Northwestern Mutual®

Three Things You Can Do to Potentially Pay Less in Taxes in 2020

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Did you know that taxes are the number one biggest bill for most people over their lifetimes? I was speaking with a client the other day and we agreed that a goal of hers is to pay less in taxes in 2020. We discussed that the highest return she can make is to save 50% tax between the state and federal government. She was already maxing out her 401(k) and wasn't sure what else to be doing. I told her there are three things she can do today that could help reduce her 2020 tax liability:

1) Increase your 401(k) contribution to take advantage of the $19,500/year cap. This was raised from the 2019 cap of $19,000. If you're over age 50, consider doing the catch-up $6,000 contribution. If you're 30 years old, the $500 increase could translate to $80,000 of extra retirement funds at age 67 assuming a 7% return.* If you're 50, the $6,500 increase including the catch-up could be worth an extra $200,000 for you by age 67 assuming a 7% return.*

2) If you qualify, open a health savings account. This is one of the least-often used financial tools, when it should be one of the most popular. The money goes into the account either on a pre-tax basis or may be tax-deductible, the earnings grow tax-free, and then all the money may be withdrawn tax-free to be used for qualified medical expenses. Amounts that remain at the end of the year are generally carried over to the next year, however, you need to be mindful of excess contributions. The money that remains in the plan every year grows and compounds tax-free. Then it can potentially be used to pay for qualified insurance premiums** in the future. For example, you can withdraw funds tax-free to pay for tax-qualified Long Term Care insurance.

3) Consider putting your money into a vehicle where you can make tax-free withdrawals in the future. Some examples of this are doing a Roth conversion annually, opening a 529 college savings account, and doing an after-tax contribution in your 401(k). Also, Permanent life insurance gives you the option of withdrawing tax-free income up to your tax basis.

January is a great time of year to be thinking about saving taxes, because you have 12 months to enjoy the benefits. Don't wait until Summer or Fall because you're limiting the positive impact. Let me know if you have any questions or if you'd like to revisit any of these strategies.

Financial Representatives do not render tax advice. Please consult with a qualified tax professional for tax advice.

*Examples are hypothetical and not indicative of any specific investment. All investments carry risk, including potential loss of money initially invested.

**Qualified insurance premiums include: long term care insurance, health care continuation coverage (such as COBRA), health care coverage while receiving unemployment compensation under federal or state law, or Medicare and other health care coverage if you are 65 or older (other than premiums for a Medicare supplemental policy).