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"Every record has been destroyed or falsified, every book rewritten, every picture has been repainted, every statue and street building has been renamed, every date has been altered. And the process is continuing day by day and minute by minute. History has stopped. Nothing exists except an endless present in which the Party is always right."
— George Orwell, 1984

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Wealth Creation Strategies

Shredding Old Papers While You Have Time on your Hands

With more time on your hands since the Greater Depression of 2020 began, many of you are asking what old documents can be safely shredded. Issue # 47 of *Wealth Creation Strategies* (***WCS***), page 7, includes a chart listing how long to retain important documents. The chart includes non-tax considerations, including proof of the cost of personal assets should you suffer a natural (as opposed to man-made) catastrophe. It also suggests keeping history, which may help remind you of restaurants and hotels you may wish to revisit, should your favorite spots ever reopen. But other important factors were omitted.

Among the omissions are capital loss carryovers, usually losses on sales of stocks or vacant land, greater than the allowable minuscule annual maximum deduction. Stock loss carryovers were common in 2008-2009 and will likely be prevalent again (although maybe not, given the current resurgence in stock values, should markets have staying power—which I would not count on). While the original chart advised keeping purchase records of stocks sold for four years after the extended due date of the return on which a sale is reported, it said nothing about what to do when sales generated loss carryovers to future years. Under current law (unchanged since 1975—since which time inflation, or depreciation of the value of a dollar, has reached nearly 500%) *only $3,000* of *net* capital losses are deductible against other income each year; any excess is carried forward until the taxpayer dies. For example, if you suffered $45,000 of capital losses, it would take ($45,000/$3,000 per year =) *15 years* before realizing the full tax benefit of the losses, assuming you had no capital gains in the intervening years. Hypothetically, the IRS could audit ten years after the initial loss and disallow the carryover if you lack proof of the *original* costs. Was it worth shredding those old records to free up a fraction of a file drawer, when you could lose tax savings of up to $1,000 per year, until the losses are used up? And this isn't just future years; it's previous "open" years not closed by the statute of limitations, usually comprising the last three years for federal purposes and four years state.

To ensure such deductions, keep proof of *both* purchase *and* sale costs of securities and other assets for which a capital loss is deducted until four years *after* the extended due date of the return on which the *last* of capital loss carryovers has been deducted. Our example would require keeping records for (15 years + 4 years after the extended due date =) 19 years after the original loss. Pretty crazy, huh?!

The same document retention idea holds for net operating loss (**NOL**) carryovers and carrybacks, *generally* where business losses exceed wage, rental and business income and the net loss is carried forward or backward to another year or years. The IRS has at times aggressively audited net operating losses carryovers/carrybacks. Issue # 61 of *WCS*, reporting an example of a Tax Court case in which a hapless taxpayer was required to present eight-year-old records (receipts and all) is worth re-reading if you suffer such losses. The same idea holds for passive loss carryovers (usually losses on rental property)

A revision of the original chart follows on the next page, with a list of *suggested* labels for each file folder (whether paper or digital), number of years to keep the files after the extended due date of the tax return, and other considerations. "Suggested" means precisely that; adapt this to your own style, needs and preferences. For business, rental or other tax-related items, be sure to create a new set of file folders each year!

