2020

Financial Planning

Feature

Year-End Planning Tips

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WEALTH MANAGEMENT

Inside the Issue

The end of the year always seems to sneak up on us, and as we enter the last quarter of a year that has been unprecedented in so many ways, it is important to reassess your financial wellness. Due to the COVID pandemic, your financial situation might have changed, creating the need to review where you are today and make appropriate adjustments. There are a few reasons to make year-end financial and estate planning a priority.

In this Edition of our Financial Planning newsletter, we will share with you our year-end planning tips and take a closer look into a few timely planning strategies. As always, please remember to consult with your tax and financial advisors before taking action and discuss the options that might be appropriate for you sooner rather than later.

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By Elena Ladygina, CFP®

Year-End Planning Tips

Here are some valuable year-end planning tips to ensure that you end the current year and head into the next year feeling good about your financial health.

INVESTMENT AND TAX PLANNING

EVALUATE YOUR RISK TOLERANCE AND REBALANCE IF NEEDED

Risk in a portfolio is determined by the mix of stocks, bonds and cash. Your optimal mix is driven by factors such as your risk tolerance, risk capacity, time horizon, income needs and unique circumstances. Remember that the important thing is to have a properly diversified portfolio and focus on your long-term goals.

FUND A 529 PLAN FOR YOUR KIDS' EDUCATION

529 plans are flexible, tax-advantaged accounts that accumulate funds for higher education. These plans allow you to invest after-tax dollars in a selection of stock and bond mutual funds. The funds in the account grow tax-free and the withdrawals are tax-free for qualified expenses. Additionally, many states offer residents a full or partial tax credit or deduction for contributions to their state's plan. 529 plans can be used for higher education as well as kindergarten through 12th-grade tuition at private schools. Any unused funds can also be used for graduate, trade or vocational education or reassigned to another beneficiary (sibling, niece/nephew, yourself, etc.).

MANAGE YOUR MARGINAL TAX RATE

If you are at a tax bracket threshold, you might be able to lower your bracket by deferring some of your income to 2021. You can also consider accelerating some of your deductions like medical expenses and charitable donations (see Donor Advised Funds) into 2020 vs. paying for deductible items in 2021. Alternatively, those in relatively low tax brackets might fill the bracket by making Roth conversions.

REVIEW ANY CAPITAL TAX GAINS AND OFFSET WITH LOSSES

If you have any unrealized losses in your investment portfolio, consider selling them to harvest a tax loss. These losses can help offset any qualified gains that you have realized. Remember to wait at least 31 days before buying back a holding sold for a loss to avoid the wash sale rule violation. Depending on the outcome of the elections, the capital gains rates might be changing so it is important to evaluate your current situation and make necessary adjustments.▶

GIFTING

GIVE TO LOVED ONES, USE ANNUAL GIFT EXCLUSION

Make sure to take advantage of your annual gift exclusion. In 2020, you can gift up to $15,000 per individual in federal tax-free gifts. For example, a couple can gift $30,000 to each of their 2 children, for a total $60,000 gifted during the year.

GIVE TO THOSE IN NEED, MAKE A TAX-DEDUCTIBLE CHARITABLE CONTRIBUTION

If you would like to take a charitable tax deduction in 2020, now is a good time to donate.

GIFT APPRECIATED STOCK AND AVOID PAYING CAPITAL GAINS

Make charitable contributions using appreciated stock in place of cash. By utilizing this strategy, you will generate an income tax deduction for the full market value of donated stock as well as avoid paying capital gains tax on those securities. Donating appreciated stock is more tax effective than donating cash and it can be used with Donor Advised Funds (see below).

QUALIFIED CHARITABLE DISTRIBUTIONS (QCD)

If you are over 70 ½ and would like to donate to a qualified charity, you can do so directly from your IRA. Donations made straight from your IRA to qualified charities count toward your required minimum distribution but are not included in your income. This is particularly beneficial to those who take the standard deduction and/or want to reduce their AGI in order to lower their Medicare premium. The maximum annual amount that can qualify for a QCD is currently $100,000.

