New Year Tax Planning

Things you can still do to help your prior year tax bill
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Hallelujah! A New Year is upon us…though we hesitate to get overly excited (we've learned this lesson as Mariners fans). The turning of the calendar didn't seem to erase all of the issues facing us, but there are green shoots of hope out there – and we hope you are seeing some for yourself. The word that keeps coming back to me as a theme for this year is "delight." I think that if we can strive to be a delight and to find delight in others and our circumstances, 2021 may prove to be a good trip around the sun.

With that in mind, it's not lost on me that I am starting this year's series of financial planning briefings on the topic of taxes. Certainly, we don't often put "delight" and "taxes" in the same sentence, or even the same paragraph. That said, a big part of effective financial planning involves good timing…and we're not going to miss our opportunity here to give timely advice on tax planning.

Contrary to much belief, your tax picture for 2020 was not finalized on December 31, 2020. Yes, there were certain things that had to be done by that date to prove worthwhile for 2020 (e.g., charitable giving, 401(k) contributions), but there is still a myriad of things you can do to help:

1. Reduce your upcoming tax bill for 2020
2. Improve your tax situation throughout 2021

In doing so, you not only keep more dollars in your pocket, but also improve your overall financial picture for the long-term. So enough for the intro, let's get to the details. We're going to focus today primarily on what you as an individual can do, while touching just briefly on some ideas for small business owners. As always, we remind you that you should consult with your tax professional before heeding any of this advice.

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Health Savings Accounts

1

Long-time readers may recall we did a deep dive on the ins-and-outs of HSAs back in November 2019 (**click here** to access). What we want to highlight here is that you can still make 2020 tax-deductible contributions to your HSA up until April 15, 2021, assuming you remain eligible for making such contributions. If you don't have an HSA opened yet but are eligible, that is fine. You can open it in 2021 to receive the 2020 contributions. Unlike deductions for medical expenses, which require you to exceed certain spending thresholds (7.5% of AGI) and to itemize your deductions, contributions to an HSA are 100% deductible "above-the-line" – meaning you get the deduction regardless of whether you itemize. In addition, above-the-line deductions lower your AGI, which can be beneficial in numerous ways (including helping you qualify for this seemingly unending stream of gov't stimulus checks).

2

IRA contributions

IRA contributions, whether Traditional or Roth, can be made through April 15, 2021 for tax year 2020. Traditional contributions are tax-deductible and receive that same "above-the-line" treatment that we looked at above with HSA contributions. Roth contributions are not deductible, but assets in that account will be tax-free forever, making this a very attractive option for many (especially if your income, and thus possibly your tax bracket, was down during this difficult year). The aggregate limit for Traditional and Roth contributions is $6,000 (+$1,000 if 50+). The caveat here is that both Traditional and Roth IRAs contributions are subject to various income and eligibility thresholds, so reach out to us for help determining whether you can make this contribution before you start plowing money into your account only to find you have to later undo it. The tables to the left start to give you an idea of what I mean here!

Ineligible to make a contribution directly to your Roth IRA? Let's chat, as you may be able to make a "backdoor" Roth contribution. We'll help you determine whether it makes sense for you and, if so, walk you through the necessary steps.

Traditional IRAs

Maximum annual contribution:
- Lesser of compensation or $6,000
- Up to $6,000 contribution can also be made for nonworking spouse
- Catch-up contributions (age 50 and over): $1,000

Traditional IRA deductibility table

Filing status	Covered by employer's retirement plan	Modified AGI 2020	Modified AGI 2019	Deductibility
Single	No	Any amount	Any amount	Full
	Yes	$65,000 or less	$64,000 or less	Full
	Yes	$65,001–$74,999	$64,001–$73,999	Partial
	Yes	$75,000 or more	$74,000 or more	None
Married/ Jointly	Neither spouse covered	Any amount	Any amount	Full
Married/ Jointly	Both spouses covered	$104,000 or less	$103,000 or less	Full
		$104,001–$123,999	$103,001–$122,999	Partial
		$124,000 or more	$123,000 or more	None
Married/ Jointly	Yes, but spouse is not covered	$104,000 or less	$103,000 or less	Full
		$104,001–$123,999	$103,001–$122,999	Partial
		$124,000 or more	$123,000 or more	None
Married/ Jointly	No, but spouse is covered	$196,000 or less	$193,000 or less	Full
		$196,001–$205,999	$193,001–$202,999	Partial
		$206,000 or more	$203,000 or more	None

Roth IRAs

Maximum annual contribution :
- Lesser of compensation or $6,000
- Up to $6,000 contribution can also be made for nonworking spouse
- Catch-up contributions (age 50 and over): $1,000

Contribution eligibility
Modified AGI is less than $124,000 (single) or $196,000 (married/filing jointly); phaseouts apply if modified AGI is $124,000–$138,999 (single) or $196,000–$205,999 (married/filing jointly).

