CORNERSTONE
Financial Solutions, Inc.

TAX REPORT

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IN THIS ISSUE

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TAX PLANNING –
A MULTI-GENERATIONAL PERSPECTIVE

Managing taxes during retirement is a significant factor in determining your ultimate lifestyle. But strategic tax planning is about so much more than minimizing today's taxes. As part of your comprehensive financial plan, the Cornerstone Advisor Team specializes in strategies for tax-efficient investing, optimizing wealth preservation, and legacy planning.

In this tax report you'll find information to help you understand the rules and how various taxes and strategies apply to you. And feel free to have your accountant or tax preparer contact us directly for any needed investment information. We are always happy to coordinate with your other financial professionals, especially to help ease your stress levels during tax season.

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LOWERING YOUR TAXABLE INCOME
Maximizing Your IRA Contributions

For families managing significant assets, IRAs can be an essential piece of tax-efficient wealth transfer and investment allocation.

If you haven't already contributed for 2024, you can do so until April 15, 2025. Just be sure to designate that the contribution is for 2024. The deadline to establish an IRA is also April 15th. Feel free to contact us if you have any questions or need help.

- Maximum contribution: **$7,000** (under 50) or **$8,000** (50+).
- Contributions to **Traditional IRAs** are tax-deferred, making them an effective way to decrease your tax bill.
- Contributions to a Roth IRA are made with after-tax assets.
- Many individuals can deduct their traditional IRA contributions. However, for active participants in employer plans and their spouses, the ability to deduct an IRA contribution phases out for those with higher incomes.
- **Consider funding IRAs for children or grandchildren** to jumpstart tax-efficient wealth accumulation.

ADVANCED STRATEGIES

<u>Backdoor Roth IRAs for High-Income Earners</u> – Since direct Roth contributions are income-restricted, a backdoor Roth IRA allows high-net-worth investors to bypass limits by converting after-tax Traditional IRA contributions.

<u>Mega Backdoor Roth IRAs for Business Owners</u> – Certain retirement plans allow larger after-tax contributions that can be converted into a Roth IRA, enabling investors to shelter even more wealth in a tax-free growth environment.

<u>Asset Location Optimization</u> – Traditional IRAs should be used for tax-inefficient investments (e.g., bonds, high-dividend stocks), while Roth IRAs should hold high-growth assets to maximize tax-free appreciation.

Roth IRA distributions do not count toward MAGI. So, shifting taxable retirement assets into Roth accounts can lower taxable income in retirement and reduce your exposure to Medicare surcharges.

CFS GUIDANCE

Roth IRA conversions can be helpful, but they are not for everyone. Read *ARE YOUR ROTH IRA DISTRIBUTIONS REALLY TAX-FREE?* On page 4. Conversions could push you above your threshold in the short-term. And salary deferrals (401(k)s for example) can reduce MAGI for the 3.8% surtax but NOT earned income for the 0.9% additional Medicare tax.

It is best to run the numbers with a qualified financial professional and calculate the most appropriate strategy for your situation. We can discuss this at your next strategy session or contact us to schedule an appointment.

Qualified Charitable Distributions (QCDs) - donating your Required Minimum Distribution (RMDs) directly to charity through a QCD can lower your taxable income while supporting causes you care about.

Charitable Gifts and Donations

- You have to itemize deductions on Schedule A in order to claim this deduction.
- Through 2025, the 60% of AGI ceiling on charitable cash contributions remains unchanged but is scheduled to revert to 50% thereafter.
- To qualify for the 60% limitation, the charitable gift must be cash (or cash equivalent) made to a qualified charity (501(c)(3)).
- You must have made the contribution on or before December 31, 2024.
- If you gifted $250 or more to any charitable organization the recipient must send you a written acknowledgment of the gift upon request. This should also state whether the recipient provided any goods or services in consideration for the contribution. If so, the acknowledgment must include a good faith estimate of the value of those goods or services.
- Don't forget about noncash donations. You can't deduct the value of your time spent volunteering, but you can deduct the cost of supplies you buy for a group as an itemized charitable donation.
- You can claim a charitable deduction for the use of your vehicle for charitable purposes, such as delivering meals to the homebound in your community or taking your child's Scout troop on an outing. For 2024, the IRS will let you deduct that travel at 14 cents per mile. (https://www.irs.gov/tax-professionals/standard-mileage-rates)

