



All Things Financial Planning

Jason Foster, Director of Financial Planning, JD

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SUMMARY:

Dear Clients,

- Introduction:
- Year-End Planning Deadlines to Consider
- Our Financial Planning Offering

After the \$1.2 trillion infrastructure bill was recently signed into law, the **\$1.8 trillion Build Back Better (BBB) legislation** has passed the House and will now be hotly debated in the Senate. We will continue to keep an eye on the ever-shifting details of the BBB bill and the impact it might have on tax and financial planning, but many of the tax proposal changes associated with the bill early on have been removed. These provisions included an increase in the highest income tax rate to 39.6% and highest capital gains tax rate to 25%. The estate tax exemption increase put into place by the Trump tax cuts will likely stay in place through 2025, and common advanced estate planning techniques involving complex trust planning and discounted family entity transfers are set to survive. The BBB's effect on inflation and the rising costs of goods will take center stage in the Senate, as this more water-downed version of the original bill could be set for a vote by the end of the year, but we may be well into 2022 before actual passage of the law takes place. As always, we will keep you informed, and we are available to discuss how this legislation could influence your financial plan.

We recently sent out an email regarding year-end deadlines and have dedicated a portion of this newsletter to these various planning actions. Within this publication there is information 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 2021. As always, if you have questions your financial advisor or the CFM planning team are available 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.

There also is a detailed article on our financial planning services, areas of focus and our process. We hope the article is helpful in providing information and examples of what we can do here at Colorado Financial Management, in order to meet your needs and further your goals.

From everyone here at CFM, we hope you have a safe and enjoyable holiday season. We look forward to 2022!

INVESTMENTS AND
FINANCIAL SERVICES



"I'm not some wacko conspiracy theorist, but isn't it true that the gold market is controlled by the Leprechauns?"

Year-End Financial Planning Actions and Deadlines

By Viktoria Falus, Senior Financial Planner, CFP, EA

It is that time of year again! The following are some year-end planning decisions to consider as 2021 comes to an end, and you prepare for 2022 and beyond. Below is a list of actions, contribution amounts and deadlines we have compiled that may apply to your unique situation. 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. IRA and SEP IRA contributions for tax year 2021 must be made by April 15, 2022. Employee contributions to 401(k)s, 403(b)s and Simple IRAs must be made by December 31, 2021. The **maximum contribution amounts for 2021** are:

- Traditional or Roth IRA: \$6,000 (plus \$1,000 catch-up if workers are over age 50)
- Traditional or Roth 401(k) through an employer: \$19,500 (plus \$6,500 catch-up for workers over age 50)
- SEP IRA: up to 25% of qualified income up to \$58,000

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. 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 2021 is **\$3,600/individual and \$7,200/family** with a catch-up amount of \$1,000 for those 55 and older. The contribution deadline is April 15, 2022. (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 because you either "use it or lose it." Check with your plan sponsor as deadlines may vary depending on the plan.

Roth Conversions

An individual may convert a Traditional IRA to a Roth IRA to enjoy tax free growth and distributions. The amount converted, however, will be included as taxable income in the year of conversion. **Funds in a Roth IRA are not subject to required minimum distributions (RMDs) beginning at age 72.** Conversions are a great strategy for those expecting to pay higher marginal tax rates in the future. In general, if you believe that your future tax rates may go up, either because of legislative changes or higher future income, a Roth conversion could save you money over time. Roth conversions are especially beneficial if you have a large current year taxable loss or an unusually low-income tax bracket year. **We recommend running a break-even analysis** to see if a conversion makes sense from a tax planning standpoint.

If you have a **Net Operating Loss (NOL)** this year, you may be able to apply it to a Roth conversion. An NOL occurs when business deductions exceed income, resulting in negative income. NOLs can be carried forward for an unlimited number of years. There is an 80%

restriction and limit on “excess business losses.” 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. Taxpayers carrying forward NOLs may use those losses to offset a portion of additional income from a Roth conversion. If you have a current or carryforward NOL and a concentration in qualified retirement funds in an IRA, 401(k), etc., you may want to consider a Roth conversion this year to offset your available NOL. The NOL calculation is complicated, however, and we recommend that you consult with a CPA to run these figures.

