Financial focus

ACP Alliance of Comprehensive Planners

WINTER 2020

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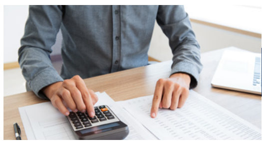

Your Future Self Will Thank You: Tax-Planning Strategies to Lighten Your Load

By Frankie Corrado, CFP®
Holmdel, NJ

In tax planning, strategizing today can set you up for success tomorrow. Three simple approaches can help you put the right pieces in place to lighten your workload (and your tax burden) come tax season.

Save for Your Future, Save Taxes Now

The US Government offers incentives for people to save for their future with current tax benefits. This comes in the form of Qualified Retirement Plans—essentially, these are employer-sponsored or personal retirement accounts that provide taxpayers tax relief now. If you save $5,000 a year in a qualified plan (such as a 401(k), 403(b), or Traditional IRA), the IRS allows you to reduce your taxable income by that amount. Next, instead of paying taxes on the income and gains in the qualified retirement account each year, taxes on all gains are deferred until you begin withdrawing, hopefully when that account will fund some of your retirement income. I highly recommend that everyone, no matter your situation, save at least 10% of your annual gross income into a qualified retirement account as a baseline to good financial planning. The benefits of current year tax relief, long-term saving, and tax-deferral will have "future you" really happy that "past you" was thinking ahead!

Self Employed? Keep the Receipts and Open a Business-Only Bank Account

I see so many self-employed people co-mingle their personal and business expenses on one credit card or bank account. I advise against this for three main reasons. One, it makes preparing your tax return time consuming and costly. If you are preparing the tax return yourself, then you must meticulously go through all of your annual expenditures and pick out just the business-related ones. And if you pay an accountant to prepare your taxes, they will most certainly charge you more if you don't give them an itemized list of your business-only expenses. Second, searching for business expenses within your entire list of bills could lead to missing deductible business-related expenses that qualify for deduction, which will increase your tax liability. Third, if the IRS were to ever audit you, you would have to show the government your entire list of expenses—personal and business. For the folks who want the government out of their lives, opening up your expense statements is not the way to go. I recommend that all self-employed people open a separate credit card and/or bank account and use it exclusively for business income and expenses. It will save you time and money at tax time and is what the IRS recommends.

Know the Rules on Capital Gains Tax

I often hear people tell me how great they are doing "in the market." What is funny is that these people only talk about their gains and never about their losses. But when someone tells me that they sold some stock and made a 50% profit, I ask if that is pre- or post-tax. It is almost always a pre-tax number. When you sell a stock for a gain, remember that you have to pay federal, state and possibly local tax on that amount. If the gain is "short term" (i.e., the holding period is less than one year), the tax rate on that gain will be whatever your marginal tax rate is. If you are in the top tax bracket, that could be 37%. Add on another 3.8% of Net Investment Income Tax (related to the Affordable Care Act), State Tax (let's assume 7%), and possible local tax (if you reside in New York City, it is 3.8% for top tax brackets), and your big smart investment gain will be reduced by over a half! That certainly impacts your "return" percentage. So, remember: your investment skills may be great, but the government always gets their cut. Know the rules and the rates. Figuring out, or having your financial advisor figure out, the tax consequences of any sale will give you a truer picture of your actual after-tax gain on that stellar investment.

Have You "Gone Solar" Yet?

By Judy McNary
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Solar systems for residential use have been available since the late 1970s but did not become popular until the 1990s. Today, the average cost is much less than it was in 2004 and generous tax incentives make it even more affordable. Four questions can help determine whether installing a solar system is right for you.

First, **consider how long you will live in your current home**. If you plan to move in less than four years, you may not fully recover the cost of the solar system. However, if you do plan to be in your home for more than four years, an installed system you own benefits you in two ways. The first is obvious: the dramatic reduction in energy bills. The second is the increase in your property value. A study done by the real estate site Zillow in 2019, comparing houses with and without solar, found that solar systems add, on average, 4.1% to a home's sales price. That means a solar system could add $10,250 value to a $250,000 home. (https://www.consumerreports.org/solar-panels/how-to-get-a-solar-tax-credit/).

Second, **look at the roof on your home**. Certain types of roofing material, such as Spanish tile or cedar shake, don't work well for solar. Best are composite shingle or metal roofs. Assess the condition of your roof, as well. If your roof is nearing the end of its life you may want to replace it before installing solar panels.

