

THE WEALTH ADVISOR

How To Improve Chances For College Financial Aid

Will your child enter college soon? However much you have managed to save, it may fall short of the very high cost of today's higher education. Financial aid—in the form of grants, loans, or work-study programs—could help make up the difference, but your child will have to apply for this needs-based aid, and that means completing the Free Application for Federal Student Aid, or FAFSA.

Even if you don't think you'll qualify for financial aid, there's no harm in trying, and you may be surprised by the results. Even students from the wealthiest families are eligible for work-study programs. And some colleges offer generous aid packages to families with relatively high incomes. So filling out the FAFSA almost always makes sense.

Nuts and Bolts of the FAFSA

The FAFSA form can be daunting. It has 130 questions about your family's assets and income. You'll have to enter information about the size of your household, your family income, the number of students in college, and most of your assets, though retirement savings are excluded. Your answers are used to determine your "expected family contribution," or EFC. That's the amount you'll be expected to contribute to your student's college education for one year. The lower the EFC, the more financial aid you may be entitled to receive.

The FAFSA is available online at www.fafsa.ed.gov. Due to a recent

change, you now can file the FAFSA for the 2017-18 school year as early as October 1, 2016. (Previously, you would have been required to wait until January 1, 2017). File the form as early as possible because financial aid often is awarded on a first-come, first-served basis.

To fill out the form, you'll need detailed income and expense data from the "base year" for the student and the parents. Some common income items are:

- Wages, salaries, commissions, and tips
- Self-employment income
- Taxable interest
- Dividends and capital gains
- IRA distributions
- Pensions and annuities
- Rental income
- Income from alimony payments

Under another change, the base year for the 2017-2018 school year is the 2015 tax year. (It would have been 2016 before.) And it's the base year—not the year your child will be entering school—that really matters.

If you still have a few years before your child heads off to

college, you may be able to take steps to minimize your income in the base year that's used for FAFSA calculations. Again, the base year is the tax year that ends more than a year and a half before your child starts school. So, if your son or daughter begins classes in the fall of 2018, 2016 is the



2017 Insurance Checkup

As your life situation changes through the years, so do your insurance needs. As we enter a new year, it's a good time to review your insurance coverage to determine if changes need to be made.

Life Insurance:

When reviewing your policy, make sure the benefit covers your current needs. Changes — such as a birth, divorce, remarriage or even a new job — are indicators that you might need to make changes to your policy. It's also important to review your beneficiaries to confirm that your death benefit will be able to help protect your loved ones in the way you intend.

Long-Term Care Insurance:

While many of us realize the impact of rising health care costs, few are adequately prepared. This year is a great time to consider your long-term care options, to prepare for your retirement and reduce the burden on your family. If you do have a plan in place, review your benefits to ensure your coverage is adequate.

Disability Insurance:

What if you can't work in the event of a disability? How will you replace your income? If your employer provides disability insurance, review your coverage as you may need to get an additional policy. If you don't have any coverage, consider getting a policy in place. Contact us today to help review your options!

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Tune Into The Tax Break For NUA

NUA isn't the latest channel available on your cable TV system. It stands for "net unrealized appreciation"—a little-known gem of a tax break for those who take payouts in the form of company stock from a 401(k) or other employer-sponsored retirement plan.

This tax law provision lets you benefit twice: once when you pay the tax on the plan distribution and once when you sell the stock.

If you receive a retirement plan distribution in company stock, you'll be taxed only on what you initially paid for it. You won't have to pay tax on any subsequent gains in value—known as net unrealized appreciation, or NUA. In contrast, cash distributions from your 401(k) normally are taxed as income, at rates up to 39.6%.

And what happens when you sell the shares you received from your retirement plan? Then you will be taxed on the difference between what you paid for the stock and its sale price. But that profit will be taxed at capital gains rates, and if it qualifies as a long-term gain—because you've

owned the stock longer than one year—the maximum tax rate is only 15% (or 20% if you're in the top 39.6% ordinary income tax bracket).

But the tax breaks for NUA aren't automatic. The distribution must be:

- Made from a "qualified" retirement plan sponsored by your employer. (IRAs don't count.)
- Because of a triggering event—you died or became disabled, you reached age 59½, or you stopped working for the company sponsoring the plan.
- Taken in a single tax year.

Assuming you qualify, though, the tax savings for NUA can be substantial. Suppose that during the past 20 years,

hypothetical investor Jane Doe has acquired 20,000 shares of company stock in her 401(k). The stock originally was bought for \$5 a share, but now it's worth \$50 a share, or a total of \$1 million.

If Jane sells the stock within the 401(k) and then takes a cash distribution of the proceeds, the entire \$1 million will be taxed as ordinary income. If Jane is in the 39.6% tax bracket, she'll be hit with a federal income tax bill of \$396,000 (39.6% of \$1 million). But if she instead takes the distribution as stock, not cash, she'll be taxed only on her original cost of \$100,000, and she will pay only \$39,600.

