But if his income reaches $106,001, then a monthly surcharge of $74.00 for Part B plus $13.70 for Part D, or $87.70 total, will apply for all 12 months of the year. Bob’s $1 of additional income increases premium cost by $1,052.40 for the year.

Medicare Planning Points

Medicare premium surcharges are imposed on individuals with MAGI over $106,000 on a single tax return or $212,000 on a joint return.

2-Year Lookback
For IRMAA purposes, MAGI is defined as Adjusted Gross Income (AGI) plus tax-exempt interest and untaxed foreign income. Medicare uses the MAGI reported on the federal tax return from two years ago. For example, to determine whether someone will pay higher premiums for 2025, Medicare uses **2023** MAGI.

Similarly, the tax return filed for **2025** will be used to calculate IRMAA surcharges for the year **2027**.

RMD Effect
Address required minimum distribution (RMD) requirements well in advance of the required beginning date, explaining how RMDs are included in income for Medicare Part B and Part D costs two years down the road. RMDs are not required from Roth IRAs during the Roth IRA owner’s lifetime.

Don’t forget that this includes older beneficiaries who are also subject to RMDs on IRAs they have inherited.

Income Reduction Strategies

The key to reducing Medicare surcharges is to reduce MAGI. Items like itemized deductions won't do that. They only reduce ***taxable*** income.

Check the tax return during the year to see if reported MAGI is near one of the threshold amounts. If income is close enough, plan to realize income and deductions to keep MAGI below the nearest threshold.

Roth Conversions
A Roth IRA conversion can be useful in minimizing future IRMAA surcharges as distributions from the Roth IRA can be tax free, reducing MAGI.

To avoid a current income spike from a Roth conversion, consider making a series of partial conversions over a number of years to avoid pushing income into higher tax brackets. This is a strategy that requires long-term advance planning.

For those in early retirement, consider the benefit of converting before the conversion income would impact Medicare costs.

Converting later may still be an effective strategy. A Roth conversion would negatively affect MAGI for Medicare purposes, but only for one year. It may make sense to take the hit in one year in exchange for no RMD concerns in future years.

HSAs (Health Savings Accounts)
Younger people may want to consider funding a Health Savings Account (HSA) rather than an IRA if they have a choice. They can make deductible HSA contributions in their working years, use other funds to pay medical expenses, and then they can access their HSA tax- and penalty-free to pay for qualified medical expenses in retirement. These distributions would not be included in MAGI for Medicare purposes the way RMDs and other traditional IRA distributions are.

QCDs (Qualified Charitable Distributions)
As a result of the tax law's increased standard deduction amounts, many are no longer deducting charitable contributions. QCDs can help restore charitable tax benefits by having those QCDs excluded from income. The exclusion from income will help to avoid Medicare premium increases.

With a QCD, an IRA owner (or beneficiary) who is age 70½ or over can transfer up to $108,000 (indexed for inflation) annually from their IRA to a charity tax-free.

A QCD can count towards the RMD and is not included in MAGI for determining Medicare costs. Keeping the RMD amount out of MAGI can result in big savings. This is not the case if an IRA owner takes their RMD and then donates to charity and claims a charitable deduction (if they can at all). With that approach, the RMD would still be included in MAGI.

For those taking RMDs, consider how a QCD could help to save on Medicare costs.

Other strategies that can be used to manage MAGI to minimize Medicare surcharges include:

- Timing investment gains and other income by accelerating them onto a tax return for a year before IRMAA calculations occur or deferring them to a year when income is expected to be lower and there may be offsetting losses.
- Obtaining spending funds from tax-free sources. For instance, one may borrow against a life insurance policy rather than take a taxable distribution from a retirement plan or use tax-free proceeds from the sale of a principal residence (as much as $250,000, or $500,000 on a joint return).
- Using a home equity conversion mortgage (HECM - reverse mortgage line of credit) to provide a source of tax-free funds with no corresponding mortgage payment expense, to keep income below the Medicare surcharge threshold amounts.

