

# The COMPASS Chronicle

Summer 2016

Highlighting important wealth management issues

## 16 Of The Best Tax Moves For The Summer Of '16

Now that the Protecting Americans from Tax Hikes (PATH) Act has removed some of the uncertainty, tax planning during the summer of 2016 should be a breeze. Here are 16 tax-saving opportunities that may be available to you midway through the year:

**1. Capital losses:** If you cashed in stock winners earlier in the year, you can start filling up the loss side of the ledger. Your capital losses will completely offset capital gains that you realize in 2016, plus up to \$3,000 of highly taxed ordinary income.

**2. Capital gains:** Meanwhile, if you sell securities and earn what qualify as long-term capital gains, the maximum tax rate is only 15% or 20% if you're in the top ordinary income tax bracket. But some upper-income investors also may have to pay a surtax of 3.8% on investment income.

**3. Higher education:** Is your child going to college in the fall? Lay the groundwork for tax breaks. You may be able to claim a higher education tax credit or a tuition deduction, though these tax advantages are phased out at relatively modest income levels. The PATH Act restores the tuition deduction and makes the American Opportunity tax credit permanent.

**4. Wash sales:** If you acquire substantially identical securities within 30 days of selling an investment at a loss, you can't deduct the loss. But this "wash sale" rule can be avoided by waiting at least 31 days to buy back the

same securities. Or you could buy the additional securities first and wait at least 31 days before selling your original shares.

**5. Dividend-paying stocks:** Most stock dividends are taxed at the same preferential tax rates as long-term capital gains. To qualify for this tax break, you must hold the shares for at least 61 days.

**6. Installment sales:** Generally, you can defer tax on the sale of real estate or other property if you receive payments over two years or longer. Besides stretching out tax payments over time, you might reduce the effective tax rate if you stay below the thresholds for higher capital gains rates and the 3.8% surtax.

**7. Hiring your child:** Does your child need a summer job? If you hire the child to work at your business, your business can deduct the wages, which will be taxable to your child at his or her low tax rate.

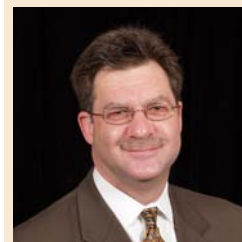
**8. 401(k) contributions:** Reduce your tax liability by increasing contributions to a 401(k) plan at work. For 2016, the maximum deferral is \$18,000 (\$24,000 if you're 50 or older). Not only do you avoid tax on the contributions, the money in your account compounds tax-deferred until you withdraw it, probably during retirement.

**9. Qualified small business stock:** Invest in qualified small business stock (QSBS) of a fledgling company (perhaps your own). The PATH Act restores a 100% tax exclusion for sales of QSBS if

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## COMPASS Corner

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Despite the fear that "Brexit," or the vote on June 23 by the U.K. electorate to exit the European Union, would be

disastrous for the world's stock markets, the reality is that the U.S. stock market sold off by about 5% over two days before subsequently rebounding. In fact, the S&P 500 recently has reached new all-time highs and has generated a total return of nearly 8% year-to-date as of the end of July. True, the European markets have not fared as well (the MSCI EAFE Index is up only 1% since December 31), but the emerging markets have come to life, gaining 12% thus far in 2016.

Bond markets rallied in reaction to Brexit in a flight-to-quality trade, with the yield on the 10-year U.S. Treasury reaching 1.32% in early July, though interest rates have begun creeping up since then, ending July at 1.46%.

Recent economic signs in the U.S. have been generally positive. Though second quarter real GDP growth was only 1.2%, about 1% below expectations, much of this was a result of a drawdown in inventory levels, which can be expected to improve in subsequent quarters. Consumer spending advanced 4.2% during the second quarter and corporate earnings growth has begun to show improvement.

COMPASS expects economic growth to be roughly 2% for the balance of the year, with modest stock market gains still possible.



# Remember The Lesson Of Rebalancing

**S**ometimes investors need to be reminded just how unpredictable equity markets can be. Any big, unforeseen event—such as the United Kingdom’s so-called “Brexit” vote to leave the European Union—can result in dramatic market swings. And because such fluctuations are as inevitable as they are unpredictable, it makes sense to be prepared for all possibilities.

The best way for most investors to deal with short-term volatility is to stick to a long-term plan, rather than panicking or making ill-considered market moves. And your plan will need a proper balance between stocks and bonds in your portfolio.

Historically, stocks have outperformed other kinds of investments and have provided a hedge against inflation, while bonds have provided steady income and more protection against market volatility.

