May 2021 Newsletter

Korbitz Financial Planning Newsletter

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Clients and Friends:

It is hard to believe we are more than a year past the start of the COVID-19 pandemic. Some parts of our lives seem to be returning to normal, but there are changes that have occurred that may be here to stay. Hopefully those will be the good changes, and the not so good ones will revert back to the pre-pandemic times.

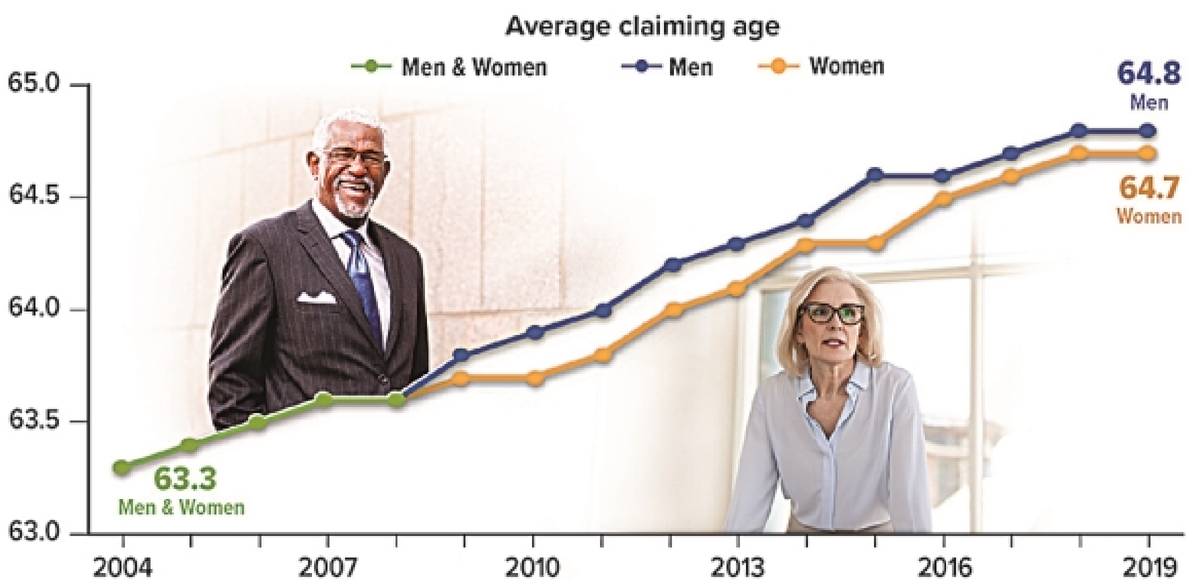
The newsletter this month focuses largely on income tax issues, with a few other topics as well.

I hope you and your family have been able to stay healthy, and I wish you very pleasant summer.

Eric

More People Delay Claiming Social Security

The average age for claiming Social Security retirement benefits has been steadily rising. Older Americans are working longer, in part because full retirement age is increasing incrementally from 66 to 67. A worker may begin receiving Social Security retirement benefits as early as age 62, but monthly benefits will be permanently reduced by as much as 30% if claimed before full retirement age — a strong incentive to wait.



Source: Social Security Administration, 2020

Tax Season Review

Well, another tax filing season is behind us, sort of. Taxpayers still have until May 17, 2021 to file or extend their 2020 returns. I would like to make some observations and suggestions based on what I have seen in the past 2 months. Some of these observations will apply to many clients, others to only a few.

Stimulus Payments: There has been a lot of confusion about the "stimulus payments." To summarize, all stimulus payments sent out are ADVANCES on credits you would otherwise get on your tax return. Which tax return? It depends. The payments sent in the spring of 2020 (generally March and April) and the payments send in January 2021 were advances on the 2020 income tax returns. The payments sent in March and April 2021 are advances on the 2021 income tax returns. If you got an advance, and should have gotten more, it gets reconciled on your tax return and you get the extra amount. If you got an advance, and should not have gotten that much, you get to keep it. Heads you win, tails the government loses.

Roth IRA contributions: I saw more cases than usual on 2020 returns of clients having to withdraw their Roth IRA contributions because their income was too high to contribute. If you are unsure about whether you will qualify to make a Roth IRA contribution, you should probably wait to contribute. Removing an overfunded Roth contribution is time consuming, may generate additional income that must be reported on your prior year return (you are required to withdraw the excess contribution AND all earnings on that excess contribution), and if you are under age 59 ½, may generate some penalties, since you are taking an IRA distribution earlier than generally permitted.

Health Savings Account (HSA) contributions: Contributions to HSAs continue to generate confusion. I recommend that you try to fund your HSA in the year you are taking the deduction, rather than splitting it between years. The reporting from the HSA custodians is not good and results in too much time spent trying to reconcile the contributions. It is best if all of your HSA contribution is done through payroll deduction or by making one contribution to your HSA once each year. One contribution, always done in the same month of the year.

Real Estate Taxes: I continue to see confusion on when real estate taxes are deducted. Real estate taxes are deductible in the year you pay them, not the year they are billed. I recommend that the majority of taxpayers pay their real estate taxes on a regular schedule. For example, always in December, or always in January. Going back and forth, January this year and December next year, results in lost tax benefits. Some states have credits related to the payment of real estate taxes. If you don't pay any real estate taxes in a given year, you give up that credit.

Qualified Charitable Distributions (QCDs): QCDs are a great way for taxpayers over age 70 ½ to contribute a portion of their IRAs to charity on a tax-free basis. That said, you need to be very careful because the financial institution (Vanguard, Fidelity, etc.) will show the QCD as a taxable distribution. It is up to you to tell your tax preparer or tax software that you did a QCD, so that the amount can be subtracted from your income.