Although there is much legislative uncertainty, it appears that the “**backdoor**” **Roth conversion** technique is likely to go away in 2022. The elimination of this loophole would affect individuals who have after tax contributions in their 401(k)/403(b) accounts. Some company plans allow employees to make contributions beyond the annual maximum deferral limits with after tax dollars. The backdoor Roth conversion strategy allows the conversion of these post tax contributions directly to a Roth IRA which in some cases can be significant. Given the likelihood of this strategy going away, if you have post tax retirement funds in a company plan, a backdoor Roth conversion likely is a prudent planning move and you should act quickly to take advantage here in 2021.

Roth conversions must be made by **December 31, 2021**, but the analysis on whether to convert Traditional IRA money, or how much to convert, should begin much sooner.

Required Minimum Distributions (RMDs)

RMDs apply to assets in a qualified plan, IRA, Qualified Annuity, 403(b), SEP, SIMPLE, or 457 plan. While minimum distribution rules do not apply to Roth IRAs, they do apply to Roth accounts in a 401(k) or 403(b). Typically, if you are **over 72 you are required to take RMDs before December 31st** (or April 1st in your first distribution year) to avoid a 50% penalty. RMDs are included in taxable income and taxed at ordinary income tax rates. If you don’t need the distribution to cover your living expenses, you might want to consider making a **qualified charitable distribution (QCD)**. This strategy allows a retirement account owner over the age

of 70.5 to donate up to \$100,000 directly to a qualified charity. If the RMD amount of the account owner is under the \$100,000 limit, then the entire RMD can be excluded from taxable income and AGI. For some retirees whose AGI levels are near the Medicare premium surcharge thresholds, this strategy can be extra beneficial, as they can potentially avoid triggering a premium surcharge.



Charitable Planning and Gifting Considerations

As in 2020, the rules for cash donations are quite favorable for non-itemizers. Cash donations of \$300 for individuals and \$600 for joint filers are deductible as an ‘above the line’ deduction. Also, the 60%-of-AGI limit on cash gifts is suspended for the current year allowing taxpayers to **deduct 100% of cash donations** regardless of income.

If your plan is to give more generously in 2021, you may want to consider ways to make use of the existing tax code, especially if you think your income tax rate may go up in the future. If your total **itemized deductions** are close to your standard deduction, then it might be sensible to make additional charitable gifts to push you over the threshold. This is a strategy that is commonly referred to as ‘bunching’ in planning circles. **Bunching means concentrating contributions in a single year**, then skipping for a few years thereafter, utilizing the standard deduction in these subsequent years. A donor advised fund (DAF) may be appealing if you are considering a bunching 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. A direct donation of publicly traded securities (or other illiquid assets) can be a highly tax efficient way to fund a DAF to potentially avoid capital gains tax on the appreciated assets.

Using a DAF can be especially ideal for those who have highly appreciated securities in a taxable account. The contribution of **long-term appreciated assets can be one of the most tax-efficient ways to give** and can simultaneously rebalance your investment portfolio. Over time, long held positions in a stock 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 a qualifying charitable deduction. **The final deadline for gifting is December 31, 2021**, but as with Roth conversions, the planning and process should be started well in advance.

As discussed earlier, a qualified charitable distribution (QCD) from an IRA for those over age 70.5 can be an excellent charitable giving strategy as well.

Wealth Transfers. The 2021 **annual gift tax exclusion allows you to gift up to \$15,000 per donee per year** (\$30,000 if “split-gifting” is elected between spouses). 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 (\$11.7 million for individuals and \$23.4 million for married couples for 2021). The amount gifted over the annual exclusion simply reduces the available unified exemption for tax free gifting during life and at death. If your estate could be subject to estate tax (at an approximate rate of 40% on assets gifted over the above thresholds), gifting during your lifetime is a great way to reduce your gross estate that could be subject to estate tax, and allow assets to appreciate outside of your balance sheet.