DONOR ADVISED FUNDS (DAFS)

Given the reduced limits on itemized deductions, it may be wise to combine or bunch annual charitable deductions into one year. In this bunching strategy, you can combine a few years' worth of donations into one year to help increase total eligible itemized deductions. If your donation exceeds the annual limits allowed, you can carry forward the donation over the next five years. Donor-Advised Funds (DAFs) are accounts where an individual can make a charitable gift to enjoy an immediate tax benefit and retain advisory privileges to disburse charitable gifts over time. Appreciated securities may be donated to a DAF but qualified charitable distributions cannot be made to a DAF.

MAX OUT YOUR RETIREMENT PLAN CONTRIBUTIONS

Make sure you take advantage of contributions to your retirement plans (IRA, 401K, 403B, etc.). Your employer may offer a matching 401(k) contribution as part of your employee benefits. This is free money and if possible, you should contribute at least the amount necessary to get the full match. In 2020, you can contribute a maximum of $19,500 to a 401k Plan and $6,000 to a Traditional IRA. Other retirement plan contribution limits are listed below. Consult with your advisor to determine whether to make a traditional or Roth contributions to your retirement account(s).

BACKDOOR ROTH CONTRIBUTIONS

For those whose income exceeds the limits for making contributions to their Roth IRA, consider a backdoor Roth contribution. This strategy involves making a non-deductible contribution to a traditional IRA and then making a subsequent Roth conversion. This works best for those who do not have existing IRA accounts. In this situation, contributions are made to your Roth IRA with no additional tax impact.

IRA CONTRIBUTIONS – AGE LIMIT ELIMINATED

The SECURE Act repealed the maximum age for contributions to a traditional IRA. Starting January 1, 2020, as long as you have earned income in 2020, you can contribute to a traditional IRA, even after age 70½. You may even be able to deduct the contribution depending on your modified adjusted gross income. ▶

CATCH UP CONTRIBUTIONS FOR 50 AND OLDER

If you are 50 or older, take advantage of catch up contributions to your retirement plans and accounts. In 2020, you are able to add another $6,500 to an employer sponosred plan and $1,000 to IRA account. Please see the table below for more details.

Here are some of the 2020 contribution limits:

RETIREMENT PLANS	
401(k), 403(b)-402(g)(1) - Maximum employee elective deferral	$19,500
Defined Contribution Plan Total Limit (Employee + Employer)	$57,000
Solo 401k Maximum Contribution (Employee + Employer)*	$57,000
Catch-up Contribution for the plans above (age 50 or older, above annual limit)	$6,500
IRA Contribution Limit	$6,000
IRA Catch-up Contribution (age 50 or older, above annual limit)	$1,000
Roth IRA Contribution Limit	$6,000
Roth IRA Catch-up Contribution (age 50 or older, above annual limit)	$1,000
SEP IRA Maximum Contribution	$57,000
Catch-up Contribution	NOT permitted in SEP IRAs
SIMPLE Maximum Contributions	$13,500
SIMPLE Catch-up Contribution (age 50 or older, above annual limit)	$3,000

Maximizing the amount you contribute will allow you to take advantage of available tax deductions and employer matching.

CONSIDER ROTH CONVERSION

There is a potential to decrease overall income tax on retirement assets over the long term with a Roth IRA conversion. A Roth IRA conversion allows investors to transfer all or some of their traditional IRA assets to a Roth IRA. All future gains are shifted to the Roth IRA, a retirement account that grows tax-free and is not subject to any future distribution requirement (RMDs). See more on this topic on page 10.

PAUSE REQUIRED MINIMUM DISTRIBUTIONS (RMDS) IN 2020

You can reduce taxable income and taxes owed in 2020 by pausing Required Minimum Distributions. The Coronavirus Aid, Relief, and Economic Security (CARES) Act granted investors the opportunity to pause RMDs in 2020. Taxpayers who have already taken all or a portion of their RMD from their IRA in 2020 might still be able to take advantage of this relief. There are specific rules to follow and individuals who have already taken their RMD should consult with their Tax Advisor before depositing money back into their IRA. Taxable distributions from retirement accounts affect other important areas such as Medicare premiums and the taxation of Social Security benefits. An analysis should be done on a case-by-case basis.

PERSONAL SUCCESS

TIME TO REFINANCE?

Mortgage rates have dropped to historically low levels and there might be an opportunity for refinance. See more on page 9 of this newsletter.

