A Looming Tax Problem?

By: Matthew D. Kelly, CFP® *June 2018*

In my last article, I outlined the noteworthy adjustments to our tax code under 2017's Tax Cuts and Jobs Act. For most, the new tax reform will result in paying less taxes to the government. Great news...right? Of course. As we've continued to run 2018 tax projections for our clients, however, we've noticed a surprising and troubling trend for many W-2 wage earners.

THE PROBLEM

Although Federal taxes have decreased, paycheck withholding has overreacted — and declined even further. What this will undoubtedly lead to is a lot of individuals and families being surprised by a potentially meaningful tax bill next spring. This is not a result of the taxpayer doing anything wrong or adjusting their withholdings incorrectly. This is simply a result of the IRS withholding tables being out of whack with the end taxpayer – you.

If you're one to check your bank account on a weekly or monthly basis, you've noticed an increase in your net take-home pay for 2018. A rise in monthly cash flow always seems welcome, but in this case, it may be an indicator that your withholdings need to be revisited.

A SCENARIO

As a quick (and overly simplified) example, let's take a look at a working couple who are W-2 employees for XYZ Company. When the withholding tables updated earlier this year, they each began receiving an additional $100 per semi-monthly paycheck. All was right with the world, but...

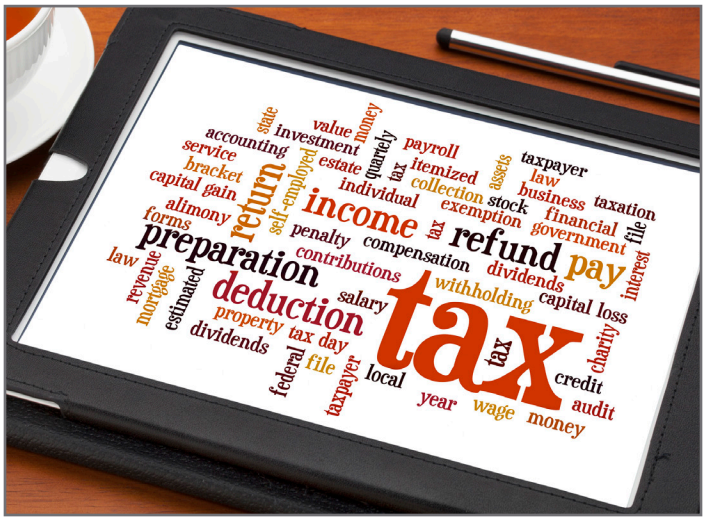
When they go to file their Federal taxes next spring, they could owe over $3,500.

HOW DO YOU FIGURE?

As a result of the new legislation, this couple's annual tax bill went down by $1,200. Good news. Since they're both paid semi-monthly, that equates to tax savings of $25 per pay per person — or $100 per month. With the new IRS withholding tables, however, they are now pocketing an extra $100 per pay per person — or $400 per month.

The additional $300 they've been receiving each month should have continued to go to the Fed. That $300 per month translates to $3,600 over an entire year.

Come tax filing time, this couple will feel as though they were wronged by the new regulations. After all, like many, they've grown accustomed to receiving a refund each year.



If their financial lives have remained the same, and they didn't make any adjustments to their withholdings, they have good reason to be a bit thrown.

IN CONCLUSION

Fortunately, this withholding inconsistency won't rear its ugly head for everyone. Self-employed individuals will be spared as they're required to make quarterly payments. Retired individuals don't rely on W-2 wages. And, many young families will receive a generous child tax credit, which will offset any shortfall.

Human nature has shown us that a minor increase in cash flow usually finds its way to another expense — not savings. Unless you fall into the camp above, or typically receive a large refund, be prepared to tackle a tax bill next spring. Better yet, consult an accounting professional for tax advice or contact a CERTIFIED FINANCIAL PLANNER® to review your entire financial picture. Whether it's for peace of mind, setting expectations, or taking action, you'll be glad you did.

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