Tax planning is often overlooked within investment management. However, it can be a very powerful tool in helping achieve investment goals. As we approach the end of a difficult year in the markets, let's discuss a few tax planning strategies:

Harvesting losses/gains

From a tax perspective the one thing you can take advantage of during a difficult market year like this one is to harvest losses to offset current or future gains. A security can be sold, to harvest the loss, and a similar security purchased to maintain the market exposure. That loss can help offset gains already taken or gains that would be advantageous to take while not changing your market exposure. If there are no gains to take in the current year those losses can help offset up to $3,000 of your income and the remainder can be rolled over each year until all losses have been used.

> *Note: There is a 30-day holding period to avoid a wash sale when buying and selling identical/substantially identical securities.*

ROTH Contribution

The benefits of a ROTH are well understood today. Many people have set themselves up to take advantage of the benefits by making contributions on a yearly basis.

> *Note: There are income limits of $214,000 for Joint filers and $144,000 for single filers and contribution limits are $6,000 with a $1,000 catchup if over 50.*

Once your AGI has passed the income limits, it is easy to think you must stop making the contribution, that however is not the case for everyone.

Back-door ROTH Contribution

If you do not have an IRA of any kind (SEP, SIMPLE, Traditional), you can set up an IRA and make a non-deductible IRA contribution. Once the contribution is made, convert the entire IRA into a ROTH and you have a de facto ROTH contribution. No taxes or penalties are owed on this transaction as your IRA will have a basis of the amount contributed.

> *Note: You will need to file an 8606 form with your taxes.*

Mega ROTH Contribution

You may also be able to contribute to a ROTH 401(k). If your employer offers a ROTH 401(k) alongside a traditional 401(k), you may have the ability to make contributions to both portions. Focusing on traditional 401(k) contributions is the best way to take advantage of tax deductions and any matching policy, so this should be the primary focus. However, if your total contribution to a traditional 401(k) is under the defined-benefit plan limit ($61,000) you can contribute to the ROTH 401(k) to bring you up to that limit. That additional contribution will not carry a tax deduction but will benefit from tax free growth.

As an example: You contribute $27,000 to the 401(k) (because you are over 50) and the company does a $13,000 matching contribution. You would still be eligible to contribute $21,000 to the ROTH 401(k) ($61,000 minus the $27,000 and $13,000 contributions).

Note: The ROTH 401(k) has different rules (sometimes more restrictive) than a ROTH IRA.

IRA contributions

There are more and more businesses that offer a retirement plan, however if you happen to be at one that does not offer a retirement plan, you can make a deductible IRA contribution. **Note that if you make a deductible IRA contribution you will not be able to make back-door ROTH contributions as described previously.** Typically, prioritizing deductible contributions, when possible, gives the greatest benefit.

Note: IRA contributions limits are $6,000 with a $1,000 catch-up if over 50.

HSA contributions

We have written about the benefits of HSA's previously (Article: Where to begin saving after college), so we will simply reiterate here that contributions are tax deductible in the year made, gains are tax differed, and withdrawals can be tax free if they are qualified.

Note: Contributions limits are $7,300 for family and $3,600 for individuals with a $1,000 catch up if over 55. For families that want to take advantage of the catch-up for both spouses, two accounts need to be opened.

Charitable Contributions

There are many ways to give to charities, of which the simplest way is to write a check. However, that is rarely the most tax efficient strategy. Donating highly appreciated stock instead, would allow you to avoid paying taxes on the gains. Alternatively, if you are taking RMDs from an IRA you have the ability to make a qualified charitable distribution (QCD) that would count towards your RMD and avoid having that taxable income.

IRA distributions/ROTH conversions

The final strategies to consider would be either taking extra distributions from your IRA to cover expenses or converting a portion of your IRA to a ROTH. This may seem counter intuitive, as both strategies would cause additional income and a larger tax burden, which typically would be avoided. However, if you find yourself with low income in a specific year you may be able to lower your future tax liability by increasing your income slightly in the current year. While you would pay taxes up front on the IRA distribution, it would be at a low rate given the lower income. In the case of a conversion to a ROTH you would also allow future growth to be tax free.

Note: IRA distributions prior to 59.5 incur a penalty so should be avoided.

These strategies can be very subjective, especially the last ones discussed as a 'low' tax year can be highly variable from one individual to another. Always consult your financial advisor before implementing any of these strategies. The goal with these tax planning strategies is to help lower your overall lifetime tax burden, which is why we consider each of these strategies for clients on a yearly basis.