

# The COMPASS Chronicle

Fall 2016

Highlighting important wealth management issues

## 16 Tax-Saving Moves To Make At The End Of '16

The national elections in November could result in political changes and legislation that might affect tax planning in 2017 and beyond. For now, though, it pays to focus on ways to reduce tax liability before the end of this year. Consider these opportunities:

**1. Give cash to charity.** If you keep the proper records, you generally can deduct contributions made as late as the last day of the year. But you'll need to know about special rules that may limit your deduction.

**2. Harvest capital losses.** If you sell securities at a loss before year's end, you can use those losses to offset your gains on other sales—including profits on assets you've held a year or less, which are taxed at full income rates. Excess losses can offset up to \$3,000 of ordinary income, and you can carry forward additional amounts to future tax years.

**3. Use your capital gains.** Gains you've already realized could be absorbed by your losses, and profits on shares you've held more than a year qualify for long-term capital gain treatment, with a maximum tax rate of only 15%, or 20% if you're in the top ordinary income tax bracket.

**4. Maximize the 0% rate.** Even better than the usual 15% or 20% maximum tax rate, you can benefit from a 0% rate on long-term capital gains up to the top of the 15% tax bracket. If you're in a low-tax year (perhaps because you've suffered a business loss), this can let you take profits painlessly.

**5. Minimize the NII surtax.** The 3.8% surtax applies to the lesser of your net investment income (NII) or your modified adjusted gross income (MAGI) that exceeds \$200,000 for single filers and \$250,000 for joint filers. Consider taking steps to reduce your NII and MAGI to limit or eliminate this tax.

**6. Buy dividend-paying stocks.** Most dividends are taxed at the same preferential tax rates as long-term capital gains. However, to qualify for this tax break, you must meet a 61-day holding period.

**7. Avoid wash sales.** Under the rule covering these sales, you can't deduct a loss from selling securities if you acquire substantially identical shares within 30 days. To avoid this rule, you simply could wait at least 31 days to acquire similar securities.

**8. Convert to a Roth IRA.** If you have funds in a traditional IRA, you might transfer the funds to a Roth. Future Roth distributions are generally tax-free. You could string out taxable conversions over several years to reduce the tax bite.

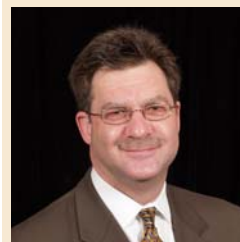
**9. Boost 401(k) contributions.** Increasing deferrals to a 401(k) plan reduces your taxable income. There's a generous \$18,000 deferral limit in 2016 (\$24,000 if age 50 or over). Assets in your account compound on a tax-deferred basis.

**10. Withdraw RMDs on time.** If you are over age 70½, you generally have to take required minimum



## COMPASS Corner

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The third quarter began with the capital markets still digesting the repercussions of the U.K.'s “Brexit” vote and

ended with the Federal Reserve still unwilling to raise interest rates since their first increase in December 2015.

For the quarter, the S&P 500 Index generated a total return of 3.85%, while for the year-to-date period the index gained 7.84%. The MSCI EAFE Index, representing foreign stocks in the developed markets, came to life during the third quarter, increasing 6.43%. The index gained only 1.73% for the year-to-date period, however, due to global growth concerns early in the year and the “Brexit” vote in late June. The emerging markets have performed well this year, gaining 9.03% and 16.02%, respectively, during the third quarter and year-to-date periods.

Bonds generally fared less well for the quarter, after rallying at the beginning of the quarter in a “flight-to-quality” trade subsequent to the “Brexit” vote. The Barclays Capital U.S. Aggregate Bond Index, a broad representation of the U.S. bond market, produced a total return of just 0.46% for the third quarter, but generated a return of 5.80% for the first nine months of the year, assisted by a decline in interest rates during the period.