Where Do We Go From Here? There are a number of tax related proposals in Congress at this time. Given the 50-50 split in the US Senate, it takes only one Democratic or Independent Senator to cause a bill to change or be defeated. Only time will tell what will pass and become law, but it would certainly appear that some tax rate increases are on the horizon. For clients in higher tax states or clients with high real estate taxes, these tax rate increases could potentially be offset to some extent if the limitation on State and Local Taxes (SALT) is repealed. This would permit the deduction of more than $10,000 of such taxes.

Key Retirement and Tax Numbers for 2021

Every year, the Internal Revenue Service announces cost-of-living adjustments that affect contribution limits for retirement plans and various tax deduction, exclusion, exemption, and threshold amounts. Here are a few of the key adjustments for 2021.

Estate, Gift, and Generation-Skipping Transfer Tax

- The annual gift tax exclusion (and annual generation-skipping transfer tax exclusion) for 2021 is $15,000, the same as in 2020.
- The gift and estate tax basic exclusion amount (and generation-skipping transfer tax exemption) for 2021 is $11,700,000, up from $11,580,000 in 2020.

Standard Deduction

A taxpayer can generally choose to itemize certain deductions or claim a standard deduction on the federal income tax return. In 2021, the standard deduction is:

- $12,550 (up from $12,400 in 2020) for single filers or married individuals filing separate returns
- $25,100 (up from $24,800 in 2020) for married individuals filing joint returns
- $18,800 (up from $18,650 in 2020) for heads of households

The additional standard deduction amount for the blind or aged (age 65 or older) in 2021 is:

- $1,700 (up from $1,650 in 2020) for single filers and heads of households
- $1,350 (up from $1,300 in 2020) for all other filing statuses

Special rules apply if you can be claimed as a dependent by another taxpayer.

IRAs

The combined annual limit on contributions to traditional and Roth IRAs is $6,000 in 2021 (the same as in 2020), with individuals age 50 and older able to contribute an additional $1,000. The limit on contributions to a Roth IRA phases out for certain modified adjusted gross income (MAGI) ranges. For individuals who are covered by a workplace retirement plan, the deduction for contributions to a traditional IRA also phases out for certain MAGI ranges. (The limit on nondeductible contributions to a traditional IRA is not subject to phase-out based on MAGI.)

MAGI Ranges: Contributions to a Roth IRA

	2020	2021
Single/Head of household	$124,000–$139,000	$125,000–$140,000
Married filing jointly	$196,000–$206,000	$198,000–$208,000
Married filing separately	$0–$10,000	$0–$10,000

MAGI Ranges: Contributions to a Traditional IRA

	2020	2021
Single/Head of household	$65,000–$75,000	$66,000–$76,000
Married filing jointly	$104,000–$124,000	$105,000–$125,000

The **2021** phaseout range is **$198,000–$208,000** (up from **$196,000–$206,000 in 2020**) when the individual making the IRA contribution is not covered by a workplace retirement plan but is filing jointly with a spouse who is covered. The phaseout range is **$0–$10,000** when the individual is married filing separately and either spouse is covered by a plan.

Employer Retirement Plans

- Employees who participate in 401(k), 403(b), and most 457 plans can defer up to $19,500 in compensation in 2021 (the same as in 2020); employees age 50 and older can defer up to an additional $6,500 in 2021 (the same as in 2020).
- Employees participating in a SIMPLE retirement plan can defer up to $13,500 in 2021 (the same as in 2020), and employees age 50 and older can defer up to an additional $3,000 in 2021 (the same as in 2020).

Kiddie Tax: Child's Unearned Income

Under the kiddie tax, a child's unearned income above $2,200 in 2021 (the same as in 2020) is taxed using the parents' tax rates.

Umbrella Insurance Offers Extra Liability Coverage

Accidents can happen, no matter how careful you are. Even if you make every effort to help ensure that your house and the surrounding area are safe for visitors, rain, snow, or ice can cause slippery stairs and walkways. You might face an increased risk of having a liability claim filed against you if you have a dog, a swimming pool, a trampoline, employ workers in your home, or own a rental property. Or you could be held responsible for a serious auto accident — a special concern if you have a teenage driver.

American society is litigious, and some legal judgments seem excessive. Standard homeowners and auto insurance policies generally cover personal liability, but you may not have enough coverage to protect your income and assets in the event of a high-dollar judgment. That's when umbrella insurance could be a big help, providing additional coverage, up to policy limits.

On top of the liability coverage amount, an umbrella policy may help pay legal expenses and compensation for time off from work to defend yourself in court. It might also cover situations not included in standard homeowners policies, such as libel, slander, invasion of privacy, and defamation of character.

Umbrella insurance is not just for wealthy households; it is also appropriate for middle-income families with substantial home equity, retirement savings, and current and future income that could be used to satisfy a large jury award. (Home equity might be protected, at least in part, by state law. Qualified retirement plan assets may have some protection from creditors under federal and/or state law, depending on the plan and jurisdiction, but you would still be liable for any judgments.)

Protecting yourself with an umbrella policy could help avoid expensive consequences down the road.

Although coverage and costs vary by insurer, you can typically obtain $1 million in coverage for $300 or less per year; higher coverage amounts can be even more cost-effective. Before adding umbrella insurance, however, you generally must purchase a certain amount of liability coverage on your homeowners and auto policies (typically $300,000 and $250,000, respectively), which serve as a deductible for the umbrella policy.[1]

Your insurer can help you determine how much current liability protection you have, and how much more you can purchase. It might be helpful to consider your assets, potential exposure, and what you consider to be an acceptable risk.

1) Insurance Information Institute, 2020

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