Year-end Tax Tips: 11/2019

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Seven year-end tax planning tips:

As we approach year end, it is important to proactively review your tax situation and consider potential tax-saving strategies. Here are seven tax planning tips worth considering as year-end approaches.

1. **Maximize the use of tax-deductible retirement plan contributions.** One of the best ways to reduce taxable income is to make pre-tax contributions to a company retirement plan, self-employed retirement account, or IRA. For 2019, the 401(k) annual contribution limit is now $19,000, and if you are age 50 or older, you can contribute another $6,000 for a total of $25,000. Traditional and Roth IRA limits are $6,000 for 2019, and if you are over age 50, you can contribute an additional $1,000. Keep in mind, if you have consulting or other 1099 income, you may be eligible to set up a self-employed retirement plan to shelter some of your income. **You have until April 15, 2020 to make IRA contributions for 2019.**

2. **Remember to take required minimum distributions (RMDs).** If you are age 70½ or older and have to take RMDs from your retirement accounts, you must do so before the end of the year; otherwise, you may have to pay a 50% tax on the amount not distributed. If you turned 70½ this year, you have until April 1st of next year to take your first RMD. However, if you wait until next year to start, you will have two distributions in the same year—which might bump you into a higher marginal tax bracket.

3. **Donate to charity.** Charitable giving can potentially be a great way to lower taxes, while also contributing to worthy causes. In the current bull market, donating appreciated securities (including stocks and mutual funds) instead of cash may enable greater tax benefits as well as a larger contribution to your favorite charity. Contributing appreciated securities entitles you to a tax deduction and also helps you eliminate future capital gains tax. **Contributing appreciated assets to nonprofits is particularly easy through a donor-advised fund (DAF).** With a DAF, you can contribute your appreciated securities (or cash), be eligible for a tax deduction for this year for the full fair market value of the appreciated stock, select how the proceeds are invested for potential additional tax-free growth, and use the funds for future grants to your favorite nonprofits. **If you are over age 70 ½ and have an IRA, consider making a Qualified Charitable Distribution (QCD) directly from your IRA to the charity of your choice.** A QCD can be more tax-efficient than taking the money out of your IRA and then donating directly to the charity. **A final charitable giving strategy that may be beneficial for you is to "bunch" charitable contributions in certain years given the fact that the standard deduction is considerably higher as a result of the Tax Cuts and Jobs Act of 2018.** The standard deduction for individuals in 2019 is $12,200, $18,350 for heads of households, and $24,400 for married couples filing jointly. If you do not have enough itemized deductions to exceed the threshold, you take the standard deduction. One strategy to consider is to bunch your giving in one year (2019, for example) by doubling your normal giving and that higher amount plus other itemized deductions may allow you to be over the standard deduction and itemize every other year ultimately saving tax dollars. Regardless of the donation method you choose, your donation will only be tax deductible if the receiving

organization is an approved 501(c)(3). Please consult your tax advisor for more information regarding deductibility of charitable donations. If you have questions about the benefits of a donor advised fund, making a QCD, or bunching charitable giving, please give us a call to discuss.

4. **Use other tax-favored accounts**
Beyond retirement savings vehicles, there are other tax-favored accounts you can use to save for your financial future, including:

- 529 plans are tax-advantaged savings accounts designed to encourage saving for future education costs. If you contribute to a 529, future withdrawals (including any earnings) for qualified higher education expenses or tuition for elementary or secondary schools are not subject to federal income tax and, in many cases, state income tax. With generous contribution limits that in most states are well into six figures, these accounts offer a substantial amount of flexibility with no income-based restrictions on their use. **By putting money into a 529 education savings plan account, you can give a tax-free gift to a beneficiary of any age.** Generally, you can make a gift of up to $15,000 per beneficiary annually ($30,000 from a married couple electing to split gifts) without having to fill out the federal gift tax form. You may also be able to contribute up to five years' worth of gifts ($150,000 from a married couple electing to split gifts) per beneficiary in one year, as long as no other gifts are made over that period. Under the new tax laws, 529s may also be used to pay up to $10,000 of tuition annually for the beneficiary's enrollment or attendance at a public, private or religious elementary or secondary school, free from federal income taxes.

