Episode 201: OBBA and You: How the “One Big Beautiful Bill” Reshapes Retirement Taxes

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SPEAKERS
Alex Murguia, Brett Layton, Wade Pfau, Briana Corbin

Briana Corbin 00:00
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Briana Corbin 00:39
ready to meet the new tax law that makes complex look simple, the one big, beautiful Bill act is here, and in part one of this three part deep dive, CPA, Brett Leighton joins Wade and Alex to translate what it all means and why it's never been more dangerous to guess your tax bracket.

Alex Murguia 00:58
Hello, everyone. Welcome to retire with style. I'm Alex, and I'm here with my trusted companion, Wade Pfau, and today we have a very special guest, Brett Layton, who's also a member of our retirement researcher Academy. And Wade, do you want to talk about a little bit what Brett brings to the table and what we'll be discussing today,

Wade Pfau 01:26
absolutely and Brett, I'll let you introduce yourself, but Brett's a CPA, and really the reason we wanted to bring Brett on for an episode is to discuss the new provisions in the one big, beautiful Bill act. There's a lot of new tax considerations, and when it comes to tax planning, we're getting to the point of the year where it's important to be thinking about that. So we really wanted an expert who could help us walk through all the different provisions of the one big, beautiful Bill act. So Brett, welcome to the show, and you can let our listeners know a little of your background in terms of what you bring to the table here.

Brett Layton 02:01

I'm a CPA with a master's in taxation. I also just finished the ricp program at the American College, so that was kind of fun. And I've always been a tax guy. I started out at big accounting firms, so I did Arthur young Arthur Andersen, two schross, that was back when they were the big eight. I left public accounting after about seven years, and then fell into corporate tax departments for the next, oh gosh, 25 years or so, and, you know, dealt with large, publicly held fortune, 500 companies with, you know, literally hundreds of subsidiaries worldwide. And, you know, I did a tour of duty in international tax and basically ran a tax department. Couple tax departments. Established a tax department. I worked for a short time for a very private, privately held company, which, when you blew all the smoke away, was really a very sophisticated family office with a bunch of businesses bolted onto the bottom of it. So that was an interesting experience to deal, you know, soup to nuts with business, personal, estate trust, the whole the whole nine yards. That takes us up to about 2014 I've been semi retired since then, and I work for generally smaller or regional CPA firms as a back office or back room specific tax consultant focusing on, you know, planning and complex returns, and I, I can do a tax return if it's an emergency, but it's really not the highest and best use of my skill set or my interest. So that's that's a quick summary. Sorry.

Wade Pfau 04:18
Great, yeah, no, we recently had some episodes on the non financial considerations of retirement, and I think we'd probably have a whole episode talking to you about that transition into wanting to be involved in continuing in the accounting world, but not necessarily on a full time basis. But yeah, that background is really helpful, because there's a lot to unpack with the legislation that was passed in July 2025, and it's, it's the one big, beautiful bill, act is the formal name, or the O, B, B, B, A, 3b, in there,

Brett Layton 04:51
one, whatever you're, I try politically agnostic, and you know, I'm, I'm kind of in. The middle of everything, I don't take sides, and it just is what it is,

Wade Pfau 05:05
sure, yeah, and so getting into that, there's a lot for us to unpack with the legislation before we really dive in any just general deep thoughts on the whole process of tax planning and what really motivates you and thinking about these

Brett Layton 05:20
things, tax planning is always important, and it's, it's, it's important, you know, from high net worth down to kind of high earner, high upper middle class. But there's even planning opportunities with folks that are on a constrained budget, and especially when there's a new tax law like this, you really have got to start that planning engine. As we'll talk about this bill a lot. There's a lot of what you know are typically called by Wade tax torpedoes, and there's traps where, if you fall within that phase out. While you may be in a 32% bracket, your marginal tax rate during that phase out may be up to 54% you know, the interaction of qualified business deduction and the salt limitation is, is just a classic example. So it's really incumbent upon a lot of people to really for these at least first couple years, start do your tax planning. And you know, the other thing that's really dangerous, I'm sorry, the other thing that's really dangerous is, is the you can't do tax planning on the back of a napkin anymore. The rules are just too complex. We have a complex tax ecosystem, and you really need to do comprehensive planning, hopefully two or three years out into the future to really get the full benefit of all that effort. Okay?