When Income Falls

If there has been a major life-changing event that results in a large reduction in MAGI, an individual may request to use their MAGI for a more recent year. If an individual disagrees with the decision about their Medicare costs, they have the right to appeal.

Do this by submitting Form SSA-44, "*Medicare Income-Related Monthly Adjustment Amount - Life-Changing Event,*" to the Social Security Administration.

The end of employment is a qualifying "life-changing event" that should be considered for every client who retires at age 65 or later. If an IRMAA surcharge will result from high salary income reported on a return filed two years earlier, but that salary no longer exists, relief from the surcharge may be readily available.

cltc Certification for Long-Term Care

CLTC® 2025 Tax Summary

Tax-Qualified Long-Term Care Insurance (LTCI)

<table>
<tr><th>Type of Taxpayer</th><th>Premium Deduction
(Traditional Policies)</th></tr>
<tr><td>Individual taxpayer who does NOT itemize</td><td>No deduction.</td></tr>
<tr><td>Individual taxpayer who itemizes deductions
(Schedule A)</td><td>Treated as accident and health insurance.
IRC §7702B(a)(1)
Limited to <u>lesser of</u> actual premium paid <u>or</u> eligible L TCI premium.
IRC §§213(d)(1)(D), 213(d)(10)

Eligible LTC premium in 2025 (indexed):
<table>
<tr><th>Attained age in tax year</th><th>Deductible premium limit</th></tr>
<tr><td>Age 40 or less</td><td>$480</td></tr>
<tr><td>Age 41 - 50</td><td>$900</td></tr>
<tr><td>Age 51 - 60</td><td>$1,800</td></tr>
<tr><td>Age 61 - 70</td><td>$4,810</td></tr>
<tr><td>Age 71 and older</td><td>$6,020</td></tr>
</table>

Medical expense deduction is allowable to extent that such expenses (including payment of Eligible LTCI premium) exceed 7.5% of AGI
IRC §§213(a), 213(f)</td></tr>
<tr><td>HSA, HRA & MSA</td><td>Eligible LTCI premium is a qualified medical expense.
IRC §213(d)(1)(D)</td></tr>
<tr><td>Employee (W-2)
(NON-owner)</td><td>Premium paid by <u>employee</u>
(e.g., "voluntary" or payroll deduction):

May NOT be paid through pre-tax cafeteria plan. IRC §125(f)
May NOT be paid through FSA or similar arrangement. IRC §106(c)
Deductible by employee who itemizes (subject to limitations above)

Premium paid by employer (ANY business type):

Employer provided LTCI treated as accident and health plan. IRC §7702B(a)(3)
Deductible by employer - NOT limited to Eligible premium (subject to reasonable compensation). May also include spouse and other eligible tax dependents. IRC §162(a)
Total premium excluded from employee's income (NOT limited to Eligible premium). Not subject to FICA, etc. IRC §106(a)
Benefits remain tax-free (See additional content on pg. 2)
</td></tr>
<tr><td>C-Corporation
Shareholder I Employee
(with W-2)
Including PCs and LLCs taxed as a C-corporation.</td><td>Treated as employee. (See above)

(NOTE that premiums may NOT reduce or be allocated against any individual's compensation in any form; the premiums must be a true corporate expense.)</td></tr>
</table>

"Self-employed" business owners:	
Sole Proprietor, Partner, S-Corporation >2% Shareholder / employee (W-2). Member of an LLC or PC taxed as any of above. *NOTE: Limited Liability Corporation (LLC) is a legal, not tax, entity – based on how the entity files.*	**Eligible for Self-Employed Health Insurance Deduction, which is taken "above-the-line" on Line 17 of IRS Form 1040 Schedule 1 (2023). May also include spouse or other eligible tax dependents.** *IRC §162(l)* **Limited to lesser of actual premium paid or Eligible LTCI premium.** *IRC §§213(d)(1)(D), 213(d)(10)* **For eligible LTCI premium in 2025 see above chart; Deduction is NOT limited to 7.5% of AGI threshold.**

Taxation of Benefits

Reimbursement benefits are not included in income.

