First Quarter 2016

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What Should You Do With That Old 401(k) Account?

If you have participated in a 401(k) plan where you work, you probably made investment choices when you signed up for the plan and you may have stuck with those investments with few modifications, watching as your account grew, with some inevitable setbacks, over the years. But now you're getting ready to leave the workforce or you're changing jobs. That raises this question: What should you do with that 401(k) at your old job?

Answer: It depends on several variables as well as your personal needs and preferences. However, depending on your circumstances, there are generally four options:

Option 1. Keep the status quo. Assuming the plan permits it (and many do), you can leave your money where it is, even if you stop working for the company. The plan administrator is legally required to observe the same requirements with regard to your account as it does for participants who are current employees. You, meanwhile, are still subject to the basic tax rules regarding distributions and penalties. For instance, you can't take penalty-free withdrawals from the plan unless you qualify under a tax law exception, such as for payouts to someone who is at least 55 years old and has "separated from service." Also, you're generally required to begin taking distributions once you reach age 70½. But if you choose this option and you haven't adjusted your investment mix in a while, you probably should review the portfolio to make sure it still meets your objectives.

Option 2. Roll over the assets into a new 401(k). If you're leaving your old job for a new one, you generally can roll over the money in your old 401(k) plan into a 401(k) or another plan provided by your new employer. It can be convenient to consolidate all of your 401(k) assets in one place, or you might prefer the investment options offered under the new plan. In any event, you won't face any income tax liability for making the transfer as long as the rollover is completed within 60 days of the job change. All of the assets you move still will be subject to the usual rules for distributions and penalties. However, if you continue working for this employer past age 70½ and you don't own 5% or more of the business, you can postpone mandatory distributions until you actually retire.

Option 3. Roll the assets into an IRA. As when you make a rollover to another employer's retirement plan, you can choose to roll over assets tax-free to a traditional IRA, even if you're retiring for good. The rollover must be completed within the 60-day deadline.

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Ben's Banter

As we are closing in on the end of the first quarter of 2016, what a year it has been already! The markets started the year as the worst performing markets in history. There was gloom for a while, but while I write this the markets have almost completely recovered those losses. Hopefully in the short term that trend will continue – we already know in the long term it will.

In 2016 we at TFA are embracing this year as a year of change and improvement! It is time for a refresh! Slowly you will start seeing our new logo, materials, website, etc. We have been working hard behind the scenes do everything just right – of course, what will remain consistent is the dedication that we all have to our clients.

Two quick reminders – First, Social Security rules are changing and elections have to be made by certain individuals before April 30th or they will be lost forever. Second, if you are over 70.5 and have to make Required Minimum Distributions from your IRA, you may now make those distributions directly to a charity, with the resulting tax savings. If you have questions please call us.

Remember, no one plans to fail, but some simply fail to plan!

Thanks,
Ben
CPA/PFS, CFP®, CIMA®

What To Know About Social Security

The Social Security Administration (SSA) recently announced that there will be no increase in retiree benefits in 2016 because of the low inflation rate. Cost-of-living adjustments (COLAs), which are based on a consumer price index for urban wage-earners, have been standard fare and most retirees expect them. In fact, this is only the third time without a yearly increase in Social Security retirement benefits since COLAs were instituted in 1975. (The other two occurred in 2010 and 2011.)

It may be small consolation, but the Social Security wage base for payroll taxes also won't go up, remaining at $118,500 in 2016. This means the first $118,500 of wages you earn in 2016 is subject to a 6.2% tax (or twice that if you're self-employed). There's also a tax for Medicare of 1.45% on all earnings.

Furthermore, the SSA has announced that the limits under the "earnings test" (the amount you can earn from working without forfeiting Social Security benefits) also are unchanged.

Did this "freeze" for 2016 catch you by surprise? If so, you're not alone. People from all walks of life, including those who already have retired, often don't fully understand the rules for Social Security or are unaware of how complex the rules are. Use this quiz to test your personal knowledge of the subject:

1) The earliest age you can begin to receive Social Security retiree benefits is:

a) age 59½.
b) age 62.
c) age 65.
d) age 70.

2) The amount you will receive if you opt for early retirement may be reduced by as much as _____ for someone born in 1960 or later.

a) 5%
b) 10%
c) 20%
d) 30%

3) To get the maximum amount of Social Security benefits, you need to wait until ______ to begin receiving benefits.

a) age 59½
b) age 62
c) age 65
d) age 70

4) Spousal benefits are available to an unmarried ex-spouse if he or she was married to the beneficiary for at least:

a) 3 years.
b) 5 years.
c) 10 years.
d) 25 years.

5) Social Security retiree benefits are partially taxable if your income exceeds ________ if you're a single tax filer and ________ if you're a joint filer.

a) $10,000/$25,000
b) $25,000/$32,000
c) $50,000/$100,000
d) $200,000/$250,000

6) The age when a Baby Boomer born between 1943 and 1954 is able to receive full retirement benefits is:

a) age 62.
b) age 65.
c) age 66.
d) age 70.