For a taxpayer with a considerable amount of appreciated assets in a taxable account and adult children in low tax brackets, a strategy involving the gift of appreciated stock could be a highly tax

efficient technique to employ. As an example, let’s assume that a taxpayer and spouse in the 32% tax bracket gifts \$30,000 of appreciated stock with a \$5,000 basis to their adult child who is in a 22% tax bracket. Taxpayer and spouse accomplish gifting goals while also removing \$25,000 of capital gains from their portfolio. Although the \$5,000 basis carries over to the adult child, the same adult child could sell the stock, realizing the same \$25,000 of capital gains, but at a potentially 0% capital gains tax rate, resulting in no tax on the transaction. Gifts must be made on or before December 31, 2021. For gifts over the annual exclusion amount, the deadline for filing a 709 Gift Tax Return is April 15, 2022.

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 in 2021**. 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.

A rule change in 2021 places an annual cap on the state income tax deduction for Colorado 529 plan contributions, depending on filing status. The cap is a per taxpayer/per-beneficiary **cap of \$20,000 annually for single filers and \$30,000 for joint filers**, effective starting January 1, 2022. If making larger contributions to a 529 is your objective to take advantage of the unlimited state income tax deduction for 2021, you may want to act quickly in the remaining weeks of this year. There is also a special rule allowing individuals to avoid gift tax consequences (gifting more than \$15,000 per person) by contributing up to \$75,000 per person (5 years x \$15,000) to a 529 plan. A couple electing to “gift-split” the contribution can double this amount, or contribute \$150,000 per person. **The deadline for contributions to a 529 is December 31, 2021.**

Investment Portfolio Decisions

Loss Harvesting. Investment losses can help you reduce taxes by offsetting income or gains. Even if you don’t currently have any gains, 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 on future tax returns. **The deadline for tax loss harvesting is December 31, 2021, but the discussion should begin earlier with your advisor and investment management team.**

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Final thoughts. Good tax planning starts with calculating your estimated taxable income for the year and understanding your tax bracket for management purposes. Having a clear understanding of your tax bracket is critical to recognizing potential year-end tax planning opportunities.

It does not look as though we will have a change in income tax rates or tax brackets for 2022. As indicated in the introduction of this newsletter, the House passed legislation that did not include any substantial changes to the tax code. Changes could be reintroduced in the Senate before final passage, but this is unlikely. It also looks as though the lifetime gifting exemption increase put into effect in 2018 will stay intact through 2025, and the overall individual exemption will move up to over \$12 million per person in 2022. It is anticipated the step-up in basis rules will remain unchanged for inherited property as well. These developments will provide clarity for tax planning purposes for the rest of this year and into 2022, which is welcome news for tax and financial planners. Let us know if you have questions or how we can help you. Have a happy holiday season!

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"If you keep working until you're 85, you can afford an early retirement."

Our Financial Planning Offering

By Tim Dutton, Associate Advisor, CFP

Whether you are a new client (if so, welcome aboard!), or have been with us for decades (if so, thank you for your continued trust), our financial planning team is available to provide robust financial planning services to help you reach your objectives. Financial planning refers to the process of determining whether and how an individual can **meet life goals** through the proper management of financial resources. All planning done at CFM is **tailored** to the specifics of the individual and comprehensive in nature so that you can feel confident we are assisting you in making **informed financial decisions** to accomplish these goals. Although we will review and provide guidance on all matters that fall under the financial planning umbrella, it is worth outlining specific areas of focus and provide examples of planning matters we typically engage in with clients to offer some perspective as to the scope and depth of our services.

Retirement Planning. We routinely assist clients with budgetary planning and cash flow projections, especially when it comes to critical decisions you are contemplating, such as when you can confidently retire, how to replace income in retirement, when it makes sense to start taking social security, how investment decisions might affect long term goals, and retirement account distribution management.



Tax Planning. We spend a considerable amount of time with clients working through various tax planning strategies. This might involve income tax bracket management through the use of Roth conversions, retirement account contributions,

harvesting in conjunction with our investment management team. Our planning team can analyze stock options so an approach can be put in place to manage the tax consequences in exercising such options. We assist with business succession strategies and will model out the possibilities so you can understand the tax ramifications of various approaches. We also work closely with outside CPAs in putting the plan together so you can have confidence when making decisions that have considerable tax consequences.

