REFLECTIONS

Client Newsletter

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To Your Future Prosperity

YEAR ROUND TAX REDUCTION STRATEGIES

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Taxes are on investors' minds earlier than usual this year, as the American Families Plan proposal makes many important changes to the current law. If this bill becomes law, we will provide a more detailed analysis. For the moment, key changes include an increase in the top tax bracket and an increase in capital gains rates on families making more than $500,000.

While current changes remain cloudy, there is always an opportunity to plan for taxes all year long. Waiting until next April can lead to tax mitigation triage, with investors looking for a way to throw a couple of thousand dollars somewhere at the last minute. Examples below will discuss why year-round tax preparation is important, and what you can do to start right now, even while we wait for any tax changes to become law.

The Real Tax Day

Bill got a new job in February in his chosen career. During onboarding, he calculated what his income was going to be for the year, following the IRS guide carefully.

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Five Star Award Winner

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Bill exceeded expectations in his job and was promoted to manager in September. He also received a significant raise. Little did he realize that he had entered a new tax bracket. Because he did not make any changes to his tax plan, Bill will have a hefty tax bill for the year.

Here is another example: Sally earned the same as she did last year with no other notable changes to her income. Her investment portfolio, however, had a very strong year of dividends and capital gains. This portfolio activity would drastically impact her tax strategy, unless she was wise and implemented a tax-loss harvesting strategy with any investments that did not perform well.

It is unwise to only evaluate your taxes at tax time because your tax situation is constantly open to change. Too often taxpayers fall into the mindset that they pay taxes once a year. The truth is that you pay taxes every single day; April is just when everyone checks for mistakes, either overpayments or underpayments throughout the year.

You need to evolve your strategy and increase or decrease your tax reduction tactics depending on the changes in your day-to-day life. If your income goes up, so might your retirement savings. If you lose your primary job and start a part-time side hustle, you may need to stop any withholdings until you get back on your feet.

Most comprehensive tax mitigation plans simply will not work unless you implement them throughout the whole year. Here are a few strategies that you can begin to implement now to keep the taxman at bay.

Winning at Taxes

One incredible tax reduction strategy for your current income year is a pre-tax retirement savings account. 401(k)s, 403(b)s, and Simple IRAs are different examples of pre-tax plans. Designed to encourage retirement saving, they send your tax liability down the road into

retirement. This allows you to avoid paying taxes on the money you put into savings during this tax year and pay the taxes on your withdrawals during retirement instead.

Health Savings Accounts (HSA) are another good option to help lower the current year's tax bills. HSAs are savings plans designed to aid people with high-deductible health insurance. If the contributions that you make are spent only on medical expenses, they will never be taxed. Just remember, to fully take advantage of the tax benefits of an HSA, you must make deposits directly from your paycheck, just like with a 401(k).

Charitable contributions are another great way to reduce your tax liability this year. Donating to a qualified recipient reduces your income tax liability in the form of a deduction. If you are going to have to pay an arm and a leg to the IRS, why not give to a cause you support instead?

It should be noted that winning at taxes does not always mean using pre-tax savings plans to defer your taxes down the road. The idea of wealth management is to grow wealth, which is probably what you are planning to do. If you only focus on saving tax money today, you might end up paying more in the future when you start to use the assets you have accumulated.

For example, suppose that you expect to make $150,000 per year as income during your working years. However, if you expect an annual withdrawal of $300,000 from retirement, waiting to pay your taxes until later, might not make sense. In situations like these, it probably makes more sense to pay the taxes now but invest in post-tax savings like a Roth IRA.

Roth IRAs and Roth 401(k)s offer retirement savings where you pay your taxes now on your income but all the growth from your savings will be tax-free on withdrawal. If you have multiple millions of dollars in growth at the time you begin taking money out for retirement, you will likely pay a lot less in taxes by going with a Roth.

Don't Guess

Back in 2014, there were reportedly 2,652 pages of tax law and nearly 70,000 pages of supporting documents. It is much longer now, though

no one can seem to agree how long. But even if you have managed to memorize every word of it, it would not advise you on which tax strategy is best for your unique, personal situation.

As the year draws to a close, now is a great time to review your current tax situation with your CPA and your advisor. With some planning, it can be easy to recommend changes to your retirement or charitable contributions, tax-loss harvesting, stock options strategies, or even simple cash flow if you have a better idea of what taxes might be due in April.

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DOES IT MAKE SENSE TO PAY OFF YOUR MORTGAGE EARLY?

