RBC Wealth Management

WealthMonitor

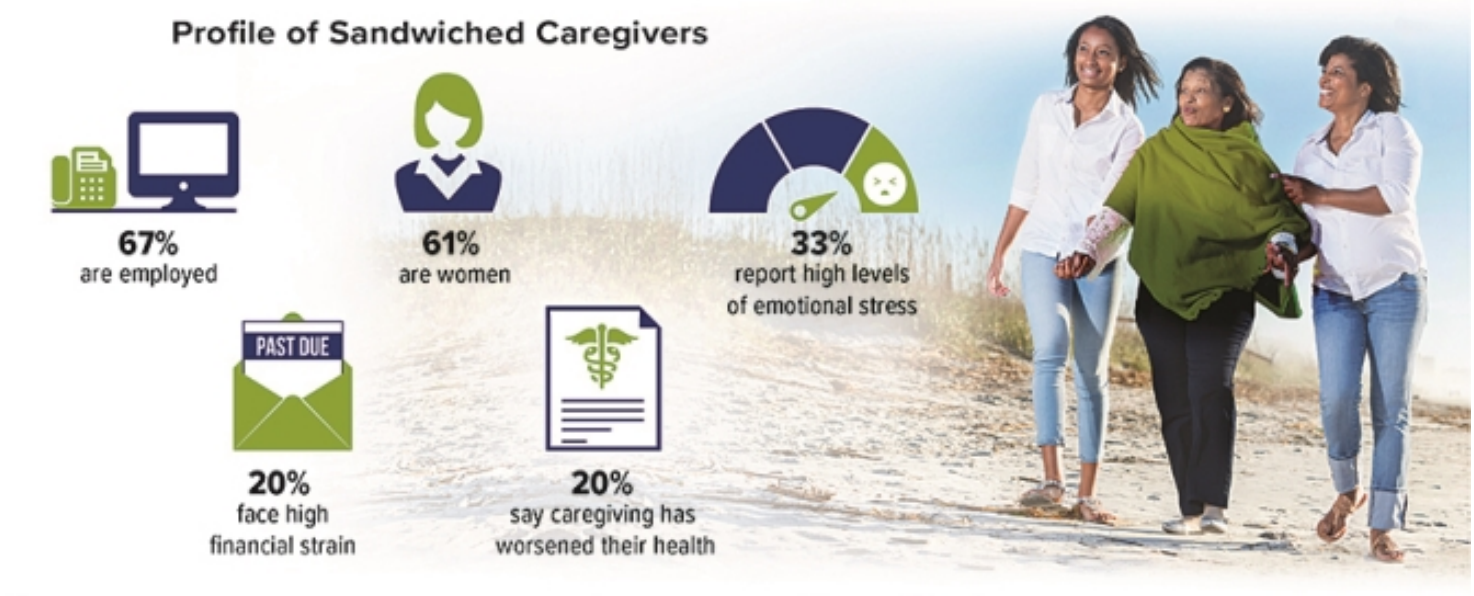


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Sandwich Generation Caregivers Face Many Challenges

Individuals in the "sandwich generation" have the dual responsibility of providing care for an adult — often a parent — while also raising children. Caring for others can be very rewarding, but the day-to-day demands of supporting multiple generations can take a financial, emotional, and physical toll on sandwiched caregivers.



Source: National Alliance for Caregiving, 2019

Is It Time to Think About Tax-Free Income?

Federal and state governments have spent extraordinary sums in response to the economic toll inflicted by the COVID-19 pandemic. At some point it is likely that governments will look for ways to increase revenue to compensate for this spending and increase income taxes as a result. That's why it might be a good time to think about ways to help reduce your taxable income. Here are three potential sources of tax-free income to consider.

Roth IRA

Contributions to a Roth IRA are made with after-tax dollars — you don't receive a tax deduction for money you put into a Roth IRA. Not only does the Roth IRA offer tax-deferred growth, but qualified Roth distributions including earnings are not subject to income taxation. And the tax-free treatment of distributions applies to beneficiaries who may inherit your Roth IRA.

Municipal Bonds

Municipal, or tax-exempt, bonds are issued by state and local governments to supplement tax revenues and to finance projects. Interest from municipal bonds is usually exempt from federal income tax. Also, municipal bond interest from a given state generally isn't taxed by governmental bodies within that state, though state and local governments typically do tax interest on bonds issued by other states.

Health Savings Accounts

A health savings account (HSA) lets you set aside tax-deductible or pre-tax dollars to cover health-care and medical costs that your insurance doesn't pay. HSA funds accumulate tax-deferred, and qualified withdrawals are tax-free. While an HSA is intended to pay for current medical and related expenses, you don't necessarily have to seek reimbursement now. You can hold your HSA until retirement then reimburse yourself for all the medical expenses you paid over the years with tax-free HSA distributions — money you can use any way you'd like. Be sure to keep receipts for medical expenses you incurred.

The Congressional Budget Office estimates that the federal budget deficit will be roughly $3.7 trillion in fiscal year 2020 and $2.1 trillion the following fiscal year. By comparison, the federal budget deficit for fiscal year 2019 was $984.4 billion.

Sources: Congressional Budget Office, April 28, 2020; U.S. Department of the Treasury, May 2020

Municipal bonds are subject to the uncertainties associated with any fixed income security, including interest rate risk, credit risk, and reinvestment risk. Bonds redeemed prior to maturity may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk. Some municipal bond interest could be subject to the federal and state alternative minimum tax. Tax-exempt interest is included in determining if a portion of any Social Security benefit you receive is taxable. Because municipal bonds tend to have lower yields than other bonds, the tax benefits tend to accrue to individuals with the highest tax burdens.

