NORTHSTAR FINANCIAL PLANNERS INC.

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FINANCIAL PLANNING NOTES
CLIENT NEWSLETTER

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A SPECIAL, EXPANDED YEAR-END FINANCIAL CHECKLIST

In a year as unique as 2020, it makes sense that our (12th) annual checklist would also be quite different from years past. There are many more opportunities and reasons to review your financial status, cash flows, and goals given the myriad of changes to the tax code and other recent legislation.

Here are a few important things to think about:

Employer-sponsored retirement accounts: To take a deduction for contributions to an employer-sponsored plan such as a 401(k) or a SIMPLE IRA, you must make your contribution through payroll deduction by the end of the year.

Your primary goal should be to save **at least enough to earn any company match offered.** Contribution limits for 2020 if you are under 50 are $13,500 for a SIMPLE IRA and $19,500 for a 401(k), 403(b), or 457(b) plan. If you are over 50, the limits are $16,500 for the SIMPLE and $26,000 for the 401(k), 403(b), or 457(b).

Charitable giving: Make your contributions (either of cash or donated goods) by the end of the year, and get a receipt from the charity. There is added incentive to contribute this year, particularly if you are contemplating a large donation, because there is no limit to the amount you can deduct based on adjusted gross income (AGI), as there has been in past years.

Gifting: You can contribute up to $15,000 per recipient per year ($30,000 if married and filing jointly). This includes contributing to your child's or grandchild's 529 college savings plan. Note: Gifting is not tax-deductible, but if you gift in excess of limits, you will need to file a gift tax return and pay gift tax.

Required minimum distribution (RMD): Thanks to coronavirus-related legislation, owners of tax-deferred accounts (like IRAs) who are older than 70½ are not required to withdraw any money from their account this year. At this point, we are assuming the requirement to take a certain amount calculated based on your year-end balance will be reimplemented for 2021—so if you are thinking of taking money out in December, it might be a good idea to hold off until January, if you can.

Prepay 2021 residence real estate taxes: Because of tax law changes, prepaying 2021 real estate taxes can lower your 2020 taxes without triggering the alternative minimum tax (AMT). There may be a limit on the total dollar amount you can deduct on your 2020 tax return, so talk with your accountant first.

Pay home business expenses now: If you have a home business or side gig, this year may have thrown your revenues and expenses topsy-turvy. If you have been

fortunate enough to keep revenue steady (or increased), while spending much less, you might want to consider accelerating some planned future business expenses to prevent ending the year with a large taxable profit.

Home business expenses Part 2—retirement plan: One thing you can do to take a big bite out of taxable income is contribute to a company-sponsored plan. If you don't have one set up, you need to get it done by year-end. Depending on the type of plan, you might be able to delay funding until the tax-filing deadline next year, but the plan must be established now.

Get a pandemic loan AS A LAST RESORT: The opportunity to borrow up to $100,000 from your 401(k) or IRA expires at year-end. This option should be seen as a last resort for individuals and business owners severely impacted by COVID-19. While you have the opportunity to repay the amount borrowed over three years without penalties or interest, you will lose any market gains during that time. It could also disrupt your long-term retirement plan if you are unable to repay the money.

Consider a Roth IRA conversion: Although markets have roared back from their springtime plummet, if you find your IRA balance is still a bit low, a Roth conversion may never be less expensive (you will have to pay the taxes on the entire amount you convert). A Roth conversion will also give you more potential for tax-free gains going forward.

Maximize health savings account (HSA) contributions: Another way to lower taxable income is through the money you contribute to an HSA qualified health insurance plan, if you have one. The annual contribution limits are $3,550 for individual coverage, $7,100 for family, and an additional $1,000 catch-up contribution if you are 55 or older.

You can make HSA contributions through payroll deduction or directly to your account. If you don't spend all the money in your account on qualified medical expenses, you can roll the balance forward, and continue to do so year after year, even if you leave the employer offering the HSA qualified plan.

Spend all your flexible spending account (FSA) dollars: Though they are not common these days, some people have flexible spending accounts to cover routine medical expenses such as prescriptions and doctor co-pays. But unlike HSAs, money left over each year does not roll over—it is forfeited. So, if there's still money in that account, get all your prescriptions refilled or get an extra pair of glasses. Maybe that's why optometrists always walk around with a big smile in December.

Harvest investment losses: Even though many stocks and asset classes are at record highs these days, you might find that some of your holdings are still down a lot. Tax loss harvesting is a means of capturing losses on your investments that can be used to offset taxable gains. Maybe you're holding some hotel or cruise line stocks that are still in the tank. Think about selling them and buying a similar but not identical stock. In that way, your portfolio will be virtually the same, but you will now have a loss available to lower taxes on other gains.

When I say "similar but not identical," that is because of specific language in the tax code that prohibits selling and buying of "substantially identical" investments if you want to harvest tax losses. Selling a cruise line's Class A stock and buying their Class B stock would violate the substantially identical rule, but buying a different cruise line's stock would not.

Maximize IRA contributions: If you aren't participating in an employer-sponsored retirement plan and want to lower taxable income, you can contribute up to $6,000 to an individual IRA, plus an extra $1,000 if you are over age 50. Alternatively, you can contribute up to the same limits to a Roth IRA (but you can't do both in the same tax year). You have until next year's tax-filing deadline to max out your contributions.

Review beneficiary designations: The beneficiaries you selected years ago, particularly for your retirement accounts, may not make sense due to last year's SECURE Act. That legislation eliminated the "Stretch IRA," which allowed non-spouse beneficiaries of your IRA to take the money out over their lifetime rather than over just a few years. A beneficiary review will help you determine if you are leaving the right types of assets to the right heirs to reduce the possible tax burden on them.

