How to Approach Your Year-end Tax Review

By Kevin Casteel, CFP®, Assistant Vice President, Financial Planner

It's a fact of life: We have to pay taxes on our income. And no one — regardless of how much money we have — enjoys paying the IRS. That's the primary reason we're constantly searching for opportunities and financial strategies to help us manage, defer, and reduce our tax liabilities.

One such opportunity rolls around at the end of each calendar year when many individuals take inventory of the strategies they've used to reduce their tax bill: the year-end tax review.

Here are a few tips to help you get the most out of this annual process.

Check where you stand with contributions to retirement and education savings/investment accounts.

- Have you reached the maximum amount (or your desired contribution) in your 401(k), 403(b), IRA, Roth IRA, and other retirement accounts? Your contribution strategy helps defer income to your retirement when you may have less income, resulting in a lower tax obligation.
- 529 plans are savings accounts operated by most states and are designed to help families save for college. While contributions to these plans are not deductible on your federal taxes, many states offer tax deductions for contributing to 529 plans up to a certain dollar limit. The earnings on your contributions grow tax-free.

Make sure you have satisfied any required minimum distribution (RMD) requirements by year's end.

- Once you retire and reach age 72, you must start making withdrawals from your retirement accounts. If you've inherited an IRA, make sure you are meeting RMDs for these accounts as well.
- RMD amounts are calculated using the prior year's ending balance in a retirement account and a factor provided by the IRS. The required withdrawal percentage increases year-over-year.
- You may want to consider using these funds to cover tax liabilities, satisfy withholding requirements, or meet charitable goals.

Your Planners Play an Important Role in Your Review

"When it's time for your year-end tax review, your tax advisor will have specific recommendations based on your unique financial situation. And while the key drivers of your retirement planning should be your goals, timeline, and risk tolerance, your financial advisor can work with you to determine tax-efficient investment strategies aimed at mitigating your tax liability and helping you build your wealth at a much faster pace."

- Kevin Casteel, CFP®, Assistant Vice President, Financial Planner

Review the status and balances of your flexible spending accounts (FSAs) and health savings accounts (HSAs).

- You can make contributions to FSAs without paying Social Security and income taxes on those amounts. However, they are of the "use it or lose it" variety unless the plan allows for a carry over. It's important to have a plan to exhaust or reduce the balance to the allowed carry over by the end of the year, otherwise the funds will be forfeited.
- Make sure you've funded HSAs to maximum or desired levels to achieve triple tax-exempt status (if used for qualified medical expenses): (1) Your contributions to the account are deductible. (2) The funds in your account grow tax-deferred. (3) When you remove funds for qualified medical expenses, the withdrawals are tax-free.

Gather information to calculate tax deductions.

- Charitable contributions, education savings, state/local taxes, medical expenses, and mortgage interest are the most common.
- Compare the totals to the standard deduction to decide if itemizing is beneficial.

Consider the impact of gains and losses.

- Harvesting losses can help offset any gains realized during the tax year, reducing capital gains taxes owed.
- Mutual funds generally pass capital gains on to investors in the fourth quarter. Depending on balances in different funds, taxes due could disrupt expected cash flow.

Enlist your financial advisor to monitor these holdings to see if taxes can be avoided.

Gather documentation and records of your charitable giving.

- Consider charitable gifts of appreciated securities. This strategy earns a charitable deduction and avoids payment of capital gains taxes. The charity receives full benefit of the gift.
- If you've reached the age of 70½ years, you could gift up to $100,000 directly from your IRA. This satisfies RMD requirements and reduces your adjusted gross income (AGI).

Consider gifting to family members to reduce future estate taxes.

Annual gifts of up to $16,000 each ($32,000 for you and your spouse combined) can be given to multiple individuals without tax consequences. The current lifetime exemption of roughly $12 million per individual is set to reduce by approximately half in 2026.

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This is not an exhaustive list by any means, and your tax advisor will have specific recommendations based on your unique financial situation. While the key drivers of your investment planning should be your goals, timeline, and risk tolerance, you should work with your financial professionals to consider tax-efficient investment strategies that factor in your tax liability and may help you build your wealth at a much faster pace.

We can help

When it comes to timing tax strategies, you'll find that some investments are more tax-efficient than others. The tax laws are numerous and complicated — it's important to seek the advice of your professional advisors to help you determine which vehicles are the most appropriate and advantageous for your financial planning goals. Contact Commerce Financial Advisors today — we're here to answer your questions and help you make informed decisions.

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Kevin is a financial planner with The Commerce Trust Company. He is a member of the financial advisory services team, a dedicated financial planning practice within Commerce Trust that provides objective financial advice to clients. Following a thorough assessment of a client's unique situation and thoughts regarding wealth, Kevin develops holistic and coordinated plans to help clients meet their short-term and long-term goals as well as take full advantage of various planning, tax, and investment strategies along the way. His areas of focus includes planning for financial independence, retirement, divorce, executive compensation, estate preservation, and business succession. Kevin joined Commerce Trust in 2015 after starting as a Commerce Bank Trainee/Credit Specialist in 2014. He previously worked at Edward Jones as a Financial Advisor Trainee. Kevin received his Bachelor of Science in business administration and finance from Southern Illinois University Edwardsville and his Master of Science in Personal Financial Planning. He also has earned his CERTIFIED FINANCIAL PLANNER™ designation.