Wade Pfau 07:09
And so really then diving into things, the first item I think worth discussing are just the general federal income tax brackets and maybe the only aspect of the legislation that simplifies things. I was like, I was happy I could, when I update the retirement planning guidebook, I could stop saying there's going to be new set of tax rates in 2020 so there's some simplification with tax brackets, if you could mention that. But then, really, I think my chapter on tax planning is ultimately going to be longer because of all these new phase outs of deductions that we're going to be talking about as well.

Brett Layton 07:40
Yeah, makes it tax rate map a very bumpy ride. So tax brackets stay the same. So we're start at 10% and we go to 37% the old brackets were 10% to 39.6% and the brackets would have jumped. So, for example, if you're in the 22% bracket, now, you would have been in a 28% bracket, excuse me, or the 12% bracket would have been a 25% bracket. The other thing that's incredibly important is that our brackets are broad. Now the brackets, if they had reverted back to pre tax cuts and Jobs Act, were much, much narrow. So the other thing that's that's interesting is that we've gotten an extra couple of years of inflation adjustment into the 10 and 12% bracket. So what that's actually done is it squeezed the 22% bracket a little bit and expanded those two lower brackets. And that's something that everybody can take advantage of. It doesn't get phased out. It's wonderful. It's basically 700 bucks for Mary filing join. But hey, you know you, you, you take your successes as as singles, and if you hit enough of them, you've won the game. Yeah.

Wade Pfau 09:19
And as we get into this common theme is going to be when do all these things begin. So the specific point you mentioned there, the the 10% and 12% brackets are going to get an extra inflation boost. That's something that will begin next year. However, with standard deductions, there's some exciting news for this year.

Brett Layton 09:37
Standard deductions are impacting us for 2025 married filing joint is now 31,500 another way to think of the standard deduction is, is that that's really your first 0% tax bracket, because if I make less than 31,500 Married filing, joint I got a standard deduction of that my taxable income is zero. And just, just to think back a few years before we had the tax cuts and Jobs Act, married filing, joint standard deduction was about 12,700 I believe. So it's a huge increase. The reality of that is it to a took a whole lot of people out of itemizing their deductions and just taking the standard deduction because it was bigger and convenient.

Wade Pfau 10:35
So 2025 the standard deduction increases, $750 for singles, $1,500 for married filing jointly, like you're saying, that's really a 0% bracket, as you feel the standard deduction, and also, as you say, the standard deduction is larger than it was historically, to help avoid itemizing. But maybe the next thing to talk about, and this is where things get more complicated. There are a number of new below the line deductions that you can take, even if you're not itemizing, which means you can take the standard deduction and also take some new below the line deductions, probably the one getting the most media attention. If you could talk about the age 65 plus, yeah, the low lying deduction.

Brett Layton 11:26
So the senior deduction is new. You know, the Polit politicians were talking about making Social Security be tax free. And that's the way it used to be back before the early 1980s obviously, that was way too expensive to fulfill on, so they came up with this standard deduction regime. So if you're over 65 you get a add on $6,000 deduction per person. So Mary filing joint, you have an additional 12,000 of deduction that is below the line. And just quickly the the the significance of that is a lot of the phase outs are based on adjusted gross income, which is the subtotal before you get your below the line deductions, and we'll talk more about that later.

