2020 Year-End Tax Tips - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 331. I am Tom Mullooly and I'm joined today by Tim Mullooly and Brendan Mullooly. Hey guys.

Tim Mullooly: Hey.

Brendan M: How's the going?

Tim Mullooly: So, there's an article in Think Advisor and it's pretty timely since we're into November now, we're closing in on Thanksgiving. It's a good time to talk about all of this, so you have time to accomplish what they're talking about in the article before the year ends. It's called 10 tax planning steps to take before New Year's Eve. There are things that you can do before the end of 2020 to potentially lower your taxable income or just pay less in taxes in general. And they ran through 10 things and we wanted to go through that list and share our thoughts on their list.

Tom Mullooly: The first one that they talked about, and I don't know if we'll hit on each of these, but taking advantage of gifting to family members. Just as a reminder, you can gift to anybody $15,000 in a calendar year or if you're married, that's $30,000 to any one person. So suppose you have three children and a husband and wife want to gift the maximum, they could actually gift 30,000 to each of the three. That's $90,000 in gifts, which is really great.

It also talked about doing gifts to 529 plans, which does allow for some expansion on the gifts. Basically you can make a five-year gift all at once. You're stopped from making future gifts for that period of time, but you can dump it all out in one year.

Brendan M: Yeah. I mean, if you could swing it and you set up a 529 account for a newborn to front-load, the benefit if you can swing it is more compounding. So instead of sending in money periodically over five years, you get it in at the very beginning and that's five years of extra compounding on every dollar that you front-load into there. It could be really great.

There tends to be a lot of questions that come from clients about gifting and the tax repercussions. And so it's never taxable income to the recipient of a gift, and it's not even taxable income to them if you're over this $15,000 threshold that we're talking. The $15,000 threshold really only comes into play when we talk about everybody's lifetime exclusion, which is the same number right now that pertains to a state tax. And so if you go over that $15,000 threshold in a year, let's say you're not married and you give somebody 30. So $15,000 of that doesn't matter. The 15 that you went over your limit counts against your own lifetime exclusion, the person giving the gift.

And so that basically just then lowers what you can exclude from your estate when you pass away. And for a lot of people with estate taxes, the levels where they are now, it's not actually a big deal. And so you want to be cognizant of these limitations but at the end of the day, if you have a really great reason that you want to give a gift to somebody and it's not going to fit into that 15 or $30,000 limit for individuals or married couples, it's not the end of the world.

Tom Mullooly: And the estate tax exclusion that Brendan was referring to at the moment is $11 million.

Brendan M: Per person.

Tom Mullooly: Per person. And so-

Brendan M: And even where it was beforehand was not a huge issue for most people.

Tom Mullooly: Right. And so over the span of my career, this estate tax exclusion has changed quite a bit and it will continue to change. We just have to be aware of where the thresholds are. I just want to spend a moment on the second point that they had about maxing out your contributions to retirement plans and health savings accounts. We don't talk that much about health savings accounts, but 401ks and other retirement plans, if you are under age 50, the maximum you can do this year is 19,500. If you're 50 and over, you can actually do the 19 five plus an additional $6,500. So you can do $26,000 for a married couple now that are working and have the income to do it. That's 52 grand that you can put into a retirement plan that is not small peanuts.

Brendan M: It's a nice reduction off your income and a great boost to your retirement.

Tom Mullooly: It is.

Tim Mullooly: I think a caveat to that though is making sure that... Or Not just maxing out your contributions just to get the maximum tax benefits. I mean, obviously you need to take into account if it makes sense for you to be putting your money into these accounts. Obviously it's being tied up for retirement. So if you're under 50, you foresee needing the money in the future, maybe think twice about how much you're putting into the account. But if you can swing it, then yeah, maximizing is a good way to take advantage of those tax advantages.

Brendan M: Kind of see the HSA that they noted in there as a similar story in the sense that these accounts they're supposed to let people defer money pre-tax to then use pre-tax dollars again to pay for medical costs. But if you're not in a situation where that is going to really be an issue, maybe you have good coverage or you're a healthy person, you can max this thing out and the money will continue growing tax deferred. And it basically just becomes an extra retirement account for folks who can afford to not use that money for, one, expenses on the front end or, two, even medical expenses. So if you can clear that and you're comfortable and you have access to one of these things, could be another way to lower your taxable income and compound for the future.

