CANBY Financial Advisors

Destination: Retirement

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In This Issue

Questions?

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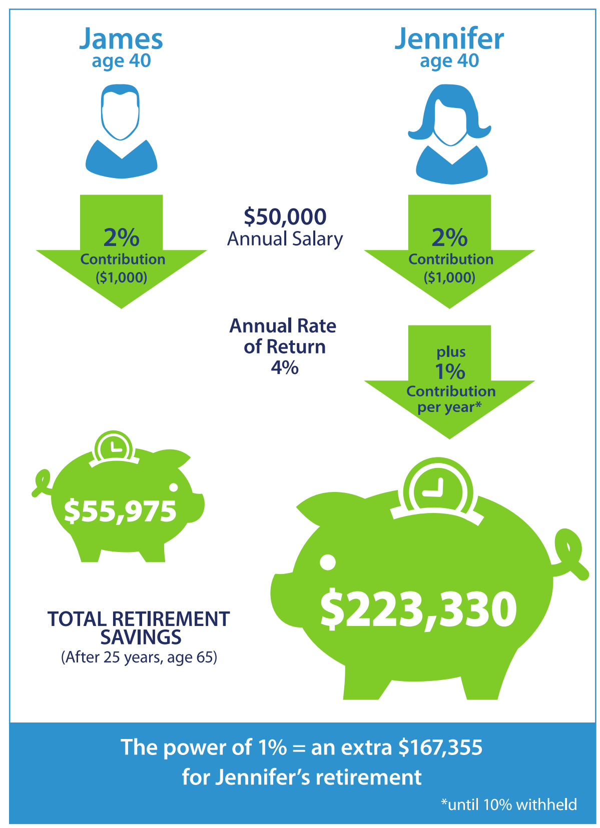
Small Changes Can Add Up to Big Gains

"Small changes add up to big things." In everyday life, this bit of wisdom might mean making nutritional tweaks to lose weight or tackling minor home improvement projects to increase the value of your home. When it comes to saving for retirement, committing to steady, incremental changes in your 401(k), 403(b), or other workplace retirement plan can have a big impact on your retirement nest egg. Below is an example that demonstrates how depositing just 1% more of your annual salary into your retirement account can make a significant difference in your savings.

The Power of 1%

James, age 40, earns $50,000 per year. Every year he contributes 2% of his salary into his 401(k) plan account.

Assuming his salary doesn't change, if James continues to do this for the next 25 years, his account will have a balance of $55,975 when he retires at age 65.



Authored by the Retirement Consulting Services team at Commonwealth Financial Network and Canby Financial Advisors.

Let's contrast James' saving efforts with Jennifer, who also is 40, earns $50,000 per year, and contributes 2% of her salary into her 401(k) plan account every year.

But unlike James, Jennifer increases her 401(k) contribution by 1% each year until she reaches an annual 10% contribution. When Jennifer retires at 65, her account balance will be $223,330. By making small, steady changes, Jennifer will earn $167,355 more than James.

Both examples assume James's and Jennifer's accounts will achieve an average annual rate of return of 4% over 25 years. In reality, their returns will vary year by year, depending on how their assets are invested. In some years, returns may be much higher. In other years, returns may be lower or even negative.

Can you increase your contribution to your 401(k) or 403(b) account each year until you reach at least 10%? Many companies make it convenient for you by automatically increasing your contribution (usually in 1% increments) each year. Ask your benefits department or retirement plan advisor if your company offers a program like this.

By making small changes over time, you'll barely notice the change in your paycheck, but you'll be taking a giant leap toward a more prosperous financial future.

Three Year-End CARES Act Opportunities

If you're like many people, you may not have been paying a lot of attention to the details of the Coronavirus Aid, Relief and Economic Security (CARES) Act when it was enacted in March of this year. This legislation is designed to provide financial aid and relief to Americans affected by the economic impact of COVID-19.

While some of its provisions will still be available in 2021, several expire on December 31, 2020. Here are three opportunities you may want consider taking advantage of this year.

1. Charitable Deductions for All

If you don't itemize tax deductions, the CARES Act lets you take a one-time deduction of up to $300 for cash gifts made to qualified charitable organizations in 2020. If you can itemize deductions, you can deduct all of your cash donations, up to 100% of your adjusted gross income (AGI). This opportunity will be available in 2021 as well.

2. COVID-related early withdrawals

If you're under age 59½ and you or your family faces extreme financial hardships due to COVID-related medical expenses or a spouse or partner losing their job, you may be able to withdraw up to combined total of $100,000 from your 401(k) plan and IRA accounts without having to pay early withdrawal penalties. You can also waive the 20% mandatory federal tax withholding. To qualify, you must meet IRS requirements (view these criteria at https://bit.ly/2I2vq8y).

Keep in mind, however, that these withdrawals will still be taxable as ordinary income. Fortunately, you can spread the taxes you'll have to pay over a three-year period, rather than having to declare the total amount withdrawn as taxable income on your 2020 tax returns.

You can also recontribute the amount you withdraw at any time over the next three years to your retirement accounts and request a federal tax refund for the taxes you've paid. For example, you can take a COVID-19-related distribution in 2020, spread the amount as taxable income for 2020, 2021, and 2022, and repay the full amount to one or more retirement accounts in 2022.

Commonwealth Financial Network® does not provide legal or tax advice. Please contact your legal or tax advisor for advice on your specific situation.

Then in 2022, you can file amended federal income tax returns for 2020 and 2021 to claim a refund of the taxes you paid each year on the original withdrawal. And you won't have to include any income from the withdrawal on your 2022 federal tax return. Note that these refile/refund provisions may not necessarily apply to any state taxes you paid.

As tempting as it may be to make these withdrawals, it should be the option of last resort. This money is meant to be used during your retirement, and any withdrawals you make before that time could affect your ability to live the way you want after you retire. This opportunity expires on December 31, 2020.

3. Greater flexibility for HSAs and FSAs

If you have a tax-free Health Savings Account (HSA) or Flexible Saving Account (FSA) that reimburses you for out-of-pocket healthcare-related expenses, you can now use these accounts to pay for over-the-counter medications without having to get a prescription first. Funds in these accounts can also be used to pay for menstrual products. This is a permanent change.

Before you take advantage of any of these CARES Act-related provisions, you may want to meet with a tax professional or financial advisor to help you understand their potential impact on your taxes and personal finances.

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