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Did The Devil Make You Do It? 8 Retirement Miscues

We're all human, and we all make mistakes. Yet some errors are worse than others, and it's important to try to avoid the kinds of miscues that could derail your retirement.

What sort of mistakes? Of course, these will vary from person to person, but here are eight common foul-ups that often bedevil soon- to-be retirees:

Mistake #1—You have no financial plan for retirement.

Although your plan doesn't have to be carved in stone—and in fact it needs to be flexible—it at least should provide some basic guidelines for your future. A bare-bones plan will look at your potential sources of retirement income and approximate what you can expect to spend—and rough estimates are better than no estimates at all. Figuring out what it may take to live comfortably during retirement is the first step toward getting there.

Mistake #2—You have too much debt.

Perhaps nothing can be more damaging to successful retirement than crushing debt. Avoiding high-interest-rate credit card charges can help you head off the problem. If you spend within your means and borrow judiciously you'll be able to save more for retirement and won't be burdened by the need to pay off compounding debt.

Mistake #3—You sacrifice retirement planning for education planning.

Saving money for your children's college education is obviously a lofty and worthwhile goal, and starting early can help ease your financial burden when tuition bills come due. But you may not want to make education saving your primary financial priority. Often, parents are able to help pay college bills while still putting away money for retirement, and your kids can help by taking low-interest loans to cover part of their costs.

Mistake #4—You don't keep an emergency fund.

Even if you've been diligent about saving for retirement, remember to expect the unexpected. You might lose your job or face another financial or medical emergency, and having a cash cushion to fall back on can help you avoid dipping into retirement funds—an option that could have short- and long-term tax and financial consequences. The usual rule of thumb is to try to set aside at least six months worth of salary in a rainy day fund.

Mistake #5—You don't have a long-term investment strategy.

You're likely to fare better if you establish a long-range investment plan for retirement rather than trying to boost your portfolio by chasing hot stocks. Time-tested principles such as asset allocation and diversification can help you make steady progress toward your goals, whereas playing investment

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Oil Prices Strengthen Growth

Over the last few weeks, there has been significant movement in the stock market. This was triggered from new technology that is helping gather large amounts of oil and gas that were considered unreachable a few years ago.

This new technology is currently being used around the world. Due to the increased supply, oil prices have fallen. In the past, during periods of increased supply, Saudi Arabia would typically slow down production to drive oil prices higher. However, since Saudi Arabia has some of the lowest production costs in the world, the Saudis chose to do the opposite, which drove oil prices down even further.

Because of this dramatic drop in prices, the Russian economy has been devastated. Oil accounts for 50 percent of Russia's exports. The current low-price situation will ultimately cause many high-cost producers to stop production. Over time, as production slows, the price of oil will begin to gradually increase.

The good news is that lower oil prices will result in tremendous savings to consumers around the world, in turn driving consumer spending. This will increase the profitability of businesses as the cost to produce goods and services is reduced. This will continue to be beneficial to the stock market, which is one of the reasons that the market has stabilized.

Donald N. Hoffman, MS, CPA

President

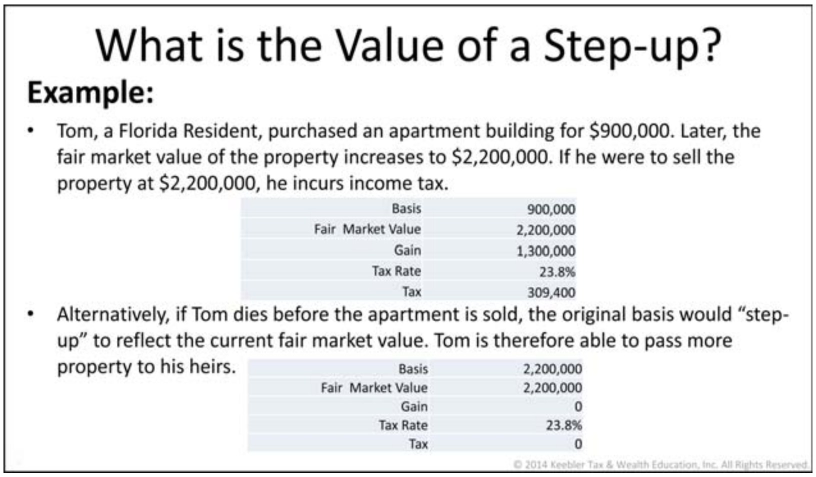
What's The Step-Up In Basis Worth?