Brett Layton 12:29
So if you're married filing joint, this starts to phase out at $150,000 once you hit $250,000

Brett Layton 12:43
of AGI, your your senior deduction is gone. So if you're ideally situated at $150,000 of AGI, and let's say 90 of it is is portfolio income and your Social Security between both spouses is 60, then this is going to save you about 24 $2,500 of taxes. If your 60,000 of Social Security was tax free, that number is a little over 8000 so it's a partial solution. You don't have to be claiming Social Security to get it. You just have to be over 65 with adjusted gross income of less than 250,000 if you're married filing joint and those are the basic requirements. The singles thresholds are, are lower than that, obviously,

Wade Pfau 13:46
yeah, and to clarify, that's like a second age 65 plus below the line deduction, because we do also have the

Brett Layton 13:55
you're still 1000, you're still going to get your add on to your standard deduction. So it's, so it's, it's really, it's really a sweet deal, but it's, it's ideal for those people that have about 150,000 of adjusted gross income on an annual basis. So if you have a super large Roth account and modest taxable accounts, then you know you might be right in a sweet spot, but individual facts will vary.

Wade Pfau 14:30
So if you're married filing jointly, and you have two people age 65 and older, you got your standard deduction of 31,500 you have an additional 3200 for the for that standard deduction, and then you have another, because there's 265 and older, $12,000 for for this new below the line deduction. That phases out. So if you're under the $150,000 AGI, you're looking at below the line deductions. Now.

Brett Layton 15:00
$46,700 yeah, so that's a, it's a real, real help to, you know, retired folks that, let's assume they don't have a massive Roth and and so, you know, if they're there, they're trying to maximize their retirement income with a constrained portfolio resources. This is going to be a great help.

Alex Murguia 15:31

Brett, did I catch that correctly while Wade was recounting the list of the deduction limits and things like that. Did you double fist pump? You do a double fist pump in excitement, as in, like, hell yeah kind of thing,

Brett Layton 15:48
yeah. And if I can kind of right way, like, yeah,

Alex Murguia 15:52
he was, like, born to be a CPA accounting, accounting chose him.

Brett Layton 16:01
I Oh dear, yeah. I spent two painful years as a computer salesman when I fed up with auditing before I really became a tax specialist, and

Alex Murguia 16:13
I think that coincided when I bought stock on Commodore 64 Thank you. Oh yeah, there you go.

Brett Layton 16:19
Yeah, yeah, I should be in the back room, you know, doing the technical stuff. I'm I, I'm not a salesman, no.

Alex Murguia 16:28
But for our listeners, he had a genuine look of excitement, and he was literally double fist pumping when Wade was recounting the new deduction limited levels.

Brett Layton 16:40
Well, I Wade's, Wade's chapter in his guidebook on taxes, absolutely without a doubt, the best stuff I've ever read on taxation in a financial planning book, right? I mean, really comprehensive and no, it's logical approach.

Alex Murguia 17:03
I read it, but only on Thursday nights after midnight.

Wade Pfau 17:09
Well, thank you, Brett. And I guess it would behoove us to maybe lessen the the fist bump a bit, just because this particular deduction we just discussed, it's available this year, but it's 2025 to 2028, and then it goes

Brett Layton 17:23
away. And that's the other reason we need plan is this bill is very broken up in terms of different start dates, different stop dates for different provisions. And it's, don't get me started on tax policy, but it's really kind of sad to see, because they're gerrymandering all this stuff to fit within a budget window, which, you know, yeah, the joint committee is going to come up with a projection, and it's the best they can do in the heat of the moment. But you know whether their projection is going to hit reality or not, is is completely unknown, and you know we're all subject to the forces of macroeconomics, and that changes everything in the future.

Briana Corbin 18:16

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Wade Pfau 18:42
Yeah, yeah. And so actually, like, if you're trying to keep organized here, we're talking about below the line deductions available, even if you're not itemizing. So even you can take the standard deduction, and there's, there's six of them we're going to talk about. So it's like, this is going to go on for a while. Probably the age 65 plus one is getting the most media attention, but number two out of six qualified business income. I think this one's a lot more complicated, but if you could comment a little bit about this

