Understanding Tax Planning

The importance of tax planning goes beyond keeping cash out of Uncle Sam's hands. You're also preparing yourself for a secure retirement. Here are a couple of tax planning tips that are easy to do.

Here's the very first thing the tax experts at Kiplinger stress to readers about tax planning: *This is not a game just for the wealthy*. *Tax planning will save you money*.

I'm most certainly not wealthy at this stage of my career, but I'm not going to get rich by giving away more money to Uncle Sam every year than I need to. So I'm happy and eager to do some tax planning, but what does that really mean?

Just because I work at Kiplinger doesn't mean I'm an expert (yet!) in tax planning, but I'm surrounded by several friendly experts (and their writings). Follow me as I explore the topic -- with a goal of trimming my tax bill next spring by more than $100 thanks to some newfound tax-planning tips. You'll come away with an understanding of the basics of tax planning so that you can make some smart money-saving moves of your own.

The tax bill you owe each spring is based on the working, saving, investing, spending, business and other personal decisions you make during the year. At its core, tax planning revolves around reducing what Uncle Sam considers taxable income to let you save or spend more of your money. For me, a childless, healthy single person, that means reviewing my retirement and **health savings account contributions** -- my best bets for tax breaks that can reduce my taxable income. (Others can apply tax-planning principles

For example, let's assume you make $50,000 per year and make no contributions to your 401(k); you'd face a $6,790 tax bill, leaving you with $43,210 in take-home pay -- and no money stashed away for your future self.

Now, let’s consider a 401(k) contribution of 4%, or $2000. Your taxable income would be reduced to $48,000, and Uncle Sam’s cut will fall to $6,350.

And if you boost retirement savings to 6%, or $3,000, that lowers your taxable income to $47,000 -- for a savings of $220 on your tax bill. Take a look at how you pay Uncle Sam less and pay yourself more as you increase your 401(k) contributions:

Your tax savings are multiplied if you also boost contributions to a health savings account. A health savings account is a powerful tool to cover out-of-pocket medical expenses: HSA contributions are tax-deductible (just like 401(k) contributions), contributions made by your employer are excluded from your taxable income, the funds grow tax-deferred in the account, and withdrawals are tax-free for qualified medical expenses, without a time limit. In 2020, you can contribute up to $3,550 if you have self-only coverage or up to $7,100 for family coverage if you are enrolled in a health plan with a deductible of at least $1,400 for self-only coverage or $2,800 for family coverage.

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