HSA funds can be withdrawn free of federal income tax and penalties provided the money is spent on qualified health-care expenses. Depending upon the state, HSA contributions and earnings may or may not be subject to state taxes. You cannot establish or contribute to an HSA unless you are enrolled in a high deductible health plan (HDHP).

To qualify for the tax-free and penalty-free withdrawal of earnings, a Roth IRA must meet the five-year holding requirement and the distribution must take place after age 59½ or due to the owner's death, disability, or a first-time home purchase (up to a $10,000 lifetime maximum).

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

Five Investment Tasks to Tackle by Year-End

Market turbulence in 2020 may have wreaked havoc on your investment goals for the year. It probably also highlighted the importance of periodically reviewing your investment portfolio to determine whether adjustments are needed to keep it on track. Now is a good time to take on these five year-end investment tasks.

1. Evaluate Your Investment Portfolio

To identify potential changes to your investment strategy, consider the following questions when reviewing your portfolio:

- How did your investments perform during the year? Did they outperform, match, or underperform your expectations?
- What factor(s) caused your portfolio to perform the way it did?
- Were there any consistencies or anomalies compared to past performance?
- Does money need to be redirected in order to pursue your short-term and long-term goals?
- Is your portfolio adequately diversified, and does your existing asset allocation still make sense?

2. Take Stock of Your Emergency Fund

When you are confronted with an unexpected expense or loss of income, your emergency fund can serve as a financial safety net and help prevent you from withdrawing from your investment accounts or being forced to pause your contributions.

If you haven't established a cash reserve, or if the one you have is inadequate, consider how you might build up your cash reserves. A good way to fund your account is to earmark a percentage of your paycheck each pay period. You could also save more by reducing your discretionary spending or directing investment earnings to your emergency account.

3. Consider Rebalancing

A year-end review of your overall portfolio can help you determine whether your asset allocation is balanced and in line with your time horizon and goals. If one type of investment performed well during the year, it could represent a greater percentage of your portfolio than you initially wanted. As a result, you might consider selling some of it and using that money to buy other types of investments to rebalance your portfolio. The process of rebalancing typically involves buying and selling securities to restore your portfolio to your targeted asset allocation based on your risk tolerance, investment objectives, and time frame. For example, you might sell some securities in an overweighted asset class and use the proceeds to purchase assets in an underweighted asset class; of course, this could result in a tax liability.

Year-End Investment Checklist



Remember that asset allocation and diversification do not guarantee a profit or protect against loss; they are methods to help manage investment risk. All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

4. Use Losses to Help Offset Gains

If you have taxable investments that have lost money and that you want to sell for strategic reasons, consider selling shares before the end of the year to recognize a tax loss on your return. Tax losses, in turn, could be used to offset any tax gains. If you have a net loss after offsetting any tax gains, you can deduct up to $3,000 of losses ($1,500 if married filing separately). If your loss exceeds the $3,000/$1,500 limit, it can be carried over to later tax years.

When attempting to realize a tax loss, remember the wash-sale rule, which applies when you sell a security at a loss and repurchase the same security within 30 days of the sale. When this happens, the loss is disallowed for tax purposes.

5. Set Goals for the New Year

After your year-end investment review, you might resolve to increase contributions to an IRA, an employer-sponsored retirement plan, or a college fund in 2021. With a fresh perspective on where you stand, you may be able to make choices next year that could potentially benefit your investment portfolio over the long term.

Three Questions to Consider During Open Enrollment

Open enrollment is your annual opportunity to review your employer-provided benefit options and make elections for the upcoming plan year. You can get the most out of what your employer offers and possibly save some money by taking the time to read through your open enrollment information before making any benefit decisions. Every employer has its own open enrollment period (typically in the fall) and the information is usually available online through your employer.

What are your health plan options? Even if you're satisfied with your current health plan, it's a good idea to compare your existing coverage to other plans being offered next year. Premiums, out-of-pocket costs, and benefits often change from one year to the next and vary among plans. You may decide to keep the plan you already have, but it doesn't hurt to consider your options.

Should you contribute to a flexible spending account? You can help offset your health-care costs by contributing pre-tax dollars to a health flexible spending account (FSA), or reduce your child-care expenses by contributing to a dependent-care FSA. The money you contribute is not subject to federal income and Social Security taxes (nor generally to state and local income taxes), and you can use these tax-free dollars to pay for health-care costs not covered by insurance or for dependent-care expenses. Typically, FSAs are subject to the use-it-or-lose-it rule, which requires you to spend everything in your FSA account within a calendar year or risk losing the money. Some employers allow certain amounts to be carried over to the following plan year or offer a grace period that allows you to spend the money during the first few months of the following plan year.

Tip: As a result of unanticipated changes in the need for medical and dependent care due to the coronavirus pandemic, the IRS announced it will allow employers to amend their employer-sponsored health coverage, health FSAs, and dependent-care assistance programs and allow employees to make certain mid-year changes for 2020. The carryover limit for unused 2020 FSA dollars is now $550 instead of $500. For more information, visit irs.gov.

What other benefits and incentives are available? Many employers offer other voluntary benefits such as dental care, vision coverage, disability insurance, life insurance, and long-term care insurance. Even if your employer doesn't contribute toward the premium cost, you may be able to pay premiums conveniently via payroll deduction. To help avoid missing out on savings opportunities, find out whether your employer offers other discounts or incentives. Common options are discounts on health-related products and services such as gym equipment and eyeglasses, or wellness incentives such as a monetary reward for completing a health assessment.

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