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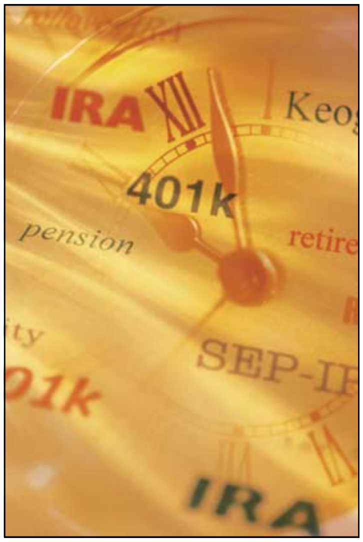
The Wealth Advisor

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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Get Your Finances In Shape For 2016

The new year is the perfect time for a financial check-up. Here are a few tips to help you get started:

Identify financial goals. If you are saving for a house, car or retirement, you need to know how much money you will need to save to reach these goals.

Create a budget. List your monthly income and expenses. Examine where you are overspending, put limits on those expenses and use the savings towards your goals.

Manage debt. Keep your debt manageable. Don't confuse what you can borrow with what you should borrow. We can help prioritize which debt to tackle first

Prepare for the unexpected. Insurance—health, life, disability, property, umbrella—will help you be prepared for life's unexpected moments. Save enough cash to operate your household for three to six months as an emergency fund.

Protect your estate. Update or prepare your will. Check title and beneficiaries of accounts to make sure your assets pass to the proper heirs without going through probate. Have durable powers of attorney and health care directives so trusted individuals can make decisions on your behalf if you become incapacitated.

Prioritize what's most important to you and remember, financial planning is a process that spans a lifetime.

William C. Martin, Jr., CPA

Financial Advisor

Be Aware Of Your Tax Surroundings

When you trade stocks, bonds, or other capital assets, it makes sense to focus on the "bottom line"—whether you'll make or lose money, and how big your profit or loss may be. But what you're doing has tax consequences, too, and you need to be aware of what they are. And sometimes the likely tax ramifications of a transaction could influence whether you go ahead with it.

For simplicity, this discussion of tax-aware investing will look only at federal taxes, although there may be similar results on the state level.

Start with the basic premise that you can "net" any capital gains and losses you realize during the year, with losses subtracted from your gains. Any excess loss can be used to offset up to $3,000 of ordinary income, which is taxed at rates as high as 39.6%. If you have additional losses, you can carry them over to the following year.

Long-term capital gains are taxed at a maximum rate of 15%, or a top rate of 20% if you're in the top ordinary income tax bracket of 39.6%. To the extent that any of your long-term capital gains are taxed in the two lowest income tax brackets of 10% and 15%, the tax rate is 0%.

That can be especially beneficial to a tax-savvy investor. Suppose you realize a net long-term capital gain of $25,000 from a securities transaction this year. If you have $15,000 of room to spare before you cross into the 25% tax bracket for ordinary income, there will be zero tax on the first $15,000 of gain. The remaining $10,000 then will be taxed at the 15% rate for long-term capital gains. In other words, you pocket $25,000 of gain and pay a total capital gains tax of only $1,500!

Short-term capital gains, meanwhile, are taxed at ordinary income rates. This could have an impact on how long you hold securities, perhaps convincing you to delay taking a profit until it qualifies as a long-term gain. Upper-income investors also may have to pay a 3.8% surtax on some investment income.

"Qualified" dividends from U.S. companies benefit from the same preferential tax rates as long-term capital gains. To qualify, you must have held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date (that is, the first date following the declaration of a dividend on which the buyer of a stock is not entitled to receive the next dividend payment).

Other types of investments, too, may be eligible for favorable tax treatment. For instance, while payouts from employer-sponsored retirement plans and IRAs are taxed as ordinary income, qualified distributions from Roth IRAs are 100% tax-free after five years. The tax law includes other statutory benefits that may apply to real estate, annuities, master limited partnerships, and life insurance.