FLEXIBLE SPENDING ACCOUNT (FSA)

FSA is a special tax-free account offered by some employers where you can contribute pre-tax dollars that will pay for services that your health care does not cover. Most plans have a “use it or lose it” feature for FSA account. Make sure that if a rollover is not allowed, you spend the balance for qualified expenses, so you do not lose it. Also note that the Internal Revenue Service (IRS) relaxed certain “use or lose” rules this year because of the pandemic. Employers can modify plans through the end of this year so check with your benefits department to see if you have the ability to carry over some of your funds into 2021. ►

CONTRIBUTE THE MAXIMUM AMOUNT TO HEALTH SAVINGS ACCOUNT (HSA)

A Health Savings Account (HSA) is a financial account established to pay for qualified medical expenses. Taxpayers receive a 100% income tax deduction, up to the annual limit, on their contributions. Contributions made by the employer are excluded from the gross income. You can withdraw these contributions tax-free to pay for qualified medical expenses and/or leave the unused funds in the account indefinitely and roll them over year to year. You can also earn interest/grow the account and the growth is tax-deferred. In 2020, you can contribute $3,550 for individual coverage and $7,100 for family coverage. At age 55 and above, you are eligible for a catch up contribution. In 2020, the catch up amount is $1,000 per person.

MEDICARE OPEN ENROLLMENT BEGINS OCTOBER 15TH

The opportunity to make changes to Medicare coverage options will begin October 15th and run through December 7th. Rather than re-enrolling in the same coverage, the open enrollment period allows individuals eligible for Medicare to make changes to Part D prescription plans, Medicare Advantage plans and even switching from Parts A and B to a Medicare Advantage plan. Everyone's situation is different, so it is important to review the "annual notice of change" regarding current coverage and determine the best solution for the upcoming year.

MAKE 2021 EMPLOYER BENEFIT ELECTIONS

Open enrollment is typically in November or December of the current year. Make sure you make any necessary changes during this time and consider taking advantage of all available options.
Plan for major life events and review your goals

How did you do with the goals you set out for 2020? Evaluate how you did and set realistic goals for the next year. If you do not have a plan already, consider putting that on your to do list. It is also important to evaluate any major events that you might have coming up (includes family, job, marriage, big purchases) and have a strategy for dealing with it.

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By Ann Schnorrenberg, Ph.D., CFP®

Time To Refinance?

Mortgage rates have dropped to historically low levels. The average 30-year fixed rate mortgage has been under 3% since the end of July, its lowest level since the Federal Reserve began tracking this number almost fifty years ago. This raises a question for homeowners with existing mortgages: does it make sense to refinance? The answer depends upon what you are trying to accomplish.

If the intent is to reduce your monthly payment and ease cash flow, then refinancing can help accomplish that goal. You can lower your monthly payment by both cutting the interest rate and extending the length of the loan. While this does stretch the period over which payments must be made, it serves the purpose of cutting costs now.

On the other hand, if the goal is to reduce the overall cost of the loan, then the answer may not be so straightforward. A lower interest rate does not always translate into a lower loan cost.
Closing costs are an expensive component of refinancing a loan. The total cost of the mortgage, including upfront costs and interest charged, is known as the annual percentage rate, or APR. While banks are required to show the APR for any loan, this rate may not reflect the actual cost to you. Banks calculate the APR under the assumption the mortgage will be held until maturity. If you expect your loan to be paid off early or at an accelerated rate, then the benefit of a refinance is reduced, and the cost of the new loan will be higher than the bank's projection.

If you do not expect to hold the new mortgage to maturity, then it is important to evaluate whether incurring closing costs is worth the benefit of a lower interest rate. This can be done by determining your personal APR. If this is something you are considering, we can help you with this calculation.

One alternative to consider in lieu of refinancing is to modify, or recast, your existing loan. This process allows you to keep your existing loan while renegotiating the terms. Call your bank and ask if they will lower the interest rate. While any rate offered will not be as good as a refinanced loan, the fee charged will be significantly less than full closing costs.

By Alexander Smit, CPA, CFP®

It Is Not Too Late To Consider A 2020 Roth Conversion

This year has brought some interesting financial planning opportunities due to COVID-19 pandemic and the resulting CARES ACT. In particular, the current economic and political environment has prompted people to rethink their tax planning. Given today's low tax rate environment, expectations of higher future tax rates and the recent decline in certain global equities, IRA owners have the potential to lower future income taxes and transfer assets to non-spousal beneficiaries more efficiently than traditional IRA assets. So, if you think that your tax rate may be higher during retirement than it is now, considering a Roth conversion might be advantageous.

