Insights & Interests: New Year Tax Planning

December 18, 2020

"There is an ancient belief that the gods love the obscure and hate the obvious. Without benefit of divinity, modern men of similar persuasion draft provisions of the Internal Revenue Code."
– Martin D. Ginsburg

As we near the start of a new year it is important to start thinking about making financial resolutions and planning for annual milestones; taxes being the first. You will want to review items that may have been put in place years prior and could need adjusting due to life changes. Many things change in our lives that could have an impact on your financial situation, from changes to jobs and family to relocations and retirement. However, it can be hard to stay on top of these things as they're occurring, particularly in a year like 2020. So implementing savings and investment plans addressing these changes is ideal early in the year to allow for an opportunity to consider and account for tax impacts of decisions.

So, to get 2021 off on the right foot, here are some tips to help you get your tax planning house in order for next tax season:

EMPLOYMENT RELATED

- **Review your withholdings**. Various changes, whether to tax laws, your marital status, children, and a newly working spouse are just a few of the reasons your withholding may not be accurate for your current situation. If your tax preparer mentioned adjusting your withholdings, or if you owed or received a large refund, you'll want to consider adjusting your withholdings. January is a great time to do it, giving you plenty of time to adjust later in the year if necessary. Don't forget state withholdings as well!
- **Review your 401(k) contributions.** Try to contribute the maximum allowed to your 401(k) plan, $19,500. If you will turn 50 in 2021 you can contribute an additional $6,500. You may have to reach out to your plan provider or HR department to put this in place.
- **Roth IRAs.** Do you have a Roth 401(k) option? Talk with your advisor about how you may benefit from contributing to a Roth plan.
- **401(k) Contributions.** If possible, turn on automatic increases to your 401(k) or other employer retirement plan to save a portion of any raise.
- **Bonus Contributions to Retirement.** Will you receive a bonus? Consider adjusting your 401(k)/403(b) contribution amount to save a large portion of any bonus you may receive at the end of the year or in a January payment.
- **Review your investment allocations.** Be sure that your contributions are invested according to your overall plan and rebalance if necessary. If investment choices are not made, your contributions could be sitting in a cash fund, not growing or keeping up with inflation.
- **Health Savings Accounts (HSA).** Check your elections and make adjustments if your benefit open enrollment period has not yet closed. If you have an HSA and didn't elect the maximum contribution, check with your HR department to make changes to your 2021 election. The IRS allows changes to HSA elections, though employers determine the rules for payroll. If you didn't max the contribution for 2020, you have until April 15, 2021 to make a deposit (outside of payroll deduction) to your HSA.
- **Flexible Spending Accounts (FSA).** There have been changes to what is allowed for FSA's, including extended use and rollover amounts. Each individual plan sponsor has to determine if and how they will implement any changes. Reach out to your HR department for updates to dependent care savings accounts and health FSA's.

SAVINGS

- **IRA/Roth IRA.** If you don't have a retirement plan through your employer, set up recurring contributions to a qualified retirement account. Talk to your advisor about retirement savings for children and grandchildren.
- **Emergency Fund.** Set aside funds to replenish any emergency funds used during 2020. If you didn't have an emergency fund, start small and work towards 6-9 months of living expenses.
- **Non-qualified Account.** Otherwise known as a brokerage or investment account. Start or increase automatic savings into an investment account to diversify the tax properties of your savings vehicles.
- **College Savings.** Start a tax qualified college savings plan, 529 plan. Colorado tax payers receive a dollar for dollar state tax deduction for contributions to any persons Colorado 529 plan.
- **Other Education Financing.** Consider creative ways to use 529 plans for student loan debt, pass through for current tuition, and apprentice programs.

BUSINESS OWNERS

Consider adding a retirement plan. There are many options for plans depending on the structure of your business. Your advisor can help you pick out the appropriate plan and get started.

RETIREES

- Though RMDs were deferred for 2020, expect to take the distribution in 2021. If you usually take monthly distributions, don't forget to turn them back on for 2021.
- Are you turning 72 in 2021? Talk to your advisor about your required distribution amount and the best option for taking it.
- If you are charitably inclined, consider a qualified charitable distribution (QCD) to satisfy your RMD and remove that RMD from your income calculation.
- Will you be 65 in 2021? Talk with your advisor about Medicare and health insurance.
- Are you thinking about Social Security? Talk with your advisor about when to start taking it, as well as the tax implications if you are still working.

TAX LOSS HARVESTING

This is the concept of realizing capital losses to offset capital gains taxes, with an added benefit of maintaining or rebalancing your target asset allocation. Be open to opportunities for tax loss harvesting throughout the year, the opportunity may not be available at the end of the year. Private Capital Management monitors client accounts for these opportunities throughout the year.

GIFTING (TAX EXCLUSION)

- The IRS has provided guidance stating that there will not be a claw back in 2021 if the unified exclusion amount is lowered. Review your taxable estate and estate plan early in the year. [1]
- Use the annual exclusion amount of $15,000 to make gifts to anyone. The gifts will be excluded from the recipient's taxable income.
- Consider talking to your advisor about ways to gift assets to beneficiaries to achieve tax savings over an inheritance if you've already met the unified tax credit limit.
- Don't forget about the option to pay education or medical bills directly to the institution for any person. The amounts are unlimited and there are no reporting requirements. Includes a wide range of education options, preschool, K-12, camps, dance, martial arts.

[1] The unified tax credit is the amount of assets that each person is allowed to gift to other parties without having to pay gift, estate, or generation skipping taxes; amounts gifted in excess of the credit would be subject to taxation at the then current federal estate tax rate. For the 2020 calendar year, the credit was $11,580,000 per individual and in 2021 it will be $11,700,000 per individual.

TAX DOCUMENT ORGANIZATION

Designate an organization method for your tax documents as they begin to trickle in. Most items will be mailed to you, however, below are some things you can work on or compile proactively:

- Update address to ensure W2 receipt if you changed jobs or moved.
- Medical receipts, including Medicare and LTC premiums
- Charitable contribution records
- Tuition statements from college
- Rental property expenses and income
- Income and expenses from self-employment

One item we can probably all agree on is putting 2020 behind us, quickly. The last act of 2020 will be filing the tax return. Thinking about how our focus this year has been, and rightly so, on navigating a long list of more pressing concerns and decisions

Because everyone's situation is different, this list is meant to be a jumping off point for thinking about tax related tasks to put in place for the start of the year. Please reach out to your advisor if you have questions about these strategies, how something may apply to your situation or if we've triggered a different question.

Have a wonderful Holiday Season!

Sincerely,
Private Capital Management Team