Tom Mullooly: There's a lot of benefits to these health savings accounts. I think the biggest drawback at the moment is that their dollar thresholds are small compared to 401ks and retirement plans. But if you're an individual filer, this year, you can put away $3,550 on a pretax basis into a health savings account. For family coverage, that amount has doubled, it's $7,100. Now, unlike retirement plans where if you're over 50, you can put more into it, with an HSA, if you're over 55, you can add an additional $1000. So if you're 55 and over, you can put in up to $8,100 for family coverage.

Not nothing. You have to be able to do it. I really think that the winning formula for HSAS is put the money away with the idea that you're not going to touch it for several years, five years or more.

Brendan M: It's a luxury that many do not have. But if you're in a position to take advantage of that, it can be really great and a nice boost.

Tim Mullooly: I think, kind of building off of that, going back to making sure that you can swing all of these things. The fifth point jumping ahead a little bit was prepare for unexpected expenses with a liquidity plan. Pretty much what we talk about a lot here, having your cash flow plan in place. And they made the point to say, without disrupting your current investments, which I think is huge.

We talked a lot over the last couple of weeks about disrupting compound interest and taking money out of the market for whatever reason. 2020 was a good example of needing to have a cash flow plan in place, making sure that you can make ends meet without having to completely unravel any progress you've made in your investment accounts.

Brendan M: Yeah. I took that as just a reminder. We make one pagers for a lot of our clients, cashflow balance sheet and just take a look at all of that because they are two parts of your financial picture that are super important because within that, you can say, hey, how, how has cashflow done? Can we update these numbers approaching year end? Nothing special about doing it then. You can do it anytime, but as good a time as any to take a look.

And then also balance sheet assets and liabilities, how have those changed over the course of the year? And hey, what if, what if the income number from the cashflow side of here was impacted like what we saw earlier this year for a lot of folks. What could I use on my balance sheet to get myself through? And hopefully that money is not money that's in stocks. You have a lot of stops along the way there between emergency funds and... The article talked about lines of credit like maybe home equity or even securities based loan. You have all these stops along the way, and then trying to rank them in terms of how much would I want to rely upon these things? Because there are some that I would want to rely upon a lot more than others. In a perfect world, the emergency fund is just cash. But there were probably other stops along the way too.

Tom Mullooly: I think the idea of having a liquidity plan or an emergency stash has never been more evident than this year with the pandemic and the recession. A lot of people who never expected to be out of work were suddenly out of work without warning at different times through the year. So it's-

Tim Mullooly: And I mean, we saw it affect people across all different types of earning levels too. There's been articles about how low earning jobs have been hit really hard, but also people that make six figures have been struggling really hard too. And it just goes to cashflow. It doesn't really matter how much money you're bringing in if you're spending all of it. Something like this happens, you stop working, that six-figure salary goes away, you're going to be in trouble too.

Brendan M: I'd argue that with lifestyle inflation, meaning the more you make, the more you spend. Somebody who's out of work who is used to living and existing on $50,000 a year could be in a lot better position than somebody who makes $150,000 a year.

Tim Mullooly: They're more prepared or used to it.

Brendan M: Because bridging the gap when your income is disrupted off of a smaller base, may be easier. It's going to mean less debt to rack up or less of an emergency fund that you'll ultimately need. And so it's all about that gap between what you're spending and what you bring home that ultimately matters, not necessarily the headline number.

Tom Mullooly: And I would say, correct me if I'm wrong, but one of the most frequent issues that we discuss, especially with new clients is the lack of an emergency fund. We've got clients that have retirement accounts and then they've got maybe some investment accounts, but nowhere on the balance sheet do we see, this is my emergency stash. And so it's become a good opening question with a lot of folks is where is, what do you consider on this balance sheet the emergency fund? And it's eye-popping to hear some of the responses, well, I've got a $10,000 credit line on my credit card that I can tap into or I've got a home equity line that I could tap into. Those things go away during bad economic periods. They're not guaranteed. And other folks have money in the market that they say, well, if I need to, I can dip into some of my stocks, but as we found earlier this year, when you go to tap into them, when you need them the most, they may be down 30 or 40%. That's a problem. Yeah. And so as ugly as it seems, we see a lot of balance sheets that are built upside down where there's no base, there's very little of an emergency Bay.

