

# THE PERSONAL PLANNER

Personal Financial Planning Tips for Today and the Rest of Your Life



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Whew! Crisis averted, at least for the moment. Now we get to see if politicians in Washington can bring themselves to compromise when they set that as their immediate objective. If not, then there's more excitement just down the road, just in time for the holidays.

October has been a surprisingly strong month in the markets given the shutdown, etc. (at least as of this writing on Oct 28). One commentator observed that it seems that "real" investors never considered the shutdown and pending debt ceiling debacle a serious threat because it was felt solutions would have to be found. Government problems aside, I would expect some moderate correction in the equity markets at some point merely because of the gains they've enjoyed the last couple of years. Stay tuned.

Hope you have a great Thanksgiving!  
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## November 2013

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## 2013 Year-End Tax Planning Considerations



As the end of the 2013 tax year approaches, set aside some time to evaluate your situation. Here are some things to keep in mind as you consider potential year-end tax moves.

### 1. The tax landscape has changed for higher-income individuals

This year a new 39.6% federal income tax rate applies if your taxable income exceeds \$400,000 (\$450,000 if you're married and file a joint return, \$225,000 if you're married and file separately). If your income crosses that threshold, you'll also be subject to a new 20% maximum tax rate on long-term capital gains and qualifying dividends (last year, the maximum rate that applied was 15%).

That's not all--you could see a difference even if your income doesn't reach that level. That's because if your adjusted gross income is more than \$250,000 (\$300,000 if you're married and file a joint return, \$150,000 if you're married and file separately), your personal and dependency exemptions may be phased out this year, and your itemized deductions may be limited.

### 2. New Medicare taxes apply

Two new Medicare taxes apply this year. If your wages exceed \$200,000 this year (\$250,000 if you're married and file a joint return, \$125,000 if you're married and file separately), the hospital insurance (HI) portion of the payroll tax--commonly referred to as the Medicare portion--is increased by 0.9%. Also, a 3.8% Medicare contribution tax generally applies to some or all of your net investment income if your modified adjusted gross income exceeds those dollar thresholds.

### 3. Don't forget the basics--retirement plan contributions

Make sure that you're taking full advantage of tax-advantaged retirement savings vehicles. Traditional IRAs (assuming that you qualify to make deductible contributions) and employer-sponsored retirement plans such as

401(k) plans allow you to contribute funds pretax, reducing your 2013 income. Contributions that you make to a Roth IRA (assuming you meet the income requirements) or a Roth 401(k) plan are made with after-tax dollars, but qualified Roth distributions are completely free from federal income tax. For 2013, you can contribute up to \$17,500 to a 401(k) plan (\$23,000 if you're age 50 or older), and up to \$5,500 to a traditional or Roth IRA (\$6,500 if you're age 50 or older). The window to make 2013 contributions to an employer plan typically closes at the end of the year, while you generally have until the due date of your federal income tax return to make 2013 IRA contributions.

### 4. Expiring provisions

A number of key provisions are scheduled to expire at the end of 2013, including:

- Increased Internal Revenue Code Section 179 expense limits and "bonus" depreciation provisions end.
- The increased (100%) exclusion of capital gain from the sale or exchange of qualified small business stock (provided certain requirements, including a five-year holding period, are met) will not apply to qualified small business stock issued and acquired after 2013.
- This will be the last year that you'll be able to make qualified charitable distributions (QCDs) of up to \$100,000 from an IRA directly to a qualified charity if you're 70½ or older; such distributions may be excluded from income and count toward satisfying any required minimum distributions (RMDs) you would otherwise have to receive from your IRA in 2013.
- The above-the-line deductions for qualified higher education expenses, and for up to \$250 of out-of-pocket classroom expenses paid by education professionals, will not be available starting with the 2014 tax year.
- This will also be the last year you'll be able to elect to deduct state and local sales tax in lieu of state and local income tax if you itemize deductions.

# Buckets of Money: A Retirement Income Strategy



*Even with a bucket strategy, you'll probably also need to determine a sustainable withdrawal rate that lets you know roughly how much of your portfolio you can withdraw each year while preserving its longevity.*

*Don't forget that all investing involves risk, including the possible loss of some or all of your principal, and there can be no guarantee that any strategy will be successful.*

Some retirees are able to live solely on the earnings that their investment portfolios produce, but most also have to figure out how to draw down their principal over time. Even if you've calculated how much you can withdraw from your savings each year, market volatility can present a special challenge when you know you'll need that nest egg to supply income for many years to come.

When you were saving for retirement, you may have pursued an asset allocation strategy that balanced your needs for growth, income, and safety. You can take a similar multi-pronged approach to turning your nest egg into ongoing income. One way to do this is sometimes called the "bucket" strategy. This involves creating multiple pools of money; each pool, or "bucket," is invested depending on when you'll need the money, and may have its own asset allocation.