- Health savings accounts (HSAs) are available to those who have high-deductible health insurance coverage and who want to set money aside to cover healthcare costs. Contribution amounts (employee and employer) of up to $3,500 for those with self-only policies or $7,000 for family policies apply in 2019. Catch-up contributions of $1,000 are available if you're 55 or older. **If you have other taxable funds to pay for healthcare costs, investing the HSA monies for long-term growth is a great strategy.**

- Flexible spending accounts may be available at your company, and these accounts allow employees the ability to steer part of their pay into a special account which can then be tapped to pay childcare or medical bills. The advantage is that money that goes into the account avoids both income and Social Security taxes. The catch is the notorious "use it or lose it" rule. You have to decide at the beginning of the year how much to contribute to the plan and, if you don't use it all by the end of the year, you forfeit the excess. **With year-end approaching, check to see if your employer has adopted a grace period permitted by the IRS, allowing employees to spend 2019 set-aside money as late as March 15, 2020.** If your company offers this benefit and you have not taken advantage of this account in 2019, you may want to consider it for 2020.

5. **Make annual or one-time gifts to family members.** Consider making annual gifts to your children, grandchildren, or other heirs up to the $15,000 ($30,000 per couple) annual exclusion amount. If you want to leverage your giving, there are unlimited gift tax exclusions for the payment of certain qualified tuition and medical expenses. To qualify for these, you will need to make the payment directly to the education organization or health care provider.

6. **Consider a Roth IRA or Roth-401(k) conversion.** Converting a Traditional IRA to a Roth IRA, or a Traditional 401(k) to a Roth 401(k) can be an effective technique to minimize long-term taxes assessed on investment earnings. Distributions from a Roth IRA or a Roth 401(k) are non-taxable, whereas distributions from a Traditional IRA or 401(k) are taxable as ordinary income.

   The best profile for a Roth conversion strategy is when you expect to be in the same or higher tax bracket during your retirement years. Given the current political environment, that is certainly a reasonable expectation for many folks! Additionally, the Tax Cuts and Jobs Act of2018 contains a "sunset," or an expiration date, for many of its provisions. Accordingly, many of the provisions are temporary and are effective through Jan. 1, 2026 unless new legislation is passed to revise or extend these provisions. **This means that in 2026, tax rates will revert back to 2017 levels which are generally higher than today's levels.** So, the current tax hit from a conversion done this year may turn out to be a relatively small price to pay for completely avoiding potentially higher future tax rates on the account's earnings. In effect, a Roth IRA can insure part or all of your retirement savings against future tax rate increases. The converted funds are generally subject to federal income tax in the year that you make the conversion (except to the extent that the funds represent nondeductible after-tax contributions).

   A few years ago, the Roth conversion privilege was a restricted deal. It was only available if your modified adjusted gross income was $100,000 or less. That restriction is gone. Even billionaires can do Roth conversions under the current rules, but no one knows how long the current rules will be allowed to last. It may be a smart idea to do Roth conversions sooner rather than later. This year would qualify as sooner.

7. **Invest tax-efficiently:**

   - **Hold investment assets for more than a year before selling them so that the long-term capital gain rate will apply to the transaction.** There is still a large tax benefit for holding assets for longer than a year, as the top long-term capital gain rate is significantly lower than the top short-term capital gain rate. Generally, taxes should not outweigh investment considerations so decisions to extend your holding period should include an assessment of any potential risk or return trade-offs that result.

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- **Place the interest-earning portion of your portfolio in your tax-deferred accounts.** With the top marginal tax rate being assessed on interest-bearing assets, the tax law favors holding these assets (taxable bonds, REITs, etc.) in tax-deferred accounts (like IRAs, 401(k) plans, 403(b) plans, etc.) where this income can be sheltered from tax until it is distributed.
- **At year end, sell positions with built-in losses to offset realized gains**. Proceeds can be placed in a comparable investment to maintain exposure to that type of investment. For example, if you sell an emerging markets stock fund to take a loss, the proceeds can be reinvested in a comparable emerging markets stock fund.
- **Consider holding tax-exempt bonds in lieu of taxable bonds for a portion of your bond portfolio.** Holding some taxable bonds can still be prudent to provide diversification, especially if these bonds can be held in a tax-deferred account like an IRA.

Final Thoughts

We welcome the opportunity to discuss these topics with you and help with your year-end planning. Keep in mind, the information provided is for illustration purposes only; it is not intended to be specific to any individual's personal circumstances. We suggest consulting with your tax advisor before implementing any of these tax planning techniques. As always, we are willing to partner with your outside advisors to coordinate financial planning strategies that make the most sense for you and your family.

—AWM Investment Team (11/19)