Third, **assess the orientation and pitch of your roof**. Ideal roofs for solar panels are unobstructed, south-facing, angled between 30 and 45 degrees. Most homes have solar panels spread across multiple roofs; and if there are no obstructions to the sun, a combination of south, east and west roofs should serve you well (in the Northern Hemisphere!). You can use Google's Project Sunroof, using your address and average monthly electric bill, to estimate your solar potential and savings over 20 years. (https://www.google.com/get/sunroof)

Lastly, **decide whether you can afford to install a system**. The good news here is that you probably can! The typical cost for residential solar systems today is between $15,000 and $30,000, but federal tax credits and potential state and local energy incentives greatly reduce this out-of-pocket price tag. The greatest savings come from the federal solar tax credit. For 2020, this credit for an installed solar system is 26% of the cost of the system. The tax credit is reduced to 22% for 2021 and expires for 2022. Note that the system must be owned by you, rather than leased, and it must be installed by year-end.

As solar system use has gone mainstream, financing has become easier and more affordable. It's easiest to pay cash, but you can use a Home Equity Line of Credit (HELOC) or a solar loan. For the interest to be tax deductible, the loan must be secured by your home so the HELOC might be the wiser choice. Another option is to install your solar system a few panels at a time. When installed at one time, the systems often use a central inverter. This means all the solar panels feed the energy into a central inverter to convert DC to AC power. If you can afford only a few panels to get started, install panels that each have their own micro-inverters and you'll be offsetting your energy bills right away. You can add more panels over time as your budget allows.

One last but important point on the federal investment tax credit to note is that it is not a refundable credit. You need to apply the credit against your total tax bill; excess credit is not refundable. This creates tremendous tax planning opportunities for you to discuss your solar plans with your financial advisor. It may be the perfect time to consider partial Roth conversions, realization of capital gains, or tax-saving moves that ensure you maximize your solar credit benefit.

The website www.letsgosolar.com is a wonderful resource, explaining how solar systems work, how to estimate the size and cost of system needed, and how to determine the best way to finance and make use of rebates and incentives. As with all major purchases, get several estimates before signing a contract.

Once you've got solar installed, smile and watch your meter go backwards as the sun shines. Your next step is an electric vehicle. There are rich federal and state tax incentives that make these surprisingly affordable to purchase as well. You'll be using the sun to energize your home and your car!

How to Get a Charitable Deduction under Trump Taxes

By Jared Hoole CFP®, MS
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The Tax Cuts and Jobs Act (TCJA) went into effect on January 1, 2018. The TCJA made small reductions in individual income tax rates and significantly reduced the tax rates for corporations. However, while the newly reduced tax rates were beneficial for most everyone, the TCJA did not come without any adverse changes. Most notable was the new cap of $10,000 on state and local income taxes. This means that taxpayers who formerly reported state income and real estate taxes as itemized deductions on their tax return were now severely limited on how much they could deduct. As a result, many taxpayers were forced to take the standard deduction rather than itemize as they had in the past. Consequently, since charitable donations are only deductible for taxpayers who itemize, many taxpayers were unable to deduct the charitable donations they had made. Luckily there is a viable solution for those who are charitably inclined and want to reduce their tax liability—a Donor Advised Fund.

What is a Donor Advised Fund?

A Donor Advised Fund (DAF) is a charitable investment account which allows you to support charitable organizations of your choice. Those DAF funds can be invested for tax-free growth and you can recommend grants to virtually any IRS-qualified public charity. It's important to note that you are eligible for an immediate tax deduction as soon as you donate to a DAF, just as you would by donating to another public charity. However, once the funds are in the DAF, you have complete freedom to initiate grants at your leisure, meaning you could space your charitable grants from the DAF out over 10 or 20 years.

Eliminate Future Capital Gains

One significant advantage of a DAF is the ability to donate appreciated securities. Donating long-term appreciated securities potentially allows you to eliminate capital gains, which lowers your overall tax liability. For example, suppose you purchased a mutual fund for $10,000 in 2000. In 2019, the fund is now worth $30,000. By donating the appreciated security to a DAF, you are getting a $30,000 deduction for something you only paid $10,000 for and saving $3,000 in long-term capital gains taxes that would be owed if you sold the security (assuming a 15% long-term capital gains rate).

