Tax-savings Strategies to Consider in 2021

The Tax Cuts and Jobs Act of 2017 has changed how Americans complete their income taxes.

There may be benefits from some of these changes with strategies to address higher standard deductions and higher retirement plan contributions.

Higher Standard Deductions

The 2021 standard deduction has increased from $12,400 to $12,550 for individuals and from $24,800 to $25,100 for couples; and similar to 2020, fewer taxpayers are likely to itemize their deductions in 2021. Traditional itemized deductions — such as charitable gifts, medical expenses and home mortgage interest — are only useful if their combined total exceeds the standard deduction. And while a higher standard deduction isn't necessarily a bad thing, you still have options if you want to itemize deductions.

1. Deduction "Bunching"

Using a deduction "bunching" strategy, you can front-load certain itemized deductions into a single year, pushing your itemized deduction total above the standard deduction. The strategy alternates between itemizing deductions one year and taking a standard deduction the next, ultimately lowering your long-term tax bill.

Example: Assume that your total itemized deduction, including charitable contributions, typically falls short of, or just over the new standard deduction. Instead of making the charitable contribution each year, you could strategically "bunch" your charitable contributions into one year in order to take advantage of a higher itemized deduction that year.

	$5,000 Charitable Contribution over two years	Result
2021 Deduction (Married filing jointly)	$10,000 State and Local Taxes + $10,000 Mortgage Interest + $5,000 Charitable Contribution ——— = $25,000 Itemized Deduction	$10,000 State and Local Taxes + $10,000 Mortgage Interest + $10,000 Charitable Contribution ——— = $30,000 Itemized Deduction
2021 Standard Deduction	$24,800	$24,800
Additional Itemized Deduction	$200 in 2021 | $200 in 2022	$5,200 in 2022*

This approach could provide an additional **$4,800** in deductions over the same two-year period.

2. Qualified Charitable Distributions

If you’re taking required minimum distributions (RMDs) from your IRA, leveraging a qualified charitable distribution (QCD) strategy can reduce taxable income while taking the standard deduction. This strategy allows you to transfer up to $100,000 per year from your IRA to a qualified charity while reducing the taxable amount of your IRA distribution. The amounts transferred count toward RMD requirements and lower your adjusted gross income and taxable income, which results in a smaller tax liability.

Example: Assume that your joint annual RMD is $25,000. If you allocated $10,000 of that to your favorite qualified charity, you could reduce your taxable income by $10,000. You can still claim your standard deduction of $27,800 ($25,100 plus an additional over-age-65 deduction of $1,350 per person for married filing jointly). If you’re in the 24% tax bracket, this strategy could save you $2,400 in federal taxes — and potentially more in state tax savings.

Taking Part of Your RMD as a Qualified Charitable Distribution (QCD)

	Dividing Distribution Between RMDs and QCDs	Result
Annual RMD = $25,000	$10,000 = QCD $15,000 = RMD	Taxable income: $15,000 24% income tax owed = $3,600 **Income tax savings: $2,400**

3. Higher Retirement Plan Contributions

- Annual 401(k), 403(b) and 457 contribution limits remain unchanged at $19,500.

- Defined Contribution and SEP Plans: $57,000 to $58,000

Maxing out your retirement plan contributions helps in two ways. First, your contributions are tax-deductible, which can help lower your tax bill during your working years. Secondly, by contributing more money during your career, compounding interest will help your nest egg grow.

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*Does not take into account annual inflation adjustment.

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