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YEAR END FINANCIAL PLANNING CHECKLIST

With the end of 2020 coming into focus, we have many areas of uncertainty to navigate on the healthcare, economic, and political fronts. As we encourage our clients to continue thinking and acting long term, there are pockets of near-term financial planning opportunities to consider as the calendar rolls toward year-end.

What we do have certainty around are historically low personal and corporate income tax rates. Regardless of who wins the election, the country has large, underfunded obligations that include the Social Security Trust Fund, Medicare, and a national debt which has further ballooned this year. At some point in time, all these elements will need to be addressed. And though no one can predict what our nation's tax policy will be in future years, we do know the tax rates will change with the possible sunsetting of the Tax Cuts and Jobs Act (TCJA) at the end of 2025, if not before then. Therefore, it is inevitable that tax rates only have one direction to go in the coming years.

With these factors in mind, we highlight a few of the common themes, answer some frequent questions, and summarize steps which could be taken by the end of 2020.

2020 Year-End Checklist

The goal of tax-conscious financial planning is to minimize total taxes paid over the short, mid, and long term. In order to optimize tax efficiency, some years may call for the deferral of income into future years if there is an expectation income tax rates could be lower in the future. The most recent example of this was when our current President was elected. As we progress towards the end of 2020, there is a possibility that future income tax rates could increase. The following is a sampling of issues to consider.

Was your household income in 2020 lower than expected?

The 2020 CARES Act provided a waiver that allowed IRA holders over the age of 72 to opt out of their required minimum distributions (RMDs) for Tax Year 2020. Based on current historically lower income tax rates, and the possibility of a higher tax environment in the future, your potentially lower than expected income in 2020 may warrant a second look at the possibility of taking a voluntary distribution from your Traditional IRA account. Also, these same lower marginal tax rates may invite you to act on the conversion of your Traditional IRA assets to a ROTH IRA.

Did you make a charitable gift in 2020?

For tax filers who claim the Standard Deduction, do not file an itemized tax return, and who normally would not receive a tax benefit from a Charitable Contribution, the

CARES Act allows for an “Above the Line” deduction for a $300 cash donation made direct to a 501(c)3 charity. If you made a charitable gift of up to $300 in 2020, remember to get documentation and report the gift to your tax preparer. Although a relatively small dollar amount, tax aware planning points to every tax dollar saved being a dollar earned.

What is the Roth Conversion strategy that seemingly everyone is talking about, and does it make sense for your Traditional IRA?

Assets in a Traditional IRA are generally funded with pre-tax dollars, grow tax-free over time, and distributions are taxed at ordinary income tax rates. In a Roth IRA conversion, the owner of a Traditional IRA volunteers to pay taxes now on some or all the assets that have grown tax-deferred in the Traditional IRA. Once the assets are converted to the Roth IRA, the assets continue to grow tax-free. While the original conversion amount can be taken out of the Roth IRA at any time, future earnings can also be taken without penalty or taxation as long as certain minimum requirements are met. Roth Conversions are most effective when the assets converted from the Traditional IRA to a Roth IRA increase in value over time, the owner of the account has the ability to pay taxes out-of-pocket, and future personal income tax rates are higher vs. today’s personal income tax rates.

Do you or your spouse not have a Traditional IRA?

As discussed, a Roth IRA allows for assets to grow tax-free as well as for distributions to be taken that are not subject to taxation (certain restrictions apply). If either you or your spouse do not currently have a Traditional IRA, but the household will have earned income in 2020, there is a strategy known as a Back-Door Roth conversion that should be explored with your advisor.

If you believe changes will soon occur in tax policy, will you benefit from a discussion on solutions which will help to preserve the currently high levels of Unified Credit/Federal Estate Tax Exclusion?

There are a myriad of gifting and estate planning techniques which can be implemented now to help preserve the historically high levels of the Unified Credit/Federal Estate Tax Exclusion of $11.58 million per individual, or $23.16 million per married couple. These current, relatively high thresholds could head lower soon, which would trigger a lost opportunity for those with a meaningful projected taxable estate.

Did you review your taxable investment account(s) before year-end 2020?

Capital gains rates are at historically low levels. Asset prices have strongly recovered as we approach the end of 2020, and many accounts are amazingly at all-time highs in value.

1. Do you have any unrecognized capital losses in the account that can be recognized to offset realized capital gains?
2. A more complex question to contemplate is if you do not have any unrealized/realized capital losses, could it make sense to recognize capital gains in 2020 and voluntarily pay taxes if there is a real concern that capital gain rates could go up in the future?

Have you reviewed your beneficiary information this year?

Now is a good time to simply check your primary and contingent beneficiary information. Beneficiary designations on IRAs and 401k accounts supersede your Will, so make sure to review and update appropriately.

Due to changes brought forward by the SECURE Act, a stretch IRA is no longer a viable strategy for a non-spouse IRA beneficiary. After the IRA owner's death, the SECURE Act's implementation of a forced 10-year period withdrawal may run inconsistent with your trust's intended direction for disbursement to non-spouse beneficiaries. It also might make sense to contact your estate planning attorney to check for an existing provision (or to add flexible wording) in the instance where a trust has been named as beneficiary of your IRA.

What is a Donor Advised Fund ("DAF") and how could it help with your 2020 tax planning?

A DAF is a low-cost, effective strategy that provides the opportunity for annual charitable gifting and allows the donor to take a full tax deduction in a single year. A unique application of this strategy allows for the "bunching" of a multi-year gift into a single calendar year. For tax filers who file an itemized return, the normal maximum deduction for a cash charitable donation is limited to 60% of Adjusted Gross Income (AGI), yet the CARES Act allows for a deduction of up to 100% of AGI in 2020. (This strategy is subject to AGI limitations. Please consult with your tax advisor for details.) Combining the change to the AGI limitation in the same tax year as a Roth Conversion can be a potentially powerful planning strategy.

Conclusion

Acting now on creative financial planning opportunities will help you build momentum into the start of 2021. Please reach out to your advisor to explore these issues, address any questions, and take the proper action steps in achieving your year-end financial goals.