	File folder label (name bolded) by the year	How long to keep*	Other considerations
1	**Tax returns**	Forever. Period.	Take little space and old returns can be immensely valuable
2	**Personal, non-deductible receipts/bills/invoices: consumables** that back up the checks/on-line debit payments; includes personal utilities	A year or two; four if you are self-employed (to prove home office expenses and you have a personal life), as well as to prove “use” tax liability	Consider the potential for research: which restaurant was it where you enjoyed that fabulous meal back in the ancient days?
3	**Personal, non-deductible receipts: expensive items**, etc. that back up the checks/on-line debits; includes furnishings, jewelry, vehicles, tools & equipment	Variable, but ideally until you dispose of the item and at least four years if you are self-employed or to prove “use” tax liability	Think how useful it would be to prove ownership and cost to an insurer for a casualty loss or to prove an item is still under warranty
4	**Personal credit card statements with receipts/bills/invoices** that back up credit card statements	See the comments directly above (lines 2 & 3), but since statements take up so little space, forever	Keep all in one folder, or divvy up between the consumable and expensive items as above
5	**Personal cash receipts**, etc.	See comments above in this column (lines 2 & 3)	See comments directly above, lines 2 through 4
6	**Personal checking account statements**	Forever, even if many could toss after four years	They take so little space!
7	**Home improvement receipts & contracts**	Four years after the sale of the home (or second home)	Even if gain would be fully excluded without, you’ll need these if you convert your home to a rental or deduct a home office
8	**Tax-deductible personal receipts**, etc. that back up checks and credit cards	Four years	Year-end mortgage statements, property tax bills, charitable donation letters/receipts, employee business expenses (for CA)
9	**Medical records**	Four years**	Or as long as needed for reimbursement/legal purposes and substantially longer for certain HSA strategies**
10	**Brokerage statements: non-retirement accounts** (generally one folder per account—e.g. Morgan, Citi, etc.)	Four years after a security is sold if no capital losses; four years after last year of capital loss carryover if applicable**	Brokers are not required to track costs of securities purchases prior to 2011. Monthly statements can be tossed *if* the year-end statement shows the full year’s history**
11	**Retirement account statements**, including IRAs, Roth IRAs, SEPPs, 401ks, Keoghs, etc.	Year-end summary statements: forever to prove cost basis of IRAs, Roth IRAs, etc.**	Monthly statements can be tossed *if* the year-end statement shows the full year’s history**
12	**Business or rental checking statements and check copies**: separate folder for each business/rental	Forever, or until four years after business or rental is sold or terminated/last year of NOL**	They take so little space!
13	**Business or rental receipts that back up checks, consumables** (current expenses): separate folder for each business/rental	Four years (longer if NOL)**	Four years after the last of any NOL or passive loss carryover is used up. Consider rental/passive loss carryovers too!
14	**Business or rental receipts for depreciable equipment** (including vehicles): separate folder for each biz/rental	Four years after the equipment is sold***	Receipts showing odometer readings of vehicles should be kept
15	**Business credit card statements and receipts**	Statements: forever**; Receipts: four years	Be sure to keep receipts for depreciable items separate (see above)
16	**Decedents’ papers**, including tax returns, business- and rental-related and carryover items listed above	Four years after the due date of the final return	We learned about ancient civilizations from a tax document, the Rosetta Stone. We can learn about our parents’ lives from old tax returns.

* Past the extended due date of the return for the year of the expense or income items or deductions claimed.

** Crucial other considerations are described below regarding statutues of limitations for capital, business and rental losses, along with the long-term HSA strategy, relevant to keeping medical records. Such issues also exist for proving “basis” (your contributions) in non-deductible traditional IRAs, as well as Roth IRAs, the latter of which is relevant to withdrawing prior to age 59 1/2 or within five years of a conversion if the conversion was done prior to age 59 1/2.

***See discussion of vehicle “trade-ins” below.

Keep decades of records for homes, rentals, business-use vehicles, Roth IRAs, IRAs and HSAs

Many think documents supporting income and deductions must be kept for only three years. As you can see in the chart, we recommend four as a bare minimum, because some states (including California) have four-year statutes. It's a bare minimum because there are loads of exceptions.

Records may be required decades after initial transactions and events supporting carryovers. These include capital losses, NOL's, foreign tax credits and passive rental activities. Also included are purchase and improvement costs of depreciable assets such as rental property, and original costs and improvements for main and second homes. While a $250,000 per person exclusion of gain applies for most main homes, the exclusion may be partial (which includes homes used for anything other than a main home since 2008—see issue # 56 of *WCS* for the gory details) and your gain may exceed the reduced exclusion. The longer the home is owned, the greater the odds of a substantial gain and the need to keep records of improvements for years, if not decades. Proof of costs of purchase and improvements should be kept until four years after the due date of the returns for the year of the sale of any such asset. In the case of property acquired via tax-deferred exchange (since the TCJA, only investment property for investment property), such records can be tossed only four years after the due date of the returns for the year of the *final* sale of the last property sold. While gains on the disposition of business *equipment* can no longer be deferred via tax-deferred exchanges, you may own assets acquired via prior exchanges (prior to 2018, such exchanges often resulted in gain deferral on business-use vehicle "trade-ins"). This means keeping cost records for real estate or business equipment, until four years after the due date of the return of the final item sold, as the entire series of transactions determines the final profit or loss.

