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10 Year-End Tax Tips for 2021

Start tax planning now and you could owe the government less money in the spring.

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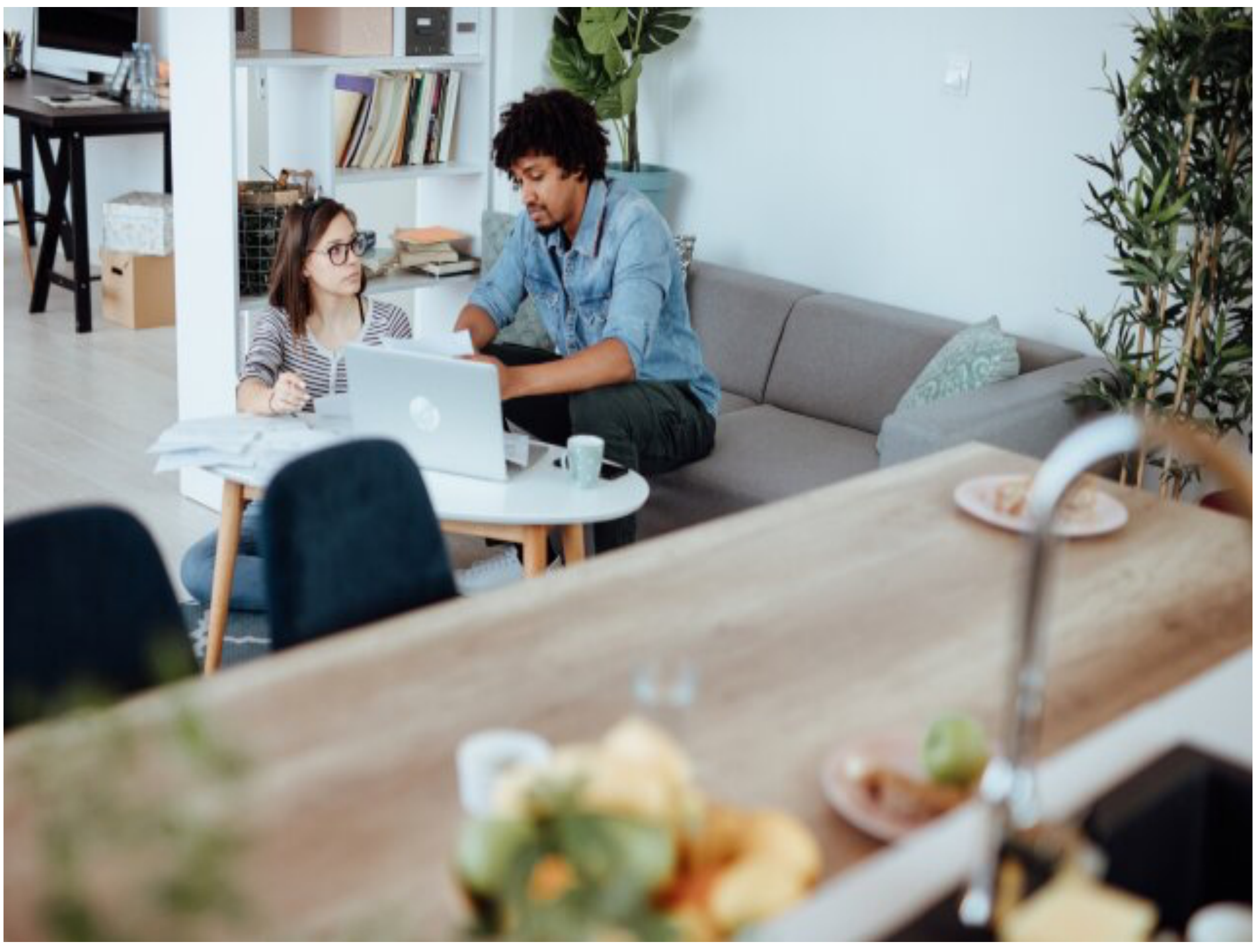

With the winter holidays looming, the clock is ticking for taxpayers who want to minimize what they will pay next spring.

"What's been on top of mind for my clients is the Biden proposal," says Andy Subkoviak, senior investment strategist with investment advisory firm Parametric in Seattle. Although its provisions seem to be a moving target, the proposed Build Back Better Act could have some significant tax implications.

That means now may be the time to consider tax-saving tips such as Roth conversions and harvesting cryptocurrency losses. Plus, there are perennial year-end tax planning tasks that should be completed regardless of if and how the law changes next year.