## Buckets for your "bucket list"

When you're retired, your top priority is to make sure you have enough money to pay your bills, including a few unexpected expenses. That's money you need to be able to access easily and reliably, without worrying about whether the money will be there when you need it. Estimate your expenses over the next one to five years and set aside that total amount as your first "bucket." Safety is your priority for this money, so it would generally be invested in extremely conservative investments, such as bank certificates of deposit, Treasury bills, a money market fund, or maybe even a short-term bond fund. You won't earn much if any income on this money, but you're unlikely to suffer much loss, either, and earnings aren't the purpose of your first bucket. Your circumstances will determine the investment mix and the number of years it's designed to supply; for example, some people prefer to set aside only two or three years of living expenses.

This bucket can give you some peace of mind during periods of market volatility, since it might help reduce the need to sell investments at an inopportune time. However, remember that unlike a bank account or Treasury bill, a money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corp.; a money market attempts to maintain a stable \$1 per share price, but there is no guarantee it will always do so. And though a short-term bond fund's value is relatively stable compared to many other funds, it may still fluctuate.

## Refilling the bucket

As this first bucket is depleted over time, it must be replenished. This is the purpose of your second bucket, which is designed to produce

income that can replace what you take from the first. This bucket has a longer time horizon than your first bucket, which may allow you to take on somewhat more risk in pursuing the potential for higher returns. With interest rates at historic lows, you might need some combination of fixed-income investments, such as intermediate-term bonds or an income annuity, and other instruments that also offer income potential, such as dividend-paying stocks.

With your first bucket, the damage inflation can do is limited, since your time frame is fairly short. However, your second bucket must take inflation into account. It has to be able to replace the money you take out of your first bucket, plus cover any cost increases caused by inflation. To do that, you may need to take on somewhat more risk. The value of this bucket is likely to fluctuate more than that of the first bucket, but since it has a longer time horizon, you may have more flexibility to adjust to any market surprises.

## Going back to the well

The primary function of your third bucket is to provide long-term growth that will enable you to keep refilling the first two. The longer you expect to live, the more you need to think about inflation; without a growth component in your portfolio, you may be shortening your nest egg's life span. To fight the long-term effects of inflation, you'll need investments that may see price swings but that offer the most potential to increase the value of your overall portfolio. You'll want this money to grow enough to not only combat inflation but also to increase your portfolio's chances of lasting as long as you need it to. And if you hope to leave an estate for your heirs, this bucket could help you provide it.

## How many buckets do I need?

This is only one example of a bucket strategy. You might prefer to have only two buckets--one for living expenses, the other to replenish it--or other buckets to address specific goals. Can you accomplish the same results without designating buckets? Probably. But a bucket approach helps clarify the various needs that your retirement portfolio must fill, and how various specific investments can address them.

**Note:** Before investing in a mutual fund, carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing.



**Generally, to be considered a tax-free exchange rather than a taxable surrender, you cannot receive the annuity proceeds--the proceeds from the annuity must be paid directly to the LTCI company. Also, Section 1035 applies only if the annuity owner and the LTCI policy owner are the same person.**

## Paying for Long-Term Care Insurance with Tax-Free Funds

The high cost of long-term care can quickly drain your savings, absorb most of your income, and affect the quality of life for you and your family. Long-term care insurance (LTCI) allows you to share that cost with an insurance company. If you're concerned about protecting your assets and maintaining your financial independence, (LTCI) may be right for you.

But LTCI premiums can be expensive, and cash or income needed to cover those premiums may not be readily available. The good news is that there are several tax-free options that can help you pay for LTCI.

### Using a health savings account

A health savings account, or HSA, is a tax advantaged savings account tied to a high deductible health insurance plan. An HSA is funded with pretax contributions up to certain annual limits set by the IRS. Any growth inside an HSA is tax deferred, and what you don't spend in one year can carry over to subsequent years. Just as importantly, withdrawals made from your HSA for qualified medical expenses are tax free.

Tax-qualified LTCI premiums are a qualified medical expense eligible to be paid from HSA funds. The maximum annual premium you can pay tax free is subject to long-term care premium deduction limits.

### Convert taxable annuity to tax-free long-term care insurance

Generally, withdrawals from a nonqualified deferred annuity (premiums paid with after-tax dollars) are considered to come first from earnings, then from your investment (premiums paid) in the contract. The earnings portion of the withdrawal is treated as income to the annuity owner, subject to ordinary income taxes. IRC Section 1035 allows you to exchange one annuity for another without any immediate tax consequences, as long as certain requirements are met. But, what you may not know is that the Pension Protection Act (PPA) extends the tax-free exchange of annuities for qualified stand-alone LTCI or combination annuity/LTCI policies. This effectively allows you to purchase LTCI with annuity cash values that would otherwise have been taxable to you if withdrawn.

However, there are some potential drawbacks:

- You may incur annuity surrender charges when transferring your annuity.

