NORTHSTAR
FINANCIAL PLANNERS INC.

OCTOBER 2021

FINANCIAL PLANNING NOTES
CLIENT NEWSLETTER

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TOP TAX SCAMS OF 2021

It's time for the least fun and entertaining top 10 list: the top tax and fraud scams of the year as reported by the IRS. Activity has been high this year—as it usually is during and following a time of disaster or crisis since government relief programs result in billions of dollars of benefits for thieves to go after.

1. **EIP theft:** As Economic Impact Payments (EIPs) were sent to most U.S. taxpayers earlier this year, scammers saw a golden opportunity. They called and emailed people claiming to be from the IRS, asking for banking information so the payment could be deposited. The real IRS never initiates contact by phone, email, or text and will never ask for your bank information, Social Security number, etc. If you receive such a communication, **hang up or delete!**
2. **Unemployment fraud:** At the height of the pandemic, tens of millions of people lost their jobs, and while thankfully most were short-term layoffs, unemployment benefit payouts have been at record levels for much of the past two years. That's a lot of enticement for scammers. They have filed fraudulent claims for unemployment compensation using stolen personal information. If you then attempted to file your own claim, your application would be denied. Even worse, if uncorrected, the benefits the thief received would be reported to the IRS as income to you. If that happens, you would receive a Form 1099-G that shows the income, in which case you would have to report the error to your state unemployment agency.
3. **Phishing:** It's the old tried-and-true scam and never goes away because it's simple and effective—a fake email that just looks legitimate enough to get you to click or open. Once opened, they either ask for personal information or download malware to your device. Phishing emails that appear to come from the IRS are popular because how many people would delete an email from the IRS? Well, hopefully **you will** because you know **the IRS doesn't communicate with taxpayers that way.**
4. **Social media scams:** You've seen it before, probably many times: A friend request from someone you're pretty darn sure you're already friends with. A few minutes later, the actual person posts on their social media feed: "I've been hacked. Don't accept any friend requests from me." By masquerading as someone you know, scammers will try to get personal information from you or send something that looks like a charity or donation link (but isn't).
5. **Vishing:** Voice-related phishing, or vishing, has become more popular, particularly related to federal tax liens. As with other scams, be wary of providing personal information to someone who has called you out of the blue. If it doesn't sound kosher, it probably isn't. **Hang up immediately.**

6. **Ransomware:** Ransomware is malicious software that encrypts your data and programs, blocking access until you pay a ransom to get a code to unlock encryption. I'm sure you remember the incident last spring when oil pipelines were shut down across the southeast U.S. following a ransomware attack. That one cost Colonial Pipeline a reported $5 million. As with the other schemes in this list, good cybersecurity practices are your best defense. Never open or click on links from untrusted sources.
7. **Fake charities:** Here's something I saw pop up on social media just a couple days ago: Someone posted a video of their sick kid in the hospital, then someone else stitched that video to a new video, providing donation information for a GoFundMe account for the family. But it turns out the family wasn't involved with the fundraising effort at all and is getting none of that money. It was a scam. Taking advantage of people's good nature is one of the easiest ways to rob people. Always check out any charity or fundraiser before donating.
8. **The IRS impersonation call:** The ominous robocall announces "law enforcement will be dispatched to your location in 30 minutes," followed by instructions to resolve an outstanding tax bill. You don't have time to figure out if it's legitimate. It's the scariest of scare tactics, and it works on a lot of people, particularly seniors. Of course, it's always a scam. Neither the IRS nor local police operate that way.
9. **Offer in Compromise (OIC) companies:** Advertising that they can help you resolve your IRS tax bill for a fraction of what you owe, these companies sell something they usually can't deliver. While sometimes the IRS does resolve a taxpayer's debts for less than the full amount owed, most filers will not meet the requirements. The company will charge you hundreds, maybe thousands, of dollars to help you complete an application you could fill out on your own, for a program they know you aren't going to qualify for.
10. **Ghost preparers:** Of course, most CPAs are ethical and trustworthy, but beware if the person doing your taxes doesn't sign the tax return declaring that they prepared it for you. If they aren't signing, it's a warning sign that they plan to claim later that they didn't file it. Why might they want to do that? Well, let's say they promise you a big refund and charge you accordingly, but they're generating that high refund with some shenanigans they know will probably be rejected by the IRS. Always use a reputable CPA, don't let the price be determined by the amount of your refund, and **make sure the preparer signs the return!**

Sadly, this isn't even close to a comprehensive list of the scams and schemes run by unscrupulous criminals. Whenever you are in doubt, call your trusted tax professional. If you don't have one, give us a call. We work with many CPAs whom we find to be competent and trustworthy, and will happily make a referral for you.