Here are 10 tax tips for 2021 to beef up your savings and minimize the amount of income tax you'll pay:

- Make 401(k), and HSA contributions.
- Schedule your RMD for 2021.
- Convert money from a traditional IRA to a Roth IRA.
- Contribute to a 529 Plan.
- Hold off on mutual fund purchases.
- Harvest your capital losses.
- Pick up capital gains if you're in a low tax bracket.
- Harvest losses on cryptocurrency.
- Donate cash to a charity.
- Meet with your tax advisor.

1. Make 401(k) and HSA Contributions

People can make tax-deductible contributions to traditional IRAs and health savings accountsup to April 15 of next year. However, the door closes on Dec. 31 for 401(k) contributions. "There's no way to make additional contributions (after the new year)," says Eric Bronnenkant, head of tax for Betterment, a financial advisory company.

Taxpayers with a qualified high-deductible family health insurance plan can deduct up to $7,200 in contributions to a health savings account in 2021. Individuals with self-only coverage can deduct $3,600. Those age 55 or older are eligible for an additional $1,000 catch-up contribution.

Tax-deductible contributions to a traditional 401(k) are capped at $19,500 for 2021. Workers age 50 and older can make an additional $6,500 in catch-up contributions.

2. Schedule Your RMD for 2021

Normally, retirees who have a traditional 401(k) or IRA must take a required minimum distribution each year once they reach age 72. Depending on the size of a person's retirement account, this distribution can be sizable and result in a significant tax bill.

Last year, the Coronavirus Aid, Relief, and Economic Security (CARES) Act waived RMDs, but they are required again this year. If you haven't already taken your RMD, make sure you do that before the end of the year.

"If you don't take it, you'll get a 50% penalty," says Craig Ferrantino, president of Craig James Financial in Long Island, New York. "That's … painful."

3. Convert Money From a Traditional IRA to a Roth IRA

Withdrawals from traditional IRAs are taxed in retirement, but distributions from Roth IRAs are tax-free. Plus, Roth IRAs don't have required minimum distributions, which can also be beneficial for those looking to reduce taxes in retirement.

Fortunately, the government allows you to convert money from traditional accounts to Roth accounts to get these benefits. When money is converted from a traditional to a Roth account, taxes must be paid on the converted amount.

With some concerned about rising tax rates, it may best to not delay making any planned conversions. "If we're going to do a Roth conversion, this is the year to do it," Ferrantino says.

4. Contribute to a 529 Plan

Families with children can use 529 plans to prepare for college expenses and save on their state income taxes next spring. Most states offer a state income tax deduction for contributions made by residents to a state-sponsored plan. However, a handful of states may allow a deduction for contributions to any 529 plan.

While there is no federal tax deduction for 529 contributions, money in these plans grows tax-free and can be withdrawn tax-free when used for qualified education expenses.

5. Hold Off on Mutual Fund Purchases

People should be wary of buying mutual funds at this time of year if they will be held in a taxable account. "It being November, it's an active time of the year for capital gains distributions," Subkoviak says.

You could get hit with a bill for year-end dividends even if you just purchased shares, and, essentially, you'll be paying taxes on a profit you didn't actually see. To avoid paying additional taxes, consult with a broker before making a purchase to find out when distributions are made.

6. Harvest Your Capital Losses

If you own stocks that have lost money, you can sell them and deduct up to $3,000 on your federal taxes. That money can offset gains on other stocks or be applied to regular income taxes.

Just be careful not to violate the wash-sale rule, which would disallow the deduction. This rule states you cannot purchase the same or a substantially similar stock within 30 days before or after the sale.

7. Pick Up Capital Gains if You're in a Low Tax Bracket

The end of the year is also a good time for some people to sell stocks that have appreciated significantly in value. This can be a particularly good strategy for those in the 10% and 12% tax brackets since their capital gains tax may be zero. The stocks can then be repurchased, which resets the basis and minimizes the amount of tax to be paid on future gains.

Even if you're not in the lowest tax brackets, you may want to sell winning stocks to reset the basis if you're also harvesting losses. Another reason to sell investments at this time of year is to rebalance your portfolio.

8. Harvest Losses on Cryptocurrency

A loophole in the law means people who own cryptocurrency should consider harvesting those losses in 2021. "Right now, the wash sale rule does not apply to cryptocurrencies," Subkoviak says.