Some tax strategies require records going back years to fully implement. Proof of non-deductible traditional IRA contributions, including those used to implement the "backdoor" Roth strategy discussed in issue # 27 of *WCS*, as well as Roth contributions and conversions, may be required to avoid unnecessary tax and penalties on withdrawals. The Health Savings Account (HSA) strategy discussed in issue # 59 of *WCS*, in which withdrawals are taken years after spending non-HSA funds on qualifying medical expenses, requires records proving not only expenses were incurred and paid for, but also that expenses were not reimbursed or deducted on prior-year tax returns. Other strategies include the use of borrowed funds for business or rental property purposes, which may require substantiation for up to four years after the loan is paid off.

The statute of limitations can be extended for decades

The IRS has authority to require detailed proof going back decades if deemed "relevant" for the year under audit. This is especially true for National Research Program audits, which involve line-by-line reviews of randomly selected tax returns for "research" purposes. The IRS can require receipted proof for every entry on current returns for financial transactions (purchase of homes, rentals, Roth IRAs, etc.) occurring long ago.

Those with ownership or even signature authority over foreign financial accounts (including cash or stocks in foreign banks, brokerages, cryptocurrency wallets or gambling sites) can have statutes extended indefinitely when not reported or, even, incompletely reported. This also applies to foreign inheritances and gifts. The sale of property for which the cost basis is deemed seriously overvalued, as well as any tax return or non-filing of returns that could be deemed fraudulent, also fail to toll* the statute of limitations.

Except for fraud, the Founders would be aghast at our acquiescence to such draconian rules. Many penalties associated with inadequate reporting of foreign financial accounts, inheritances and gifts arguably violate the 8th Amendment** to the U. S. Constitution, but I am not a Judge. Stanley Milgram's findings on obedience (that people often succumb to and allow grotesque overreach by authority figures) is exemplified by jurors' and judges' acceptance of IRS-imposed penalties for failure to properly report foreign financial accounts. However, we must deal with reality and do everything possible to not run afoul of these oppressive edicts.

* Tolling is a legal doctrine that pauses or delays the running of the period set forth by a statute of limitations. The statute of limitations does not begin to run until the proper return or form is filed and, sometimes, *correctly* completed.

** The 8th Amendment to the U.S. Constitution reads: "Excessive bail shall not be required, *nor excessive fines imposed*, nor cruel and unusual punishments inflicted" [emphasis added].

A Later Start Date for RMDs, But Shortened "Stretch" IRAs

The **SECURE** ("Setting Every Community Up for Retirement Enhancement") Act, enacted in late December 2019, significantly affected retirement planning.

Those who turned 70½ during 2019 were *generally* required to take their first **Required Minimum Distribution** (**RMD**) from their retirement plans (including IRAs, SEPPs, profit sharing plans, 401ks and 403bs) in either 2019 or *by* April 1, 2020. The SECURE Act delays the start of RMDs for younger taxpayers: those turning 70½ in 2020 or later are now required to begin taking RMDs in the year they turn 72 or by April 1 of the year following the year in which they turn 72 (in which case, two RMDs will be taken in that following year). Because the Coronavirus Aid, Relief, and Economic

Security (CARES) Act, passed March 27, 2020, waived RMDs for everyone in 2020, no one is required to *start* taking RMDs in 2020 (except for defined benefit pension plan owners).