The process of a Roth conversion requires an individual to rollover or take a distribution from a Traditional IRA and move those assets to a Roth IRA. The overall goal of the Roth conversion is for the individuals to pay the taxes today while rates are low and market prices are down. When we wrote the initial article "Wealth Planning Opportunity in a Bear Market" in the beginning of April, the overall stock market was at its lowest level since December 2016. On March 23rd, the S&P 500 was down 33.8% from the peak on February 19th, 2020.

Why do lower market prices create an advantage for a Roth conversion? As a tax planning strategy, you would be able to transfer the shares of an individual stock at those lower market prices and then take advantage of tax-free growth. Your current taxable liability would be based off the lower market value.

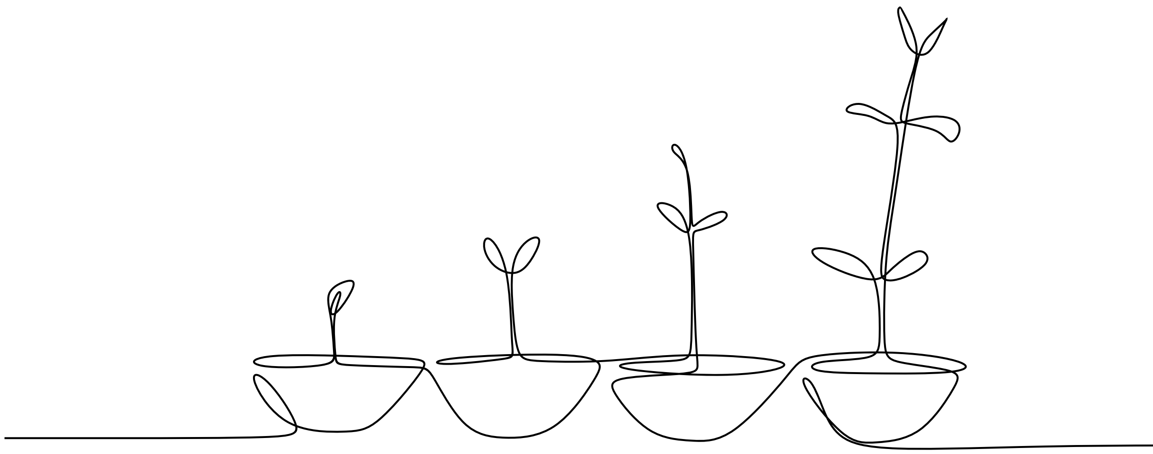
Recently, the market has seen the fastest recovery in history amid the coronavirus pandemic. The recovery is mainly due to technology and consumer discretionary as they have significantly benefitted from the "new normal". But there are many individual stocks that have not recovered yet from the shutdown.

The Coronavirus Aid, Relief, and Economic Security (CARES) ACT waived the required minimum distribution for 2020. In our previous article, "The Cares Act Impact on Retirement Assets" we noted the tax benefit of eliminating the need for individuals to take RMD's for 2020.

The waiver of required minimum distributions may lower the tax bracket for many taxpayers this year. Since Roth conversions are most effective during low tax bracket years, consider converting some of your IRA to a Roth IRA if you are in this situation. The tax planning benefits of Roth conversions include:

Reduced RMDs in subsequent years
Reduced income tax liability, which in effect may potentially reduce Medicare Part B premiums and taxable Social Security
Tax free growth and any distributions you take out in retirement are free from federal taxes
More efficient transfer of assets to a non-spousal beneficiary

Managing your tax bracket may help determine whether you take a full or partial Roth conversion. For example, considering a partial Roth conversion in an amount that fills up your current tax bracket may be the most tax-efficient method. We strongly suggest consulting with your accountant before determining that amount you want to covert.



By Thomas Farrell, CFP®, CEPA

Grantor Retained Annuity Trusts (GRATs)

There are many ways to transfer wealth to family and charitable organizations. In many cases, these transfers require the outright transfer of assets irrevocably. In times of economic uncertainty, it can be disconcerting to give away assets that might be needed for personal use down the road. To alleviate this concern, investors may simply prefer to retain a certain amount of principal and feel more comfortable gifting the excess.

