It's Not Too Late – Act Now, Before Annual Enrollment

Some year-end changes, you and your employees might want to consider.

An internet search can easily identify many suggested year-end tax tips.[i]

This article offers an employee benefits version of year-end actions – changes a plan sponsor and/or a participant might consider. ***Always, always consult with benefits and tax counsel before making any decisions or taking any action.***

Annual Enrollment Process

Recognize that this year's annual enrollment is likely to be unique. Be here now. Pay attention. Plan sponsors should consider conducting a full positive enrollment in 2020 for 2021 – committing sufficient resources including individual contact with every associate (recognizing that in-person meetings are not anticipated, and that many, perhaps most employers do not expect to make significant changes in coverage options). (Re)consider every available option.

Plan Sponsor Actions to Consider

- Add a Health Savings Account (HSA) -capable coverage option effective ***December 1, 2020*** (or if it is too late, reconsider in time for December 1, 2021). That option is available whether or not you already offer an HSA-capable coverage option. You will want to consider using a 13-month deductible (for the period December 1, 2020 – December 31, 2021) of say, $1,520 (single) and $3,040 (non-single)[ii]. Employees could make a mid-year change in coverage and contribute the HSA maximum for 2020 ***AND*** 2021 – Single tier: $3,550 (2020), $3,600 (2021); Non-Single tier: $7,100 (2020), $7,200 (2021); as well as the per person catch-up for those age 55+ as of December 31st : $1,000 (2020 and 2021). For everyone who enrolls in HSA-capable coverage, consider a $1 employer contribution on the first day of HSA-capable coverage – to open the HSA account and to start the HSA claims clock running. That is, eligible expenses include all items incurred on or after the date the HSA is opened, even if contributions don't occur until after the expense is incurred. Careful administration is necessary for individuals currently enrolled in a general Health Flexible Spending Account (Health FSA). See Sidebars #1 and #2 – illustrating the value of HSA-capable coverage and savings.

Sidebar #1: An HSA offers participants tax preferred utility capable of quadruple duty:

- Now, Before Retirement: Fund (via contributions or investment earnings) current or future medical, dental, vision, hearing and long-term care (LTC) expenses, COBRA and LTC premiums.
- Future, Retiree Medical: The same as above, plus Medicare Part B & D, and Medicare Advantage premiums,
- Beyond Medical, Retirement Income: HSA assets withdrawn after age 65 access tax preferences that exceed those of the 401k (contributions are pre-tax for FICA and FICA-Med),
- Legacy, No Required Distributions, No Forfeitures: A surviving spouse who is designated the beneficiary can continue the account; a non-spouse, non-dependent beneficiary will ultimately receive any residual as a taxable payout.

Sidebar #2: Medical costs are often a retiree's largest expense – and employee contributions to a 401k may offer less value when compared to a comparable reduction in take home pay that is used to fund an HSA[iii]:

HSA or 401(k)?

Reducing Take Home Pay $1,000 / year - 35 Years - Age 30 - 64

Assumed 6% / Year Earnings

Payout in 25 "Equal" Installments - Ages 65 - 90

Assumes No Change in Marginal Tax Rates Throughout the Period

	Health Savings Account	**401(k) Account**
Deposit /Year*	$ 1,603	$ 1,429
Balance At Age 65	$ 183,989	$ 164,017
Annual Payout To Age 90	$ 14,396	$ 12,833
Annual After Tax Value to Age 90	$ 14,396	$ 8,983
Difference in Value		**60.3% MORE!**

* Assumes a 25% federal, 5% state, 6.2% FICA and 1.45% FICA-Med marginal rate

- Add Roth 401k contributions to your 401k plan. The maximum contribution amount is $19,500 in 2021, same as 2020. Keep in mind that Roth 401k contributions are "after-tax" – which means that your 401k plan need not limit contributions to payroll deductions.
- Add "catch-up" contributions to your 401k plan. An individual age 50+ as of December 31, 2020 can contribute $6,500 (catch-up contributions are not subject to non-discrimination testing nor the limits on deferrals or annual additions, IRC §§402(g), 415(c)).[iv] Catch-up can be either pre-tax or Roth 401k contributions. The catch-up limit is unchanged for 2021.
- Add 401(a) after-tax contributions to your 401k plan if it is not a safe-harbor plan (and be careful to limit contributions by highly compensated employees so as to pass the ACP test). The limit on annual additions for 2020 is $57,000 ($58,000 in 2021). These contributions may but need not be made via payroll deduction.
- Add in-plan Roth conversion provisions to your 401k plan. Roth only became available in 2006. Many plan sponsors did not add Roth when it was first available. Many have yet to offer Roth. As a result, some participants may have a lifetime of savings in your plan that will be taxable once distributed. In-plan conversion provisions give participants an opportunity to time the taxation via a Roth conversion - perhaps taking advantage of the somewhat lower federal marginal income tax rates following the Tax Cuts and Jobs Act of 2017.[v] Be careful to consider state income taxes.
- Add employer contribution "true-up" provisions. Due to COVID, some employees may have had periods of employment where they lowered or suspended 401k contributions and didn't get the full employer match. A "true-up" would allow them to obtain the full employer financial support. So, for example, if your plan matches 50% of the 1st 6% of pay, an individual whose contributions averaged 6% of pay would receive the full 3% employer matching contribution (you would perform that calculation at/after year-end).