The irony is the beginning age at which one can make Qualified Charitable Distributions (**QCDs**) from IRAs to charities is unchanged at 70½ (confusingly, *not the year* in which one *turns* 70½; rather, only after *the precise date* one turns 70½). For 2020 only, then, QCDs do not reduce RMDs, as there is nothing to reduce. So why might charitable seniors make donations via QCDs this year? First, because the Tax Cuts and Jobs Act (TCJA) nearly doubled the standard deduction, with relatively few itemizing personal deductions (especially seniors, most of whom pay little or no mortgage interest), personal donations likely save no federal tax. Second, because they reduce the value of IRA accounts on which RMDs are based, QCDs reduce future RMDs and future taxable income, saving taxes in the long run. You could get a more immediate savings, however, by waiting until next year to make donations via QCDs, thereby reducing next year's taxable distributions (RMD minus QCDs = net taxable RMDs). If your 2021 RMD is $15,000 and you normally donate $3,000 yearly, simply double-up and donate $6,000 and pay tax on only ($15,000 - $6,000 =) $9,000, rather than on $12,000 or $15,000.

There's an offsetting change, which is ironic considering the trillions in new debt that have been added to federal obligations since February 2020: federal government "budget rules" require any future revenue losses from tax cuts to be offset by revenue gains from tax increases. Delaying the start of RMDs required an offset, so Congress dramatically shortened "stretch IRAs," the moniker given to inherited IRAs and other retirement plans that could be withdrawn over the lives of beneficiaries under the old rules. The new rules shorten the withdrawal period to ten years after the year of the decedent's death for all deaths in 2020 or later, except for retirement plans inherited by one's spouse, minor children of the retirement plan owner, a disabled or chronically ill person (determined at the time of the decedent's death), or any beneficiary (e.g., brother, niece, friend) less than 11 years younger than the owner.

The value of income smoothing

Because RMDs aren't required until the 10th year, a gaping **tax trap** has opened for the unaware. Because few taxpayers and tax pros understand the value of "**income smoothing**," many withdraw from inherited retirement plans without proper planning, often all at once.

For example, a single person earning $80,000 per year inherits a $250,000 IRA or other retirement account. He or she doesn't withdraw it, whether because of inertia or the banker or broker wants to keep the account in his/her hands and exclaims, "Take it all in year ten!" The additional tax will be $75,645 in year 10, or any other year in which the full monty is withdrawn. However, if the person takes it ratably over the 10 years, he/she could have withdrawn $25,000 per year, costing only $5,575 of additional tax per year, or $55,750 over the 10 years. (This assumes Congress doesn't change tax rates and both income and the account value remain the same—I would not expect major gains over the next decade unless investing from far lower levels.) The value of "smoothing" income is, then, ($75,645 - $55,750 =) $18,885 greater than the additional tax cost of taking a final-year —*or any one year*— lump sum withdrawal. Under this set of assumptions, the savings is the same regardless of which year you withdraw compared with withdrawing evenly over ten years.

Similarly, a joint filer with yearly income of $80,000 could withdraw the $250,000, "smoothed" over ten years at $25,000 per year, with an additional tax of $3,165 per year, or ($3,165 x 10 =) $31,650 of federal income tax over ten years, while the tax cost of withdrawing in any one year is roughly $55,405. The couple taking the lump sum just squandered ($55,405 - $31,650 =) $23,755 on completely unnecessary taxes! Of course, scenarios vary all over on the tax hit of a windfall, depending on taxable income, filing status, growth of the assets and the type of investments (for example, IRAs turn capital gains into ordinary income, so it can be helpful to move funds more quickly—but not all at once!—into Roth or non-retirement accounts). It's a complex analysis!

Federal tax savings for a joint filer with $80,000 wage income withdrawing a $250,000 inherited IRA ratably over ten years vs. taking a lump sum in any one year

	Total income	Federal income tax	Additional tax created by IRA withdrawal(s)	Tax savings by "smoothing" income
Wage income	$80,000	$6,290 (a)		
Take $25,000 per year for 10 years	$105,000	$9,455 (b)	(b) - (a) = $3,165 x 10 = $31,650 (d)	
Take $250,000 lump sum in any one year	$330,000	$61,695 (c)	(c) - (a) = $55,405 (e)	(e) - (d) = **$23,755**

Federal tax savings for a joint filer with $160,000 wage income withdrawing a $250,000 inherited IRA ratably over ten years vs. taking a lump sum in any one year