A Grantor Retained Annuity Trust (GRAT) is a more sophisticated gifting strategy that may work well in today's market and interest rate environment. A grantor in a trust is the giving party and a grantee is going to be a receiving party. A GRAT would be utilized after exhausting the annual gift exclusion allowance. This strategy can satisfy a grantor's desire to retain current assets but give away the growth on those investments. GRATs are appropriate for investors who prefer to never touch principal and only spend portfolio income.

To create a GRAT, an individual transfers assets with potential for capital appreciation to a trust for a specified period of time. During the term of the trust, the grantor retains a right to receive an annuity payment equal to the approximate present value of the original gift (original value of the asset plus rate of interest specified by the IRS, known as the 7520 rate). At the end of the trust term, after all annuity payments have been made to the grantor, any remaining assets are distributed to the beneficiaries (typically the children of the grantor). Simply put, the grantor gives away any growth on the asset.

There are several key aspects to consider when using GRATs as a wealth transfer and estate planning strategy.

The term of the trust is established when the GRAT is created and is typically short-term (about two years). This helps limit the risk of death during the term of the GRAT and provides some comfort to the grantor that assets do not need to be tied up long-term. From an investment perspective, investors usually fund GRATs with assets that have the potential for meaningful capital appreciation like growth-oriented stocks or shares of a closely held business. The lower the IRS mandated 7520 interest rate, the easier it is for underlying equities to outperform. The 7520 rate (published monthly) for September 2020 is at a record low of 0.4%. Imagine competing in a 100-meter hurdle race where the hurdles are only 6 inches high!

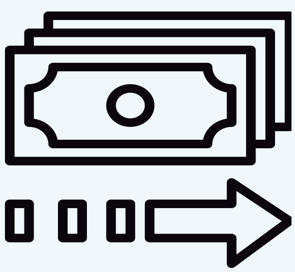
The current environment presents an effective way to transfer the growth in equities to the next generation by using GRATs given the combination of low hurdle rate (0.4%) and the recent decline in global equities.

LET'S LOOK AT AN EXAMPLE.

Investor creates a 2-year GRAT and funds it with $1,000,000 of equities in September 2020 with a rock bottom 0.40% 7520 (hurdle) rate.

At the end of years 1 and 2, the grantor receives an annuity payment back equal to the present value of their initial contribution.

In this scenario, the grantor receives approximately $500K back at the end of year one and another $500K at end of year two. Suppose equities perform well and the account earns 20% annually over the two-year period. At the end of the trust term, all investment growth above 0.4% is distributed to the beneficiaries free of estate (and possibly) gift tax. At this point the GRAT has ended and the grantor can continue to enjoy using the original principal. No further action is required.



Alternatively, rolling GRATs can be used to continue the gifting strategy for as long as the grantor chooses.

In this case, rather than the first annuity payment simply be paid back to the grantor, it is used to fund GRAT #2 (can also be a 2-year term). The second annuity payment can then be used to fund GRAT #3 and so on. Investors may choose the rolling GRAT strategy if markets do not outperform the hurdle rate in a given trust. Using annuity payments to fund new GRATs may help increase the probability of outperformance and successful transfer of growth to the beneficiaries.

THE DOWNSIDE OF A GRAT IS MINIMAL.

one

Cost of establishing the trust. There are attorney fees involved with establishing the terms of the trust. An attorney who specializes in trusts and estate law is recommended when using GRATs as part of an overall estate plan.

two

The grantor could die during the term of the GRAT. If death of the grantor occurs, the transferred assets would be included in the decedent's estate.

three

The assets transferred into the GRAT may not result in a gift. If assets held in the GRAT fail to outperform section 7520 rate, then the GRAT is unsuccessful from a gifting standpoint. In this situation, any remaining assets would revert to the grantor at the end of the trust term.

For further questions and to explore how GRATs can fit into an overall estate plan, please do not hesitate to contact your Withum Wealth Advisor. An estate attorney is required to execute the legal documents and to provide legal advice.

CONCLUSION

As always, if you have any significant changes in your life or questions about your portfolio, please do not hesitate to reach out to us. The financial planning process is a continual and dynamic process. Reviewing your progress and planning for future needs, can lead to better results. Take advantage of this year-end period to set yourself up for success in 2021. And we are here to help you to:

SIMPLIFY THE COMPLICATED.

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Need More Information? Please do not hesitate to contact a member of the Withum Wealth Management Team with any questions or concerns:

T (732) 450 0147
info@withumwealth.com
withumwealth.com

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