Brett Layton 19:10
is a lot more complicated. It may not apply to your classic retired person, but for somebody like me who still has a relatively modest Schedule C going, it's qualified business income, excuse me, will allow you a deduction of basically 20% of that qualified business income. There's a lot of little nuances in that rule. If you you basically can go up to about, you know, close to $400,000 before all the cutoffs and limitations hit you. There's really two classes of people once you get up to that, let's say, four. $100,000 level, and that's specified service trade and business people. So that's folks like me and you, and attorneys and doctors and business consultants. So if we have more income than that, our qbi deduction goes away. If I'm a restaurant operator or a machine shop owner, then it doesn't go away, but it is throttled back to the lower of a couple of standards, one half of my w2 income, or I can pick 25% of my w2 income, and then 10% anyway, some small percentage of my total capital assets in my business at historical cost. And so if I'm running a machine shop, I'm putting a lot of people to work, and I'm going to get my full qbi deduction because I've, I've met that test. But if I'm a doctor and I make, you know, 500,000 bucks a year, I don't get a qualified business income deduction below the line. And so that came in in in 2017 and it was a response to the small business people who had flow through type income and to equalize them with the reduction of the corporate tax rate from 35% to 21%

Wade Pfau 21:44
okay, and of this six we're talking about now, this is the, the only one that existed before the legislation, but it's now made permanent as part of the tax code, so you can enjoy your qbi forever.

Brett Layton 21:57
Yeah, yeah, as long as you want to continue to, you know, participate in the labor market or participate in the business market and run a business, and by the way, you're paying employment taxes on all that, which is, you know, when I first started working, and that was No big deal, right? I mean, I blew through my limits, you know, by the end of the first quarter, and it was behind you, and you pay, you know, couple 1000 bucks in payroll taxes, and you're done, right? But now, you know, if you're self employed, payroll taxes are 15.3% and they just, they last forever. The Medicare part of it lasts forever. And and then, if you have net investment income tax on top of your self employment tax, it, it becomes demotivation.

Wade Pfau 23:01
Fair enough. Yeah, yeah, sorry, it adds up, because that's separate from income, yeah,

Brett Layton 23:09
and only next one deductible.

Alex Murguia 23:12
In fact, this, this podcast, is going to be three hours. It doesn't, it doesn't do us any good to make it past 90 minutes.

Wade Pfau 23:21
Wait, yeah, we're gonna run out of deductions the next one, part of the campaigning and so forth. The tips. Qualified tips may not be as sweet as it sounds without getting into the details, but what are the details about deducting tip income?

Brett Layton 23:41
Max deductions, 25,000 which is not bad, not bad. The phase out starts at 150,000 single 300,000 married filing joint. And there's some nuances to it. You have to be in a profession that the IRS recognizes as being a standard tip position. So a bartender is an easy one, right? But if you're an attorney and your client tips you, I'm sorry that doesn't qualify. Because you're you don't have a tip position. And then the definition of tips also has to be, it has to be a voluntary, consensual, non mandatory payment. So now, if you go to a big restaurant and you have a party of aid and there's a mandatory 20% tip added to the bill, then that tip is not a qualified tip, because there's no discretion on the part of the patron. And so we're going. It, you're going to see that get played around with. And they'll, they'll, they'll come up with 20% tip suggested, oh, phraseology on the you can avoid that by washing dishes for half an hour and in the in back by the dishwasher. But, you know, they'll, they'll try to come up with something to make that qualifying. So the other thing that happens

Alex Murguia 25:28
is Wade, and I can't wait, and I just cannot avoid endless soup and salad. We're sucking, and we look for friends.

Brett Layton 25:36
So again, all that tip income is going to be subject to employment taxes. It needs to be for post 2025 if it isn't in on your w2 or your 1099, then you don't get it for 25 the w2 is already out. They're going to allow a couple of different approaches to determining what your qualified tip income is and and that's the basic gist of it.

Wade Pfau 26:08
I think you made the important point that everyone can't just run out and say, ask their employers to tip them instead of paying them a salary. Not that straightforward, right? Yeah, it's

Brett Layton 26:19
controlled to that list, which is out in tentative form for traditional tip positions.