Brendan M: I think it's a lot of that stems from people and people in our industry shaming people for having money in the bank- With interest rates where they've been for the majority of the past decade, people get shamed for keeping too much at the bank. And certainly we've seen instances where people have excessive amounts of cash at the bank and that can happen for a multitude of reasons. But I think people in our line of work are so eager to get every dollar folks have invested under their management, that sometimes they tell them to put money into investment accounts or something that shouldn't actually be there. And it should be kept at the bank. And sometimes they do tell them the right thing and folks just don't want to listen because they think themselves that it's a poor decision to leave money at the bank when it's earning zero or half a percent or something like that. And they see that opportunity costs as just too much to withstand. And I don't think it is.

Tim Mullooly: Yeah. And I think, people in our industry, you're not going to get on TV or sell a lot of books if you tell people to have money in the bank. I mean, from a young age, I feel like a lot of people just hear, once you get a career to start investing as soon as you can. Start investing as soon as you can. Make your money work for you. It's true but there are steps you need to take before you get there. And a lot of people just gloss over those steps. So you can't really blame some individuals because they were never told to have an emergency fund or have money in the bank.

Tom Mullooly: I know I've had some conversations with people this year, not clients, but I'm sure you guys have also gone through the same experience where this year under the CARES Act, you can actually take money out of your retirement plan. Yes, it is going to be taxable. They are waiving the penalty that you would normally have if you're taking money out of a retirement account before 59 and a half. But some of the reasons that I've been hearing are we don't have an emergency fund or we have too much credit card debt or we have credit card debt that we need to get rid of or... I'm actually encouraged to hear that people did save money and now they're using this opportunity to rebalance the balance sheet a little bit and hopefully get headed on some better habits.

Brendan M: Yeah. Unfortunately like Tim said, no, nobody wants to read the article about setting up an emergency fund. They want to read the five hot stocks for next week. And I think that that proves itself when we see folk's balance sheets time after time.

Tim Mullooly: The cashflow and balance sheet really work hand in hand, like you were talking about in the next point that they had was about your balance sheet and how you need to review not just the assets. The article was more talking about people that own their own businesses, their business balance sheets. But I think it can apply to everyone. I feel like people get caught up in counting their assets and what they have and sometimes neglect what they owe, especially when it comes to credit card debt or other types of debt. Maybe the interest rates are really high on them or there are different ways that you could be paying it off or paying off more.

So there's two sides to that balance sheet. There's the assets and then there's the liabilities. So I think it's important to pay attention to both sides of that.

Tom Mullooly: You can live in a million dollar house and have no equity. And if the value of your house goes down in the future, you will have negative equity.

Brendan M: Another component that we usually build into cashflow and balance sheet for folks would be starting with gross income and then getting all the deductions out of the way to the net income. And the fourth quarter of a year in general, I think is a great time to review your tax situation because things can change over the course of a year. And if you're doing this in September, October, November, you still have a little time before the end of the year. So if you review your tax situation, see what you're projected to owe, if there's a big discrepancy or you're not on track, you can ride the ship or at least have the heads up that that's going to be coming come April when you go to file your taxes.

And in fact, after October 15th, I think it's a great time to touch base with your accountant if they do this kind of tax planning work for you or an advisor if they're the ones who are doing this sort of work, because they're less busy filing returns for people in the cases of accountants and tax preparers, and they can give you the attention. And they'll be happy that you did this too, because I think a lot of them, an aspect of their jobs they don't enjoy is telling people in April, hey, you have a big tax bill because that's not necessarily the accountant or preparer's fault at all.

Tim Mullooly: Even though a lot of people seem to think that it is.

Brendan M: Exactly. So they have to be the messenger of the bad news. And so to discuss this in the fourth quarter, when you have time to change where you're headed or at least have a heads up that you should start setting aside money, because you're going to owe X come April. I think this is a great time to look at stuff like that.

Tom Mullooly: How many times have we heard people say, I don't want to use that accountant anymore, I had to pay too much in taxes. It's not really their fault.

Tim Mullooly: Especially when, what is it now, like 90% of people take the standard deduction since the 2017?

Brendan M: Yeah. I think it's really a withholding story or some dramatic income event or life event that changes your filing status or what bracket you're going to be in. And you never accounted for the changes that... Especially in a year like this where folks have been tapping into things like retirement accounts for CARES Act distributions. I mean, if you did that and you didn't speak to your accountant or tax preparer beforehand, you can kick the can and find out in April or you could find out now. And it'll probably be pretty close. We can't predict what will happen over the next two months either, but we're pretty close to the end of the year. So you should have a very good idea of where you're ending up for taxes. So don't delay, take a look.