NAVIGATING HEALTH CARE TAXES IN RETIREMENT

Under The Affordable Care Act, individuals with higher income levels are subject to an additional 3.8% Medicare surtax on investment income, including taxable interest, dividends, capital gains, and rental property income. For those still working or earning self-employment income, there could also be an additional Medicare tax to consider.

3.8% MEDICARE INVESTMENT TAX, A.K.A. THE MEDICARE SURTAX

Imposed on the lesser of (1) net investment income or (2) your Modified Adjusted Gross Income (MAGI) if it exceeds $125,000 for married filing separately, $200,000 for individual filers, and $250,000 for married filing jointly. Trusts and estates are hit particularly hard, with the surtax kicking in at $15,650 in 2025.

What is considered investment income?

Investment Income: Interest, dividends, capital gains (long and short), annuities (not those in IRAs or company plans), royalty income, passive rental income, other passive activity income.

NOT Investment Income: Wages and self-employment income, active trade/business income, distributions from IRAs, Roth IRAs and employer plans, excluded gain from the sale of a principal residence, municipal bond interest, proceeds of life insurance policies, veterans' benefits, Social Security benefits, gains on the sale of an active interest in a partnership or S corporation.

OTHER HEALTH CARE TAX PROVISIONS

The 3.8% surtax gets the attention, but there is also an additional 0.9% Medicare tax on wages and self-employment income over the MAGI thresholds. Also, medical expenses must exceed 7.5% of AGI to be deductible. That 7.5% also applies to the medical expense exception to the 10% penalty on early IRA or plan withdrawals.

***Cornerstone is proud to bring you insights like this article from Ed Slott and Company, LLC**. As a member of Ed Slott's Elite IRA Advisor Group™, Gordon keeps our team ahead of tax law changes and retirement planning strategies. Exclusive training like this helps us guide clients through the complex rules to avoid unnecessary taxes and fees—so you can make the most of your retirement!*

ARE YOUR ROTH IRA DISTRIBUTIONS REALLY TAX-FREE?

Common Roth IRA Planning Mistakes:

- Assuming that all Roth distributions are tax-free. Early withdrawals of earnings can still trigger taxes and penalties.
- Not considering the impact of Required Minimum Distributions (RMDs) on inherited Roth IRAs.
- Failing to strategically convert Traditional IRAs to Roth accounts over multiple tax years to manage bracket creep.

When you opened your Roth IRA account, you may have assumed all distributions would always be tax-free. While Roth IRAs offer significant tax advantages, there are certain circumstances where distributions can be subject to income tax.

Roth IRA distributions can consist of contributions, converted funds and earnings—or any combination of the three. Understanding the differences between the types of funds you're withdrawing, as well as how your age impacts your distribution, can help you better avoid paying unnecessary taxes on your Roth distributions.

What are the ordering rules?

"Ordering rules" which dictate the order in which these categories of Roth IRA money must be withdrawn. All Roth IRAs are considered one Roth IRA for distribution purposes.

Roth IRA contributions count first

If there are no contributions or those amounts are completely exhausted, converted funds are next.

Once all converted funds have been exhausted, earnings will make up the remainder of the distributions.

1. **Are you withdrawing a contribution?**

   Roth IRA contributions are the annual amounts that you contribute to a Roth IRA account. A distribution of Roth IRA contributions will always be both tax and penalty free.