When you're developing an estate plan for your family, several elements factor into the equation, including a lot of tax ramifications—which may include both estate taxes *and* income taxes. They're not mutually exclusive and, in fact, they're often intertwined.

A case in point is the so-called "step-up in basis" on inherited assets. That can be a reason to keep some assets in your estate rather than trying to reduce the estate's value.

Slimming down an estate, particularly by making gifts to family members during your lifetime, is often a good idea. However, there's a marital deduction that normally allows you to leave unlimited assets to your spouse free of estate tax, while transfers to other heirs are sheltered by a generous individual estate tax exemption that's inflation-indexed. Each person can shield $5.43 million from estate and gift taxes in 2015, up from $5.34 million in 2014.

Meanwhile, if you sell real estate or other assets before you die, you'll owe capital gains tax on your profits. The maximum tax rate on a long-term gain (on assets you've held longer than a year) is 15%, or 20% for investors in the top ordinary income tax bracket. In addition, you may be liable for a 3.8% surtax on net investment income (NII), including capital gains, that exceeds an annual threshold. That adds up to a possible effective tax rate of 23.8% on capital gains at the federal level.



What is the Value of a Step-up?

Example:

- Tom, a Florida Resident, purchased an apartment building for $900,000. Later, the fair market value of the property increases to $2,200,000. If he were to sell the property at $2,200,000, he incurs income tax.

Basis	900,000
Fair Market Value	2,200,000
Gain	1,300,000
Tax Rate	23.8%
Tax	309,400

- Alternatively, if Tom dies before the apartment is sold, the original basis would "step-up" to reflect the current fair market value. Tom is therefore able to pass more property to his heirs.

Basis	2,200,000
Fair Market Value	2,200,000
Gain	0
Tax Rate	23.8%
Tax	0

But if you bequeath appreciated assets to your heirs, they can largely avoid capital gains taxes. Those taxes are calculated according to how much the price has gone up from your "basis" in the asset—basically what you paid for it, subject to adjustment. When you die, the basis of the assets your heirs receive is "stepped up"—increased to their value on the date of your death. That eliminates tax liability on the appreciation of the assets during the time you owned them. Of course, those assets have to be in your estate to qualify for that benefit, but the generous exemptions for estates will help your heirs avoid estate taxes, too.

Consider this example. Tom, a resident of Florida, bought an apartment building for $900,000 that is currently worth $2.2 million. If Tom sells the building now, he must pay an effective tax rate of 23.8% on a $1.3 million capital gain, or $309,400 (23.8% of $1.3 million). But what if he keeps the property and leaves it to his heirs? The basis of the property is stepped up to the full $2.2 million, and they'll owe capital gains taxes only if it appreciates further before they sell it. What's more, the estate tax exemption means they won't owe estate taxes on their inheritance.

Note that Florida doesn't have a state income tax. If Tom resided in a high tax state, such as California or New York, the savings would be even more pronounced. ●

Social Security: Taxes In And Out

It seems like the IRS has you coming and going on Social Security. While you are working for a living, you must pay taxes into the system to provide benefits for current retirees. Then, when you finally retire, you're entitled to receive retirement benefits but they might be subject to tax as well.

Don't confuse the two taxes. The Social Security tax you pay as an employee is a payroll tax that applies to wages, commissions, and other compensation as part of the FICA tax. An employee's combined FICA rate for Social Security and Medicare in 2014 is 7.65% on the first $117,000 of compensation and 1.45% (Medicare only) above that. But the tax that may apply to Social Security benefits you get in retirement is a federal income tax that is reported along with other items on Form 1040. It's more complicated than the payroll tax.

Here's how it works: You're liable for tax on Social Security benefits if your provisional income (PI) exceeds certain thresholds in the tax law. For this purpose, PI is the total of (1) your adjusted gross income (AGI), (2) your tax-exempt interest income (for example, from municipal bonds), and (3) one-half of the Social Security benefits you received. For example, if the combined AGI of you and your spouse is $100,000 and you collect $5,000 in municipal bond income and $20,000 in Social Security benefits, your PI is $125,000 ($100,000 + $5,000 + $20,000).

There are actually two thresholds for computing the tax on Social Security benefits.

Threshold 1: For a PI between $32,000 and $44,000 ($25,000 and $34,000 for single filers), you're taxed on the lesser of one-half of your benefits or 50% of the amount by which PI exceeds $32,000 ($25,000 for single filers).

