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Financial Solutions for the Life You Are Living and the One You Want to Live

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FALL 2014

Tax Planning as You Age

While tax planning should be a consideration through all phases of life, the nature of that planning changes as you approach retirement age. During your working years, your primary tax planning objectives are to reduce your current income taxes while saving for retirement. After decades of accumulating money, you now need to ensure you withdraw and manage that money properly. Here are some tips:

Rolling out of a 401(k) — If you don't want to leave your funds in your 401(k) plan, you should consider transferring your money to an individual retirement account (IRA). You can now transfer directly to a Roth IRA. While there are no income tax ramifications if you rollover from a 401(k) plan to a traditional IRA, you do have to pay taxes on the amounts that would be taxable when withdrawn when converting to a Roth IRA (i.e., contributions and earnings in deductible IRAs and earnings in nondeductible IRAs). However, if you pay the income taxes from funds outside the IRA, you have essentially increased the value of your IRA, since you won't have to pay income taxes on qualified withdrawals.

If you own stock in your employer's company in your 401(k) plan, consider those assets separately. There is a provision in the tax code that may save you a substantial amount of taxes. Instead of rolling over the company stock, have the shares distributed to you and put them in a taxable account. You will owe ordinary income taxes on the cost basis of those shares, which equals the price that was paid when the stock was purchased. (If you take the distribution prior to age 59½, you may also owe the 10% federal income tax penalty on the cost basis.) At this point, you do not pay taxes on any appreciation in

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End of 2014 and Start of 2015 Financial Moves

It is that time of year again. It is time for some end of the year adjustments as well as planning for changes going into year 2015.

Some adjustments to continue to take advantage of this year.

Before 12/31/2014:

1. Donate cash or appreciated securities to your favorite charity(s) and/or start your own family foundation
2. Donate and itemize new and used clothing to a local nonprofit (**http://www.bankrate.com/finance/money-guides/tax-guide-for-donated-goods.aspx**)
3. Review 401(k) contribution. The maximum for Year 2014 is $17,500. If you are age 50 OR over; there is an extra $5,500 allowance for $23,000 maximum.

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Tax Planning

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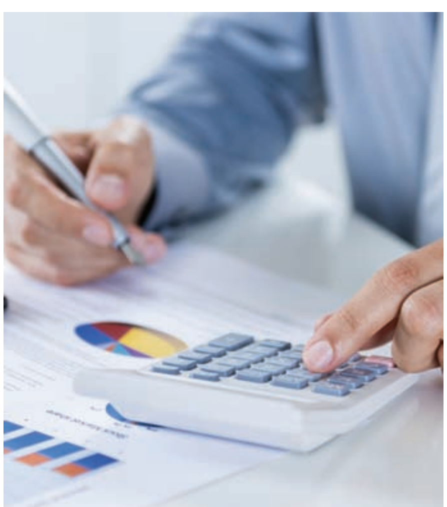
the stock's value. When you sell the stock, provided you have held it for at least one year, you will owe capital gains taxes at a maximum rate of 20% on the net unrealized appreciation, rather than ordinary income taxes that would be paid on other traditional IRA distributions. If you have substantial appreciation in your company stock and are in a high marginal tax bracket, this strategy can save you a substantial amount of taxes.

Handling an inherited IRA — IRAs are becoming an increasingly significant asset for many people due to 401(k) rollovers and asset growth. Thus, it is becoming more likely that you will inherit an IRA. Don't immediately cash out an inherited IRA, which requires the payment of income taxes on the distribution. If you inherit a traditional IRA from a spouse, you can delay distributions until age 70½ and then take distributions over your life expectancy. No distributions are required during your life if it is a Roth IRA. If you inherit the IRA from someone other than your spouse, you must start taking distributions in the year following the owner's death, but you can take those distributions over your life expectancy. Make sure to investigate whether you are entitled to an income in respect of a decedent (IRO) deduction, which is available when federal estate taxes are paid on IRA assets. This deduction can help offset income taxes due on distributions.



Dealing with a second home — If you plan on moving after retirement, you might want to acquire a home in that location before retirement. But first, be aware of the 1031 exchange rules. These rules allow you to sell one property and purchase another of like kind, deferring any gains. For instance, this tax rule can be used to help acquire a retirement home. Start out purchasing a small investment property. You can sell it at a later date and purchase a more expensive property, deferring the gains. You can continue this process until you eventually purchase your retirement home. However, before living in the home, you must first rent it out to defer the gain. While there are no clear-cut rules on how long the home must be rented, the Internal Revenue Service has validated a two-year period. After that, you can move into your retirement home and use it as your principal residence. As long as you live in the home for two of the last five years before selling, you could then sell the home and exclude $250,000 of gain if you are single and $500,000 of gain if you are married filing jointly.