Alex Murguia 26:28
I will say this, though Wade, this sounds that would be a great like Seinfeld type of episode. I know once remember, there was an episode where George, like, put out the $20 that was

available in tip and started deducting based on, like, if the water took too long to refill. But could you imagine an episode where, literally, like, you're paid on tips with your co workers?

Brett Layton 26:51
Thank you. Well, you know there's tax billing and all that stuff, right? Yeah, wait.

Alex Murguia 27:00
Would I be able to make rent if

Wade Pfau 27:02
you had to rely on tips from our listeners? No,

Alex Murguia 27:05
well, I forgot that. I mean from our workers. I think I have to pay money to our listeners. See, all the way around.

Wade Pfau 27:15
Needs to set up a tip jar on the podcast site. There we go. Patreon.

Brett Layton 27:19
Well, my my current wife and I met at the Old Spaghetti Factory, and I was a bartender and she was a waitress. So there we go. That was a long, long time ago. I don't think I can move fast enough to be a bartender anymore.

Wade Pfau 27:37
And then this one does also. All of these are talking about phase out. I think all but one of the six are going to phase out with income. And what happens is, if you're getting tips that are qualified and deductible, the phase out is going to hit you generally in the 22 and 24% brackets, which raise your effective marginal rate to 24.64% or 26.88% Yeah. So yeah. Might like, if we're thinking about, like, with the tax planning, if we're thinking about Roth conversions, that might not put you over the hurdle of stopping a Roth conversion, but some of the things we're going to talk about for later on, when we get to state and local taxes, that's going to be a real roadblock on

Brett Layton 28:19
and with all these bumps on the tax roadmap, the tax rate roadmap. Man doing a Roth conversion on based off of back of the envelope calculation, just assuming that you know you're going to be in the bracket that your income is in, or you think it's going to be in. It just be tremendously dangerous.

Alex Murguia 28:43
And you couple that with the state that Wade was alluding to earlier, right?

Brett Layton 28:48
And I live in California. Here we come, right? You know, no capital.

Wade Pfau 28:55
I'm in Texas, so I don't worry about

Brett Layton 28:57
stating where nobody

Wade Pfau 29:01
Revit in. Next one. It's a cousin of the tips, qualified tips. It's qualified overtime pay. This is a new below the line, non itemized deduction.

Brett Layton 29:15
Lee, before the shutdown happened, we did have draft forms for these items come out now, now that the federal government's shut down, my my hope is, is they're still working, but I'm not sure there's going to be issuing a lot more draft forums out to the tax community for us to chew on. But So overtime is, is? It's, I hate to be negative, but it's a little more limited than you might think. So first, you have to be an employee in the right classification, which basically means hourly, non exempt. And so if you're you know. An assistant manager at a CVS or something. Yeah, you're working 70 hours a week, but you're not getting any overtime, and you don't qualify for this because you're an exempt employee. So you know, it's a 12 and a half $1,000 deduction. 12,500 is the max. And again, that's sort of the same phase outs 150 and 300 I think I know 300 for married filing, joint and again, the deduction that you get is only the half of your time and a half hourly wage weight, so you're still going to pay full tax on your regular time your own. This qualifies you the only your half in time and a half qualifies for the data deduction. Again, it's similar in that this deduction, that half is subject to full payroll taxes, and you know, to do, what else have I missed? I think that's basically the the outline of the deduction. So again, it's great if you're a non exempt hourly employee who works overtime, another, another help on your income tax liability. Yeah.

Wade Pfau 31:34
And then so with the tips, it was up to 25,000 for singles or married filing jointly. That the overtime. It's the 12,500 for singles, but 25,000 for for married

Brett Layton 31:47
per worker. So if you're married filing, if you're married and you're both, you know, non exempt hourly workers, you have a shot at $25,000

Wade Pfau 31:59
and these all, they're 2025 until 2028 also, they're part of that family of temporary things we have now for the next few years.

