COLORADO
FINANCIAL
MANAGEMENT®

All Things Financial Planning

Jason Foster, Director of Financial Planning, JD

December 2020

SUMMARY:

- Introduction
- Year-End Planning Deadlines to Consider

Dear Clients,

With the election behind us we are now focused on year-end planning items to consider for 2020. We recently sent out an email as a reminder of these fast approaching deadlines and have dedicated this newsletter to these various planning actions. Within this publication, there are comments related to retirement planning, health savings account contributions, Roth conversions, charitable planning and wealth transfers, and investment rebalancing and tax loss harvesting. Please review these possible actions to decide whether any of them should be a part of your year-end planning. The accompanying deadlines are provided to make sure the action will be recorded for 2020. As always, if you have any questions, your financial advisor, client service manager, or your CFM planning team would be happy to answer these questions and have a conversation with you about whether any of these actions make sense in the broader context of your overall planning objectives.

We plan to host more financial planning topical presentations in 2021 and will be meeting to discuss subjects that will convey relevant and essential information to assist you in making planning decisions. As long as we are still dealing with the pandemic, we will plan on having these presentations virtually. Be on the lookout for these types of announcements in the coming months.

From everyone here at CFM, we hope you have a safe and enjoyable holiday season.

© Randy Glasbergen / glasbergen.com

"I have a diversified retirement plan: sometimes I wish for money, sometimes I hope for money, sometimes I pray for money..."

Year-End Financial Planning Actions and Deadlines
By Viktoria Falus, Senior Financial Planner, CFP

In reviewing year-end financial planning initiatives for 2020, there are some important changes to the rules, due to the pandemic, that you should keep in mind. Below is a list of actions, contribution amounts and deadlines we have compiled that may apply to you. Please let us know how we can assist.

Retirement and Medical Expense Account Planning

Make contributions to Qualified Defined Contribution Plans, Tax Advantage Plans, and IRAs to take advantage of **current year deductions and tax-deferred growth** within the account. If the account is a Roth IRA or Roth 401k, the growth is tax free.

IRA and SEP IRA contributions for tax year 2020 must be made by **April 15, 2021**. Employee contributions to 401(k)s, 403(b)s and Simple IRAs must be made by **December 31, 2020**.

Contribution limits for Traditional or Roth IRAs are $6,000 (plus a $1,000 catch-up if you are over age 50), whereas Traditional or Roth 401(k)s through an employer are maxed out at $19,500 (plus a $6,500 catch-up for employees over age 50). SEP IRA owners can contribute up to 25% of qualified income up to a $57,000 max.

Take advantage of the repeal of the RMD (Required Minimum Distribution) for 2020. RMDs apply to assets in a qualified plan, IRA, Qualified Annuities, 403(b), SEP, SIMPLE, or 457 plans. While minimum distribution rules do not apply to Roth IRAs, they do apply to Roth accounts in a 401(k) or 403(b). Prior to 2020, if you turned 70 1/2, you were required to take RMDs before December 31st (or April 1st in your first distribution year) to avoid a 50% penalty. The **SECURE Act** has now changed this requirement and pushed back the starting RMD age to 72. This starting deadline has been further delayed by the **CARES Act of 2020, allowing all individuals subject to RMDs to forego these distributions for 2020**. If you have no need for the distribution to cover living expenses, then this **pause in RMDs may provide significant tax savings**. For example, if you are 73 and have $1,000,000 in IRA money, your RMD for 2020 would be approximately $40,000, which is included in your taxable income for the year, if you were required to take the distribution. Assuming a 35% tax rate, by not taking the RMD, this is an estimated tax savings of $14,000.

Contribute to a Health Savings Account. If you have a high deductible health plan with a Health Savings Account (HSA) and sufficient cash flow, consider maximizing your tax-deductible contributions to the HSA. Earnings within an HSA are not taxable, and amounts distributed from an HSA for qualified medical expenses are also tax free.