	Total income	Federal income tax	Additional tax created by IRA withdrawal(s)	Tax savings by “smoothing” income
Wage income	$160,000	$21,550 (a)		
Take $25,000 per year for 10 years	$185,000	$27,050 (b)	(b) - (a) = $5,500 x 10 = $55,000 (d)	
Take $250,000 lump sum in any one year	$410,000	$86,025 (c)	(c) - (a) = $64,475 (e)	(e) - (d) = **$9,475**

CA State tax for a joint filer with $80,000 wage income withdrawing a $250,000 inherited IRA ratably over ten years vs. taking a lump sum in any one year *

	Joint Filer	CA state income tax	Additional tax over ten years	Tax savings by “smoothing” income
Wage income	$80,000	$1,680 (a)		
Take $25,000 per year for 10 years	$105,000	$3,270 (b)	(b) - (a) = $1,590 x 10 = $15,900 (d)	
Take $250,000 lump sum in any one year	$330,000	$23,940 (c)	(c) - (a) = $22,260 (e)	(e) - (d) = **$6,360**

Federal tax savings for a single filer with $80,000 wage income withdrawing a $250,000 inherited IRA ratably over ten years vs. taking a lump sum in any one year

	Total income	Federal income tax	Additional tax created by IRA withdrawal(s)	Tax savings by “smoothing” income
Wage income	$80,000	$10,780 (a)		
Take $25,000 per year for 10 years	$105,000	$16,455 (b)	(b) - (a) = $5,675 x 10 = $56,750 (d)	
Take $250,000 lump sum in any one year	$330,000	$86,425 (c)	(c) - (a) = $75,645 (e)	(e) - (d) = **$18,895**

Federal tax savings for a single filer with $160,000 wage income withdrawing a $250,000 inherited IRA ratably over ten years vs. taking a lump sum in any one year

	Total income	Federal income tax	Additional tax created by IRA withdrawal(s)	Tax savings by “smoothing” income
Wage income	$160,000	$29,650 (a)		
Take $25,000 per year for 10 years	$185,000	$36,615 (b)	(b) - (a) = $6,965 x 10 = $69,650 (d)	
Take $250,000 lump sum in any one year	$410,000	$114,425 (c)	(c) - (a) = $84,775 (e)	(e) - (d) = **$15,125**

Other strategies

Larger withdrawals should be considered for any year in which job or business losses, major medical expenses or other deductions result in lower taxable income. Larger withdrawals could be taken to start a business, purchase a new vehicle or buy a home. Withdrawals, however, should be shrewdly and carefully planned: withdraw for years leading up to such an event or large purchase because, nearly always, *the longer the withdrawal period (assuming stable incomes) the lower the overall tax cost*.

Withdrawals from inherited IRAs can be offset by increasing 401-k and other retirement plan contributions for working taxpayers. Joint filers with ordinary income of $105,000 in 2020 are *generally* at the nub of the 22% bracket (all income up to that point is taxed at zero, 10% or 12%; income greater than this is *usually* taxed at 22% and higher). An additional $19,500 of ordinary income can be offset perfectly by contributing a like amount, the 2020 maximum, to one spouse's 401-k through an employer ($26,000 for those 50 and over; double the appropriate figures for joint filers). This effectively gets you past the prohibition against rolling inherited retirement funds into your own retirement accounts. You essentially funnel withdrawals from the inherited IRA into your employer's (or your own if self-employed) plan, from which you can withdraw later in life at a much more leisurely pace (based on your life expectancy per new and improved IRS tables, those age 72 divide the prior end-of-year account balance divided by 27.3). You aren't rushed into taking withdrawals over 10 years as you are with inherited accounts.

Another strategy would be to retire, live on inherited IRA withdrawals, and allow future Social Security "benefits" to grow from the time you turn 62 to as late as age 70. Recall from issue # 44 of *Wealth Creation Strategies* that, for every month the start of Social Security is delayed, permanent inflation-adjusted "benefits" increase by about ½% per month, compounding to roughly 7% per year and an incredible 72% from age 62 to 70. And should the aging Ponzi scheme survive, this may do a whole lot better than will stocks, bonds or savings.