Tim Mullooly: Yeah.

Tom Mullooly: Speaking of people taking standard deductions versus itemizing, there is a part of the CARES Act that was rolled out this year due to the virus where they did discuss charitable giving. And this is something that I've shared with a couple of organizations and charities that I'm involved in as well. I passed this message along to them recently prior to 2020 under the new tax act. So in 2018 and 2019 taxes. Typically, if you were an itemizer for your taxes, you could deduct somewhere between 20% up to as much as 60% of the gift of your adjusted gross income in charitable contributions, donations that you're making. And if you were someone who did not itemize last year, well, the CARES Act is opening a window for these folks this year. And I think it's important that not only individuals are aware of it, but the organizations are also were aware of it.

If you were not an itemizer or last year, this year, you can take a up to $300 deduction without even getting involved in itemizing.

Brendan M: This is above the line.

Tom Mullooly: What they call above the line. Did you make a charitable contribution? You can deduct up to $300 and you don't have to get involved with itemizing whatsoever. So that's a nice gift, not only for you to deduct off your taxes, but also for the organization or the charity that you're giving to. However, for folks that do itemize, this year, because of the CARES Act, they can now deduct up to 100% of their adjusted gross income in charitable contributions. That is eye-popping in terms of the amount of money that can be gifted. And if you're in that fortunate position, boy, this is a year to do it.

Tim Mullooly: Yeah, definitely. I also think an important point. They made the distinction to say that it needs to be recorded and received your charitable gift by December 31st, which is a Thursday this year. I bring that up because don't call the make the donation on Monday of that week, you know what I mean?

Tom Mullooly: People do it.

Tim Mullooly: Right. We've gotten calls from people to make charitable gifts or contributions to their accounts December 29th for the end of the year. And it's like-

Tom Mullooly: It won't happen.

Tim Mullooly: This is why we're recording this and giving it out to you guys now in the beginning of November. So you have time to do this ahead of time. Don't leave it to the last minute because it just makes everything stressful.

Tom Mullooly: Yeah. Usually brokerage firms will request that you get all of these requests for gifts in by December 15th. But every year we have folks that reach out to us December 29-

Tim Mullooly: The week in between Christmas and new year's.

Tom Mullooly: Yeah, December 30th.

Tim Mullooly: Try not to do that.

Tom Mullooly: Yeah. The organization needs to have the money in hand and record it on or before the 31st. While we're talking about it, it's always important to remember to select the right kind of gift to give. As a general rule of thumb, give cash to people and give appreciated assets to organizations, to charities.

Brendan M: Bingo.

Tim Mullooly: Not much more to-

Tom Mullooly: Yeah. Give cash to people and then give some kind of securities or assets, something that's appreciated... Because you can deduct the fair market value of whatever you're giving, even though you bought a stock years ago, it's way up, you're basically turning the tax situation over to a non-profit. They don't have tax.

Brendan M: Or if you're giving a stock to somebody that you've held forever there and hurting your cost basis, which is not advantageous to them. It still is, but it's going to be less of one after they net out the capital gains tax they're going to have to pay on it.

Tom Mullooly: Very true.

Tim Mullooly: So one of the last points that they made in the article was to consider harvesting tax losses. So that's if you own a stock or a fund that you have losses on, you can sell it and use those towards lowering your taxes

Brendan M: Review everything that's happened over the course of this year too. And it doesn't necessarily mean that you want to be done with the investments that you're discussing that have gains or losses. But if you have taxable investments in a brokerage account or a joint account or something like that, it just makes sense to on a yearly basis, manage those for the fact that taxes are going to be due on them. And so it could mean moving on from something for a brief period of time that you then buy or replace with something similar. It doesn't mean that you're done with it, but just to be smart. Ultimately if you have taxable assets, you want to end up with as little a tax bill at the end of the investing period when you're going to consume as possible, because what you eat at the end of that is the after tax after else number. And so if you've got a giant capital gain in something, you can work over the years to slowly chip away at that to make your ultimate liability at the end not as great.

Tom Mullooly: Great. All good tips. If you've got questions on these, just reach out to us. We'd be happy to walk you through the finer details of these, but that's going to wrap up episode 331. Thanks again for tuning in, and we will catch up with you on the next episode.