The maximum contribution for tax year 2020 is $3,550/individual and $7,100/family with a catch-up amount of $1,000 for those 55 and older. The contribution deadline is **April 15, 2021**. (Distributions from an HSA for non-medical expenses are subject to income taxes, plus an additional 20% excise tax penalty for such expenses before age 65).

Spend available Flexible Savings Account money. Contributions to an FSA are tax deductible to an employee, much like an HSA account. Unlike an HSA, if the employee fails to use all contributed amounts within a certain period, usually the end of the year, contributions are forfeited back to the employer (use it or lose

it). Check with your plan sponsor as deadlines may vary depending on the plan.

Roth Conversions

You may **convert a Traditional IRA to a Roth IRA** to enjoy tax free growth and distributions. The amount converted, however, will be included in your taxable income in the year of conversion. **Funds in a Roth IRA are not subject to RMDs and conversions are a great strategy for those expecting to pay higher marginal tax rates in the future**. Since taxes are paid on a conversion up front, rather than when you withdraw the money, you will owe no taxes on future earnings if your withdrawals are qualified.

A Roth conversion could prove to be a savvy planning strategy in the current year if you are of RMD age because the lack of distributions required to be taken from a pre-tax retirement account may result in you being in a lower tax bracket, which could allow you to convert money and pay taxes at lower income tax levels. Converting pre-tax money to post-tax money will also lower your future RMDs from your pre-tax retirement accounts.

For those who have a Net Operating Loss (NOL) this year from a business, **utilizing the NOL to offset a portion of additional income from a Roth IRA conversion** can be an effective tax savings plan. An NOL occurs when business deductions exceed income, resulting in negative income. NOLs can be carried forward for an unlimited number of years. As a result of the CARES Act, a NOL arising in tax years 2018, 2019, or 2020 can be carried back a maximum of five years and applied to prior tax returns. (The carryback provision was disallowed in 2017 with the TCJA.)

The new provision also temporarily removes the taxable income limitation to allow a NOL to fully offset income and suspends the limits on 'excess business losses' for individuals and pass-through entities. The 80% restriction and limit on "excess business losses" will apply again beginning in 2021. Unlike net capital losses, where taxpayers are limited to only $3,000 annually to offset any ordinary income, there are fewer restrictions on NOL offsets. If you have a current or carryforward NOL and a concentration in qualified retirement funds such as IRA, 401(k), etc., you may want to consider a Roth conversion this year to offset your available NOL. This NOL calculation is complicated and we recommend that you consult with a CPA to run these figures.

Roth conversions must be made by **December 31, 2020**, but the analysis on whether to convert Traditional IRA money, or how much to convert, should begin much sooner.

Charitable Planning and Gifting Considerations

Taking Qualified Charitable Distributions (QCDs) from IRAs may not be as tax effective this year for those who typically gift a portion or all of their RMDs to charity due to the lack of an RMD mandate for 2020. You may want to **shift your focus and donate appreciated securities** from a taxable account this year, if it enables you to itemize your deductions.

The CARES Act provides a **$300 deduction** from income for charitable giving on your 2020 income tax return, regardless of whether you take the standard deduction or itemize. If you plan to give more generously, you may want to consider ways to make use of existing tax advantages, especially if you think your income tax rate may go up in the future. If your projected itemized deductions will be close to your standard deduction, then it might be prudent to make additional charitable gifts to push you well above this deduction threshold. This is a strategy that is commonly referred to as **'bunching' contributions**. Bunching means concentrating charitable contributions into a single year, then skipping future contributions for a few years thereafter and simply taking the standard deduction in these years. A Donor Advised Fund (DAF) is an appealing vehicle to utilize if you are considering such a strategy.

DAFs are accounts established at firms such as Charles Schwab and Fidelity to facilitate charitable contributions while receiving an immediate income tax deduction. You can contribute to the fund as often as you like, and then recommend gifts to your favorite charities whenever it makes sense for you.