Tax aspects are a critical part of your investment decisions. If you can learn how they work and what the potential tax impact is, you may be able to keep more of your investing profits. We can help you determine how to proceed. ●

Show More Life With A Living Trust

In some financial circles, a revocable living trust has been touted as a staple of estate planning that can even be used to replace a legally valid will. Normally, however, a living trust is viewed as a supplement to a will, not an outright replacement. Here's how this estate-planning technique may serve you best—in life and death:

It's important to understand the basic differences between a will and a living trust. Your "last will and testament" is a legal document determining how, when, and to whom your possessions will be distributed upon your death. It doesn't have any effect until you die. However, a will normally must go through probate before distributions are made. (Property passing through joint rights of survivorship may be one exception to that rule.)

In addition, a will alone may not achieve all of your estate-planning objectives. For instance, you can't impose any conditions on gifts made through a will.

A revocable living trust also is a legally valid document, and you may be able to transfer securities, real estate, or other property to the trust, and you can give the trustee power to manage it on behalf of the designated beneficiaries. Typically, you might name yourself as both the trustee and the initial beneficiary of the trust. At the same time, you can designate other family members—say, your spouse, your children, or both—as secondary beneficiaries entitled to receive remaining assets in the trust when it terminates.

With a living trust, you'll retain a high level of control while you're alive. For instance, you may be able to sell trust assets and keep the cash, amend the terms of the trust (for example, by changing secondary beneficiaries), or revoke it entirely. Unlike a will, a living trust allows you to place restrictions on gifts to

New Law Tightens Social Security Loopholes

New federal legislation signed on November 2, 2015 – the Bipartisan Budget Act – effectively ends two popular Social Security planning techniques: the “file-and-suspend” strategy and the “restricted application” strategy. However, some retirees still may benefit from one or both of these for a limited time.

Other basic rules affecting Social Security retirement benefits haven’t changed. So if you’re preparing to retire you’ll still face important decisions about applying for benefits. In particular, you’ll need to determine whether you want to apply for Social Security benefits early, at full retirement age (FRA), or later.

- You’re eligible for Social Security retirement benefits when you turn 62, but if you start then you’ll receive less than if you delayed payments for a few years. At age 62, your benefit will be about 25% lower than it would have been if you waited until your FRA.
- If you wait until FRA to apply for benefits, you will receive 100% of the benefits to which you’re entitled. The FRA varies according to your date of birth. For those born before 1943, FRA is 65. For those born from 1943 through 1954, FRA is age 66. It gradually increases until topping out at age 67 for those born after 1959.
- Finally, you can delay the start of benefits past when you reach FRA, and that would increase your monthly payment. The longer you wait, up until you turn 70, the higher your benefit will be. (Delaying past 70 won’t bump up your benefit, however.) If you were born in 1943 or later, your annual benefit amount will rise by 8% for each year beyond FRA that you wait to collect benefits.

Other special considerations may come into play for married couples. In a situation in which one spouse is entitled to a greater benefit than the other based on their respective earnings histories, the lower-earning spouse may claim “spousal benefits” providing a larger monthly payment. This wrinkle in the law for Social Security relates to these two loopholes closed by the new law:

1. File-and-suspend strategy. With this approach, the higher-earning spouse usually opts to apply for retirement benefits at FRA. That spouse then suspends payment of the benefits, as now allowed by Social Security rules, which can lead to greater future benefits. Typically, that higher-earning spouse would wait until age 70 before starting to receive benefits. In the meantime, the lower-earning spouse claims spousal benefits, which will be larger than he or she otherwise would have received.

Under the new law, the file-and-suspend strategy won’t be available beginning April 30, 2016, six months from the date of enactment. If you suspend your benefits, your spouse won’t be entitled to the higher spousal benefit. However, if you’re already using file-and-suspend, you’re “grandfathered in” under the new law. In addition, you still can benefit from this technique if you qualify and apply for benefits before May 1, 2016.

