Year-End Planning Checklist:

As we approach the final months of the year, we wanted to make sure we didn't miss any opportunities to make some financial moves that reduce your tax bill and/or improve your financial plan. Begin by reviewing your budget and adjust accordingly. Are you on track to meet your short/long term goals? Most important, did you update your net worth statement, and did it increase this past year?

There are also some "housekeeping items" that you should think about with respect to your taxes. With that in mind, we've listed some topics below that we can talk more about.

Please note, we are not CPAs and can't provide tax advice, but we can provide ideas to consider and bring forth to your tax advisor. Here are some of the things you should consider.

Year-End Financial Planning

Now that we're in the final months of the year, it's time to make sure you don't miss any opportunities to make financial moves that could reduce your tax bill and/or improve your financial plans. Here are some housekeeping items you should think about with respect to your taxes.

Consider Making the Maximum Allowable Contribution to Your Health Savings Account (HSA).

You can contribute $3,650 for individual coverage and $7,300 for family coverage. If you are over age 55, you can contribute an additional $1,000 a year (or $8,300 if you have family coverage).

HSAs are the most tax-favorable of any type of tax-deferred account because no taxes will ever be taken out if you use the funds for qualified distributions (e.g., approved healthcare expenses). The money goes in pre-tax and comes out pre-tax for qualified expenses. And, since most experts predict you will spend about $250,000 in medical care expenses in your older years, there is little chance you will run out of healthcare expenses. Most HSAs allow you to invest

the HSA balance over $1,000, so this can be a valuable wealth-building tool. The only prerequisite is that you must be in a high-deductible health plan that is approved for accompanying HSAs. For this reason, we put this strategy at the top of our to-do list, even before maxing out on retirement plans.

Consider Contributing More to Qualified Retirement Accounts if You Are Able to Do So.

For example, if you find out that your bonus may be a bit more than you anticipated or you get a raise, think about contributing even more to your retirement plan(s). If you haven't already contributed the maximum to these accounts, and you are in a relatively high tax bracket, that extra contribution will save you taxes immediately at your highest marginal tax bracket. Here are the 2021 maximum contributions for the most popular plans:

- For the current tax year, the maximum allowable 401(k) contributions are as follows.
    - For individual contributions **(these must be made by December 31)**:
        - $19,500 up to age 49
        - $26,000 for age 50+ (with $6,500 catch-up contribution)
    - For employee plus company contributions **(these can be made by the tax deadline)**:
        - $58,000 up to age 49
        - $64,500 for age 50+ (including the catch-up contribution)
- For the current tax year, the maximum allowable contributions are as follows (these can be made by the tax deadline):
    - $6,000 up to age 49
    - $7,000 for age 50+ (with $1,000 catch-up contribution)
        - There are no income limits for participation in a traditional IRA if you are not covered by a retirement plan at work. Otherwise, the income limit is $125,000 (married filing jointly). If only your spouse is covered by a plan at work, the limit is $208,000.

We suggest you only max out on your retirement plan AFTER you max out on your HSA because of the tax effectiveness of HSAs.

Keep Track of Your Flexible Spending Accounts.

You may also be in a Flexible Spending Plan (FSA) at work. These accounts let employees steer part of their pay before taxes into a special account they can tap to pay childcare expenses or medical bills. If you have an HSA as well, the FSA will be what is called a "limited purpose" plan that covers only dental and vision expenses. Whatever your plan, make sure you use the funds by the deadline (which likely will be some date next year — be sure to check with your

plan administrator). Otherwise, you may forfeit the excess. For 2020 and 2021, Congress enacted a temporary act that companies CAN allow people to carry over funds into the following year, but companies are not required to adopt this temporary reprieve. It's important that you find out your company's rules for 2021.

Note: People are often confused about the rules governing FSAs and HSAs. You don't need to deplete an HSA every year. With year-end approaching, check to see if your employer has adopted a grace period permitted by the IRS that allows employees to spend 2021 set-aside money as late as March 15, 2022. If not, you can do what employees have always done to use these funds by the deadline — make a last-minute trip to the drug store, dentist, or optometrist to use the funds remaining in your HSA account on eligible items.

Convert a Portion of Your Traditional IRA to a Roth IRA.

