NEWS

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ACP Members Provide Tips for Taxpayers to Get the Most out of Their Returns in 2021

As tax season heats up, tax-focus financial planning professionals weigh in

WILMINGTON, NC [March 25, 2021] – With the new tax deadline of May 17 looming for much of America (and June 15 for states impacted by the February storm), seven certified members of the Alliance of Comprehensive Planners (ACP), have provided an array of tax tips to help the general public and those who are still in the midst of or soon to be preparing their 2020 tax returns. A community of tax-focused financial planners who provide comprehensive planning strategies for their clients on a commission-free retainer basis, ACP members adhere to fiduciary standards, which means that they are legally and ethically bound to put their clients' best interests first.

Journalists who would like to interview one or more of these professionals are invited to contact ImpactMediaManager@ImpactCommunications.org. Consumers who are looking for professional tax strategy, financial planning and investment management services, as well as financial advisors interested in learning more about joining the organization, are invited to visit www.ACPlanners.org.

REMINDERS FOR 2021 TAX SEASON

According to Tricia Rosen, CFP®, MBA, EA, Principal of Access Financial Planning, LLC in Andover, MA, a few tax preparation reminders to keep in mind for 2021 which may be overlooked are:

1. For those who take the standard deduction instead of itemizing, the above the line charitable deduction for 2021 was increased to $600 for a married filing jointly couple, whereas for the 2020 tax year the deduction was $300 per tax return regardless of filing status. The contribution needs to be made in cash and to an IRS approved charitable organization.

2. For those who itemize their deductions, the adjusted gross income limit for cash contributions to qualifying public charities remains suspended for 2021, which means for cash contributions made in 2021, taxpayers can deduct up to 100% of their Adjusted Gross Income (AGI).

3. The penalty for overstating a charitable deduction has been increased from 20% to 50% of the underpayment, so don't be tempted to fudge the numbers to take advantage of the larger deductions. Keep a receipt for any charitable donation over $250.

4. The IRS operates on a pay-as-you-go system, which means you are required to pay taxes on income as it is earned throughout the year, otherwise you may incur penalties. Although the federal income tax deadline has been moved to May 17, 2021 and many states have also moved their income tax filing deadline to May 17, 2021, keep in mind that the date for paying quarterly estimated taxes has not changed from April 15, 2021. A recent tax law change makes the first $10,200 of unemployment income tax-exempt for taxpayers with a modified adjusted gross income of less than $150,000, however states vary on how they treat unemployment income. If you filed your tax return before the new unemployment income exclusion was enacted, the IRS is advising taxpayers not to file an amended return. Instead, the IRS will recalculate the tax due and refund any overpayment to the taxpayer without any action required by the taxpayer. Economic stimulus payments are considered a tax credit and not income, so they are not subject to income taxes.

TIP #1: SKIP DO-IT-YOURSELF TAX PREP THIS YEAR

Working with a professional tax preparer may be more important now than before the pandemic because more people will have complex tax return situations. The growth in individual investors participating in stock trading and not understanding the tax impact of trading may catch many people unaware, many people who worked remotely during the pandemic in a state which is different from their usual state may have to file a tax return in more than one state, and states may have different regulations than the IRS which can add to confusion when it comes to tax return preparation.

The accessibility and popularity of trading apps such as Robinhood have enabled many inexperienced investors to participate in the stock market. While greater accessibility to one of the few meaningful ways to grow wealth is a positive aspect of the trading apps, the lack of education and guidance around trading has many newer investors making mistakes which have serious consequences. As an example, new investors may not be aware of the wash sale rules which prohibit selling an investment for a loss and replacing it with the same or a substantially identical investment 30 days before or 30 day after the sale. If a wash sale takes place, then the IRS will not allow the investor to write off the investment loss. As a consequence, inexperienced investors may have a much larger taxable capital gain on stock trades than they anticipated if they are making frequent trades in the same or similar stocks.

“We often hear people say their tax return isn’t complicated, so they’ll just do it personally,” said Linda Y. Leitz, PhD, CFP®, EA, Founder and President of Peace of Mind Financial Planning, Inc. in Colorado Springs, CO. “But taxes change every year and it’s probably not wise to assume your situation doesn’t need professional input. You could be missing deductions, or you could be taking unallowed deductions, which could cost you in penalties if you’re audited.”