COMPASS believes that, barring some meaningful, unforeseen event, the Federal Reserve no longer has any excuses left and will be forced to raise interest rates in December to maintain credibility with investors.

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# 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. ●

## 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

# Seeking Financial Aid: Don't Fear The FAFSA

**S**aving money to pay for college is a daunting proposition even if you're reasonably well off financially. With tuition increases continuing to outpace the overall inflation rate year after year, parents may be hard pressed to come up with all of the funds needed to finance a child's higher education. But financial aid could help fill the gap.

Each year, more than 13 million undergraduate and graduate students get some form of financial assistance. But the federal government and universities won't simply hand you the money. To determine whether you qualify for financial aid, you must complete and file the Free Application for Federal Student Aid (FAFSA).

Who should fill out a FAFSA? Practically everyone. Even if you don't think you'll qualify for financial aid, there's no harm in trying because the filing is free. And even students from the wealthiest families may need to submit a FAFSA if they're going to be in a work-study program.

But just because you should file a FAFSA doesn't mean you won't be intimidated by the process itself. Although the form has been simplified somewhat in recent years, it still can be challenging. Don't hesitate to seek our assistance.

## Starting the Process

Virtually every college admission

program requires a FAFSA for financial aid purposes. While a school may ask for other financial information in addition to that sought in the FAFSA, the basis form is pretty much mandatory.

And so you'll have to come up with answers to about 130 questions about your family assets and income. Based on the information you provide, the FAFSA administrators will calculate the "expected family contribution" (EFC) for your family. How many people are in your household, your family income, the number of students in college, and most assets (but not retirement funds) will be factored in.

Where can you find the FAFSA? It's available online all year long at [www.fafsa.ed.gov](http://www.fafsa.ed.gov). But you can't file it until January 1 of the year in which a student plans to start college (for example, January 1, 2016, for someone starting school on September 1, 2016). But be sure to file the form as early as possible because financial aid often is awarded on a first-come, first-served basis. Late filers may miss the bus and receive nothing.

To fill out the form, you'll need income and expense data from the prior year, including:

- Taxable income for both the parents and the student, including wages, pensions, capital gains, interest, dividends, annuities, unemployment compensation, alimony, rents, and business income

- Non-taxable income for both the parents and the student, including workers' compensation, welfare benefits (but not food stamps), housing and food allowances, child support, untaxed Social Security benefits, untaxed income from pensions and annuities, veterans' benefits, tax-exempt interest income, deductible payments made to a retirement plan, and earned income tax credit

- Expenses such as income taxes and child support

- The value of cash, savings, and checking accounts of the parents and the student

- The net worth of all investments of parents and student (except for retirement plans), including stocks, bonds, CDs, money market funds, mutual funds, commodities, trust funds, education IRAs, and state-based college savings plans (excluding pre-paid tuition plans)

- The value of estate holdings (e.g., rental property and second homes), but you don't have to count the equity in your principal residence

- The net worth of a family business or farm (excluding farms that are principal residences)

## The Expected Family Contribution (EFC)

The EFC is the amount your family is expected to contribute to your student's college education for one year. The lower the EFC, the larger the financial aid award that your student may receive.

Sometimes the EFC rules can work in your favor. If your student is admitted to a school that agrees to meet students' full financial needs, the EFC lets you know the most you'll have to pay regardless of how much that college costs.

Suppose that a family's EFC is \$25,000 and the student is applying to a school with a total cost of \$35,000 a year. That family might expect to receive up to \$10,000 in financial aid. What if the college costs \$50,000? The financial aid award could be as high as \$25,000. The basic equation to remember is:  $\text{Cost} - \text{EFC} = \text{Need}$ .

Filing a FAFSA is a necessary evil for those seeking financial aid for college. We can help you position your family for the best possible result. ●

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

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. ●



# Don't Chase After The Market News

**D**id you read the newspaper today or check the news online? Invariably, the stock market will be heading up or down, with the movement triggered by anything from company earnings announcements to a change in economic indicators or even a political event such as Brexit. And, more often than not, financial pundits may respond by urging investors to buy or sell something.