IRC§§104(a)(3), 7702B(a)(2)

Per diem (or indemnity) benefits are not included in income except for amounts that exceed:

- $420 per day
  (2025 indexed), <u>or</u>
- Total qualified LTC expenses.

IRC §§104(a)(3), 7702B(a)(2), 7702B(d) IRS Revenue Procedure 2023-34

Return of premium (non-forfeiture) benefits:

- Available only upon total surrender or death.
- May not be borrowed or pledged.
- Included in gross income to extent of any deduction or exclusion allowed with respect to premium.

IRC §7702B(b)(2)(C)

<u>Linked-Benefit LTCI</u>

LTC benefits paid from a Tax-Qualified (7702B) annuity or life insurance "linked benefit" plan are tax-free as noted above. *IRC§7702B(e)*

Cash surrenders from a LTCI linked-benefit plan that paid LTCI benefits may have a reduced cost-basis. *IRC§72(e)(11)*

Premium payments for annuity or life insurance benefits in linked-benefit LTCI plans are NOT deductible. (Separate TQ LTCI continuation rider premiums may be deductible.)

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SECURE 2.0 EFFECTIVE DATES

Enacted December 29, 2022

Effective Date 1/26/2021 10% penalty exception: Federally declared disasters. Plans and IRAs. $22,000 maximum.

Effective 2023

- RMD age raised to 73.
- QLAC changes: no 25% limit; increased to $200,000 (indexed).
- Missed RMD penalty reduced from 50% to 25%. Reduced to 10% if corrected "timely."
- IRA annuity aggregation with other IRA assets for RMDs.
- One-time $50,000 QCD (indexed) to a CRUT, CRAT, or charitable gift annuity.
- Age 50 exception: Private sector firefighters and state and local government corrections workers added. Available under age 50 with 25 years of service.
- Form 5329 statute of limitations: 3 years for missed RMD; 6 years for excess contribution.
- 10% penalty exception: Terminal illness. Plans and IRAs. No maximum.
- 10% penalty exception: Net income attributable to excess contributions.
- Special needs trusts can have charity as remainder beneficiary.
- Roth allowed for SIMPLE and SEP plans.
- Roth employer match and nonelective contributions allowed.

Effective 2024

- IRA catch-up contributions indexed for inflation.
- QCD $100,000 limit indexed for inflation.
- Matching plan contributions can be made on student loan payments.
- 10% penalty exception: Emergency expenses. For plans and IRAs. $1,000/year.
- 10% penalty exception: Employers can offer in-plan emergency savings accounts. $2,500 maximum deferral. Plans only.
- 10% penalty exception: Domestic abuse. For plans and IRAs. Limited to $10,300 for 2025.
- Higher SIMPLE plan limits for deferrals and catch-ups and nonelective contributions.
- 529-to-Roth IRA rollovers: $35,000 lifetime limit.
- No lifetime RMD on plan Roth accounts.
- Surviving spouse may elect to be treated as deceased spouse.
- Plan catch-ups must be Roth if wages greater than $145,000 (indexed) in prior year. ***Delayed until 2026.***

Effective 2025 or earlier Expansion of Employee Plans Compliance Resolution System (self-correction) to IRAs.

Effective 2025 Higher catch-up limits for ages 60-63 for plans and SIMPLEs.

Effective 2026

- ABLE program age requirement raised from 26 to 46 for disability onset.
- 10% penalty exception: Long-term care insurance premiums. Plans only. $2,600/year.

Effective 2027 Saver's Match: 50% of IRA or plan deferrals (up to $2,000) by low-income savers.

Effective 2033 RMD age raised to 75.