7) For 2016, the maximum amount you're allowed to earn in the year you reach full retirement age—but before the month of your birthday—without forfeiting any benefits is:

a) $15,480.
b) $26,480.
c) $41,880
d) $55,880.

Answers: 1-b; 2-d; 3-d; 4-c; 5-b; 6-c; 7-c

5 Reasons To Amend Your Estate Plan

It's 2016...do you know where your estate plan is? If you're like most busy people, you may have made a will, perhaps when your children were born, and it's possible you've taken other steps to lay out what will happen after you're gone. But frequently those plans are just gathering dust.

Now's a good time to crack open the vault and take a closer look. Typically, your estate plan will need a minor update, and in some cases a complete overhaul may be in order. Consider these five reasons to revise your plan:

1. Family changes: Your personal situation may have shifted because of a divorce, a separation, or the death of a spouse. You might want to add or subtract beneficiaries to trusts or estates if children or grandchildren have been born since you created your estate plan or if a beneficiary has died. Or your intended heirs may have married or divorced, further complicating matters.

2. Financial changes: When you created your estate plan, you probably owned fewer assets or different assets than you have now. You may need to revise your will or trust documents, especially if the value has changed dramatically. Or perhaps you've acquired a business interest or sold one—another potentially big change to your financial status. A job loss or change also could have an impact on your plan.

3. Tax law changes: It seems like the federal estate tax law is amended every other year, so it's important to keep abreast of the latest developments. For instance, your estate plan may not reflect the ever-increasing federal estate tax exemption. The exemption, which was $650,000 a decade and a half ago, has ballooned to $5.45 million for someone who dies in 2016. Other tax law provisions, such as the "portability" of exemptions between

Tax-Optimizing A Retirement Portfolio

Locating investments in the right type of account can make a big difference in your retirement savings and lifestyle.

Here's the story, told through an example of a hypothetical couple —Jodi and Mark — with $1 million in savings. Their tax-advantaged IRA accounts hold $360,000 in stocks and stock mutual funds, plus another $240,000 in taxable bonds. Jodi and Mark's taxable account holds $400,000, with 60% in stocks returning 10% annually in capital gains and 40% in muni bonds yielding 3.6% of income.

To keep it real, let's make these very reasonable assumptions:

- bonds yield 6% of income annually
- stocks return a 10% capital gain annually
- residents of a state with high-income tax
- combined state and federal tax rate of 40% on income
- capital gains rate of 20%

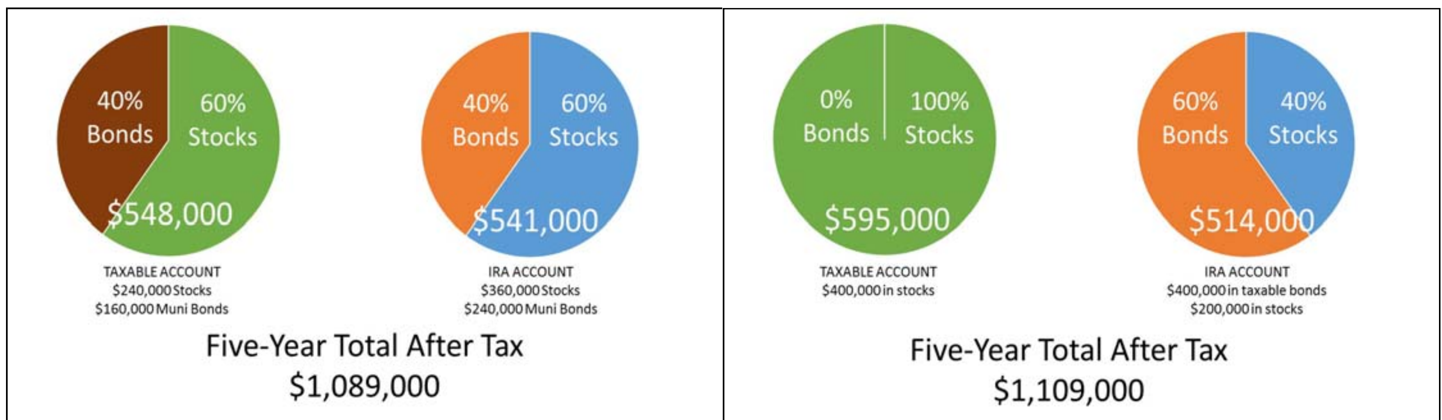
After five years, the after-tax value of the taxable account is $548,000 and the IRA's after-tax value grows to $541,000 — a total of $1,089,000.

But now look at what happens when you apply a little strategic tax planning by employing a strategy to optimize the location of your investments to minimize taxes.

Optimizing for location would place all $400,000 in the taxable account in stocks to benefit as much as possible from the 20% favorable capital gains rate. Why settle for income from the muni bonds of 3.6%, when the after tax-return on stocks annually over the long run has averaged 8%? Meanwhile, optimizing the $600,000 IRAs would mean holding $400,000 in bonds and $200,000 in stocks. Instead of a 60% stock and 40% bond allocation, the IRA would hold the reverse — 40% in stocks and 60% in bonds.

