Summary 2014
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The Prosperity Consulting Group, LLC
A Wealth Management Company

The Wealth Advisor

Learn What You Are Not Allowed To Do In Your IRA

It sure feels like the IRA, or at least the traditional individual retirement account, not the Roth, has been around forever. In fact it originated in 1974, and its selling points—the possible tax-deductibility of contributions and tax-deferred growth—quickly made it a centerpiece of retirement planning. However, even though this tax-advantaged saving vehicle may seem like a permanent part of the landscape, it's possible you don't know as much about it as you think you do.

In particular, many retirement savers aren't aware of the strict rules relating to "prohibited transactions," and the restrictions against holding certain types of investments in an IRA.

Prohibited Transactions

Typically, a "disqualified person" can't engage in any prohibited transaction with regard to a self-directed IRA. That includes the IRA owner, but it also extends to others on a long list: the owner's spouse, the owner's "ancestors" and "lineal descendants" (in other words, parents, grandparents, children, and grandchildren), spouses of lineal descendants, investment managers and advisors, anyone providing services to the IRA (for example, an IRA custodian or trustee), and any corporation, partnership, trust, or estate in which the IRA owner has an interest of 50% or more.

One wrong step could jeopardize the tax-deferred status of the account, as well as trigger penalties and taxes. The transactions on the IRS' no-no list include any direct or indirect:

- Sale, exchange, or leasing of property between a plan and a disqualified person;
- Lending of money or other extension of credit between a plan and a disqualified person;
- Furnishing of goods, services, or facilities between a plan and a disqualified person;
- Transfer to—or use by or for the benefit of—a disqualified person of the income or assets of a plan in the person's own interest or for the person's account;
- An act by a disqualified person who is a fiduciary in which he or she deals with the income or assets of a plan in the person's own interest or for the person's own account; or
- Receipt of any consideration for a personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving income or assets of the plan.

You will want to avoid prohibited transactions at all costs. If you don't, you may lose the tax-exempt status of the IRA, plus you'll be treated as if you had received a distribution on the first day of the tax year in which the prohibited transaction occurred. In other words, the value of the IRA will be included in your taxable income for that year. To make things worse, you'll

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What You Should Know About Annuities

There are many different types of annuities, but simply put, an annuity is a contract with an insurance company designed to pay a stream of income to the contract holder that cannot be outlived.

There's a lot of confusion concerning annuities because they are complex products with many moving parts. Many times they are not explained adequately (or even understood) by the seller.

If you cash in an annuity before a specific period of time, you typically will need to pay a surrender charge. For that reason, an annuity should be considered a long-term investment.

Over the last few years, annuity fees have increased and benefits have been reduced, making them less attractive.

There are situations when annuities make sense, but it's best to have an expert review and explain an annuity before you make a decision. When you hear of an annuity that is "too good to be true," it usually is.

We are happy to review old and potential annuities and give our objective opinion before you lock into one for many years to come.

Erin M. Ansalvish

Director of Financial Services

IRA Rollovers: When Once Is Enough

Tax laws let you roll over money from one traditional IRA to another without owing taxes as long as you follow the rules and get it done quickly enough. But there is one restriction you might not know about: IRA-to-IRA rollovers generally are allowed only once a year, and a new court ruling says this once-a-year rule applies to *all* of your IRAs and not just a particular account.

This decision runs counter to what most tax experts believe. The IRS itself has interpreted the rule differently in its own publication on rollovers. Yet the Tax Court decided firmly against the taxpayer in the new case (Bobrow, T.C. Memo 2014-21).

In most cases, you won't be taxed if you transfer funds from one IRA to another as long as the rollover is completed within 60 days. (If the money isn't moved directly between trustees, income tax will be withheld and you'll have to recoup it on your tax return). That effectively gives you interest-free use of the funds for almost two months.

But there's one fly in the ointment. According to the plain language of the tax law, a taxpayer may roll over funds from one IRA to another IRA only once a year. The Tax Court applied this rule to all of a taxpayer's IRAs in the new case.

In this case, a taxpayer in 2008 received a distribution from traditional IRA #1 on April 14 and then took money out of IRA #2 on June 6. He repaid the required amount into IRA #1 on June 10 and did the same for IRA #2 on August 4. Because both repayments were made within the 60-day "window" for IRA rollovers, the taxpayer believed each rollover qualified for tax-free treatment. Therefore, he did not report any tax liability for IRS rollovers on his 2008 tax return.

However, the Tax Court said the once-a-year limit on IRA rollovers invalidated the transfer to IRA #2, causing that second distribution to be taxable. Based on its reading of the law and legislative intent, the court determined that the rule applies to all of a taxpayer's IRA accounts. "Regardless of how many IRAs he or she maintains, a taxpayer may make only one nontaxable rollover contribution within each one-year period," the court concluded.