Use a DAF to Lower Your Taxes

Since the TCJA limits the amount of state and local taxes you can itemize, many taxpayers now receive a larger benefit by taking the standard deduction. This effectively eliminates the benefit of charitable donations since they are only deductible for taxpayers who itemize. Traditionally the four major deductions taxpayers itemize on their Schedule A are medical expenses (over 7.5% of AGI), state and local taxes, mortgage interest, and charitable donations.

The 2019 standard deduction for a married couple filing jointly is $24,400. Assuming state and local taxes paid are $10,000 or higher, a married couple would need over $14,400 in medical expenses, mortgage interest, and charitable donations to itemize rather than take the standard deduction. This is where a Donor Advised Fund can come in handy. Circling back to the example with $10,000 in state and local taxes to deduct, no deductible medical expenses (above 7.5% of AGI) and mortgage interest of $9,400, charitable donations would need to exceed $5,000 to justify itemizing. This is where the DAF comes into play. Rather than donate small amounts each year without receiving a tax deduction, consider making a large contribution to a DAF in one year. Doing so would allow you to get the benefit from your charitable donations in that year, and in subsequent years you could take the standard deduction and make charitable donations from your DAF. Remember, contributions to a DAF are deductible in the year they are donated, but the funds themselves can be gifted over several years. Essentially by frontloading your charitable donations, you can qualify for larger tax deductions without disrupting your annual gifting strategy.

As with any tax law changes, there are always loopholes that allow savvy taxpayers to work the system. Using a Donor Advised Fund to bunch your deductions in one tax year can be very beneficial, especially when combined with other charitable gifting strategies such as donating used clothing, household goods, and furniture to Goodwill or the Salvation Army in the year you itemize. Charitable gifting strategies along with good tax planning can help reduce your tax burden and ensure you don't pay the government more than you have to.

Seeing Charitable Giving in a New Light

By Kevin Jacobs CFP®, EA
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For many people, winter and the end of the year is the season of giving. However charitable actions are not something reserved for a certain time of year. Rather, the spirit of giving needs to find a place in our hearts and minds each day.

I've been thinking a lot about what charity means in my own life, which led me to explore the origins of the word "charity". The Latin translation struck a chord with me. Caritatum is the Latin word for charity and in the Vulgate (the Latin Bible), it is used as a translation of the most powerful type of love in Ancient Greece, agape. Agape is love in its highest manifestation because it centers on respect and care for others, seeking the best for them unconditionally.

This is a powerful view of charity because it stretches beyond our typical worldview of charitable efforts. While monetary support is an excellent and important component of charitable giving, it is not the only one. The giving of ourselves for the greater good—that is what charity is all about. I'd like to explore ways that you can add a new dimension into your charitable efforts: your time.

Beyond the Finances

Giving money in support of your church or local charity is likely an important part of your financial life. But there is more to giving than finances. We give in order to offer support to the people around us and that can be done in so many ways other than financially. You can give your time, talents, and attention to a cause that is important to you.

Many people donate their time and energy during the holidays, whether it be serving food on Thanksgiving or spending part of Christmas day at the soup kitchen. While these efforts are incredible, it is important to find ways to extend your giving beyond the holidays. One way to do that is using your gifts and talents to help others.

You have a unique set of skills that can be beneficial to the community at large. Perhaps you have a strong financial background, you might consider joining the financial board of a local organization. Or maybe you are a gifted musician. You can use this gift in volunteer programs that bring music to nursing homes or other care facilities. Be proactive in finding where the need is and then use your skills to help fill that need.

You can also be open to saying yes to upcoming opportunities. You might find out that people in your community are all volunteering for a construction project. If you can, take the opportunity to help others through volunteer work and fellowship with your community at large. Charitable giving is about making connections with the people in your life. Drawing closer to your community is a wonderful way to collectively be a part of something bigger than yourself.

Impact-Focused Life

What is the driving force of your life? Woah, you probably weren't expecting such a deep question, but the answers that come from exploring this question set the tone for the way you want to live your life and how your finances can support that vision.

Increasing your charitable efforts is a great way to live a more impact-focused life. You may not always be able to offer as much financial support as you want, but that doesn't mean your efforts need to stop. Use your passions to help those around you, and that dedication will make a positive impact on your life and the community at large. Being charitable really means giving your time and talents freely, without reservation, expectation, or desire for reciprocation.