—Steve Tepper

Source: *The IRS' 'Dirty Dozen' Tax Scams For 2021*, WealthManagement.com, July 2, 2021.

ADVANTAGES OF A ROTH IRA CONVERSION IN ESTATE PLANNING

As you create or update your estate plan, you might consider using Roth conversions to minimize the tax hit your heirs will take. Tax law changes both past and future make this strategy more and more attractive.

Read on to learn about the changes and how a Roth conversion may help you make a more impactful gift to your children, grandchildren, and other loved ones.

Tax and Estate Plan Changes

Until recently, you could leave an IRA to your heirs, and they'd have the rest of their lives to make withdrawals from it. This long timeline allowed them to take advantage of investment growth and enjoy some tax flexibility.

However, the SECURE Act of 2019 eliminated this so-called "stretch IRA" for most beneficiaries.[1] Now, if you leave a traditional IRA to your adult child, for example, they must empty out the account within 10 years.

This rule reduces the impact of your gift. Your heirs must pay taxes on the distributions, and the income could bump them into a higher tax bracket.

As for tax brackets, the Tax Cuts and Jobs Act in 2017 lowered tax rates—but only temporarily. Unless Congress acts, the tax brackets will revert in 2026.

Given our country's jaw-dropping deficit, it's also reasonable to assume taxes will increase at some point.

And finally, President Biden has proposed eliminating the step-up in basis for inheritances.

All this means that Uncle Sam stands to take an even larger bite out of the legacy you leave to your loved ones, which is why you should consider the suitability of a Roth IRA conversion.

How a Roth IRA Conversion Can Benefit Your Estate Plan

A Roth IRA works differently from the traditional IRA. With a traditional individual retirement account, you don't pay taxes until you withdraw money from the plan. But with a Roth IRA, you pay taxes upfront, your contributions enjoy tax-free growth, and your distributions are generally tax-free.

Similarly, you pay taxes at the point you convert a traditional IRA into a Roth IRA. So, when that Roth account becomes part of your estate plan, you have essentially covered the tax bill your heirs would have received.

What's more, in paying taxes, you have reduced your estate value, potentially reducing estate taxes.

Note that tax-free withdrawals begin only after five years have passed from the date of the conversion. So if you were to die, say, three years after making a Roth conversion that you leave to your daughter, she may have to pay taxes if she makes withdrawals within the first two years of inheriting it.

We say "may" because only the earnings are taxable. The original conversion amount has already been taxed. If your daughter withdrew only from the contribution you made, she would likely avoid taxes.

Roth conversions are best made in years where you have lower income or more deductions to offset the taxes you pay. You also need to have the cash on hand to pay the taxes.

A Roth conversion should be part of a long-term strategy of conversions based on your current and future financial situation, devised in collaboration with your estate planning attorney and CPA to help ensure no details slip through the cracks.

Final Thoughts

No one can predict whether and when taxes will increase. However, the government will have to pay for the deficit, which generally means reducing spending or raising taxes—or both. Meanwhile, the elimination of the stretch IRA calls for creative problem-solving to help your heirs get the most out of your gift.

While your surviving spouse can stretch out a traditional IRA over their lifetime, your adult children and grandchildren, in most cases, will have to close the account within 10 years and pay taxes on the distributions. Roth IRA conversions could help your heirs keep more of their money if taxes do increase.

*Timothy Barrett, "Who Can Still Do a Stretch IRA After the SECURE Act: Explaining the Exceptions to the Rule," Kiplinger, 3 August 2020, https://www.kiplinger.com/retirement/retirement-plans/iras/601163/who-can-still-do-a-stretch-ira-after-the-secure-act.