Threshold 2. For a PI greater than

4 Roth Conversion Strategies: Is One For You?

The hubbub over Roth IRA conversions continues unabated. Many who haven't taken the plunge are debating whether to use this technique, while others who already have transferred traditional IRA funds to a Roth are looking to feather their growing nest egg. Barring any radical changes in the tax law, a conversion remains a workable option for knowledgeable retirement-savers.

What's the driving force behind the conversion trend? The reasons may vary from one person to the next, but there are essentially four main types of conversions: strategic, tactical, opportunistic, and hedging.

First, let's examine the roots of a Roth conversion. With a traditional IRA, you can build up your account with contributions that may be partially or totally tax-deductible, in addition to amounts that are rolled over tax-free from an employer's retirement plan such as a 401(k). But distributions are taxable at ordinary income tax rates to the extent they represent deductible contributions and earnings. What's more, you must begin taking required minimum distributions (RMDs) from an IRA in the year after you turn age 70½.

In contrast, contributions to a Roth IRA are never tax-deductible, and you have to pay tax on a rollover from an employer plan. But the tax benefits come fast and furious on the back end. "Qualified" distributions—those made after age 59½, on account of death or disability, or used to pay first-time homebuyer expenses, up to a lifetime limit of $10,000—from a Roth that's at least five years old are completely exempt from federal income tax. Other payouts are taxed under special "ordering rules," which treat amounts as coming first from nontaxable contributions.

To top things off, you don't have to take distributions from a Roth IRA during your lifetime. That can help preserve your nest egg for the benefit of your heirs.

The money you convert from a traditional IRA to a Roth is taxable as income, and that negates some of the benefits of transferring those funds.

Why convert? Here's a quick breakdown of the four main types of Roth conversions and the reasons for converting:

1. Strategic: This kind of conversion is motivated by long-term wealth transfer objectives. For instance, if you intend to pass most of your IRA assets to your heirs, the ability to avoid RMDs during your lifetime may figure prominently in your plans. A Roth IRA lets you withdraw funds only as you see fit. In addition, converting to a Roth may be especially helpful from a strategic point of view if you're in a lower tax bracket now than you expect to be in retirement (and thus might pay a lower rate on the conversion than you otherwise would pay on distributions during retirement).

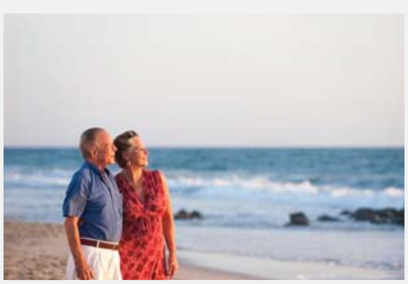
2. Tactical: These are based on shorter-term incentives that may expire—relatively low tax rates, tax credits, charitable contribution carryovers, and net operating loss (NOL) carryovers. Suppose you've carried over a large charitable deduction from a few years earlier. (Charitable carryovers last only five years while NOLs may be carried over for up to 20 years.) By converting to a Roth this year, you can use the carryover to offset much or even all of the conversion tax.

3. Opportunistic: With this type of conversion, you may be trying to benefit from short-term stock market volatility or the ups and downs of particular sectors or kinds of assets. If stocks, say, have declined in value, thus bringing down the value of your traditional IRA, you could end up paying a lower conversion tax. To take advantage of such opportunities you might create multiple Roth IRAs, using a different kind of asset class for each one.

4. Hedging: This is the least common motivation for a Roth conversion. In this case, you're banking on rising tax rates or other legislative or political changes that would discourage future conversions.

Regardless of the type of conversion, deciding whether to convert needs to be based on relevant economic variables and a thorough analysis of your particular situation. Typically, you'll need to take into account factors such as your current and projected tax rates; whether you'll need account assets to pay living expenses during retirement; current age, investing timetable, and health status; and whether you'll need to tap your IRA funds to pay for part or all of the conversion tax. We can help you make a sound decision. ●

$44,000 ($34,000 for single filers), you're taxed on 85% of the amount by which PI exceeds $44,000 ($34,000 for single filers) plus the lesser of the amount determined under the first tier or $6,000 ($4,500 for single filers). Silver lining: You'll never owe tax on more than 85% of your total benefits.



These two thresholds aren't indexed annually for inflation. If your PI exceeds a relatively low level of $32,000 ($25,000 for single filers), you'll owe the tax year in and year out. And you'll get hit with the higher tax rate every year that your PI exceeds just $44,000 ($34,000 for single filers).

