Technical Note: Tax Calculation Methodology

Application: Foothills R&R Wealth Planner (v35)

Module: Dynamic Tax Engine

Overview The Wealth Planner utilizes a sophisticated "Gross-Up" algorithm to estimate future tax liability. Unlike simple calculators that assume a flat tax rate , this engine dynamically adjusts your effective tax rate every year based on your specific income sources, withdrawals, and 2025/2026 IRS brackets. Version 35 introduces multi-bucket withdrawal sequencing and destination-aware event taxation.

1. Federal Tax Logic & Withdrawal Sequencing (New) The calculator follows IRS "Provisional Income" rules for Social Security and standard bracket progression. For the high-net-worth profiles typically modeled, the engine assumes 85% of Social Security benefits are taxable. The remaining 15% is treated as tax-free cash flow.

- **Tax Bucket Classifications:** Assets are categorized into Cash, Taxable, Tax-Deferred, and Roth.
- **Withdrawal Strategies:** The engine automatically sequences drawdowns to cover cash gaps based on user selection:
  - *Tax-Efficient:* Cash → Taxable → Tax-Deferred → Roth
  - *Preserve Taxable:* Cash → Tax-Deferred → Roth → Taxable
  - *Roth First:* Cash → Roth → Taxable → Tax-Deferred
- **Bracket Inflation:** 2025/2026 uses exact, official IRS legislative numbers. If a future tax year is selected, the engine applies a compound inflation factor (default 3.0%) to widen brackets and increase the Standard Deduction. This prevents "Bracket Creep" in long-term projections.

2. State Tax Logic & Exemptions State taxes are calculated on the Total Taxable Income.

- **Standard Logic:** (Taxable Income - Standard Deduction) * State Rate.
- **North Carolina (NC):** The engine recognizes NC as a "Social Security Exempt" state. The taxable portion of Social Security is deducted from the state tax base before the 4.75% rate is applied. No-Tax States (TX, FL, etc.) are applied at 0.00%.

3. The "Widow Tax Shock" Financial planning often overlooks the tax implications of losing a spouse; this tool models it explicitly. When the Spouse Plan Until age is reached, the spouse is removed from the simulation. The following year, the filing status shifts to Single. The Standard Deduction drops by ~50% (e.g., $32,200 to $16,100), and brackets compress. As a result, a surviving spouse often pays a higher percentage of their income in taxes than the couple did previously.

4. Capital Gains & Event Destinations (Updated) One-time events are handled with specific tax and routing logic. The user inputs the cash amount received after transaction costs and specifies a unique tax rate for the event.

- **Formula:** Event Tax = Net Proceeds * (Tax Rate / 100). This tax is deducted immediately from the event cash flow.
- **Destination Routing (New):** Post-tax proceeds are directed based on user selection: applied to the current year's spending deficit, held in a Cash Reserve asset (2.0% return), or reinvested into a Taxable portfolio asset (5.0% return).

Disclaimer: This methodology provides a high-fidelity estimate for planning purposes and assumes the use of Standard Deductions. It does not account for complex itemized deductions, RMD specifics, or capital gains tax brackets.