The main difference between Traditional and Roth IRAs is how and when taxes are taken, and there are differences regarding when and how you can use your money. Roth IRAs are qualified retirement accounts where your contributions go into the plan after taxes but are free of taxes once you reach retirement age (59 ½). This is different from Traditional IRAs, where you contribute money before taxes but are taxed on the money when you retire. Roth IRAs have some advantages over Traditional IRAs, so you should talk with your financial advisor every year about whether it makes sense to convert some of your Traditional IRA to a Roth IRA (and pay the taxes now versus later).

The advantages of a Roth IRA are:

- Your investment gains grow tax free. You can withdraw investment gains after owning a Roth for 5 years and you reach age 59 ½.
- You can always withdraw your initial contributions to the Roth IRA at any time, tax and penalty free.
- If you have certain qualified expenses — such as a first-time home purchase medical expenses, education expenses, or adoptions — you can even withdraw your investment gains without a penalty before age 59 ½.
- Roth IRAs are not subject to so-called "Required Minimum Distributions," which force you to withdraw your money and pay taxes on them.

If your tax accountant is telling you that this is a relatively good tax year, or if you feel as if you can "fill up" your current favorable tax bracket, consider converting some of your pre-tax IRA to a Roth IRA. Even if you are not yet age 72, it's not too early to start planning for Required Minimum Distributions. You must start making regular minimum distributions from your traditional IRA by April 1 following the year in which you reach age 72. You can reduce the amount of your RMDs by converting some of your Traditional IRA to a Roth IRA prior to this.

Do Some "Tax Harvesting" if You Have Investment Losses.

Tax-loss harvesting is a strategy in which you sell taxable investment assets such as stocks, bonds, and mutual funds at a loss to lower your tax liability. You can apply this loss against capital gains elsewhere in your portfolio, which reduces the capital gains tax you owe. In a year when your capital losses outweigh gains, the IRS will let you apply up to $3,000 in losses against your other income and to carry over the remaining losses to offset income in future years. The goal of tax-loss harvesting is to potentially defer income taxes many years into the future — ideally until after you retire, when you likely will be in a lower tax bracket. This process lets your portfolio grow and compound more quickly than it would if you had to take money from it to pay the taxes on its gains.

Consider Bunching Charitable Donations to Maximize Itemized Deductions.

When the IRS raised the standard deduction ($25,100 for married filing jointly in 2021), it meant a lot of taxpayers no longer itemize their deductions. Now, only about 11% of taxpayers itemize, because it's difficult to find enough deductions to exceed the standard deduction. As you approach the end of the year, if you're on the itemize-or-not borderline, your year-end strategy might be to focus on bunching. This is the practice of timing expenses to produce lean and fat years. In one year, you cram in as many deductible expenses as possible. The goal is to surpass the standard-deduction amount and claim a larger write-off. One of the most popular expenses for bunching, because of the extent to which you can control it, is the charitable deduction. In alternating years, you can skimp on donations to hold them below the standard deduction amount because you get credit for the full standard deduction regardless of how much you actually spend.

To make your deduction even more valuable, consider giving gifts of appreciated stock versus cash. That way, you will save in capital gains taxes in the future as well.

If you don't have a charity or charities that you want to give that much money to, you could consider a Donor Advised Fund. A Donor Advised Fund allows you to deduct the entire contribution in the year you make it and decide later how you want to dole out grants to charities of your choice. You can open a Donor Advised Fund at financial-services firms such as Schwab Charitable. Contributing one lump sum this year may help lift your deductions above the standard deduction amount and allow you to itemize. Even if you don't itemize, you can still deduct a small level of charitable donations. For 2021, this amount is up to $600 per tax return for those who are married filing jointly and $300 for other filing statuses.

Make sure you discuss this with your tax advisor, because there is a risk to bunching if you think you will owe the Alternative Minimum Tax (AMT). The AMT is triggered by adding deductions back into the mix, so you may inadvertently trigger or increase your AMT.

Do a Check Up on Insurance Values.