Deductibility
Contributions to Roth IRAs are not deductible.

Conversion eligibility
There is no income restriction on eligibility for a Roth IRA conversion.

3 SEP-IRA contributions

For independent contractors and small business owners, the SEP-IRA can be an enhanced means of getting money into a retirement account on a pre-tax basis, as your contribution limit will often be significantly higher than it would be with a Traditional IRA. In addition, you have much longer to get this number sorted out, as the SEP plan can be opened and contributions made until the employer's actual tax-filing deadline, including any extensions (this often translates to Oct 15th). Generally, you may contribute up to 25% of compensation (~20% if you're self-employed) or $57,000 for tax year 2020 or $58,000 for tax year 2021, whichever is less.

Get organized! 4

I would venture to guess that hundreds of millions of dollars of tax savings are left on the table each year because of:

1. Lost records
2. Just not knowing the rules

If you can't prove it, you can't claim it. If you didn't even know it was available in the first place, you won't claim it. Take the next few weeks to get organized. Find records of important expenses that you incurred. Ask questions of us and/or your CPA to learn what's possible. With this, you'll be ready come tax time to take advantage of every opportunity to lower your tax bill (legally, of course!). Some things you might want to start searching for that often get overlooked (this is not an exhaustive list):

1. **Charitable giving history:** The CARES Act made it such that charitable giving has enhanced tax perks for 2020, so you can get some benefit even if you don't itemize!
2. **College expenses:** Even with your favorite student learning from the confines of your basement, you still incurred tuition and other costs, and those may add up to a valuable tax credit, depending on your income.
3. **Continuing education expenses:** Maybe you don't have a college student, but that doesn't mean you didn't have education expenses. With an economy in turmoil, you may have engaged in continuing education opportunities for yourself, and those expenses may get you a valuable tax credit (the Lifetime Learning Credit).
4. **Private mortgage insurance expenses:** With it getting harder and harder to put down 20%, PMI is a more common expense for younger homeowners, and these expenses can be deductible if you itemize.
5. **Medical expenses:** As mentioned earlier, you can claim a deduction here if you itemize and your out-of-pocket medical expenses exceed 7.5% of AGI. We see this come into play most often for retirees, but it can be used by anyone.
6. **Major expense receipts:** If you live in Washington (or any other state with no state income tax), you can instead take a deduction for sales taxes paid if you itemize. While it's generally advisable to take the suggested number based on your income (the IRS has a

handy calculator for this), you can add to this if you had major expenses during the year. Before you start adding things up, be sure to check out the **rather short list** of qualifying "major" items, as provided by the IRS.

Lastly, if you're wondering whether all that working from home is going to help you come tax time, the unfortunate answer is "probably not." If you are a W2 employee, the answer is "definitely not" – whereas if you have self-employment income, you might just qualify, but the rules are strict. **Here's a link** to learn more from the IRS, and we invite you to contact us or your CPA to learn more.

That should do it for now. With a tax code that is thousands of pages long, we could probably go on much longer, but we want you to still like us! Please do reach out with questions and/or ideas for future financial planning briefings. Lastly, here's to a delightful 2021!

Additional Resources

2020 Tax Tables

2021 Tax Tables

Understanding Health Savings Accounts

Reporting a Backdoor Roth Contribution

Let's chat!

Tax considerations are an important part of good financial planning and portfolio management. That is why we have strived to have a deep understanding of tax considerations and seek to integrate them into your financial plan. If you are one that prepares their own taxes, we can likely help you uncover ways to make your financial picture more tax-friendly. If you work with a CPA, we can work in collaboration with them to simplify your life and ensure you are paying as little as is legally allowed. This all starts with a conversation, so please reach out and let's chat!

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