Have a risk review: As much as you may not want to relive it, take a few moments to reflect back on March and April of 2020, when much of the global economy was shutting down and we experienced the most rapid bear market in history. There was a lot to deal with—concern about the health and safety of loved ones, job and business concerns. Were you also a little freaked out about your investment portfolio? Or were you way more than a little freaked out?

A risk review is a useful exercise because now that markets are calmer (at least that is the case as I am writing, and, I hope, as you are reading), you can think about whether the amount of risk your portfolio is exposed to is the proper amount.

We can only hope we do not see a return of volatility like we had this year ever in our lifetimes, but it would be folly to pin the same hopes on seeing no large market declines at all. They happen. And they will happen in the future. If your experience this year caused you worry and cost you sleep, this could be an opportunity to re-evaluate and move to a less risky investment strategy.

See the doctor: Most medical and dental plans offer free annual or bi-annual wellness visits. Of course, nothing is free—you are paying for those appointments through those astronomical monthly insurance premiums. Or you may have already maxed out your out-of-pocket health care costs for the year. In either case, take advantage and go to see your doctor and dentist for a checkup.

Check your credit report: You can get a free credit report from each of the major credit agencies once a year. In fact, each of the credit agencies (Experian, Equifax, and TransUnion) are offering free weekly credit reports through April 2021. AnnualCreditReport.com is a good place to get started.

Talk to your financial advisor: If you haven't talked to us this year, let's get together via Zoom or just catch up on the phone. It is important that we touch base with you occasionally to check our strategy and plan, especially if you have had important life-changing events this past year or anticipate big changes in 2021.

On behalf of the Northstar staff, I wish you and your family a safe and happy holiday season and new year, and a great 2021.

—Steve Tepper

Source: *Fourteen Financial Planning Tips to Act on Before Year-End,* WealthManagement.com Staff Nov 20, 2020.

IS BUYING A VACATION HOME A GOOD INVESTMENT IN RETIREMENT?

As you near retirement age, it can be tempting to invest in a second home in the vacation spot of your dreams. After all, the property's value can appreciate over time, and you'll have a permanent vacation spot for making memories with your children and grandchildren when you're not renting it out for passive income. But is buying a vacation home really a good investment?

In reality, a second home may not be the cash cow you imagine it to be—and it might be more work than you want to take on, especially if you envision retirement as a lowkey time for relaxation.

Many people buy a vacation home with mixed purposes: to have a permanent vacation option in the place of their dreams and to earn a passive income from a real estate investment. Let's take a look at a few points to consider before deciding if purchasing a vacation home in your retirement is the right choice for you.

Can You Afford a Vacation Home?

A vacation home is likely to come with quite a few costs. Aside from the purchase price, you'll have other costs to consider, like:

- Taxes
- Homeowner's association fees
- Utilities
- Maintenance costs (which will be higher in beachfront properties that take a beating from the salt and wind)
- Insurance (which can be more expensive for rental properties)
- Rental-management expenses (such as repairs, maintenance, and the cost of a management company)

Costs associated with owning a vacation property can be difficult to predict. Emergency repairs can erode your cash cushion. If you're living on a strict fixed income in retirement, be aware that the costs of owning and maintaining a vacation home may rise faster than your cash flow allows.

A Second Home Is Treated Differently by the IRS

Remember that if you ever decide to sell the property, you'll be subject to a capital gains tax. Unlike your primary residence (which allows for a capital gains tax exclusion of up to $250,000 for individuals and $500,000 for married couples), a secondary home isn't eligible.

To avoid this situation, many homeowners downsize by selling their primary home and moving into their vacation home. After they meet IRS requirements, that vacation home is considered their primary residence and becomes eligible for the capital gains tax exclusion if they decide to sell it.

Second homes can come with tax benefits, including a tax deduction on expenses such as:

- Mortgage interest
- Real estate taxes
- Casualty losses
- Maintenance
- Utilities
- Insurance
- Depreciation

The deductions you can claim depend on how much you rent out the property versus how much you use it personally. It is important that you understand the tax impacts of a vacation home. Consider talking with a fee-only, fiduciary financial advisor who can help you assess the pros and cons of a second home in light of your entire financial situation.

Use for Rental Income Pre-Retirement

If you're considering buying a vacation home as a retirement investment, odds are good that you're thinking of renting it out to generate a bit of passive income.

If income is your primary reason to invest in a vacation home, it's essential to compare your likely rental income with the costs, including mortgage, taxes, and maintenance and management expenses.

Some people find that the income just offsets the costs, and some people find the income falls short. You'll want to do your homework on the home's history as a rental, as well as the rental income generated by other homes in the area.

Do you plan to retreat there often? Many vacation properties are in areas with short-term rental seasons. Choosing to stay there yourself during the peak holiday season can conflict with your ability to earn the income you seek. Before you buy a second home, take the time to determine the appropriate balance between personal enjoyment and household income.

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A Vacation Home Can Be a Complicated Investment

Before you make the leap into vacation property investing in retirement, make sure you consider the advantages and downsides to owning that property—and think about your motivations for buying the home.

If your primary motivation is to find a solid investment, make sure to do your research. You want to feel confident that you will earn at least enough income to offset the expenses.

Our Plantation, Florida financial planning firm generally recommends that you don't put yourself in a position that you primarily depend on the investment property income for cash flow. Other income sources are important, such as your retirement plan distributions, pension, and Social Security benefits.

If you're looking for a vacation getaway for your family and you have the financial means, a second home can be a great choice in your retirement as you create new memories with your loved ones.

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