Utilizing a DAF is especially ideal for those who have highly appreciated securities in a taxable account. Contributions of long-term appreciated assets can be one of the most tax-efficient ways to give and simultaneously rebalance your investment portfolio. Over time, positions in an investment can create substantial unrealized gains and overweight the portfolio. With a **charitable rebalance**, you can donate a highly appreciated stock position to a charity or DAF, allowing for both the **exclusion of unrealized capital gains and the qualifying charitable deduction** on your tax return. Afterward, you have the ability to purchase new shares of the same highly appreciated stock (with proper timing) or other investments to rebalance the portfolio, depending on your particular asset allocation strategy. Final deadline for charitable gifting is **December 31, 2020**, but the planning process should be started well in advance.

Wealth Transfers. The **2020 annual gift tax exclusion** allows you to gift up to $15,000 per donee per year ($30,000 if a "split-gift" is elected between spouses) without any tax related complications. Gifting over these amounts will require a gift tax return to be filed, but no taxes would be owed unless you have gifted more than the unified exemption amount ($11.58M for individuals and $23.16M for married couples for 2020). The amount gifted over the annual exclusion amount simply reduces the available unified exemption for tax free gifting during life and at death. If your estate could be subject to estate tax, gifting is a great way to reduce your overall net worth and to allow these gifted assets to grow and appreciate outside of your estate. Gifts must be made on or before **December 31, 2020**. The deadline for filing a 709 Gift Tax Return is April 15, 2021.

Fund a 529 College Savings Plan. If you reside in Colorado, every dollar you contribute to a Colorado 529 plan can be deducted from your state income tax return. Once contributed, the **funds in the account grow tax free and are distributed tax free if used for qualified higher education expenses**. Contributions to 529 accounts are also considered a completed gift for federal gift and estate tax purposes, even though you own and control the account. A special rule allows individuals to frontload up to $75,000 (5 Years x $15,000) in one year, without any gift tax consequences. A couple electing "gift-splitting" can contribute double this amount, or $150,000. Contributions to 529s must be made by **December 31, 2020.**

__**Investment Portfolio Decisions**__

Tax Loss Harvesting. Investment losses can help you reduce taxes by **offsetting income or gains**. Even if you do not currently have any gains to offset, there are benefits to harvesting losses now, since they can be used to offset income or gains in future years. If you have more capital losses than income or gains, you can carryover up to $3,000 of losses to offset income or gains in future years. **Final deadline for tax loss harvesting is December 31, 2020**, but planning should be done well in advance.

If your income will be reduced this year due to the waiver of the RMD, assuming you do not need to take a distribution from your IRA for living expenses, you may want to consider purposefully selling highly appreciated assets to generate capital gains. Depending on your reduced taxable income level, such a strategy could put you at a **zero long-term capital gains rate** this year. For 2020, the 0% long-term capital gains rate applies to married couples filing jointly with taxable income of $80,250 or below, or individuals with taxable income of $40,125 or below.

* * *

In addition to the general deadlines and strategies mentioned above, there is also the possibility of a

future modification to the tax code in 2021 that would have the remote possibility of applying retroactively to the beginning of 2021. Although these changes are speculative at best and are based on campaign platforms and promises, there are additional long-term planning opportunities you may want to explore and consider in the limited amount of time left in 2020 to take advantage of the current law, as there will be some uncertainty in 2021 and beyond with a new administration taking power. We discussed these possible changes advocated by President-Elect Biden in the Q3 Newsletter. This publication is available on our website, or we would be happy to send you a copy of it for your convenience. Although we believe it is important to inform of you these possibilities, we also think it is prudent to not overreact and make sweeping changes to your financial and estate planning based on changes in the law that currently have no legislative footing as of yet.

Let us know if you have questions or how we can help you. Have a happy holiday season!

The Financial Planning Department
And Your Entire Colorado Financial Mgmt. Team

COLORADO
FINANCIAL
MANAGEMENT®

303-443-2433 www.colofinancial.com

Boulder	Denver	Loveland
4840 Pearl East Circle, Suite 300E	3033 E First Ave, Suite 408	4848 Thompson Pkwy, Suite 320
Boulder, CO 80301	Denver, CO 80206	Johnstown, CO 80534