- Transferring your annuity means you won't have the potential income the annuity could provide.
- While premiums for qualified LTCI are tax deductible as qualified medical expenses, annuity payments used to pay for long-term care are not tax deductible.
- Not all long-term care policies allow you to pay premiums in a lump sum, so you may have to make partial 1035 exchanges from the annuity to the LTCI company, but not all annuities allow partial 1035 exchanges.

### HELPS may help

Another opportunity to pay for LTCI on a tax-free basis may be available to qualifying retired public safety officers. Part of the Pension Protection Act of 2006, the Healthcare Enhancement for Local Public Safety (HELPS) Retirees Act, allows certain retired public safety officers to make tax-free withdrawals from their retirement plans to help pay for LTCI for themselves and their respective spouses and dependents.

Eligible retired public safety officers include law enforcement officers, firefighters, chaplains, and members of a rescue squad or ambulance crew. Public safety officers must have attained normal retirement age or they must be separated from service due to a disability. HELPS does not extend to 911 operators, dispatchers, and administrative personnel. In addition, if an eligible participant dies, the exclusion from tax for withdrawals does not extend to surviving spouses or other beneficiaries of the participant's retirement plan.

Eligible government retirement plans include qualified trusts, Section 403(a) plans, Section 403(b) annuities, and Section 457(b) plans. Up to \$3,000 per year may be withdrawn on a pretax basis, and the money must be paid directly from the retirement plan to the LTCI company. However, not all retirement plans may allow for these withdrawals, and some state laws may not allow the tax-free treatment of distributions.

HSAs, the PPA, and the HELPS Act have opened the door to long-term care coverage for people who might otherwise have a hard time affording it. Your financial professional may be able to provide more information on these and other ways to help you plan for the potentially high cost of long-term care.

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## Is it true that my child can receive Social Security benefits based on my earnings record?

Your child--whether he or she is your biological child, adopted child, or stepchild--may be able to receive Social Security monthly benefits based on your earnings record if you're receiving disability or retirement benefits from Social Security, or in the event of your death. These often overlooked benefits can provide steady income for your family when it's needed the most.

How much will your child receive from Social Security? When you start receiving retirement or disability benefits, your child may be eligible to receive up to 50% of your benefit. When you die, your child may be eligible to receive up to 75% of your basic benefit (the benefit that the Social Security Administration calculates you would have received if you had reached full retirement age at the time of your death). Various factors will affect the amount of your child's benefit, including whether other family members are also receiving benefits on your earnings record.

To receive Social Security benefits based on your record, your child must generally be a

dependent under age 18 (or age 19 if a full-time student in grade 12 or lower) and unmarried. However, if your unmarried child is disabled and was disabled before age 22, he or she can qualify for benefits based on your record at any age; benefits for a disabled child may end, though, if your child marries or is no longer considered disabled.

You can find out more about family benefits based on your earnings record by checking your Social Security Statement. To access your statement, sign up for a *my* Social Security account at the Social Security Administration's website, [www.socialsecurity.gov](http://www.socialsecurity.gov). Your statement will give you important information about Social Security that you can use to plan for your family's financial future. This includes how you and your family members qualify for benefits, estimates of your future retirement and disability benefits, and what survivors benefits your child and other family members might receive if you die.



## Do I need to make any changes to my Medicare coverage for next year?

If you're currently enrolled in Medicare, you've probably begun receiving information about your coverage. That's because the annual enrollment period for Medicare runs from October 15 through December 7. During this period, you can make changes to your Medicare coverage that will be effective on January 1, 2014. If you're satisfied with your current coverage you don't need to make changes, but you should review your options before you decide to stay with your current plan.

Your Medicare plan sends you two important documents every year that you should review. The first, called the Evidence of Coverage, gives you information about what your plan covers, and its cost. The second, called the Annual Notice of Change, lists changes to your plan for the upcoming year (these will take effect in January). You can use these documents to evaluate your current plan and decide if you need different coverage. If you haven't already gotten one, you should soon receive a copy of Medicare & You 2013, the official government Medicare handbook. It

contains detailed information about Medicare that should help you decide if your current plan is right for you.

As you review your coverage, here are a few points to consider:

- Will your current plan cover all the services you need and the health-care providers you need to see next year?
- Does your current plan cost more or less than other options? Consider premiums, deductibles, and other out-of-pocket costs you pay such as co-payments or coinsurance costs; are any of these costs changing?
- Do you need to join a Medicare drug plan? When comparing plans, consider the cost of drugs under each plan, and make sure the drugs you take will still be covered next year.
- Does your Medigap plan (if you have one) still meet your needs?

If you have questions about Medicare, you can call 1-800-MEDICARE (1-800-633-4227 or TTY 1-877-486-2048) or visit the Medicare website at [www.medicare.gov](http://www.medicare.gov).