When purchasing the second home, be sure to get a mortgage on that property rather than a home-equity loan against your principal residence. Interest is only deductible on $100,000 of a home-equity loan, while the entire interest on a mortgage up to $1,000,000 would be deductible.

Selling a business — Many business owners find that their business comprises a substantial portion of their net worth. Thus, when it comes time to sell that business, they naturally want to negotiate as large a selling price as possible. But keep in mind that there are many ways to structure a sale. You might want to consider an installment sale, so the gain is recognized over a period of years rather than a single year. You may want to consider including a consulting contract for a period of years. If you are selling the business to employees, an employee stock ownership plan may make sense.

Reviewing your estate plan — As you approach retirement, it's a good time to review your entire estate plan. While the estate tax exemption is large ($5,340,000 in 2014), estate-planning strategies should still be considered. Those with large estates probably don't want to leave their entire estate to their spouse. While that will avoid estate taxes on the first spouse's death, estate taxes may be owed after the second spouse's death if the estate is larger than the estate tax exemption. While changing estate tax exemption amounts can make it more difficult to plan, you should still consider leaving part of your estate to other heirs. If you don't want to make outright distributions in case your spouse needs the assets, you can set up a trust (commonly referred to as a credit shelter or bypass trust) to hold those assets. Your spouse can then use the income and even some of the principal, with the remaining assets distributed to your heirs after his/her death. This preserves the use of your exclusion amount. You may also want to add a disclaimer provision to your estate-planning documents, detailing what happens if one of your heirs disclaims his/her inheritance. This provides a way for heirs to decide after your death how much should be placed in various trusts.

These are only a few situations to consider as you approach retirement age. Please call if you'd like to discuss your specific situation in more detail. ❍❍❍

A Budget Is Your Savings Plan's Best Friend

Your budget holds your savings plan together and is the key to maintaining healthy savings. A budget also shows you where your money is going every month so that you can ensure you are bringing in more than is going out and saving enough to meet your goals.

4 Steps to Creating a Budget and Sticking to It

✔ **Track where your money goes** — If you don't know already, it may take 3–4 months for you to get a really good idea of where you spend money and how much you spend. You can track your expenses using your bank statements, receipts, or logging it into a journal or smartphone app. Add up the total for each month and then average it out.

✔ **Put your budget on paper** — Once you've tracked your expenses, put your budget on paper. In the expenses column, include all expenses: groceries, gas, housing, clothing, entertainment, gifts, and so on. In another column, input your income. If you have a salary, you can input how much you receive each paycheck; but if your income varies, you can use the average of the last three months. Subtract your expenses from your income to see how much money you have left every month. If you have a negative number, you know you need to make some changes in your budget.

✔ **Keep looking for ways to increase your savings** — Almost all expenditure categories offer potential for savings. With essential expenses with fixed amounts, such as your mortgage, taxes, and insurance, you may be able to refinance your mortgage, find strategies to help reduce taxes, or comparison shop your insurance to reduce premiums. Essential expenses that vary in amount, such as food, medical care, and utilities, can usually be reduced by altering your spending or living habits. Discretionary expenses, such as entertainment, dining out, clothing, travel, and charitable contributions, typically offer the most potential for spending reductions.

✔ **Reevaluate** — It is critical to reevaluate your budget after the first few months to ensure that it fits your needs and goals. If you find that you are continuously spending more money than budgeted for necessities, adjust your budget. Once you get past the first few months with a new budget, reevaluate every six months or as needed.

Having a budget is key to saving money. Without one, it is easy to spend money blindly. A pair of shoes here, a power tool there, a toy for your child — it all adds up. If you don't decide where to spend your money and how much to spend each month, chances are you will not be saving. Please call if you'd like to discuss this in more detail. ❍❍❍

Government Bonds and the Economy

The government finances debt by selling U.S. debt obligations — Treasury securities or Treasuries. The issuance of federal debt securities brings in money that's used to pay for regular government spending. In 2013, for example, the federal government ran a $680 billion budget deficit — financed by Treasury securities. The issuance of new Treasuries is also used to pay off maturing debt securities. In 2013, the U.S. issued approximately $7.9 trillion in securities.

Who owns that debt? Social Security funds hold 16% of the debt, other federal government funds hold 13%, the Federal Reserve holds 12%, China holds 8%, Japan holds 7%, other foreign nations hold 19%, state and local governments hold 3%, mutual funds hold 6%, and all other holders account for 17%.

Generally, shorter-term Treasuries pay lower interest rates because they're less risky. Because Treasuries are fixed-income securities, there is risk inherent in longer-term investment. It's easier to foresee how the market might change in three months than in 10 years; hence, the yields that longer-term securities pay are typically higher.