What can you do about it? You might lower your PI by harvesting capital losses to offset capital gains or deferring taxable income to the following year. But remember that the income from tax-free municipal bonds counts against you in the calculation of PI. Consider all the relevant factors, including the potential tax implications for Social Security benefits, in your investment decisions. ●

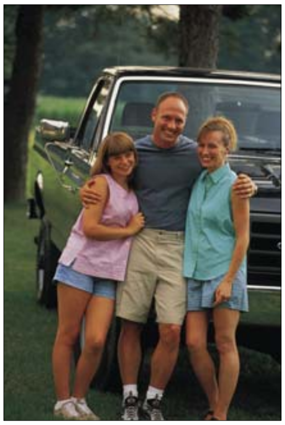
Keeping A 529 Plan Rolling Along

If you were thinking ahead, you may have set up a tax-advantaged Section 529 plan for your first child at an early age. Once your kid is ready for college, you'll reap the rewards of your foresight.

But what happens when your son or daughter graduates? If there's still money in the plan, your tax savings don't have to stop there. If you have other children, you could designate one of them to be next in line as the 529 plan beneficiary, and then choose another and another . . . possibly even extending the plan's benefits to your grandchildren!

Section 529 plans, sponsored and operated by individual states, encourage families to set aside funds for future education expenses of the younger generation. As long as certain requirements are met, the money invested in the plan can grow without any erosion by taxes; and distributions that go to pay qualified college expenses—including tuition, fees, books, supplies, equipment, and room and board for full-time students—are completely tax-free.

There are two main types of plans: prepaid tuition plans and college savings plans. A prepaid tuition plan enables you to lock in rates at an in-state public college, whereas a college savings plan gives you more flexibility—the money can be used at a public or private college of your choice—but doesn't offer guarantees.



Keep in mind that it doesn't matter which state's college savings plan you choose, because no matter where it's set up, you can choose where to spend money from the account. But there could be an advantage to using your home state's plan. More than half of the 50 states offer a state tax deduction or credit for Section 529 plan deposits made by residents.

Now suppose your daughter is finishing college and your son is poised to attend next fall. Assuming some funds are left in the account, you can simply switch the beneficiary designation for the 529 plan to the younger child. Typically, a plan will allow one such change each year. If a younger child will enter college before the older one graduates, you might want to set up a separate account.

Although a plan can continue indefinitely, with your grandchildren eventually becoming beneficiaries, it terminates when the latest beneficiary reaches age 30. Of course, if there's a gap—say, your youngest child turns 30 and you have no grandchildren— you still can set up a new plan for a grandchild in the future.

A final bonus: There's a special gift tax break for 529 plans. Not only are transfers to 529s considered gifts that qualify for the annual gift tax exclusion ($14,000 in 2014), you can make up to five years worth of contributions in one year. And your spouse can do the same. Together, you could transfer up to $140,000 into a child's or grandchild's 529 entirely exempt from gift tax. ●

8 Retirement Miscues

(Continued from page 1)

hunches is likely to produce more losers than winners. And taking a smart, deliberate approach is as important for investing the assets in tax-sheltered retirement plans, such as 401(k)s and IRAs, as it is for taxable accounts.

Mistake #6—You underestimate health-care costs.

As people live longer and longer—and as growth in health-care costs continues to outpace overall inflation—you'll need to allocate a healthy portion of your savings to personal care. Often, health insurance plans and Medicare will cover much less than you've counted on and you'll need to use your savings to make up the difference. What's more, an extended stay in a nursing home could destroy your retirement nest egg. Consider buying long-term-care insurance to help ward off future disasters.

Mistake #7—You don't factor in taxes.

People often disregard the impact that federal and state taxes can have on their retirement savings. For instance, if you've been accumulating funds in a 401(k) plan and traditional IRAs, when you withdraw money from those accounts to pay your retirement expenses those distributions normally will be taxed at ordinary income rates. In addition, whether you want to or not, you'll have to start taking money from those accounts after you turn age 70½. Your long-term plan for retirement needs to take these taxes into account.

Mistake #8—You count too heavily on Social Security benefits.

After you've paid into the Social Security system during your working career, it's only fair that you reap the benefits. But those monthly payments usually aren't enough to live on comfortably, not by a long shot. It's important to view Social Security as only a supplement to other sources of retirement income—from your investments, company retirement plans, and IRAs.

Making any of these mistakes could cause trouble when it's time to retire. But if you know what to look out for you may be able to avoid problems—and the best time to start fixing things is now. ●