The Retirement Income Store®

NEWS

Vol III Issue III—March 2021

TheRetirementIncomeStore.com

Tax Season 2021 and Its Potential Impact on Your Retirement

By David J. Scranton, Founder, The Retirement Income Store

2020 is in our rear-view mirror, but we're not out of the woods yet. We must still file our 2020 taxes. That's why, with April 15th fast approaching, we're devoting this month's issue to making sense of the recent changes to tax laws and what it could mean for your retirement.

Hopefully, the coronavirus recession didn't cause you to dip into your retirement savings—because for many, it did. Recognizing this potential, Congress included a provision in the CARES Act that allowed people under age 59 ½ to take up to $100,000 from a 401(k) or IRA through the end of 2020, without the usual early withdrawal penalty.

Nevertheless, the CARES Act does not allow you to waive the income tax on that withdrawal, meaning you'll have to account for it on your 2020 return. That's just one way in which the rules around retirement plans changed in 2020.

Last year was also the first in which the SECURE Act – which stands for Setting Every Community Up for Retirement Enhancement – was in place. It also prompted several changes, including pushing the age for taking required minimum distributions (RMDs) from your retirement accounts from 70 ½ to 72.

In addition, the CARES Act allowed Americans to skip their RMDs altogether in 2020 without penalty—which could bring significant tax savings to many this year, since the money taken from traditional IRAs counts as taxable income.

Another change prompted by the SECURE Act is that starting last year, it eliminated the age limit for contributing to traditional IRAs, which had previously been 70 ½. Since the money you put into a traditional IRA is tax deductible, that could be another good way to reduce your tax burden this year.

Just remember: you will ultimately have to pay taxes on that money when you take it out. Additionally, starting at age 72, you'll have to take an RMD each year. That's why having the right strategy in place to satisfy your RMDs without having to delve into your principal is one of the most important components of successful retirement planning.

The best way to ensure you have the right plan in place is to work with a financial advisor who is experienced in navigating the complexities of planning and saving for retirement—preferably an advisor who is a fiduciary and specializes in retirement income solutions.

Which Deductions Might Be Best For You?

As you know, deductions can help reduce how much of your income is subject to taxes, while tax credits lower your actual bill, dollar for dollar. The best way to determine whether itemizing is your best option is to work with a tax advisor. If itemizing does make sense for you, here are some potential deductions you could claim:

1. Charitable Giving

To encourage more giving during the pandemic, the CARES Act allows you to deduct up 100% of your adjusted gross income (AGI) in qualified charitable donations if you itemize. Even if you're taking the standard deduction, the CARES Act added a new "above-the-line" deduction that will help you write off up to $300 of charitable contributions made in cash.

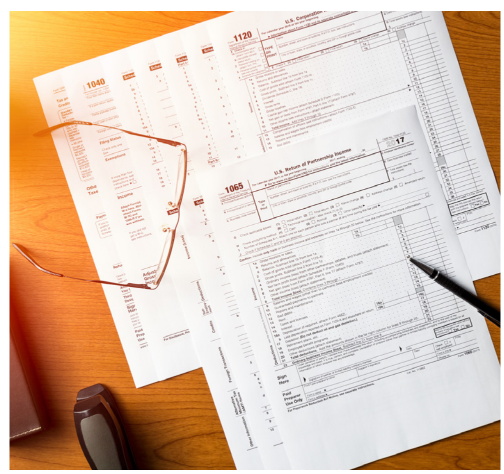
2. Medical Deductions

If you spent a lot of time in the hospital or got hit with some big medical bills last year – as many did due to the pandemic – you might get some tax relief. This year, you can deduct any medical expenses above 7.5% of your AGI. So, if your AGI was $100,000 dollars, you can deduct out-of-pocket medical expenses above $7,500, but only if you itemize.

3. Business Deductions

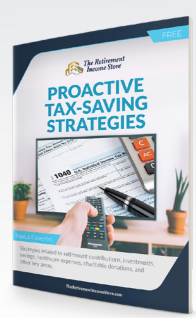
If you're self-employed, there are several deductions you can claim, including travel expenses and the home office deduction if you use a part of your home for your business. Unfortunately, if you're one of the millions of employees who ended up working from home this year due to the pandemic, you cannot claim the home office deduction since it's reserved for those who are self-employed.

The right tax specialist can help you identify the deductions and tax credits you are eligible for, and which would work best for you—while the right financial advisor can help you create a financial plan that can help minimize your tax burden over the long term.



Did You Know?

If you were forced to take money out of a 401(k) or traditional IRA due to COVID-19 this year and now find yourself facing a big tax bill, there's some good news. You have a three year window to put that money back into the account. If you do, you'll receive a refund on any taxes you paid on it.



Check out our Proactive Tax Saving Strategies Report for more helpful tips about how you might be able to help reduce your tax burden this year.

DAVE'S CORNER

Keeping Up With Changes to Tax Laws

Tax laws and guidelines change a bit each year, but this year the changes are more extensive, largely due to the coronavirus pandemic. For example, if you received extended unemployment benefits through the CARES Act, they're taxable.

The good news is that the stimulus check you may have received does not count as taxable income. Instead, it's being treated like a refundable tax credit – like an advance on the money you would have received as part of your 2021 tax refund.

As I mentioned on page one, the CARES Act altered rules around RMDs and early withdrawals from retirement accounts, and those changes could impact your tax return.

Besides that, here are some key points about tax season that you should be aware of for your 2020 tax return. The first thing is that April 15th is the filing deadline. Although the deadline was extended last year due to the pandemic, most of us must file our 2020 tax return by April 15th. That is, unless you live in Texas—where the IRS has extended the tax filing deadline to June 15th for those impacted by the winter storms.[1]

Another important thing to be aware of are the updated tax brackets. While the tax rates are the same as in 2019, the marginal brackets themselves have been adjusted upward by a few hundred dollars to account for inflation.

Finally, it is important to realize that the standard deduction has increased this year to $12,400 for single filers, and $24,800 for married couples filing jointly. That's important in helping you determine whether it makes sense to itemize. As you know, if you itemize, you calculate your deductions one by one. Itemizing is more work but can be worth it if your itemized deductions exceed the amount of the standard deduction.

[1] https://www.irs.gov/newsroom/victims-of-texas-winter-storms-get-deadline-extensions-and-other-tax-relief

Don’t Let RMDs Put You At Risk of Cannibalizing Your Savings

One of the changes prompted by the CARES Act that has the biggest potential to impact your retirement has to do with RMDs, which were waived for the 2020 tax year. Thanks to that provision, along with the SECURE Act—which raised the age for taking first-year RMDs to 72—many who would otherwise be dealing with RMDs on their 2021 tax return are getting a temporary break.

However, even if you may not have to start dealing with RMDs for another five or ten years, that doesn’t mean you should put off preparing for them. We can’t stress enough that having the right strategy to satisfy your RMDs can be one of the most important elements of a successful retirement plan.

RMDs start at almost 4% of your IRA balance and increase each year as you get older – and the penalty for not taking sufficient RMDs is 50%!

Once you’ve properly calculated what your RMDs will be, the most important thing to consider is whether you have the right asset allocation to satisfy them. In my experience, that means an allocation that can generate *at least* 4% in dividends or interest.

If you’re earning less, that means you might have to tap into the principal balance of your savings to satisfy your RMDs, which could lead to the cannibalization of your savings. The bottom line is that even if the current crisis or the SECURE Act have given you some additional time before your RMDs kick in, the sooner you adopt a sound strategy for satisfying them, the better prepared you’ll be.