That interpretation directly conflicts with guidance in Pub. 590, *Individual Retirement Accounts (IRAs)*. On page 25, the IRS provides an example with similar facts in which the once-a-year rule is applied to each IRA separately.

What happens now? As a follow-up, the IRS announced that it intends to follow the Tax Court ruling. Thus, it will likely pursue actions against other taxpayers who make multiple IRA rollovers in one year. As a result, it makes sense to stick to the strict letter of the law as defined by the court in the new case. ●

Markets May Not Be Certain, But Experience Is

Have you ever wished you could do it all over again? Experience can be a great teacher, and it's natural to imagine that with the benefit of hindsight you would have made better decisions about everything from raising your children to managing your financial affairs. And while that may or may not be true, what is certain is that you can offer younger family members some of the insight you've acquired along the way.

Here are some thoughts you might pass along:

1. When you get a pay raise or a new higher-paying job, consider earmarking at least part of the additional money for retirement savings. You'll be amazed by what tax-deferred compounding can do to even relatively small sums over the course of several decades. And using raises to increase your contribution to a 401(k) can be relatively painless. Ratchet up your saving rate by a percentage point or two each year and you'll soon reach the maximum for annual pre-tax contributions to 401(k)s and similar employer-sponsored plans—$17,500 in 2014 if you're younger than age 50. Beginning at 50, you'll be eligible to contribute an extra $5,500 a year.

2. Try to resist the siren song of early retirement. Leaving your job in your 50s may be tempting, but it runs counter to several financial realities. Most people have not saved enough to retire comfortably even at the traditional age of 65, and quitting early can mortgage your future in two ways—reducing the amount you can save while extending the time that your savings must support you. By the same token, however, every year you keep working improves your situation. Moreover, as life expectancies increase, more and more people find they want to stay on the job at least part-time, and not only for financial reasons. Working can help keep you engaged and healthy,

Remarrying In Your 50s? 7 Key Aspects

Jack Webster had given up on romance after his marriage splintered five years ago. His two children were now both in college. Rhoda Seaver, divorced with three teen-aged children, also was skeptical about diving back into the dating pool. But Jack and Rhoda found each other through a dating service and now are engaged to be married.

It's not an uncommon story. According to the Census Bureau, more than 50% of the divorced males in this country over age 50 and more than 40% of the divorced females in the same age bracket end up remarrying. But there's more to creating a union late in life than just melding family units. Several important financial considerations may be difficult to resolve for soon-to-be retirees. Here are seven issues that could cause problems:

1. Social Security and pension benefits. If you're divorced, getting remarried generally will suspend your right to receive Social Security benefits based on your ex-spouse's earnings record. Similarly, if you're widowed and plan on collecting benefits based on your deceased spouse's record, you may have to wait until age 60 to remarry. (Getting married again also could affect the amount you're entitled to from a former spouse's pension plan. Contact the pension plan administrator to determine the impact of remarriage on benefits.)

2. Marriage penalty. Because of the way federal income tax rates are structured, some couples are hit with a "marriage penalty" if both have substantial incomes. In other words, filing a joint return will produce greater tax liability than they would have to pay if they continued to be single filers. That problem has been exacerbated by the 2013 tax law and its new top income tax rate of 39.6%.

3. Estate planning. It's always crucial to have a valid will in place so that your heirs won't have to depend on state law to dictate where assets will go. That's even more important if you're remarrying. You'll certainly need to revise an existing will as well as being sure to update beneficiary designations for retirement plans, because those supersede your will. Moreover, even if your will says your home will go to children from a prior marriage, it will go to your new spouse if the two of you own it jointly with rights of survivorship.

4. College financial aid. Will a new marriage in your 50s affect the financial aid your children are entitled to when attending college? To determine financial aid awards, the government looks at the income and assets of the "custodial parent"—the one with whom a child has lived for most of the preceding year—but such calculations also may reflect income and assets of a new spouse when the custodial parent remarries. Your intended's wealth indeed might reduce your child's college aid. (Some colleges also include the noncustodial parent's assets in the equation.)

5. Health-care expenses. Your state may impose special rules relating to payments of medical expenses, and the rules for nursing home care could be particularly significant. Typically, if someone requires nursing home care, it may be possible to transfer some of that person's assets in an attempt to qualify for assistance under Medicaid (subject to certain imposing restrictions). However, in some states, you may still be responsible for the costs of a spouse, even if the spouse has transferred assets out of his or her name. Such rules could affect your financial arrangements with a new husband or wife.

6. Alimony. If you receive alimony from your ex-spouse, it likely will come to a halt when you remarry, though remarriage generally doesn't affect child support. Consider how this will affect your family's lifestyle. Figure out whether you still will be able to afford some of the luxuries you enjoy now or whether you'll have to scale back. Look at options for replacing the lost income.