2. Restricted application strategy. The new law also effectively ends the restricted application strategy, sometimes called “claim now, claim more later.” Here, a spouse who is approaching FRA and is eligible for benefits on his or her own behalf *and* for spousal benefits files a restricted application to receive spousal benefits only. That spouse then waits until later—typically until age 70—to apply for benefits based on his or her own earnings record. This approach enables the spouse to build up more Social Security credits.

The new law eliminates the option of filing a restricted application for spousal benefits only. If you will turn age 62 after 2015, you must claim all of your benefits upon filing, based on whichever will give you a higher payment—your own earnings history or the spousal benefit. However, if you turn 62 before January 1, 2016, you still can use the restricted application strategy when you reach FRA.

The new law closes two loopholes that had been able to generate thousands of dollars in extra retirement benefits for some couples. But there still will be room for decisions that could boost your Social Security benefits. For example, it may be advantageous to delay benefits until you’re past FRA, even without the file-and-suspend strategy. We would be glad to assist you in deciding how to proceed. ●

beneficiaries. The trust becomes irrevocable when you die.

The main advantage living trusts have over wills is that the property transferred to the trust doesn’t have to go through probate. Depending on the state in which you live, probate can be time-consuming. In addition, unlike a will, a living trust isn’t available to public inspection, ensuring complete privacy with respect to the assets it holds and distributes.

But don’t assume that a living trust is a panacea. It will require some time and work on your part to make all of the necessary arrangements. Also, if you devise a “pour-over will” to catch assets not in the living trust, the will must be probated anyway. Finally, despite some claims to the contrary, there are no estate-tax benefits for property transferred to a living trust.

Clearly, a living trust may provide valuable benefits, but it usually works best hand in hand with your will. We can help you work with your attorneys to find a solution that works for you. ●

Add To Your 401(k) With No Pain

We don't have to tell you how important it is to save as much as you can for retirement through a 401(k) or other plan offered by your company. But that's often easier said than done. When you're paying off a big mortgage on your home and putting your kids through college, you may be left without much you can direct into your retirement plan. But there may be a way to add to your 401(k) without feeling any pain.

It has to do with timing. If you earn more than the maximum Social Security wage base—$118,500 in 2015—you could allocate all or some of your year-end payroll tax savings to add to your 401(k) salary deferral. If you do that every year, you could boost your 401(k) account balance by tens of thousands of dollars or more. And you may not even notice those extra contributions.

With a 401(k) plan, you can defer part of your salary before taxes to an account established on your behalf, within generous limits adjusted for inflation. For 2015, the maximum you can put in is $18,000—or $24,000, if you're age 50 or older. Your company may sweeten the pot with matching contributions based on a stated percentage of your compensation.

Both employee and employer contributions to your account will grow and compound on a tax-deferred basis until you take money out, usually during retirement. If you start early enough and save diligently, you can accumulate a sizable nest egg during your working career.

Suppose that you contribute $12,000 a year and your employer provides a 3% match of your contributions. If you are 20 years away from retirement and earn an 8% return annually, you will accumulate $858,990 before calling it quits. But adding to your contributions at the end of each year can help you do even better. Note: This example is hypothetical. Actual results will vary and are not guaranteed.

During the year, Social Security tax is deducted from your paychecks. For 2015, you'll pay 6.2% on that first $118,500 of wages. Once you clear this Social Security wage base for the year, you can increase your 401(k) deferrals instead of pocketing the extra money. Because your take-home pay isn't reduced, you won't feel any pain.

How much will it help? Suppose, in the previous example, that you're able to increase your annual deferrals by $3,000 a year. With the same 8% annual return over 20 years, your nest egg will grow to $1,073,738—or $214,748 more than if you had spent your year-end payroll tax savings!

Even if your wages don't exceed the Social Security wage base this year, you can look for ways to earmark more of your salary for retirement savings—a top priority no matter what your financial circumstances. ●

That Old 401(k) Account

(Continued from page 1)

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. ●