But you can drive yourself crazy, if you haven't already, by making stock market decisions based on what just has occurred or what you think will happen next. In fact, chasing after the news is a common investment mistake. There are at least four good reasons to avoid this temptation like the plague:

## 1. The stock market usually moves ahead of the news.

There was no "all clear" signal that the severe stock market downturn of 2008-2009 had abated. But the market hit bottom on March 9, 2009, and embarked on a long, profitable climb even as other financial news remained dire. Typically, stocks move about six months ahead of economic

developments, reflecting the collective knowledge, trends, and inclinations of investors. If you try to beat the market by reacting to the latest news, you'll probably be much too late to benefit.

## 2. You don't have all the necessary information.

Markets tend to move based on the decisions of mutual fund managers or professional analysts who monitor and interpret financial data for a living. They have a lot more information than you do, and they get it much sooner than you—and millions of others like you—who will hear it on television or find it on the Internet. That puts you at a decided disadvantage.

## 3. You can't believe all the hype.

In this electronic age, media reports are often prone to hyperbole, as the pressure to generate interest from a fickle public continues to increase. That could lead producers to overreact

to news tidbits or sensationalize minor events. One small incident usually doesn't portend a complete economic collapse, so take reports of impending doom with a grain of salt. It isn't likely

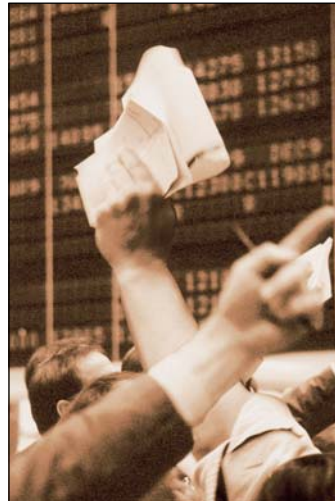
that the sky is falling!

## 4. Market timing is difficult, if not impossible.

To be successful at market timing, you have to be extremely skilled or lucky, or both. Over the long term, buying or selling based on what you hear or read almost never beats a consistent, methodical long-term approach. It's better to make investment decisions based on

financial particulars rather than on instincts and hunches.

Building a diversified portfolio combining stocks, bonds, and other investments can help you progress toward your financial goals—and it can help you stop worrying about what you hear on the news. ●



## 16 Tax-Saving Moves

(Continued from page 1)

distributions (RMDs) from employer retirement plans and traditional IRAs each year. There's a penalty of 50% of the required amount if you miss the December 31 deadline.

### 11. Donate stock to charity.

Giving appreciated stock to charity normally gives you a deduction of the fair market value of property you've held more than a year—letting you avoid tax on your gains.

**12. Beware the AMT.** The alternative minimum tax (AMT) uses a complex roster of adjustments and tax preference items to snare many high-income investors. Postponing some preferences to 2017 could help you cut or avoid the AMT.

### 13. Bunch medical expenses.

Generally, you only can deduct medical expenses that exceed 10% of your adjusted gross income (AGI) in 2016 (7.5% of AGI if you're 65 or older). If you might clear that threshold this year, consider adding elective services or procedures to increase your deduction.

**14. Shift income within the family.** If you transfer taxable investments to a lower-taxed family member, the family may save tax overall. However, investment income above \$2,100 received by a young child in 2016 generally is taxed at the parents'

top tax rate.

### 15. Use installment sale method.

Generally, you can defer tax on the sale of real estate if you receive payments over two years or longer. That also could reduce the effective tax rate by keeping you below the thresholds for capital gains and the 3.8% surtax.

### 16. Be generous around the holidays.

Finally, you can give each family member up to \$14,000 in 2016 without paying any gift tax. Using this annual

exclusion reduces the size of your taxable estate. ●