It's a good idea to check your insurance values from time to time to make sure that they are providing adequate protection. Many times people's lives change but their insurance policies don't, causing their insurance to become out of date. Here is a quick list of policies to check:

- Life Insurance: typically, life insurance needs increase with new children, additional houses, or debts, etc. Your life insurance company can help to determine your life insurance needs. Your financial advisor can also provide an estimate.
- Homeowner's Policy: If the value of your house has increased significantly, your homeowner's policy should also increase. It should be equal to the amount needed to rebuild your home in the event of a total loss.
- Disability Insurance: Most companies limit the amount available for disability insurance, even when pay continues to exceed the maximum. Your disability policy should recover at least 60% of your earnings if you are disabled and also cover the inability to perform your "own occupation" (as opposed to "any occupation").
- Umbrella Liability Coverage: As your non-retirement assets grow, so should your umbrella liability coverage. In the event of a lawsuit for negligence, your non-retirement assets may be at risk. Some states may even make your retirement assets at risk. Make sure your umbrella liability policy at least equals your non-retirement assets, and keep your liability coverage active for both your homeowner's and car insurance.

Know the Kiddie Tax Rules.

If you have children under the age of 21, you might be tempted to gift them some investments in an attempt to transfer some of the taxable income to them at their lower tax rate and enable them to pay for things like college expenses out of that fund. Be careful that you do not gift too much. Congress created the "kiddie tax rules" to prevent this. If the gain or income from the stock is too large and the child's unearned income exceeds $2,200, they could end up paying taxes at the same rates as you do.

Contribute to a 529 College Savings Plan.

For your young children, 529 accounts are one of the best ways to save money for future education expenses. The main benefit is that investment earnings in the 529 can grow tax free and will not be taxed if the 529 funds are used for qualified educational expenses. While using a 529 account won't reduce your federal tax bill, it could lower your state tax tab. More than 30 states allow you to deduct at least a portion of 529

plan contributions from state income taxes. 529s work best when they are started when kids are very young so funds have time to appreciate tax free. Grandparents can also contribute to 529s, and there is a special provision that allows them to contribute up to $75,000 per grandparent per child in any one year without triggering gift taxes (typically the maximum gift in any one year is $15,000 per person per giftee, but 529s have this special perk).

Withdraw the Required Minimum Distributions (RMDs) from Retirement Accounts.

If you own a qualified IRA and you are over age 72, you need to be withdrawing money from your qualified retirement plan (e.g. 401k or IRA). These are called Required Minimum Distributions or RMDs. Failing to take out enough funds triggers one of the most draconian of all IRS penalties:

- A 50% excise tax on the amount you should have withdrawn based on your age, your life expectancy, and the amount in the account at the beginning of the year.
- After that, annual withdrawals must be made by December 31 to avoid the penalty.

If you don't need the cash flow and would prefer not to increase your taxable income, you may want to consider a Qualified Charitable Distribution (QCD), directly from your qualified account to a public charity. However, you won't get the charitable contribution itemized deduction. QCDs are limited to $100,000 per year, and you can make a QCD gift as early as age 70 1/2.

Consider Deferring Income to Your Company's Non-Qualified Deferred Compensation Plan.

This strategy is appropriate if you have already maxed out your company-provided retirement plans and the company offers a non-qualified deferred compensation plan (NQDC). If so, this may be a good way to avoid current year taxes. NQDCs are simply withheld earnings held by the company in an account so you avoid paying current taxes on the earnings. The account is paid out in some form after you retire, and only then do you pay the taxes. There is one important caveat: These funds are at risk to the extent the company does not survive (unlike a 401k, which is an account that is separate from the company's assets). Nevertheless, if your company is solid financially, it can be a real tax saver as there are typically no limits to how much you can defer (up to your maximum income). You have to elect to participate in the plan prior to 2022 in order to participate.

Start Thinking About a Strategy to Transfer Your Wealth and Avoid Estate Taxes.

For the vast majority of us, this is not an issue because the IRS currently exempts $11.7 million from estate taxes and allows you to pass an unlimited amount of wealth to a spouse without paying estate taxes. However, the $11.7-million exemption is set to "sunset" after 2025, with the threshold reverting to the previous exemption of $5.49

million (adjusted for inflation). This exemption could be at risk for further reductions as some state estate taxes kick in at a much lower amount. Bottom line, if you have accumulated a good amount of wealth, it's not too early to start discussing an estate strategy.

One of the most basic strategies is simply to make sure most of your wealth doesn't have to go through probate court. Probate can be costly and time consuming, meaning your heirs could be waiting months for their inheritance when they need it the most. For that reason, make sure all your financial accounts have "transfer on death" provisions, and make sure all your qualified retirement accounts have updated beneficiary information. You might also consider placing assets into a revocable trust to make sure they are distributed as you desire. You should also make sure your physical assets such as homes, boats, and vehicles are titled as Joint Tenancy with Right of Survivorship (JTWROS) with your spouse so he or she can simply take ownership in the event of your death.