Fixing the W-4 Mess: Completing Form W-4 to Break Even at Year-End

The W-4 is intended to calculate federal withholding on wage earnings roughly equal to your actual tax liability. Created during WWII, it helps to ensure taxes are paid ratably during the year, as income is earned. But rarely is anything close to accuracy achieved—as evidenced by large year-end tax bills or refunds.

After the Tax Cuts and Jobs Act (**TCJA**) passed in December 2017, the continued use of both the pre-2018 and 2018-2019 versions of Form W-4 resulted in enormous under-withholding or greatly reduced refunds for many of you in both years. Employees who didn't change jobs could continue to use the old form, while those who changed jobs were required to use the newly created version. Both versions used number of exemptions and marital status to calculate withholding, even though the TCJA eliminated exemptions. As described in "W-4s and Your Withholding" on pp. 7-8 of issue # 65 (Fall 2018, Part IV) of *Wealth Creation Strategies*, the new W-4 included four pages of instructions and four detailed worksheets, one of which wasn't even in the W-4 instructions. Incredibly, every itemizing two-income family with kids had to complete the worksheets to "accurately" determine their allowances. The IRS created an online calculator to "simplify" the calculations; this did not help. One taxpayer, who went public with her results, found she could claim an astounding (and woefully incorrect) 84 withholding allowances. The failure of this version of the W-4 was the inevitable result of trying to fit a round peg into a square hole.

Two years later, we finally have a W-4 that makes *some* sense and produces a more accurate result. While imperfect, we cannot demand much more of a flawed system.

The old W-4 determined withholding by counting number of "withholding allowances," or exemptions, starting with one for each taxpayer and dependent. This, in addition to the "standard deduction," indicated annual tax-free income for withholding purposes. In 2017, each exemption equaled $4,050 and the standard deduction was $6,350 ($12,700 for joint filers). So, a single filer with two dependents could claim the standard deduction plus two withholding allowances, worth ($6,350 plus $4,050 x 2 =) $14,450, indicating that much in tax-free yearly earnings. Itemizers, whose actual deductions exceed the standard deduction, could claim one additional withholding allowance for every $4,050 that itemized deductions exceeded the standard deduction. When the TCJA eliminated exemptions for calculating the actual tax, exemptions should have been dropped from the W-4, but that wasn't done. Taxpayers' lack of understanding of exemptions and the standard deduction, the latter of which was nearly doubled under the new law, resulted in a huge under-withholding problem. Two years later, the IRS finally created the new W-4 and got it *mostly* right, but many tax credits (dollar for dollar offsets to tax) are still not factored in without resorting to a complex online calculator. Worse, withholding as a percentage of income is not allowed, even though a correct percentage can easily be calculated once filing status, estimated yearly income by type of income, and expected deductions and credits is known. Below, we show an easy fix.

Introducing the New W-4

In recognition of the fact that "allowances" or "exemptions" are no longer claimed on Form W-4, the form's title has been changed from "Employee's Withholding *Allowance* Certificate" to "Employee's Withholding Certificate" and the filing is a bit more intuitive. Step 1 asks for your filing status: single, married or head of household. (In the rare instance of married filing separate, check "single.") In Step 2, check a box if you have more than one job *or* you are married and both of you work. Your checkmark effectively turns your "married filing joint" status to "single" status for *withholding* purposes, effectively allocating half the standard deduction to each of you and cutting most tax brackets in half. If you don't check this box, the higher the income at the 2nd job, the more you will owe at year-end.

After Step 2, a note tells you to complete Steps 3 and 4 for only ONE job between taxpayer and spouse, which should be the *highest* paying job. In other words, DO NOT duplicate or otherwise use Steps 3 and 4 on any other W-4 you or your spouse file (unless spouses "split" credits and deductions). This is crucial, lest you erroneously claim you have twice the amount of credits, income or deductions asked about in these sections. For those reading between the lines wondering whether you could split those credits and deductions between spouses, the answer is yes, but carefully.