In its French and Latin origination, the translation of the word mortgage is "death pledge." It is not surprising that many individuals dream of the day they can pay off their mortgage, burn the bank note, and live debt free. This is a goal worth celebrating for sure, but does it apply to your own situation? Should you throw every extra dollar toward your mortgage or should you invest that money instead? Like most financial choices, the answer is going to differ depending on your unique situation. Let's look at the pros and cons of each strategy.

What Will Give You the Most Growth?

The most important factor when evaluating your options is that of growth. A dollar spent paying down a mortgage is one that could be invested elsewhere. You want your money to work for you, so the question to ask is, "What option will give you the biggest payoff?" In this case, you will find the answer by pitting your mortgage interest rate against your expected investment return. You can calculate some rough numbers to assess which decision would make more financial sense.

Let's look at an example to give you some context. Say your mortgage interest rate is 5%. If you estimate that, based on your risk tolerance and time horizon, you can pursue an investment return of 4%, it would make more sense to pay down your mortgage. Otherwise, you are potentially throwing away 1%. However, if you are not as conservative with your investments and believe you could earn 8% on your investment, it might be more beneficial to invest.

This may sound simple on paper, but there are plenty of factors that could affect the outcome. And as we all know, even the best return estimates are far from guaranteed. It is important to run a thorough analysis and consider taxes on investments, mortgage interest deductions, risk, and private mortgage insurance, among the other elements of your financial life.

Weighing Your Options

There are some pros and cons to each choice that go beyond the raw math. Liquidity is a significant pro for investing since you will have greater access to the funds in case of an emergency. If you put the money toward your mortgage, for all intents and purposes, it is not accessible. The only way to get the money back is to sell your house or refinance your mortgage.

On the other hand, an advantage to paying down your mortgage is that your house will be paid off sooner. You will have a greater chance of being able to enter retirement without a mortgage, or at least have your mortgage paid off earlier in retirement. This lets you free up more cash flow for your retirement. If you invest, your mortgage will be another bill you have to pay while in retirement.

The Diversification Question

When it comes to minimizing risk, we have all heard of the importance of diversifying our investments. In this case, if you are heavily invested in real estate, paying off your mortgage will add even more eggs to the same basket. If the housing market crashes, so will a significant chunk of your portfolio. From a risk standpoint, you may be better off holding onto the mortgage and keeping your portfolio more diversified.

Is Being Debt-Free Important to You?

Let's say that you have a relatively low interest rate and are not worried about paying another bill in retirement. Does that mean you should hold on to your mortgage? Not necessarily, because there is a factor that cannot be calculated or plugged into a formula: peace of mind.

Some people do not want to have any debt to their name and eliminating it would relieve them of a financial burden. Others have no problem carrying debt if it makes financial sense and they are being wise with their money. When deciding whether you should pay off your mortgage, do not forget to factor in your values and how you feel about debt.

It's Not All or Nothing

For some people, it may make more sense to choose a combination of these two choices. Maybe that looks like adding more money to each mortgage payment to bring down the principal while still putting the bulk of your extra money in other investments. Paying off your mortgage is a big financial decision, and before making such important decisions, it is always a good idea to consult with a financial advisor.

SHOULD YOU INVEST YOUR HEALTH SAVINGS ACCOUNT INTO A BROKERAGE ACCOUNT?

So, you have maxed out your retirement savings with an IRA and 401(k), now what? The lesser-known Health Savings Account (HSA) might be your answer. Many investors are unsure of how they can maximize their HSA to protect their health and create a more well-rounded retirement plan. Here we will explore what makes an HSA different from other retirement savings accounts and who it can help.

What Is a Health Savings Account?

An HSA is a special fund for anyone in a high-deductible health insurance plan (HDHP). For 2021, the deductible sum for employees on an HDHP ranges from $1,400-$7,000 for individuals and $2,800-$14,000 if it also provides for your family.[1] If qualified, you can open an HSA account at any provider compatible with your insurance, then you deposit contributions into the HSA by deducting a specified amount from your salary (or self-employed income).

A Health Savings Account is a tax-advantaged account that you can use to pay for current or future IRS-qualified medical expenses. Unlike popular Flexible Spending Accounts (FSA), with an HSA there is no "use it or lose it" provision – meaning funds you do not spend roll over into the following year. Your HSA also stays with you if you change jobs, so the benefit is not locked to your current employer. The annual contribution limit is $3,600 for individuals and $7,200 for family coverage, with a $1,000 catch-up addition for those over 50.