“Even if you’ve prepared your own tax return in the past, the recent tax law changes have been so extensive both in the quantity of changes and in the scope of the number of taxpayers impacted that using a qualified tax preparer is even more valuable now to be sure you are preparing your return correctly and not overlooking anything,” added Rosen. “Understanding the complexities of accurately reporting income and losses due to investing or living and working in multiple states may require help from a qualified tax preparer such as an Enrolled Agent or a CPA.”

TIP #2: UNDERSTAND STIMULUS CHECK ELIGIBILITY

“This year the stimulus checks introduce a little wrinkle,” added Leitz. “If you filed a return for 2019 that indicated you qualified, you got a check. If you don’t have to file a return for 2020, you might want to anyway. That return will include which stimulus checks you received – or didn’t receive – and confirms it with the IRS. And if you were entitled to stimulus money, but didn’t get it, that lets the government know to send you your share.”

“Sometimes people can be in a hurry to file their taxes to get a much-anticipated refund, but this can backfire with the stimulus program,” added Rorik Larson, MBA, EA, CFP®, of Essential Financial Strategies, Palos Heights, IL. “Stimulus payment eligibility is based upon the most recently filed tax return. Taxpayers can help themselves by reviewing the rules for the stimulus payment to see if their 2019 tax return and/or 2020 tax return makes them eligible for the $1400 stimulus payment. The full payment will be received for those with income below the eligibility amount and a prorated reduced amount up to the phaseout amount.”

According to Larson, the limits are $75,000 gross income ($80,000 phase out) if single, $112,500 ($120,000 phase out) if filing as head of household, or $ 150,000 ($160,000 phase out) if married filed jointly. “If the 2019 income is too high but 2020 income creates eligibility, get the 2020 return filed quickly,” Larson said. “Likewise, if the 2019 income creates eligibility but the 2020 does not, it makes sense to hold off filing until the payment is received so not to create an ineligible situation. This deliberated delay strategy might include filing an extension if payments are delayed until after April 15th.”

TIP #3: DON’T FORGET TAX PROJECTIONS FOR ESTIMATED TAX PAYMENTS

Have your advisor do tax projections, so you can make estimated tax payments and avoid penalties, advises Carol Friedhoff, CFP®, EA, MS, PMP, of Savvy Outcomes in Tucson, AZ. The process is simple, she said.

"The individual gathers all sources of income, deductions they can take, and what taxes have been paid so far," Friedhoff explained. "Use tax software to project if more taxes need to be paid. If so, the individual would make an estimated tax payment."

TIP #4: TAKE ADVANTAGE OF ROTH CONVERSIONS FOR WORKING CLIENTS IN 12% TAX BRACKET

Roth IRAs can be a key piece in planning financial success throughout your life, and carefully managing them can further their value, said Jared Hoole, CFP®, Founder and President of Lakeside Financial Planning in Windham, NH.

"One tax planning strategy we are starting to implement is Roth conversions for working clients who are in the 12% tax bracket," he said. "Traditionally, we have recommended that clients who are still in the workforce, and under the Roth phase-out limitation, contribute directly to their Roth IRA accounts. In the past, most of our Roth conversion recommendations have been reserved for retired clients who are in low tax brackets."

Now, in addition to direct Roth contributions, Hoole said they are also recommending that those working clients who are in the 12% tax bracket also make a Roth IRA conversion. The conversion amount would be whatever additional income is needed to fill up the bucket.

"For example, if a married taxpayer had a taxable income of $60,250 in 2020, then we would recommend converting $20,000 since the top of the 12% bracket is $80,250 for 2020," he explained. "Given that current tax rates are historically low and will likely go up in the future to help offset COVID-19 relief spending by congress, we feel like now more than ever is a critical time move money into tax-free Roth accounts." The deadline for Roth conversions is the end of the year. While it may be too late to implement this strategy for 2020, it is a good time to start thinking about conversions for 2021.