The bottom line: $1,109,000 expected value on the total portfolio after five years versus $1,089,000. Getting an extra 2% — $20,000 — over five years on a $1-million portfolio may seem insignificant, but it compounds without being taxed every year in the IRA. After 10 or 20 years, tax-advantaged compounding becomes so powerful it prompted Albert Einstein to say, "Compound interest is the eighth wonder of the world."

Because of the long-term nature of this strategy, getting started on the right course soon is wise. If you have questions about tax optimization, please contact us. ●



the estates of you and your spouse, also may need to be addressed.

4. Geographic changes: If you've pulled up stakes and moved the homestead, maybe downsizing to a place in a warmer climate, this significant change also probably needs to be reflected in your estate plan—especially if you've moved to a state with substantially different tax laws.

5. Personal changes: Finally, you may have had a change of heart about beneficiaries or developed different priorities or preferences. For example, you might decide to cut a daughter-in-law or son-in-law out of your will or decide to attach conditions to particular gifts or bequests. It's your estate plan, so you can "fix" it however you like.

Of course, you don't have to undertake all of this on your own. Rely on your financial, tax, and legal advisers for guidance. ●

7 Tax Breaks Set To Last Forever

After years of passing "tax extender" laws, Congress finally enacted tax legislation in 2015—the Protecting Americans from Tax Hikes (PATH) Act—that permanently restores several key tax breaks for individuals. These seven tax provisions are now a permanent part of the tax code until, if ever, Congress changes them. They are:

1. American Opportunity Tax Credit. Before PATH, parents could claim a maximum $2,500 American Opportunity Tax Credit (AOTC) for qualifying higher education expenses, subject to phase-outs based on modified adjusted gross income (MAGI). But the maximum credit was scheduled to drop to $1,800 in 2017 with lower phase-out levels. The new law preserves the higher AOTC.

2. Sales tax deduction. Before 2015, taxpayers could choose to deduct state and local sales taxes instead of claiming the usual deduction for state and local income taxes. This optional deduction, especially valuable if your state has no income tax, has been restored retroactively for 2015 and made permanent.

3. IRA transfers to charity. Under a provision that had expired, if you were over age 70½ you could transfer up to $100,000 ($200,000 as a married couple) directly from an IRA—as part of your required minimum distribution, or RMD, to a charity with no tax consequences. The PATH Act restores this rule for 2015 and makes it permanent.

4. Conservation deductions. If you grant a conservation easement for property you own, you get a deduction based on the easement's value. Previously, that deduction could be for as much as 50% of AGI (100% for farmers and ranchers), rather than a 30% limit, and there was a 15-year carry forward period for excess amounts instead of five years. Both enhancements are restored permanently retroactive to 2015.

5. Qualified small business stock. Under a former law, investors could exclude 100% of the gain from the sale of qualified small business stock (QSBS) that they acquired before 2015. That amount was scheduled to drop to 50% for QSBS purchased after 2014. Now the 100% exclusion is permanent.

6. Child tax credit. Parents had been entitled to a child tax credit of up to $1,000, subject to a phase-out, with an additional refundable credit of 15% of earned income that exceeded $3,000. But that threshold was set to increase to $10,000 in 2017. The PATH Act restores the lower threshold and makes it permanent.

7. Educator expenses. Finally, teachers and other educators had been able to deduct up to $250 of their out-of-pocket classroom expenses. The new law restores this deduction, retroactive to 2015, and makes it permanent. Future maximums will increase with inflation.

The PATH Act also extends other individual tax breaks, as well as business provisions, and makes some of them permanent. ●

That Old 401(k) Account

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To avoid having income tax withheld (which you could recoup when you file your tax return), you can arrange a trustee-to-trustee transfer so that the money never touches your hands. You might decide to roll over the assets into a Roth IRA, rather than a traditional IRA. With a Roth, you'll owe income tax on the amount you convert, but then you'll be in line for future tax-free distributions. And with a Roth IRA, you're not required to take mandatory distributions after age 70½ as you are with a traditional IRA.

Option 4. Cash in your chips. Of course, the money that has accumulated in your 401(k) all of these years is yours to keep. If you really need it now, you can simply take the money, whether you're retiring or switching to another job. But cashing in your 401(k) account when you leave your job means you'll have to pay income tax now on the amount representing pre-tax contributions and earnings. In addition, if you're under age 59½, you'll generally owe a 10% penalty tax on the taxable amount, unless a special tax law exception applies. Finally, you will lose the ability to continue to generate tax-deferred earnings within the cozy confines of a 401(k), traditional or Roth IRA, or other tax-advantaged retirement plan. And you'll have less in your nest egg when you do retire.

What's the best option? There is no definitive right or wrong answer. If you urgently need the money, you may be forced to cash in the account now. Otherwise, you may want to stick with one of the other options, or perhaps a combination of a couple of them. We would be glad to discuss the alternatives and help you formulate a plan that suits your situation. ●

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