[1] https://www.healthcare.gov/high-deductible-health-plan/

Benefits of a Health Savings Account

An HSA provides tax savings in three ways. Here's how:

1. Contributions to your HSA are tax deductible: any HSA contributions reduce taxable income
2. HSA interest and investment earnings grow tax-free
3. When used for IRS-qualified medical expenses, distributions are tax-free

HSA deductions can be made up until your tax filing deadline. They are "above the line," meaning they can help you shrink your adjusted gross income or modified AGI before the calendar strikes April 15th. Notably, there are no income limits and no phase-outs for HSA tax deductions. This means that HSA contributions can help affluent investors who have been phased-out of tax benefits and minimize their exposure to the 3.8% surtax on net investment income.

Can You Invest Your Health Savings Account into a Brokerage Account?

Smart planners might think of an HSA as a "Medical IRA." By investing HSA funds for a later date when you will need to pay for medical costs, you can allow your funds to grow tax free. To invest in your Health Savings Account, you typically open a specific health savings brokerage account. The brokerage account links to your HSA and allows you to invest in a variety of stocks, bonds, mutual funds, and ETFs. You can invest some or all your HSA, allowing you to plan for more near term medical costs or focus on longer term growth and tax savings.

Preparing for medical expenses and other health-related emergencies should be a key part of your comprehensive financial plan. As retirement approaches, the cost of your health-related needs can be your biggest financial burden. Saving in a tax-smart manner can leave more of your assets available to fund inevitable health care costs.

Choosing to invest in an HSA brokerage account can have a far-reaching effect on how productive and financially rewarding your health savings will be for you down the line. At Windgate Wealth Management, we know just how to help you achieve affordable healthcare and a reassuring retirement plan by analyzing your particular portfolio risks and recommending the best health savings option.

FIVE STAR AWARD WINNER

We, at Windgate Wealth Management are the proud recipient of the Five Star Wealth Manager Award for the 7th year in a row. The Five Star Wealth Manager Award is committed to identifying and qualifying a select group of advisors who have a strong commitment to their clients and service, quality of their practice, and professional accomplishments.

Five Star Professional employed a rigorous research process to identify the Five Star Wealth Manager award winners in the Chicago area. Award-winning professionals were carefully selected from among thousands of wealth managers for their knowledge, service, and experience. Award winners represent an exclusive group of wealth managers who have demonstrated excellence in their field by satisfying 10 objective selection criteria.

To view the award, go to: https://fivestarprofessional.com/spotlights/87105/ or find us in the October issue of *Chicago Magazine*.

Michael Corbett, CEO/CIO and Sean Condon, CFP®

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The Five Star Wealth Manager award, administered by Crescendo Business Services. LLC (dba five Star Professional), is based on 10 objective criteria Eligibility criteria - required: l. Credentialed as a registered investment adviser or a registered investment adviser representative; 2. Active as a credentialed professional in the financial services industry for a minimum of 5 years; 3. Favorable regulatory and complaint history review. (As defined by Five Star Professional, the wealth manager has not: A. Been subject to a regulatory action that resulted in a license being suspended or revoked, or payment of a fine; B. Had more than a total of three customer complaints filed against them settled or pending] with any regulatory authority or five Star Professional's consumer complaint process. Unfavorable feedback may have been discovered through a check of complaints registered with a regulatory authority or complaints registered through Five Star Professional's consumer complaint process; feedback may not be representative of any one client's experience; C. Individually contributed to a financial settlement of a customer complaint filed with a regulatory authority; D. Filed for personal bankruptcy; E. Been convicted of a felony); 4. Fulfilled their firm review based on internal standards; 5. Accepting new clients. Evaluation criteria considered: 6. One-year client retention rate; 7. Five-year client retention and professional designations. Wealth Managers do not pay a fee to be considered or placed on the final list of Five Star Wealth Managers. Award does not evaluate quality of services provided to clients. Once awarded, wealth managers may purchase additional profile ad space or promotional products. The Five Star award is not indicative of the wealth manager's future performance. Wealth managers may or may not use discretion in their practice and therefore may not manage their client's assets. The inclusion of a wealth manager on the Five Star Wealth Manager list should not be construed as an endorsement of the wealth manager by Five Star Professional or this publication. Working with a Five Star Wealth Manager or any wealth manager is no guarantee as to future investment success, nor is there any guarantee that the selected wealth managers will be awarded this accomplishment by Five Star Professional in the future. Five Star Professional is not an advisor firm, and the content of this article should not be considered financial advice. For more information on the Five Star Wealth Manager award program, research and selection criteria, go to www.fivestarprofessional.com/research

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09.2021