Step 3 asks how many qualifying dependents you have. Most taxpayers will simply multiply the number of qualifying children (those under age 17 *at year-end*) by the child tax credit of $2,000 per child and, separately, the number of other dependents by the "other" dependent credit of $500 per dependent. I would have added an additional line for "expected other credits," especially the tuition credits for which many qualify. No doubt, IRS officials wanted to avoid extra complications and explanations of which parent and what expenses qualify. If everything is otherwise filled out correctly, such taxpayers would simply be over-withheld by *up to* $2,500 in tuition credits per qualifying student. A knowledgeable person (us, perhaps) might simply report total expected credits on one of the lines in Step 3, even if that's more than the paper W-4 calls for. (The online estimator accounts for other credits, but it's complicated.) An important caveat: a revised W-4 must be filed with your employer at the start of the year in which a child turns 17 (or no longer qualifies you for a tuition credit) or you lose an "other" dependent credit.

Step 4 asks for other income and deductions and whether you'd like extra tax withheld. You may not want to complete this step because you may not want your employer to know about other income you or your spouse earn. And, it's tricky because adjustments should be made based on type of income. If the income is ordinary—interest, pensions/IRAs, etc., simply add the yearly expected income on which no tax is withheld. However, if there is withholding but it is too low, common with retirement income, or if there is substantial non-ordinary income, adjustments must be made, which makes this section not amenable to "DIY." For example, if you have long-term capital gains or qualifying dividend income, an adjustment should be made for the fact that such income is normally taxed at lower rates than ordinary income. If the additional income is from Self-Employment, an adjustment should be made to also pay Self-Employment tax if you are to avoid estimated tax payments.

Expected deductions are claimed on the next line. This gets tricky, too, because you need to know how much expected itemized deductions will exceed the standard deduction, the extent of allowable real estate or business losses, net capital losses and a variety of other allowable deductions, some of which are limited or phased out at higher incomes.

On the final line, you can request additional tax withholding from each paycheck. This line is impractical if income varies substantially from one paycheck to another. If income drops to the amount of additional tax withheld, you won't have a paycheck.

You can complicate the process by using the online estimator or worksheet, but such adjustments are best left to us. Because we understand the logic behind withholding, we can calculate this without resorting to the labyrinthine-like online calculator. If a married couple has three or more jobs between them (or a single person with two or more jobs or payers), further adjustments are required, best done with our help.

My solution is to allow percentage withholding which, unfortunately, the IRS does not currently allow. To allay IRS concerns that some would decide on too low a withholding rate, I would add this line to Step 4, shown on the Doug Thorburn version of the mocked-up W4:

"If my withholding as calculated from my responses above is less than ___% (often 12% or 22% for those with 2nd jobs; this will vary based on your situation) of my taxable pay, increase total withholding to this rate (*but do not decrease to an amount less than that calculated above*)."

Why you owed with 2018 or 2019 tax returns even though your tax decreased from 2017 (assuming the same income)

The fact that the Step 2 check box, allowing brackets and deductions to be cut in half for withholding purposes, was not on the intervening versions of Form W-4 is the reason married filers were often severely under-withheld under the TCJA. While taxes dropped for most taxpayers, withholding dropped by more than the tax. This was especially true for working joint filers both claiming "married" on their W-4s.

While this was a problem under pre-2018 law, the near doubling of the standard deduction and concomitant elimination of personal exemptions greatly exacerbated under-withholding beginning in 2018.

The problem is this: each employer assumes *yours* is the only income in the family and withholds accordingly. There is no withholding on the "standard deduction" amount. In 2017, checking the "married" box equated to no withholding on the first $12,700 standard deduction plus $4,050 per "exemption" claimed (so, $16,750 for those claiming married with one exemption). Under the TCJA, "married" equates to no withholding on the first $24,000 earned in 2018, inflation-adjusted to $24,400 in 2019 and $24,800 in 2020. If you're using the old W-4 (which is allowed until 2021 if you haven't changed jobs since 2017), you may also be claiming "exemptions" under the old system which, in 2020, are deemed to be worth $4,300 each. Because the 2020 standard deduction is $24,800, if your old W-4 shows M-2 (married with two exemptions), the employer will withhold *zero* tax on the first ($24,800 + $4,300 x 2 =) $33,400 earned for the year, pro-rata, meaning nothing is withheld on the first ($33,400 / 52 =) $642.31 of weekly earnings. ***A married couple each claiming M-2 on old W-4s have no federal tax withheld on a combined $66,800 if they each earn $33,400 per year.*** Because the standard deduction is only $24,800 and there are no more exemptions, they will actually owe tax at year-end on ($66,800 - $24,800 =) $42,000 of taxable income; at a combination of 10% and 12%, this yields a tax of roughly $4,600 (plus, for California residents, more than $1,000, with only a smidgeon withheld). Yikes!