7. Beneficiary designations. When you get remarried, it's common practice to change the designated beneficiary (or beneficiaries) on insurance, retirement plan accounts and annuity contracts (see #3). Don't forget to do this. If you fail to do this, an ex-spouse might be entitled to most or all of such benefits.

It's only prudent for Jack and Rhoda to consider these financial issues before saying "I do." Other considerations, such as whether to use joint checking accounts or a prenuptial agreement, also may come into play. Having an open discussion before you remarry may avoid problems that could fester later. ●

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particularly if you find something you really like to do.

3. Consider postponing Social Security. You can begin receiving benefits as early as age 62, but each year you delay will increase the amount of your monthly payment, and if you wait until age 70, you'll get 76% more than if you had started drawing benefits at 62. And most people will live long enough to get a larger total payout if they begin later.

4. Don't feel like you have to go it alone in making financial decisions. Working with an advisor could help you make sense of complex financial markets and chart a comfortable path toward your goals. The right advisor can assist you in deciding how much to save, how to allocate your investments, how to weigh the pros and cons of buying a home and other major financial choices, and, when the time comes, how to deploy your retirement nest egg. ●

Is It Too Late For Roth Conversion?

When you're creating a retirement paycheck from a blend of Social Security, pensions, and personal retirement accounts, it only makes sense to do what you can to minimize income and investment taxes. For example, consider the distributions from your traditional IRAs or 401(k)s. Most or all of that income will be taxed at full income rates that now go as high as 39.6%. In contrast, under most circumstances, withdrawals from Roth IRAs aren't taxed at all. So should you switch from traditional IRAs to a Roth? Or is it too late to benefit from such a conversion?

The answer depends on your situation. Because you'll have to pay income tax on the money you convert to a Roth IRA, one crucial calculation involves whether your federal income tax bracket will be higher or lower during retirement. It usually makes sense to convert before retirement if you expect to be in a higher tax bracket later, while if you anticipate being in a lower bracket in retirement, you probably should wait until then to convert. If you are retired and expect to remain in a relatively low tax bracket, you might decide not to convert at all.

The main attraction of a Roth IRA for retirees is the lure of tax-free payouts while living on a fixed income. Distributions you take after age 59½ from a Roth you've had for at least five years will be exempt from federal income tax.

And, from an estate planning view, with a Roth you won't be subject to the mandatory lifetime distributions that traditional IRAs require. But because a Roth conversion is taxable, it's like taking money out of an IRA for almost any other reason—and it may or may not pay off.

Example 1: You're in the 39.6% tax bracket now, you expect to be in the 28% bracket in retirement, and you have $500,000 in an IRA. If you convert to a Roth this year, you'll have to pay a tax of $198,000. That's probably not worth the future benefit of receiving tax-free payouts—money that would have been taxed at the 28% rate without the conversion. However, if you wait until you drop into the 28% bracket, the conversion will cost less and may be worthwhile.

Example 2: You're in the 28% bracket now, you expect to be in the 39.6% bracket during retirement, and you have $100,000 in an IRA. If you convert to a Roth this year, you'll pay a tax of at least $28,000. (It may be higher because part of the conversion could be taxed at a 33% rate.) But that may be preferable to being taxed on that money at the top 39.6% rate during retirement.

You'll also need to weigh other factors, including the size of your account and whether a series of smaller conversions might reduce your overall tax liability. Also, a Roth conversion effectively could increase the 3.8% surtax on your net investment income. We can help you figure out the best strategy for your situation. ●

What Not To Do In IRA

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be socked with a 10% tax penalty on that distribution amount, unless you've reached age 59½ or the payment is made on account of death or disability.

Prohibited Investments

When you set up a self-directed IRA, you have a great deal of flexibility in choosing investments. Typically, you might use any combination of stocks, bonds, mutual funds, cash-equivalents, and other standard investment vehicles.

However, the tax law does prohibit several types of less typical investments. On the prohibited list are:

Life insurance. Annuities are allowed, but you can't acquire whole, universal, or variable universal life insurance inside any type of IRA.

Collectibles. You're not allowed to transfer priceless family heirlooms to your IRA, nor can you invest in other collectibles such as artwork, wines, stamps, precious stones, porcelain, pottery, jewelry, or collectible trading cards.

Personal residence. Your IRA can't hold any property that you personally use. That may include your primary residence, a vacation house, or a spare place in the city. Certain other types of real estate, such as undeveloped land, may be permitted.

Coins. Generally, you can't hold any type of coin made of gold, platinum, or any other precious metal inside an IRA. To be allowed in an IRA, a coin's actual currency value must exceed its value as a collector's item. (However, the IRS does provide a limited number of exceptions that are allowed in IRAs, including American Eagle coins that have never been in circulation and Canadian Maple Leaf coins.)

If you invest in any of these inside your IRA, the IRA won't be disqualified (as it would be in the case of a prohibited transaction), but you'll still face the taxes and penalties outlined above. So do your best to stay away from prohibited investments. ●