Now suppose that Jane sells the stock immediately for \$1 million. Her \$900,000 gain (\$1 million - \$100,000) is taxed as long-term capital gain at the maximum 20% rate, giving her a tax bill of \$180,000. Add that to the \$39,600 she paid on the distribution, and her total taxes are \$219,600—or \$176,400 less than she would have paid if she'd sold the stock inside her retirement plan. ●



Views On Retirement Communities

How do you feel about retirement communities? Such places, often reserved for those who are age 55, or older, have many supporters and detractors, and opinions may vary widely even from one spouse to another. In the end, this is a personal decision that you have to make for yourself or as a couple. Consider these key considerations:

Common Advantages

- There's generally plenty to do in a retirement community. Depending on the location, you may be able to use your newfound leisure time for golfing, tennis, swimming, gardening, theatre, clubs of all sorts, and

numerous other activities.

- Security is another reason why many senior citizens are flocking to these developments. Many communities are gated and have a visible security presence. Plus, with so many neighbors around all the time—rather than being away at work—suspicious activities tend to be reported quickly.

- The homes usually are located close to a reputable medical facility, shopping, and other conveniences. Some even have retail stores.

- A retirement community may offer peace and quiet, with no teenagers revving up their car engines

or having all-night parties.

- Homes are built with retirees in mind. They generally provide easy access for disabled individuals and the elderly.

- You can meet and socialize with people in your own age group.

Common Disadvantages

- You may have strong ties to your current community. Many people feel most comfortable staying in the home where they raised their kids and living close to long-standing friends and neighbors.

- Do you have adult children or grandchildren living with you? If that's the case, you may not want to

Five Tax-Smart Ways To Transfer Your Wealth

If you're like most well-to-do people, one of your main financial objectives is to transfer wealth to your heirs with a minimum of tax erosion. Several estate planning techniques could help you move closer to that elusive goal. Consider these five opportunities:

1. Lifetime gifts. One of the simplest wealth transfer methods also can be one of the most effective. By giving away property to other family members during your lifetime, you remove those assets from your taxable estate. If you plan carefully, you can make direct gifts without incurring any gift tax liability. And you also may be able to leave assets to your heirs under favorable tax conditions.

The primary tax breaks are:

- An annual gift tax exclusion covering transfers of up to \$14,000 per year per recipient (\$28,000 for gifts by a married couple). You can make these gifts to as many people as you like.

- In addition, everyone is entitled to transfer a total of \$5.45 million in 2016 (the amount is indexed to inflation) in lifetime gifts and bequests without tax consequences.

- Inherited property benefits from a "step-up" in basis—the value of the assets, for calculating taxable investment gains, is what they're worth at the death of the person who made the bequest, rather than when he or she

uproot them. In addition, they may not be allowed to live full time in an age-restricted community.

- Even if you don't have youngsters living with you, you may enjoy being around younger people. The age mix in your neighborhood may suit you just fine.

- One frequent complaint of young retirees is that they don't want to live with "old" people. They see themselves as being young or at least acting as if they were. And some people view living in a



acquired them. That can reduce future taxes. (But note that lifetime gifts don't get a step-up.)

2. Intra-family loans. Usually, you can lend up to \$10,000 to a child or another relative with no strings attached—and no questions asked by the IRS. You don't even have to charge interest. However, if the borrowed amount exceeds \$10,000 and you don't charge a reasonable interest rate, the IRS will consider the amount you didn't charge as interest income to you. One exception is that on loans of \$100,000 or less, the amount of interest you're treated as receiving annually for tax purposes is limited to the child's net investment income for the year.

3. Dynasty trusts. This type of trust is designed to span several generations. You transfer selected assets—say, a combination of stocks, bonds, and real estate—to a trust managed by an independent trustee, usually a professional or financial entity. The trust may be created during your lifetime or through your will. Once the trust is established, it is irrevocable, so you give up control over the assets and the right to change beneficiaries. Depending on the terms, income may continue to accumulate within the

retirement community as a stigma to be avoided at all costs.

- The association fees for maintaining the community grounds—often including swank clubhouses, golf courses, and other amenities—can be pricey. If you're not a golfer, or shun the swimming pool, the extra costs might not be worth it to you.

In any event, get all the information you need to make the best choice for your situation. Your advisers can help. ●

trust or be paid out to beneficiaries. The trustee also may have discretion to use part of the principal for the health, education, support, and maintenance of the beneficiaries, or under other circumstances.