Which RMD age to use?

Age 72 (or 70 ½)	Born 1950 or earlier
Age 73	Born 1951 – 1959
Age 75	Born 1960 or later

2025 Tax Planning

Taxable Income Brackets for 2025 *Ordinary* Income Tax Rates

Marginal Tax Rate	Married Filing Joint	Single
10%	$0 - $23,850	$0 - $11,925
12%	$23,851 - $96,950	$11,926 - $48,475
22%	$96,951 - $206,700	$48,476 - $103,350
24%	$206,701 - $394,600	$103,351 - $197,300
32%	$394,601 - $501,050	$197,301 - $250,525
35%	$501,051 - $751,600	$250,526 - $626,350
37%*	Over $751,600	Over $626,350

* The top rate is effectively 40.8% for those subject to the 3.8% Medicare surtax on net investment income (those with MAGI over the thresholds of $250,000 joint filers/$200,000 single filers).

2025 Trust Tax Rates

Ordinary Income Tax	Capital Gain Rates
10% $0 - $3,150	0% $0 - $3,250
24% $3,151 - $11,450	15% $3,251 - $15,900
35% $11,451 - $15,650	20% Over $15,900
37% Over $15,650	

Trust Tax Rates – Distributions from inherited IRAs that exceed **$15,650** and are made to and retained in discretionary trusts will be subject to the top 37% rate. After the SECURE Act, inherited IRA funds will have to be paid out to most of these trusts under the 10-year rule, accelerating trust taxes. Roth conversions during the IRA owner's life become more valuable if the IRA beneficiary is a trust.

Qualified Business Income (QBI) Deduction

20% Deduction Phase-Out Ranges

$394,600 - $494,600 - Married Joint

$197,300 - $247,300 - Single

Taxable Income Brackets for 2025 *Long Term Capital Gains and Qualified Dividends Tax*

Long Term Capital Gains Rate	Married Filing Joint	Single
0%	$0 - $96,700	$0 - $48,350
15%*	$96,701 - $600,050	$48,351 - $533,400
20% **	Over $600,050	Over $533,400

*The 15% rate is effectively 18.8% for those subject to the 3.8% Medicare surtax on net investment income.

**The top rate is effectively 23.8% for those subject to the 3.8% Medicare surtax on net investment income.

2025 Transfer Taxes

Transfer Tax	Exemption*	Maximum Rate
Estate, Gift, GST Tax	$13,990,000	40%

*The estate and gift exemptions are portable. The unused amount can be transferred to a surviving spouse. The GST exemption is NOT portable.

Annual Gift Tax Exclusion **$19,000**

Standard Deductions

Married-Joint	$30,000
Single	$15,000
Head of Household	$22,500

Extra Standard Deduction for Age 65 or Blind
$1,600 (married-joint)
$2,000 (single)

Qualified Charitable Distributions

Available only to IRA owners and IRA beneficiaries who are 70½ or older. The annual QCD limit for 2025 is $108,000 per IRA owner, ***not*** per IRA account. For 2025, the limit for a QCD to a split interest entity is $54,000. QCDs are more valuable due to the larger number of taxpayers that are using the increased standard deduction.

Roth Conversion Planning Ideas

Roth conversions are permanent and work best for those who believe they will be subject to higher marginal tax rates in the future.

Roth conversions are not all or nothing. Consider a series of smaller annual conversions over time to spread out the income tax.

Timing Roth conversions for maximum tax efficiency:
Convert before RMDs begin. RMDs cannot be converted, so no conversion can be done until the RMD is withdrawn.

Avoid the impact of Roth conversions on Medicare IRMAA charges for Parts B and D based on income. Since Medicare has a 2-year lookback provision, consider conversions before age 63.

If a spouse died during the year, consider a Roth conversion for the surviving spouse since this may be the last year to take advantage of married-joint tax return rates. Include the conversion income on the final joint tax return.