2. **Are you withdrawing converted amounts before age 59 ½?**

   Converted funds are never subject to income tax. However, they will be subject to the 10% penalty for early distributions (unless an exception applies) if you are under 59 ½ and they have been in a Roth IRA for less than five years. Each conversion starts its own 10% penalty 5-year clock, and the converted amounts are withdrawn on a first-in, first-out basis.

3. **Are you withdrawing converted amounts after 5 years or age 59 ½?**

   A distribution of converted funds after 5 years or after age 59 ½ will be entirely income tax and penalty free.

4. **Are you withdrawing earnings before age 59 ½?**

   Earnings withdrawn prior to age 59 ½ are generally subject to income tax regardless of how long they've been in a Roth IRA account.

   Earnings withdrawn prior to age 59 ½ are also generally subject to the 10% penalty for early distributions unless an exception applies.

5. **Are you withdrawing earnings after age 59 ½ and 5 years?**

   Earnings withdrawn after age 59 ½ are never subject to the 10% penalty. They may, however, be subject to income tax. If you have held any Roth IRA for more than 5 years, your earnings are tax free. If not, they are taxable at ordinary rates.

MINIMIZING TAXES ON MULTI-GENERATIONAL WEALTH TRANSFERS

Estate taxes and inefficient wealth transfers can erode generational wealth.

Consider these options for passing down your assets efficiently:

Use Dynasty Trusts to Protect Wealth for Multiple Generations – A properly structured dynasty trust allows assets to grow tax-free while keeping them protected from creditors, lawsuits, and future estate taxes.

SLATs (Spousal Lifetime Access Trusts) for Strategic Tax-Free Gifting – A SLAT allows an individual to gift assets to a trust for their spouse and heirs while removing those assets from their taxable estate.

Leverage Annual Gifting Strategies – The IRS allows individuals to gift up to $18,000 per recipient (2024 limit) without triggering gift taxes—an excellent way to transfer wealth tax-efficiently.

Roth IRAs as Wealth Transfer Vehicles – When used correctly, Roth IRAs can eliminate significant tax burdens for heirs.

> **Multi-Year Roth Conversions to Control Bracket Creep** – Converting assets to a Roth IRA gradually over multiple years can help avoid unnecessary tax spikes and reduce taxable RMDs later.
>
> **Roth Conversions for Multi-Generational Tax Efficiency** – Unlike Traditional IRAs, inherited Roth IRAs allow heirs to take tax-free distributions. So, converting taxable accounts to Roth IRAs can minimizes taxable RMDs AND help ensure heirs inherit tax-free income.
>
> **Trust Structuring for Roth IRAs** – Families can use carefully structured trusts to maintain control over Roth assets for multiple generations while preserving tax-free growth.

Case Study:

A couple in their 60s strategically converted $2 million from their Traditional IRA into a Roth IRA over five years, keeping their taxable income below the highest federal tax bracket. Their heirs will now receive tax-free distributions rather than facing a substantial tax burden from inheriting a Traditional IRA with RMDs.

This hypothetical case study is for illustrative purposes only. Individual cases will vary. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation. Prior to making any investment decision, you should consult with your financial advisor about your individual situation.

MAY & OCTOBER Complimentary shredding for clients. Bring in a few items or a few boxes!

JUNE 3 Client Appreciation Event – Sioux Falls – Great Shots

JUNE 5 Client Appreciation Event – Huron – Putters & Scoops

TAX-SAVVY INVESTING:
UNDERSTANDING THE ESSENTIALS

Understanding Roth IRA Conversions

A Roth IRA conversion – whether you convert part or all of your traditional IRA into a Roth IRA - is a taxable event with pros and cons. The amount you converted is subject to ordinary income tax. It might also cause your income to increase, subjecting you to the Medicare surtax.