Let's take a couple earning combined wages of more than $105,050, at which point additional income is taxed at 22%. Say each earns $75,000 ($150,000 total income). Using the old W-4, both claiming M-2, recall from the first example above there is no withholding on the first ($24,800 + $4,300 x 2 =) $33,400 for each spouse, or $66,800 of total income between the two of them. Yet, if they are not itemizing and have no other deductible losses, the real "zero" bracket is only the standard deduction of $24,800. Withholding on each assumes 10% and 12% rates, which is withheld on only [$75,000 – ($24,800 + $4,300 x 2) =] $41,600. Withholding will total about $4,600 on each $75,000 salary, or $9,200 combined. Yet the real tax on the $150,000 of wages is roughly $19,125, for a year end tax bill of ($19,125 - $9,200 =) $9,975. Double yikes!

Let's take a more extreme but not unheard-of example—in fact, common among TV and film studio employees earning residuals. Say each spouse has two jobs and therefore four W-2s total, each reporting $33,400, claiming M-2 on old W-4s on all jobs. Income is earned evenly over the year at each job. Each employer uses withholding tables that assume total family income is only $33,400. The total federal (and state, for that matter) withholding is—are you ahead of me here?—**zero**! Yet, they owe tax on ($33,400 x 4 =) $133,600 of total earnings at year-end. While the tax on the first $24,800 is zero, the tax on the next $80,250 is taxed at 10% and 12% and income exceeding that first $105,050 is taxed at 22%. The total tax is more than $15,500 federal (plus about $5,500 for California residents, while withholding was near zero for those claiming M-2 on the state Form DE-4)! The year-end combined tax bill would be more than $20,000. Triple yikes!

Those who *should* check the box in "Step 2" but do not will continue to suffer under-withholding, albeit a bit less than these examples. The new W-4 results in withholding of no tax on only the standard deduction based on filing status claimed and does not include anything for personal exemptions, since they no longer exist for this purpose.

Continuing use of the old W-4, or the new one while failing to check the "Step 2" box, accounts for the increasing under-withholding, not to mention confusion, for many taxpayers since 2017 even though overall taxes for 80% of you decreased under the TCJA. The solution is to ensure each spouse completes a new (2020) Form W-4 and checks the box in Step 2, where appropriate. For a married couple, your employer will withhold as if there is no tax on the first $12,400 of income—which, with two jobs between spouses, correctly equates to the married filing joint $24,800 standard deduction.

When there are two or more jobs at the same time, you can request that an additional amount from each paycheck be withheld. The best way to do this is to calculate the proper additional tax based on your marginal tax bracket, which we can easily tell you. Trouble arises, however, when additional income straddles two or more tax brackets and/or results in a phase-out of tax credits. With reasonable estimates of full-year incomes by category and payer we can make necessary adjustments for such situations.

Most states "piggyback" on the federal form, where the same scheme is used for state withholding. But oh, not California: the old rules for itemized deductions still largely apply and a separate state equivalent, Form DE-4, should be filed to ensure proper withholding. However, the California rules, standard deductions, exemption credits and tax rates are vastly different from federal. If married with two incomes, the "single or married but with two or more incomes" box should be checked in the "filing status" section (google "DE-4"). Withholding allowances can be carefully claimed; the standard deduction (for 2020) is $4,537 for single filers and $9,074 for heads of household and married filers. One withholding allowance equates to $1,000 of deductions over the state standard deduction, as well as for other deductions (allowable business and rental losses, capital losses, etc.). If there's additional income or losses from other sources, we can help you adapt.

The withholding forms used for other types of income, including the W-4V for Social Security withholding and W-4P for pension withholding, are completely and irrationally different. We can help with these as well.