TIP #5: CONSIDER QUALIFIED CHARITABLE DISTRIBUTIONS (QCD)

For charitably inclined individuals over age 70 ½ with IRA assets, consider doing Qualified Charitable Distributions (QCDs). It's one of the few ways the tax code allows people to take money from their traditional IRA without paying income tax, explains Kenneth F. Robinson, JD, CFP®, Founder and President of Practical Financial Planning in Rocky River, OH.

"Not only is any QCD tax free, it also counts toward any annual Required Minimum Distribution (RMD), saving federal (and sometimes state) income tax," he said. "It also reduces the amount of future RMDs. QCDs save hundreds or thousands in tax liability and are clearly better for many taxpayers than taking the money out of the IRA and then writing a check to the charity."

With the taxpayer's instructions, the financial institution that holds the IRA can send those charitable contributions directly to the charities or make distributions payable to the charity but delivered to the taxpayer. Both have the same end result:
the taxpayer saving on taxes by reducing taxable income.

"When you can let your tax preparer know how much of your distributions were QCDs for the year, those gifts to charity will be excluded from your income," Leitz said. "This is especially helpful if you don't have enough in deductions to itemize."

For charitably minded taxpayers that are eligible to itemize, there can also be tax savings to transfer stock or other investments with large gains to their favorite charity rather than write a check each year.

"The taxpayer benefits from the charitable deduction of the market value of the transferred investment and avoids paying capital gains tax on the investment. This is especially true if they had sold the investment first and then gave the charity the cash from the sale proceeds," added Larson.

TIP #6: THINK TAXES BEFORE, AS, AND AFTER YOU RETIRE

For many, retirement is a new exciting time filled with adventure and the opportunity to choose how they want to live life, but it can be easy to overlook taxes while transitioning to retirement. A frequent problem for new retirees is not withholding from their taxable pensions, 401(k)s, or traditional IRAs once they leave the workforce. While working, employers are mandated to withhold tax money for income and other taxes. Withholding from retirement distributions is at the discretion of the retiree.

"Our income tax structure is a pay as you go system," said Larson. "This means state and federal authorities expect to collect their portion of the taxes at the time taxpayers receive taxable income. Thus, at tax time, it is possible that in addition to a significant tax bill, there could be penalties assessed for late payment. A tax-focused financial planning professional, such as members of The Alliance of Comprehensive Planners, can help folks avoid this situation by calculating necessary withholding or quarterly estimated payments."

TIP #7: UNDERSTAND THE TAX IMPACT OF AN IPO ON EMPLOYEE RESTRICTED STOCK UNITS (RSUS) AND STOCK OPTIONS

The nuance of equity compensation taxation can be intimidating for some, but financial planners with a tax focus can help, said Jane Yoo, CFP®, the CEO of Jane Financial, a comprehensive financial planning firm serving women in tech in Oakland, CA.

For example, if the taxpayer's employer recently went public, the IPO's impact on the individual's taxes will depend on whether they have Restricted Stock Units (RSUs) or stock options.

"When your RSUs vest, most employers withhold some shares to cover income and payroll taxes," Yoo said. "This covers most, but not all, of your tax bill. Work with a financial advisor or tax professional to figure out how much you will owe next April 15th, and whether to pay estimated taxes."

Stock options are more complicated. When an employee exercises their options, the difference between the stock price on the date of exercise and their strike price is profit, which is subject to tax.

“When you sell the resulting stock, any growth since the exercise date is also subject to tax. Incentive Stock Options (ISOs) are especially complex because of the Alternative Minimum Tax (AMT),” Yoo said. “At the very least, consult with a tax professional or a member of the Alliance of Comprehensive Planners before you exercise stock options.”

ABOUT THE ALLIANCE OF COMPREHENSIVE PLANNERS (ACP)

The Alliance of Comprehensive Planners (ACP) is a community of tax-focused financial planners who provide comprehensive planning strategies for their clients on a fee-only retainer basis. ACP members are required to maintain the CFP® or CPA/PFS designation and complete ACP’s rigorous training program. To learn more about this fiduciary network or to find a certified ACP member, visit www.ACPlanners.org.

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