Diversification and asset allocation—core principles for attempting to control investment risks—are used to create a portfolio that may have the breadth to reduce volatility when markets get turbulent. Your overall tolerance for risk can help determine how you allocate your

investments to stocks, bonds, and other assets. Diversification and asset allocation are designed to minimize inherent risks, although there are no absolute guarantees.



But as important as it is to choose a mix of investments that makes sense for you, you’ll also need to revisit your portfolio periodically to help restore the balance you’ve established. If stock prices rise, for example, that part of your portfolio may grow larger than you intended—and this could make you vulnerable if equity prices fall. “Rebalancing” helps you get back to the target percentages you started with.

Yet as simple as that may sound, rebalancing can seem counterintuitive in practice. It requires you to sell

investments that have been doing well and buy others that have slumped. Your natural inclination may be to keep riding a wave of success, and to stay away from parts of the market that haven’t performed well.

But rebalancing can help impose needed discipline for your plan. It can enable you to sell high and buy low and to maintain the broad balance that may cushion your holdings against volatility. And though it sometimes may result in a lower rate of return than you would have gotten if you’d let your winning positions continue to grow, that may be a small price to pay for feeling more comfortable

about your investments.

Rebalancing also can help you resist the impulse to try to “time” the market—attempting to jump in when prices are rising and to get out before they fall. That is rarely a recipe for success and could lead to significant losses.

How often should you rebalance? Expert opinions vary, but you probably should review your portfolio and rebalance at least once a year. The end of the year could be a good time to get your ducks in a row. ●

## What’s The Truth About Probate?

**H**ave you heard horror stories from families that had to suffer through costly, protracted probate proceedings after a relative dies? The possibility is very real, especially if a will is contested. Yet while it might turn into a nightmare, sometimes probate works like a dream. Before you take drastic steps to avoid probate, it’s important to know what it’s likely to involve.

The first thing to know is that laws concerning probate vary from state to state. In some states, the process may be quick, while in others it’s likely to take a while.

Probate is the court-supervised

process of distributing the assets of someone who has died, according to that person’s will. Even when there’s no will, however, assets usually still have to go through probate. Among the exceptions are life insurance proceeds, which normally can go to designated beneficiaries without passing through probate.

If there’s a will and an executor, that person usually handles the probate process. When there’s no will, the probate court will assign someone to assume those responsibilities. The person representing the person who has died will tally up and list the assets; pay outstanding debts, bills,

taxes, and fees; and distribute the assets to beneficiaries according to prevailing laws. It may be helpful to hire an attorney to assist a court-appointed representative.

Probate proceedings are open to the general public. And even if an estate is relatively simple, probate can eat up time and money, perhaps delaying the distribution of assets that family members are counting on. And the last thing grieving family members are likely to want is to be caught up in interminable meetings and legal wrangling.

One way to avoid the hassles of probate is to establish a living trust and

## 20 Questions On Required Minimum Distributions

**D**o you remember playing “20 Questions”? Here are the answers to 20 questions about required minimum distributions (RMDs). Most of this information comes from the frequently asked questions section of the IRS website.

Q1. What is an RMD?

A. This is the amount you’re required to withdraw from your 401(k) plans, other employer-sponsored retirement plans, and IRAs.

Q2. Which plans do the RMD rules apply to?

A. The rules cover all employer-sponsored retirement plans, including pension and profit-sharing plans, 401(k)s, 403(b) plans for nonprofits, and 457(b) plans for government entities, plus traditional IRAs and IRA-based plans such as SEPs, SARSEPs, and SIMPLE-IRAs.

Q3. When do I have to begin taking RMDs?

A. The required beginning date (RBD) is April 1 of the year after the year in which you turn age 70½. For example, if your 70th birthday was January 1, 2016, you must begin taking RMDs no later than April 1, 2017.

Q4. When do I have to take RMDs in future years?

A. The deadline is December 31 of the year for which the RMD applies. Thus, if you turn 70½ in 2016, you must take the RMD for the 2017 tax year by December 31, 2017.

Q5. How do you figure out the RMD amount?

A. Divide the balances in your plans and IRAs on December 31 of the prior year by the factor in the appropriate IRS life expectancy table.

Q6. Can I withdraw more than the required amount?

A. You can withdraw as much as you like; RMDs are the least you are allowed to take.

Q7. If I take more than the RMD this year can I withdraw less in a future year?

A. No. Each RMD is calculated based on the account balance and life expectancy factor for that particular year.

Q8. Do I have to take RMDs from all of my retirement plans?