Brett Layton 32:07
So this is again, just extremely frustrating, but we'll see what happens. You know, the primary reason for the shutdown is is all the health related stuff, and who gets thrown off, and how much credit you may have to recapture, and all the rest of it. So, you know, we could, we could have another bill, and some of this other stuff may fall in underneath it, but something has to happen between now in 2028 or it just goes away,

Wade Pfau 32:44
yeah, and then the third one in this family, the tits, the qualified, the overtime pay, and then the third one is the auto loan interest.

Brett Layton 32:52
Yeah, is it's great if you, if it works for you. Okay? You need to purchase a new car in 2025 or later. It needs to be assembled in the US. You need to provide your you need to provide the VIN for it. This is for personal use only, generally, right? And you could decode your VIN code. And if it's the first character is a one four or a five, it's generally us assembled. The max interest deduction is $10,000 but the phase out starts at 200,000 for married filing joint. I believe it's 100,000 for single and for married filing joint, once you hit 250,000 you don't get any deduction at all. So and so I, I'm in a, you know, I went out and bought a new 2025, car, and I bought it on November, you know, I don't know 20th of 2024, and when this so I thought, oh, man, I'm going to be able to deduct my interest, right? Too bad. So sad you lose. I don't care if you bought your new car assembled in the US on the 31st of 2024, December. You don't get it. You don't get it. So, so a lot of a lot of little hoops to jump through. But if you did buy a new car and you did finance it, it's worth looking into.

Wade Pfau 34:39
Yeah, and like you're saying. So that one phases out over a $50,000 range, so that it's a 20% like each dollar of income, you'll lose 20 cents of your deduction here. So it Yeah, multiplies tax rates by 1.2 in that when you're making the tax map, yeah, yeah. None of that stuff had to be in the old edition of the retirement planning daybook. It's it's more complicated now, well, you're

Brett Layton 35:03
extremely good at the math. Wade,

Wade Pfau 35:07
thank you. The the sixth. So out of the the six here, the sixth one is the only one that doesn't phase out. So that does make it a little easier. But the new, newest member of the family of non itemized deductions would be, and this is only available if you take a standard deduction, a new charitable contribution, separate from itemized only available if you stand if you're using the standard deduction. Available

Brett Layton 35:34
standard deduction, it's $1,000 for single, $2,000 married filing joint, 1000 bucks a piece. And it's, it's important for the for the seniors, you have to do a cash contribution to a public charity, right? So I can't, you know, rent a pickup and haul a bunch of stuff off to Goodwill that's worth a couple 1000 bucks and take a deduction. It's a cash deduction, and

Wade Pfau 36:14
no donor advised funds either,

Brett Layton 36:16
but no donor advised funds. That's always a tricky point. And but if you're not itemizing, you need to remind all your seniors, especially that keep track your deductions and and claim it here.

Wade Pfau 36:38
And then that also does not begin until 2026, so you can't use it this year, well, this year, right? But starting next year, that one is permanent, though, starting next year. So you have that

opportunity, you can get your standard deduction and up to 1000 for singles, 2000 married filing jointly, cash donations, you can also deduct, and it doesn't phase out. So that's nice. Yeah, I'm gonna definitely take advantage of that

Brett Layton 37:03
one until they change it, right? So, you know, I'm nothing's permanent in the tax law, but you're absolutely right in the characterization. It is a non moving code section,

Wade Pfau 37:17
permanent until new law makes it non permanent. At least it doesn't. It's not legislated to end at any point in the future. So that's, yeah, that's probably an episode in and of itself. We'll keep the recording going, because we're just getting to the beginning.

Briana Corbin 37:33
Okay, we'll leave it there for now. But this is just the beginning. The conversation with Brett Leighton continues next week, as we dive deeper into what the one big, beautiful Bill Act means for retirement tax planning, stay tuned. Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only, and are not intended to provide specific advice or recommendations for any individual or on any specific securities to determine which investments may be appropriate for you. Consult your financial advisor. All investing comes with the risk, including Risk of Loss past performance, does not guarantee future results. You