In terms of reducing your estate and shielding assets from taxes, the IRS allows you to gift $15,000 per year ($30,000 if your spouse also gifts) per person without triggering any gift tax implications. Beyond that, there are certain trusts that can "freeze" your assets at their current level so that any appreciation in the assets doesn't hit your estate. Most tax experts believe that trusts created under the current $11.7-million exemption will be "grandfathered" when and if the exemption declines. For that reason, it will be helpful to create such trusts prior to 2026.

Finally, many taxpayers don't realize that life insurance proceeds can be included in the estate of the deceased, if that deceased owned the policy, regardless of who the beneficiaries are. A trust can be a helpful tool to remove the proceeds from the estate, because in effect, the trust will own the policy (as opposed to the deceased).

These are all complicated due to the need to make sure trusts are drawn correctly, so it's very important to use the services of a qualified estate tax attorney in creating any trusts.

Manage Your Marginal and Capital Gains Tax Matters

If you're on the threshold of a tax bracket, you may be able to put yourself in the lower one by deferring some income to 2022. Here are a few thresholds to keep in mind:

- **37 percent marginal tax rate:** Taxable incomes exceeding $523,600 (individual), $628,300 (married filing jointly), $523,600 (head of household), and $314,150 (married filing separately)
- **20 percent capital gains tax rate:** Taxable incomes exceeding $445,851 (individual), $501,601 (married filing jointly), $473,751 (head of household), and $250,801 (married filing separately)

- **3.8 percent surtax on investment income:** The lesser of net investment income or the excess of modified adjusted gross income (MAGI) greater than $200,000 (individual), $250,000 (married filing jointly), $200,000 (head of household), and $125,000 (married filing separately)
- **0.9 percent additional Medicare tax:** W-2 earnings and self-employment income above the same MAGI thresholds as the investment income surtax. (For clients with W-2 earnings above the MAGI thresholds, total Medicare taxes will be 2.35 percent; for self-employed clients, total Medicare taxes will be 3.8 percent.)

Pay Attention to American Rescue Plan (ARP) Details

This statute, signed into law by President Biden in March 2021, changed the Child Care Tax Credit and the Child and Dependent Care Credit (for 2021 only). It also changed the taxation of unemployment compensation and canceled student debt.

- **Child Tax Credit:** In July 2021, the IRS began issuing 50 percent of this credit in six monthly advanced payments. Payments are based on 2020 income, so if your income increased in 2021, keep in mind you may need to reconcile the advanced payments. Be sure to review your eligibility for the credit.
- **Child and Dependent Care Credit:** In 2021, the credit is fully refundable. If your family earns less than $125,000 annually, you may claim a 50 percent refundable credit on care expenses of $8,000 for one child or dependent or expenses of $16,000 for two or more children or dependents.
- **Unemployment Compensation:** In 2020, $10,500 of unemployment benefits were exempt from income tax. This exemption does not apply in 2021, so, if you received benefits but didn't have taxes withheld, it's possible you may owe taxes.
- **Canceled Student Debt:** Under the ARP, you won't owe taxes on student loans that are canceled or forgiven between 2021 and 2025. This relief applies to both federal and private loans.

Rebalance Your Portfolio

Reviewing your capital gains and losses may reveal tax planning opportunities, such as harvesting losses to offset capital gains.

Form a Plan for Stock Options

If you hold stock options, it's a good idea to develop a strategy for managing your current and future income. As part of this, be sure to have your tax advisor prepare an alternative minimum tax (AMT) projection. Keep in mind AMT exemption limits increased in 2021 to $73,600 for single tax filers and $114,600 for married joint filers. If you're thinking about exercising incentive stock options, you may want to wait until January 2022 if, depending on your AMT projections, there's any tax benefit to waiting.

Adjust Withholding and Prepare for Student Loan Repayment

If you think you may be subject to an estimated tax penalty, consider asking your employers (via Form W-4) to adjust your withholding to cover shortfalls. The IRS tax withholding calculator can help you with your estimates. Student loan payments, which the CARES Act paused in March 2020, are scheduled to resume in February 2022. If you reduced other debt during this period, you'll need to adjust your monthly cash flow to include upcoming student loan payments.

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