4. GRATs. With a grantor-retained annuity trust (GRAT), you transfer assets into the trust while retaining the right to receive annual annuity

payments for a specified number of years. When the GRAT term ends, the remaining assets are distributed to the beneficiaries you named. The annuity payments you receive during the

term of the GRAT and resulting gift tax value is calculated using a government rate for this purpose, which is currently relatively low. So while you continue to receive annuity payments based on that low rate during the GRAT term, if trust assets grow at a faster rate, the beneficiaries will benefit when they receive the balance remaining at the end of the trust term.

5. IDGTs. Often you might transfer assets to a trust and name loved ones as "income beneficiaries" who get the investment income the trust generates. That way, you'll avoid income tax on those future earnings. However, the trust will be taxed on that income, and the top 39.6% rate for trusts kicks in when income exceeds \$12,400 in 2016. To avoid that result, the trust could be structured to be intentionally "defective," so that income is taxable to you instead of to the intentionally defective grantor trust (IDGT). The gift tax liability for transferring assets into the trust may be sheltered by the estate and gift tax exemption.

Other concepts, such as naming a trust as an IRA beneficiary, also can be helpful in certain situations. But the five listed here may help you achieve your goals.

Keep in mind, though, that trusts are complex, and you'll need professional assistance in structuring and implementing these estate planning ideas. ●



Why Would You Take Your RMDs Sooner?

Is it time for you to begin taking required minimum distributions (RMDs) from your retirement plans? The rules for 401(k)s, other employer-sponsored plans, and traditional IRAs generally call for these payments to start after you reach age 70½ and to continue each year. But you don't actually have to begin RMDs until the "required beginning date" (RBD) of April 1 of the year *after* you turn 70½.

Nevertheless, you might bypass this respite. Why would you do that? Because you still must take another RMD later that year. Thus, you would be doubling up on payouts and have to pay more tax.

Although your savings in 401(k)s and traditional IRAs grow without being taxed along the way, you eventually must start receiving RMDs, taking one each year by December 31. These RMDs generally are taxed at ordinary income tax rates.

If you're still working and don't own the company you work for, you may be able to postpone withdrawals from an employer-sponsored plan with that company until you retire. But

this exception doesn't apply to traditional IRAs.

The amount of the RMD is based on IRS life expectancy tables and the value of your accounts on the final day of the previous tax year. Your financial advisers or the financial company holding your account can provide assistance in computing the amount.

The penalty for failing to take an RMD is equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and any smaller amount you did withdraw). For example, if you're required to take \$20,000 and you're in the 28% tax bracket, the penalty for failing to withdraw is \$10,000, plus you'll owe \$5,600 in federal income tax on the distribution.

If you postpone your first RMD until the following year, you'll have to take two RMDs in that year. If you

remain in the same tax bracket, that will double the tax you owe, or the extra payment may push you into a higher tax bracket. Going back to our

example of an annual \$20,000 RMD, you'll have to take two RMDs for a total of \$40,000 in the following year. Suppose that \$10,000 of the extra amount is taxed at the 33% rate. Your total tax bill on RMDs for that year comes to a whopping \$11,700

($28\% \times \$30,000 + \$10,000 \times 33\%$).

Furthermore, doubling up on RMDs increases the possibility you'll have to pay the federal surtax on "net investment income," and it could hike your state income tax liability as well.

As you approach your RBD, consider your options. In many cases, you'll be better off taking your first RMD in the year in which you turn age 70½, rather than the following year. ●



College Financial Aid

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base year to focus on. For 2019, it's 2017, and so on.

7 Ways to Reduce Base-Year Income

These seven strategies could help you reduce your adjusted gross income (AGI) for FAFSA purposes—and might have tax benefits as well:

1. Transfer income-producing assets to your child. This can help because your income counts against financial aid more than your child's does. And at least some of the future earnings on those assets will be taxed at your child's lower rate.

2. Sell off stock losers. If you unload losing positions, you can use those losses to offset any capital gains

plus up to \$3,000 of ordinary income. That could limit your income in the base year.

3. Hold onto stock winners. Not selling assets at a profit, meanwhile, could also minimize your income. In both cases, though, you need to consider the investment prospects of the assets as well as the potential tax implications.

4. Contribute more to your 401(k). The money you have in your employer-sponsored retirement plans and IRAs doesn't count against you in the FAFSA calculations. Increasing your contribution can help reduce your AGI while at the same time you save more for retirement.

5. Postpone year-end bonuses. If you're in line for a large bonus at the end of the base year, see whether you

can arrange to receive the payment in January rather than December.

6. Launch a new business venture. Most new companies show a loss in the first year of operation. That could help offset your income from other sources.

7. Borrow against your home. Loans don't count as income. If you need cash, you might tap into home equity rather than selling off securities and raising your AGI.

Be aware that some schools also require the CSS Profile for financial aid. This form requires more information than the FAFSA.

You'll need to file a FAFSA for every year that your child is in college. But the optimal approach is to maximize benefits in the first year and go from there. Your financial advisers can help. ●