A. Although you must calculate the RMD separately for each IRA you own, you can withdraw the total amount from just one IRA or any combination of IRAs that you choose. However, for employer-sponsored plans other than a 403(b), the RMD must be taken separately from each plan account.

Q9. What happens if I fail to take an RMD?

A. The IRS imposes a penalty equal to 50% of the amount that should have been withdrawn (reduced by any amount actually withdrawn).

Q10. How are RMDs taxed?

A. Generally, the entire amount of an RMD is taxable at ordinary income rates. The exception is for amounts attributable to non-deductible contributions to an IRA.

Q11. Are there any exceptions to the RMD penalty?

A. The penalty may be waived if you

can show that the shortfall was due to reasonable error and you now have withdrawn the required amount.

Q12. Is an RMD subject to the net investment income (NII) surtax?

A. Distributions from retirement plans don’t count as NII. However, RMDs will increase your modified adjusted gross income (MAGI), and a higher MAGI could make you subject to the tax.

Q13. Can I still contribute to my plans if I’m taking RMDs?

A. Yes. If you’re still working and participating in a plan, you may qualify to continue your contributions.

Q14. Do I have to take an RMD if I’m still working?

A. Generally, you have to take RMDs from all employer-sponsored plans and IRAs. However, you don’t have to withdraw an RMD from non-IRAs if you still work full-time and don’t own 5% or more of the business.

Q15. Can an RMD be rolled into an IRA or other plan?

A. Absolutely not. Rollovers are prohibited.

Q16. Can an RMD be donated to charity?

A. Yes. Under a recent tax law extension, if you’re 70½ or older you can transfer an RMD of up to \$100,000 directly from an IRA to a charity without paying tax on the distribution.

Q17. What happens if I die before my required beginning date?

A. No distribution is required for the year of death. For subsequent years, RMDs must be taken from inherited accounts. A spousal beneficiary has greater flexibility than non-spouses, including being able to treat the account as his or her own.

Q18. What happens if I die after my RBD?

A. The beneficiaries of the accounts must continue to take RMDs under complex rules. Again, spousal beneficiaries have greater flexibility than other heirs.

Q19. Do the RMD rules apply to Roth IRAs?

A. No. You don’t have to take RMDs from a Roth IRA during your lifetime. After your death, however, your heirs must take lifetime RMDs from the Roth.

Q20. When should I arrange my RMD?

A. The sooner, the better. Don’t wait to get caught in a year-end crush. We can help with the particulars. ●

transfer assets into it. The contents of a living trust don’t have to go through probate, and the amounts and recipients of bequests remain private.

Yet in some states, probate can work to a family’s benefit, especially

if an estate is relatively small or someone has died without a will. State law can lay out a blueprint for ensuring that the right people receive the property. In addition, it may be better for the family to have the estate bear the cost of the probate process. The laws in some states include provisions for a relatively fast, inexpensive resolution to probate that may be preferable to using a living trust or other complex arrangements.

Your financial advisor and your attorney can explain the laws in your state and help you decide 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 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. ●



## 16 Tax Moves For Summer Of '16

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you hold the stock at least five years before selling it.

**10. Roth IRA conversions:** You can convert some or all of the funds in a traditional IRA to a Roth. In return for paying income tax on the converted amount, future Roth IRA distributions will be tax-free if they meet certain conditions. To minimize the current tax impact, you could stagger taxable conversions over several years.

**11. Vacation homes:** You can write off certain rental activity costs, plus depreciation, but be careful: If you use the rental home for more than 14 days or for 10% of the days the home is rented out, whichever is greater, your deductions are limited to the amount of

your rental income.

**12. Dependency exemptions:** You probably still can claim a \$4,000 dependency exemption for a child graduating from college in 2016 if you provide more than 50% of the child's annual support. Figure out the amount needed to put you over the half-support mark.

**13. Charitable gifts of property:** Don't toss out old furniture and clothing; give items in good condition to charity. Generally, you can deduct the fair market value of property donated to a qualified organization, within certain limits.

**14. Conservation easements:** A special tax provision allows you to claim deductions for donating conservation

easements involving property you own. Under the PATH Act, you can deduct up to 50% of your adjusted gross income (AGI) this year (100% for farmers and ranchers) instead of the usual 30%-of-AGI limit.

**15. Day camps:** If your under-age-13 children attend a day camp while you (and your spouse, if married) work this summer, you may qualify for the dependent child care credit. However, the cost of overnight camp isn't eligible.

**16. Estimated taxes:** Check to see whether you're withholding enough income tax from your paychecks and adjust the amount if necessary to avoid owing an "estimated tax penalty" in 2016. ●

