SMART MOVES

FOR THE NEW YEAR AND BEYOND

When it comes to preparing yourself financially for a new year, starting early is often a smart move. For many Americans this winter, this may be doubly true. Considering the impact COVID-19 has had on the financial landscape, and the changes wrought by the CARES Act and the SECURE Act, there are some important items to remember.

Keep in mind, this article is for informational purposes only; it is not a replacement for real-life advice. Also, tax rules are constantly changing, and there is no guarantee that the tax landscape will remain the same in years ahead. With that in mind, let's look at what you should be thinking about as we head into 2021.

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The CARES Act

The CARES Act enabled any taxpayer with a Required Minimum Distribution (RMD) due in 2020 from certain retirement accounts to skip those RMDs. This effectively meant that retirement accounts could continue to potentially grow even as the economic outlook remained somewhat uncertain.[1]

Withdrawals from a traditional IRA, a 401(k), and other retirement plans are taxed as ordinary income and, if taken before the age of 59 1/2, may be subject to a 10 percent federal income tax penalty. However, as part of the CARES Act, many accessed their retirement funds in 2020 without being subject to the 10 percent penalty under certain circumstances, such as if their income was reduced.

The CARES Act also made changes for those with Health Savings Accounts, or HSAs. As you may recall, the IRS extended the federal income tax filing period from April 15, 2020, to July 15, 2020. Additionally, taxpayers were able to defer federal income tax payments until July 15, 2020, without the normal penalties and interest.

In addition, the CARES Act gave companies extra time to make contributions to employee HSAs in 2020, which may make for an even brighter 2021. In addition, it expanded what qualifies as a "reimbursable expense," and over-the-counter medicine can be purchased with an HSA account. These new, broad uses for one's HSA could help account holders soften the blow of medical care going into the new year.[2]

HSA limits were not adjusted in the CARES Act, however. They are $3,550 if you are single and $7,100 if you have a spouse or family. An additional annual "catch-up" contribution of up to $1,000 is allowed for each person in the household over age 55.[2]

Money taken out of an HSA for a nonmedical reason may be considered taxable income. If you make such a withdrawal before you turn 65, the withdrawn amount may be subject to a 20 percent federal tax penalty. HSA funds roll over year to year if you don't spend them.[3]

The SECURE Act

Another piece of legislation that passed in late 2019 and began to be implemented in 2020 was the Setting Every Community Up For Retirement Enhancement Act, or SECURE Act. This impacted numerous financial areas, but there are two main changes to keep in mind for those looking ahead.

New IRA Rules

The legislation eliminated the required minimum distribution (RMD) rules in regard to defined contribution plans and Individual Retirement Account (IRA) balances upon the death of the account owner. Under the new rules, non-spouse beneficiaries are generally required to withdraw all the funds in the account by the end of the 10th calendar year following the year of the account owner's death. In short, "stretching" an IRA over several generations is no longer allowed.[4]

It's important to highlight that the new rule does not require the non-spouse beneficiary to take periodic withdrawals during the 10-year period. However, all the money must be withdrawn by the end of the 10th calendar year following the inheritance.

Some groups may have other minimum distribution requirements, including the surviving spouse of the IRA owner, disabled or chronically ill individuals, individuals who are not more than 10 years younger than the IRA owner, and any child of the IRA owner who has not reached the age of majority.

IRA Contributions and Distributions

Another major change in 2020 was the removal of the age limit for traditional IRA contributions. Before the SECURE Act, you were required to stop making contributions at age 70½. Now, you can continue to make contributions as long as you meet the earned-income requirement.[5]

Also, as part of the Act, you are mandated to begin taking required RMDs from a traditional IRA at age 72, an increase from the previous 70½. Allowing money to remain in a tax-deferred account for an additional 18 months (before needing to take an RMD) may alter some previous projections of your retirement income.[5]

The SECURE Act's rule change for RMDs only affects Americans turning 70½ in 2020 or later. For these taxpayers, RMDs will become mandatory at age 72. If you meet this criterion, your first RMD won't be necessary until April 1 of the year after you reach 72.

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Avoid Taxing Surprises

For those actively employed, financial transactions made late in the year can have an unexpected impact on your taxes. These can include, but are not limited to, year-end and holiday bonuses or a special one-time dividend from a company (Note: dividends on common stocks are not fixed and can be decreased or eliminated on short notice). Depending on your situation, your taxes can become complicated rather quickly.

One choice to help simplify the process is to use the Internal Revenue Service's Tax Withholding Estimator located at IRS.gov. This handy tool may help taxpayers better understand their tax situation so they can estimate their overall tax liability.[6]

Remember, this article is for illustrative purposes only. Please contact a tax, legal, or accounting professional before implementing a strategy or modifying an existing strategy when it comes to handling holiday bonuses or a special one-time dividend from a company.

The Best Financial Moves?

In truth, no two taxpayers are alike, and it's important to find the strategy that best suits your unique situation. In a normal year, taxes and retirement preparation can be complicated financial events. As we've seen from the events of 2020, today's financial landscape may be trickier to navigate than ever. But please remember, we're here to help you every step of the way.

1. IRS.gov, 2020
2. Benefitspro.com, May 15, 2020
3. Healthcare.gov, 2020
4. Waysandmeans.house.gov, 2019
5. MarketWatch.com, 2019
6. IRS.gov, August 8, 2020