Whether you should invest in government bonds depends on your risk appetite, your investment horizon, and your goals. For example, if you are uncomfortable with relatively high levels of risk — Treasuries might match your risk appetite well. If you're investing for the relatively short term — say, for retirement in five years, Treasuries of the same term might provide you the stability you need and the peace of mind that at least your principal is safe. If your goal is to preserve capital, certain Treasuries can accommodate that goal, essentially earning just enough to protect against inflation.

If, however, you're investing for retirement in 30 years, your portfolio likely needs to include higher risk, higher return investments like stocks. Bonds still have their place but should make up a relatively smaller percentage of your total portfolio the further away you are from your investment goal and the more aggressive that goal is.

Is investment in government securities right *for you*? Please call to discuss this topic in more detail. ❍❍❍

End-of-Year

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4 Create a tax loss. Example: if you have a cost basis of $10,000 in a mutual fund that is currently valued at $9,000, you can take a $1,000 tax loss by making an exchange.

5 SPEND Flexible Spending Account (FSA) Dollars. These do NOT rollover after March 15, 2015. This is one of the few times it is recommended to spend!

6 Start a 529 College Savings Plan BEFORE 12/31/2014 to get the state tax deduction.

The IRS recently came out with some changes that depending on your situation, many need to be taken advantage of.

Looking Ahead to 2015:

7 New! Review 401(k) contribution. The maximum for year 2015 is $18,000. If you are age 50 OR over; there is an extra $6,000 allowance for $24,000 maximum.

8 Adjust your 401(k) contribution to include the new Roth 401(k). Consider changing your 401(k) contribution so that a portion goes into the new Roth 401(k). Example: if you are contributing 10% of your salary in the normal pre-taxed manner, adjust so 5% goes to pre-tax and 5% to after-tax Roth 401(k) — 10% total gets deferred. This is tax diversification.

9 Evaluate your family Balance Sheet and Cash Flow Statement in January. Where are there gaps? Is there room to save or even spend more each month or year?

10 Complete and communicate your Estate Plan to a trusted family member or friend.

11 Flexible Spending Account (FSA) Dollars will rollover (up to $500), from year 2015 to 2016. You no longer have to *use it or lose it*.

12 IRA contribution limits are unchanged at $5,500 for Traditional and Roth IRAs with the $1,000 catch-up for age 50 and over. You have until 4/15/2015 to contribute for year 2014.

13 IRA income limits are up slightly for Traditional and Roth IRAs for Year 2015.

If you have any questions regarding any of the above, feel free to call the office to discuss or make an appointment. Early morning and evening appointments can be made in order for you to avoid missing any work or taking any additional leave.

Sincerely,

Andrew D. Wade, CFP®
President

Caring for an Aging Parent

If you are helping an aging parent financially, review the tax laws to determine whether you qualify for some tax relief. The key is to determine whether you can deduct your parent as a dependent. To do so, your parent's gross income can't exceed the exemption amount, and you must provide over half your parent's support.

What happens if you share your parent's support with your siblings or other relatives? If the combined total equals more than half your parent's support and each person contributes at least 10% toward care, you can file a multiple support declaration. Even though more than one person contributed to the support, the parent can only be claimed by one person.

If you claim your parent as a dependent, any medical expenses paid for your parent can be claimed as a medical deduction on your tax return. Your total medical expenses, including your parent's expenses, must still exceed 10% of your adjusted gross income before you can take the deduction. If your parent lives with you and you must obtain outside care to go to work, you may be able to claim the dependent care credit. Also look into whether your employer offers a flexible spending account for elder care. ❍❍❍

Financial Thoughts

The difference in average annual full-time earnings between young adults ages 25 to 32 with a college degree and those in the same age group with only a high school diploma is $17,500 (Source: *Time*, April 28, 2014)

Nationwide, it is 38% cheaper to buy versus rent a home. The average credit score for approved mortgage applicants is 755. Approximately 92% of mortgage borrowers opt for a fixed-rate mortgage (Source: *Money*, May 2014).

The average length of retirement for those turning 65 in 2014 is 19 years. The average 401(k) balance at the end of 2013 was $89,300, up 16% from 2012 (Source: *Money*, May 2014).

Approximately 55% of individuals with a household income under $100,000 say they are living paycheck to paycheck, while 37% of those with a household income over $100,000 indicate they are living paycheck to paycheck. This financial stress impacts relationships, with money being the top source of marital stress and the source of couples' most serious arguments — 41% of respondents indicated that they argued about money at least once a month (Source: *Money*, April 2014). ❍❍❍