HOW AN HSA CAN BOOST YOUR RETIREMENT SAVINGS

So you have a 401(k) and an IRA. You have the Roth versions of these retirement accounts as well, and you have a brokerage account. Is there anything else you can do to increase your retirement savings?

Yes, there is! If you have access to a health savings account (HSA), you have access to a highly flexible, tax-advantaged savings account that you can use in retirement.

The Triple Tax Benefits of a Health Savings Account

Like your 401(k) or IRA, you can make tax-advantaged contributions to an HSA. If you have an HSA through your employer, you'll reduce your taxable income by making pre-tax contributions to your health savings account. (Plus, your employer might match your contributions, increasing your balance.)

If you have an HSA on your own, your contributions are tax-deductible in the year you make them.

Regardless of whether you contribute through your workplace or on your own, your contributions grow tax-deferred. And unlike a flexible spending account (FSA), your contributions can grow from year to year. The HSA lacks the "use it or lose it" requirements of an FSA.

You owe no federal taxes as long as you use your HSA savings to pay for qualified medical expenses. (Check with your state to make sure you understand its rules.) If you use the HSA balance on non-health expenses before age 65, you face federal income taxes and a 20% penalty on the withdrawal.

However—and this is what makes the HSA a powerful tool in retirement—the penalty is eliminated once you reach 65. So, just like your traditional IRA or 401(k), you just pay income taxes on any distributions that you don't use for qualified health expenses.

Now, you may decide to use your HSA for only health care expenses. And with today's retiring couples facing an estimated $300,000 in health care costs over the rest of their lives, that decision is a smart one.

But the fact that you can use your HSA similarly to your IRA or 401(k) adds flexibility to your retirement savings strategy.

What's more, unlike your traditional retirement accounts, you won't face required minimum distributions (RMDs) with your health savings account. You can let your HSA savings sit in the account if you want without being forced to take a distribution.

An HSA provides other uses as well. Normally, you can't use an HSA to pay for insurance premiums. However, if you stop working before age 65, the age you would enroll in Medicare, you can use HSA funds to pay for health care coverage while receiving unemployment benefits or for health care coverage through COBRA.

Once you reach age 65, you can use your HSA to pay for Medicare Parts B and D premiums (though not for a Medicare supplemental policy like Medigap). And finally, you can use your HSA to help cover costs for a "tax-qualified" long-term-care insurance policy. As you age, the amount the HSA can cover increases.

How to Contribute to an HSA

You can contribute to a health savings account if you have a high-deductible health plan. For 2021, that would be a plan with a $1,400 minimum deductible for self-only coverage and $2,800 for family coverage.

Also for 2021, you can contribute up to $3,600 for a self-only HSA and $7,200 for a family HSA. If you are age 55 or older, you can contribute an additional $1,000 as a catch-up contribution.

Assuming your plan provider offers the option, consider investing your HSA funds rather than keeping them in cash. By investing your contributions, you take advantage of the power of compounding, giving your HSA balance a chance to grow, much like your 401(k) or IRA balance is growing. Just make sure that your HSA investments are in line with your risk tolerance and return goals and that your HSA fees and expense ratios are reasonable.

The above investment strategy assumes you plan to wait to use your HSA in retirement, paying for health care costs out of pocket before then. If you want to use your HSA for current expenses as well, determine an appropriate amount to earmark for cash versus investing all your contributions.

If you have questions about how an HSA fits into your retirement planning, give us a call!

WHO WE ARE

ALLEN P. GIESE, ChFC®, CLU®, ChSNC®
President, Investment Advisor Representative

STEVE TEPPER, CFP®, MBA
Vice President, Chief Operations Officer, Investment Advisor Representative

GARY S. GLANZ
Director of Business Development, Investment Advisor Representative

GARY C. GONZALEZ
Investment Advisor Representative

STACY SAAVEDRA
Client Service Specialist

RICHARD LOTTIER III
Client Service Specialist

LIAN TEPPER
Client Service Specialist

NORTHSTAR FINANCIAL PLANNERS INC.

(954) 693-0030
1250 S. Pine Island Road, Suite 275
Plantation, FL 33324

northstarplanners.com
info@northstarplanners.com