Financial Planning Strategies
2020

You've probably heard from us personally about some or all of these strategies, but we think it's important to outline some of the key action items we think are broadly applicable to our clients. In this short note you'll learn about a few financial planning strategies that would be timely to address before year-end.

Roth IRA Conversion

Strategy Basics:[1]

A Roth IRA Conversion takes the balance of a Traditional IRA and converts it into a Roth IRA. In essence, you pay income tax on the converted amount today in order to avoid paying taxes on any distributions from the Roth IRA account in the future.

How it works:

Traditional IRAs are generally funded with pre-tax contributions, meaning you didn't pay income taxes on the money you saved. Any distributions from the account when you retire are taxable at your standard income tax rate.

Roth IRAs are the opposite: contributions to the account are taxable, while distributions are tax-free. Thus, when you convert a Traditional IRA to a Roth IRA, you'll need to pay taxes on the converted amount.

For those who expect to see tax rates rise, or their incomes rise, Roth IRAs can be a useful way to reduce your tax burden over the long run. By paying taxes upfront, you can avoid the possibility of higher income tax payments in the future. Roth IRAs also have other benefits; for example, there are no required minimum distributions from a Roth IRA.

The process itself is fairly simple, but because it triggers a tax bill it's important to plan ahead and ensure that you have sufficient cash on hand. It's also critical, obviously, to ensure that the strategy is a suitable match for your needs.

What Makes it Compelling:

For many policy-watchers, it seems increasingly likely that we'll see higher taxes in the future. Given federal debt levels in the wake of the pandemic and the currently scheduled expiration of the 2017 tax cuts in 2025, we believe it's a reasonable strategy to consider.

Donor-Advised Fund Contributions

Strategy Basics:[2]

A donor-advised fund is essentially an investment account for charitable contributions. Making contributions of appreciated securities or cash can give you an income-tax deduction while making it easier to support causes or charities for the long-run.

How it Works:

In addition to cash, there are a number of non-cash assets you can contribute to a donor-advised fund, which helps maximize the tax benefits of this strategy.

Once your contribution is made, you can take an immediate income-tax deduction. That's why this is a useful strategy to consider before the end of the year. Your donation grows, tax-free, until you're ready to contribute it to a cause. You can support any qualifying public charity with your funds.

What makes it compelling:

Large lump-sum contributions to a donor-advised fund can help you maximize the value of the charitable deduction. What's more, in a year like this one, where we've seen significant jumps in several asset classes, it can be worthwhile to consider non-cash contributions. This gives those assets the chance to continue growing while providing a tax deduction for you today.

What Can You Contribute to a Donor-Advised Fund?

Cash equivalents, such as checks, wire transfers or cash positions from a brokerage account

Publicly traded securities or mutual fund shares

Gift Giving to Family

It's not exactly a strategy, but gifts to family can and should be done in a strategic way. Gift taxes are triggered when a cash gift exceeds $15,000 for single filers and $30,000 for married couples.

Any cash given above this amount can be claimed under the lifetime exemption. That means that the "excess" gift is subtracted from your estate tax exemption limits.[3]

For now, that limit is $11.58 million for single people and twice that for married couples. These limits are set to expire in 2025, which makes it very important to be careful and strategic about gifting above the annual limits.

Contributions to college savings plans:[4]

Contributions to 529 college savings plans can trigger a gift tax, though again it is possible to take advantage of the lifetime exemption for large gifts. This means you can essentially give five years worth of gifts in one year. These accounts can be incredibly powerful tools; please reach out so that we can help you navigate the most advantageous approach for all parties.

Paying institutions directly:

For those looking to contribute to a loved one's education or medical treatment, keep in mind that payments made to qualifying institutions on behalf of another person are not subject to the gift tax. For example, if you wanted to give cash to a younger relative for college, you could pay their tuition directly instead and avoid the gift tax issue altogether. The same applies for medical expenses.

Tax Planning for the Future

Year-end tax planning is critical, but it doesn't start in December. We'll be talking with you about tax strategies for next year and the future on an ongoing basis, and we encourage you to reach out to us with questions, concerns, and news so that we can help you make the most of your tax planning.

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Sources:

1. For more on this subject, please visit: https://www.fidelity.com/building-savings/learn-about-iras/convert-to-roth?imm_pid=700000001009716&immid=100785&imm_eid=ep5444719382&&audience=kwd-32105254774&gclid=Cj0KCQiA2af-BRDzARIsAIVQUOfB-hstj-AN3FFHWVvnEi1gUvZ1SUm1hvhv1Gt4Lfhf_fV2EdIPBkoaAiDGEALw_wcB&gclsrc=aw.ds

2. For more on this subject, please visit: https://www.fidelitycharitable.org/guidance/philanthropy/what-is-a-donor-advised-fund.html

3. For more on this subject, please visit: https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-gift-taxes

4. For more on 529 plans, please visit: https://www.morningstar.com/articles/563216/a-gift-tax-loophole-for-529-plans