- Add "liquidity without leakage" in the form of 21st Century plan loan provisions - electronic banking, a change to a line-of-credit structure, and behavioral economics processes, tools and concepts. This added liquidity might have value for those who need money to make a late in the year contribution. Others may need added liquidity in order to continue their contributions if student loan or other debt payments resume early in 2021.

Employee Actions to Consider:

- Max-out your HSA contribution[vi]. If you are already participating in HSA-capable coverage, the annual maximum contribution for 2020 is $3,550 (single tier), $7,100 (non-single tier). And, for those age 55+ as of December 31, 2020, "catch-up" contributions of up to $1,000 are possible (each spouse needs his/her own HSA). And, if it is too late for you to adjust your pre-tax contributions through your employer's cafeteria plan, don't forget that you can make a tax-deductible (above the line) contribution for 2020 as late as April 15, 2021. HSA contribution maximums for 2021 are $3,600 (single), $7,200 (non-single), and $1,000 (per person catch-up).
- Max out 401k plan contributions, including catch-up or 401(a) after-tax contributions.
- Consider converting some 401k taxable savings or taxable IRA assets to a Roth basis – particularly if you or a spouse (if filing jointly) experienced a reduction in wages in 2020, perhaps due to COVID.
- Pay close attention to your Health and Dependent Day Care FSA plan provisions, including any grace periods and carryover provisions. The 2020 Health FSA and Dependent Day Care FSA maximum contributions are $2,750 and $5,000, respectively. Those cafeteria plan pre-tax contribution limits are unchanged for 2021.

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[i] For example, see Intuit/Turbo Tax, Accessed 11/11/20 at: https://turbotax.intuit.com/tax-tips/tax-planning-and-checklists/top-8-year-end-tax-tips/L5szeuFnE See also: AICPA, Financial Planning Tips from AICPA to Act on Before Year-End, 11/17/20. Suggestions include: Prepay real estate taxes, accelerate gifts to charity, pay home business expenses, self-employed to open retirement plan, payments to cover insufficient withholding, pandemic distributions with three year tax averaging/opportunity to repay, Roth IRA Conversion, maximize HSA contributions, leverage capital losses, ensure you contribute enough to maximize the employer match in your 401(k), maximize Roth contributions, review beneficiary designations, gift today to reduce future estate taxes, revisit risk tolerance. Accessed 11/17/20 at: https://www.businesswire.com/news/home/20201117005067/en/14-Financial-Planning-Tips-from-AICPA-to-Act-on-Before-Year-End

[ii] IRS, Notice 2004-50, Q&A24, Accessed 11/11/20 at: https://www.irs.gov/irb/2004-33_IRB#NOT-2004-50

[iii] Author's calculations.

[iv] IRS, Accessed 11/11/20 at: https://www.irs.gov/retirement-plans/401k-plan-fix-it-guide-the-plan-failed-the-401k-adp-and-acp-nondiscrimination-tests#:~:text=These%20nondiscrimination%20tests%20for%20401,of%20the%20HCEs%20and%20NHCEs. https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits#:~:text=Insurance%20Contracts%2C%20etc.-,Overall%20limit%20on%20contributions,but%20not%20catch%2Dup%20contributions)

[v] Tax Cuts & Jobs Act of 2017, Pub. L. 115-97, signed by President Trump on 12/22/17.

[vi] Remember that contributions to a Health Savings Account receive greater tax preferences than an equal amount of contributions to a 401k plan because HSA contributions through your employer's cafeteria plan are pretax for federal and most state income taxes, as well as employee-paid and employer-paid Social Security (FICA) and Medicare (FICA-Med). For comparison, since President Reagan signed the Social Security Amendments Act of 1983 into law, deferrals to a 401(k) plan are pre-tax for federal and most state income tax purposes – not FICA or FICA-Med. More importantly, distributions of pre-tax employee and employer contributions and investment earnings on those monies from your 401k plan are taxable income – taxes are not avoided, only deferred. For comparison, withdrawals from Health Savings Accounts of pre-tax or tax-deductible employee contributions and employer contributions, and investment earnings on those contributions are tax free when received for eligible expenses. Eligible expenses include almost all out of pocket medical, dental, vision, hearing and Long-Term Care (LTC) expenses. Eligible expenses also include LTC premiums (See IRC §7702B). Eligible expenses also include Medicare Part A, B and D premiums (once Medicare coverage starts).