Estate Planning. Our planning team is heavily involved with our clients in reviewing and providing wealth transfer strategies. We offer comprehensive reviews of estate planning documents, provide observations and recommendations based on the client's objectives, and collaborate with outside counsel to implement the desired changes. We review estate tax mitigation strategies while keeping a close watch on appreciated assets to secure capital gains tax savings when it comes to gifting strategies and legacy planning. The planning team will analyze the titling of assets and your beneficiary designations to make sure assets will eventually flow properly through the estate plan to assure the desired objectives. If trust planning is necessary, we work with outside counsel to make sure the appropriate estate plan structure is chosen, and discuss the ideal distribution language within the trust to make sure you are comfortable with the beneficiary's access to the wealth you have built. We have conversations related to fiduciary selections within your estate plan, such as who should serve as trustees, agents under power of attorneys, and/or personal representatives. If you have a philanthropic intent, we have an array of solutions and techniques to maximize your generosity, and to potentially save on taxes, too.

Risk Management. Asset protection is a critical part of any comprehensive financial planning process. Whether a client has an existing life insurance policy, a long-term care policy, or no insurance at all, we review the financial plan to evaluate what is objectively required when looking at the broader financial planning context. CFM works closely with a third-party insurance analyst to provide a review of any existing policies so we understand how each insurance policy functions, and if a particular type of insurance is an appropriate solution, whether it would be prudent to utilize the existing policy or exchange it for a bet-

ter one. We review the need for umbrella insurance and the amount necessary to make sure your net worth is adequately protected. We also can provide an analysis of any existing annuities clients own, and whether these contracts are a constructive component of the overall financial plan. The review might result in keeping the annuity, liquidating it (and potentially paying the corresponding taxes), or exchanging the annuity for a different product that better suits the overall financial plan.

The Process. In order to provide comprehensive financial planning, an information gathering process must take place. This is a means of **discovery**, as we listen to your needs and objectives, and gather the necessary information to build the plan. We use **sophisticated planning software** to build a detailed balance sheet with all assets. We spend a significant amount of time understanding how these assets work, the potential growth or rate of return associated with each asset, whether the asset generates cash flow, what type of cash flow from a tax management perspective, and how your financial future will be shaped collectively through owning these assets. Based on this review, we can **analyze the data** and propose strategies and solutions, allowing you to make corresponding decisions. We will then move to **implement the plan and decisions you make**, and can regularly meet with you to **monitor, review, and re-evaluate the plan.**

The financial plan created in the beginning is never meant to be static in nature. We anticipate change as your financial world transforms over time. During the initial or subsequent meetings, we can "stress test" the overall financial plan for future events. This process can be a confidence builder for clients assuming the events are manageable in the plan. It can also result in reassessing certain aspects of the plan if the plan cannot absorb the change. Examples of variants that could upset the proposed success of the plan could include a job loss, increased expenditures in the budget, a gifting strategy to fulfill legacy planning or charitable goals, the potential need for long term care and incorporating the future cost of this event, a potential lower rate of return for investments, the sale or purchase of real estate, retiring earlier than expected, and education planning and funding. Clients can view how these life events or decisions will influence the success of the financial plan and make adjust-

ments accordingly, if the success of the plan is in jeopardy.

In utilizing our planning software as the hub for the financial plan, assuming the balance sheet is accurate following our **onboarding process**, future meetings to assess the plan or to contemplate a change or decision can result in a very efficient process. Clients can log in to our planning software as well. They can update their profile with information, and assuming accounts are linked properly, they can access an updated balance sheet whenever they would like, or review shared financial plans created for their benefit. They also can store important documents for organizational purposes, such as tax returns or estate planning documents, in a secured storage space specific to their client profile.

Your CFM advisor and planning team can engage and assist you in creating a financial plan that is unique to your specific circumstances. The interactions and onboarding sessions are designed to gather information and data critical to achieving this goal. Our comprehensive process means you can be confident in the presentation and implementation of the plan, and because your financial affairs will evolve over time, we will be in unique position to help you plan for any and all changes. Contact us today to start this planning process with CFM. We look forward to assisting you.

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