- You do not have to convert all of your IRA to a Roth. It is best to prepare a tax projection and calculate the appropriate amount to convert.
- Roth IRA conversions are not subject to the pre-age 59½ penalty of 10%.
- Many 401(k) plan participants (if their plan allows) can convert the pre-tax money in their 401(k) plan to a Roth 401(k) plan without leaving the job or reaching age 59½.

Understanding Cost Basis

What Is Cost Basis and Why Does It Matter?

Cost basis represents the original value of a security, typically the purchase price, adjusted for stock splits, dividends, returns of capital, and other corporate actions. On your Raymond James Comprehensive Statement, cost basis is displayed for securities held in nonqualified accounts, giving you a basic snapshot of potential capital gains or losses.

How to Use the Cost Basis on Your Statements

Your statements provide unrealized and realized gain/loss calculations as a courtesy to help you monitor your investment performance, but they are not a substitute for official tax documentation.

Cost basis figures on monthly, quarterly, and year-end statements should never replace Form 1099-B when preparing taxes. Here's why:

- Adjustments Can Occur: Between year-end statements and the issuance of 1099s (typically mailed in mid-February), events such as wash sales, income reallocation, and corporate actions may impact cost basis calculations.
- Avoid Errors: Relying on statement figures instead of 1099-B can result in incorrect tax reporting and potential IRS issues.
- Beyond Taxes: Cost basis on statements should not be used for reconciling account fees, performance tracking, or deposits/withdrawals.

If you're unsure how cost basis impacts your tax strategy, please reach out to our team. We're here to help!

Understanding Reinvested Dividends

What is a Reinvested Dividend and Why Does it Matter?
This important calculation can save you a bundle.

A reinvested dividend is when your mutual fund dividends are automatically used to buy additional shares instead of being paid out as cash. If you have mutual fund dividends that are automatically used to buy extra shares, each reinvestment increases your tax basis in that fund. An increase in your tax basis in the fund can reduce your taxable capital gain—or increase your tax-saving loss—when you sell shares.

How to Avoid Double Taxation on Reinvested Dividends
If this applies to you, tracking reinvested dividends can save you a bundle.

- If you forget to include reinvested dividends in your tax basis, you could end up paying taxes twice—once in the year they were reinvested and again when you sell the shares.
- Mutual funds often report the tax basis of redeemed shares, and financial institutions must report this to both investors and the IRS for shares purchased after regulatory changes.

If you're unsure about your tax basis, check with your fund provider or reach out to us for help.

Understanding How Capital Gains and Losses Are Applied

What Are the Ordering Rules for Capital Gains and Losses and Why Does it Matter?
The IRS follows specific ordering rules to determine how gains and losses offset each other. Understanding how capital gains and losses are applied can help you minimize your tax liability.

continued on next page

How to Maximize Tax Savings with Capital Losses
If this applies to you, knowing the correct order for offsetting gains and losses can make a big difference. Here's how it works:

- **Short-term losses** must first offset **short-term gains**.
- **Long-term losses** must first offset **long-term gains**.
- If there are **net short-term losses**, they can be used to offset **net long-term gains**.
- If there are **net long-term losses**, they can be used to offset **net short-term gains**.
- If all gains and losses net to an overall loss, up to **$3,000 can offset ($1,500 if married filing separately)** ordinary income.
- **Remaining unused capital losses** can be carried forward to later tax years and then considered in the same manner as described above.

Remember to look at your 2023 income tax return Schedule D (page2) to see if you have any capital loss carryover for 2024. This is often overlooked, especially if you are changing tax preparers.

Do you know someone who could use our help?

Not all financial planners review annual tax returns to coordinate investments, financial planning, and tax-strategy.

Feel free to let your friends and family know it's a valuable service they should get from their financial planner. Or have them contact us for a complimentary, no-obligation strategy session.

State income tax laws could be different from federal income tax laws. Visit https://tax.findlaw.com for a wide range of information and links to tax forms for all 50 states. All examples mentioned in this report are hypothetical and meant for illustrative purposes only.

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