www.libertyassetmgt.com | 630.789.9653 | Fourth Quarter 2015

LIBERTY
Asset Management, Inc.

Steer Clear Of These 7 Traps For IRA Owners

The rules for IRAs offer plenty of opportunities to save a tidy nest egg through contributions directly to the accounts as well as rollovers from 401(k)s or other employer-sponsored retirement plans. Funds in the accounts normally compound tax-deferred while you're working and into the early years of your retirement. You won't owe a penny of federal income tax until you take money out of your IRA.

But if you don't fully understand those rules for IRAs you could run into trouble. Consider these seven common tax traps:

1. You withdraw money from your IRA too early. Because IRAs are meant to be used for retirement saving, the government will penalize you for taking withdrawals prematurely. Generally, a 10% tax penalty applies to distributions made before you reach age 59½, although there are some exceptions—your heirs won't owe the penalty on withdrawals if you die before you reach that age, and you also are allowed to take "substantially equal periodic payments" over several years without penalty. But when you do have to pay the penalty, 10% is added to the regular income tax you owe on the withdrawal.

2. You fail to withdraw money from your IRA. But you're also not allowed to keep money in an IRA indefinitely. The IRS requires you to begin taking required minimum distributions (RMDs) in the year after you reach age 70½. Then you must take an RMD, based on a life expectancy table and the amount in your account at the end of the prior year, for each succeeding year. Failure to take RMDs results in a penalty equal to 50% of the amount that should have been withdrawn.

3. You don't complete a rollover in time. The tax law allows you 60 days from the time you receive a distribution from a tax-deferred retirement plan to redeposit the funds in an IRA. This rollover is exempt from federal income tax. That's generally true whether the rollover comes from an employer plan or from another IRA. However, if you don't redeposit the same amount as you withdrew within 60 days, the transfer is treated as a taxable distribution.

4. You double up on RMDs in the first year. Technically, you don't have to take your first RMD until April 1 of the year following the year in which you turn age 70½. However, if you wait until then to withdraw that first year's RMD, you still must take an RMD for the second year as well. What's more, doubling up on RMDs in one year may increase your overall tax by pushing you into a higher tax bracket. You might end up owing less in taxes if you take the first distribution during the

(Continued on page 4)

What Do You Think Your Life Will Be Like In Retirement?

Much that is written about or spoken about retirement relates to the need to save for your life after work. How much have you accumulated? How much more do you need to save? How is your money invested? Should you downsize your home? Have you planned far enough into the future?

These are all legitimate questions you'll want to address well in advance of the day you finally call it quits. But are you also asking yourself the "other" question: What will my retirement be like? Your lifestyle is likely to change drastically when you retire, and it's a good idea to try to prepare yourself for the road ahead.

Recognize that the changes aren't just financial. Are you mentally and physically ready for retirement? Often, people who stop working wonder what to do with all of their free time. Here are some of the possibilities you might want to consider:

- Start or expand a hobby.
- Join a gym or take up golf or another sport.
- Become active in a seniors group.
- Volunteer for charity work.
- Travel extensively.
- Go back to school or otherwise learn a new skill.
- Go back to work on a part-time basis (perhaps as a consultant).

These activities may provide purpose and meaning in the years ahead as you focus on the quality of life you hope to enjoy in retirement. It's just as important to set your sights on your personal objectives as it is to save enough money to live on.

Three Ways To Defuse Estate Rifts

It's impossible to know what will happen to your family after you're gone, but it's doubtful you're envisioning a bitter squabble over your possessions. Yet many a family is torn asunder when a patriarch or matriarch leaves this world.

Although there are no guarantees the claws won't come out, here are three documents that may reduce the potential for a serious rift:

1. A will. Virtually every adult with assets of any value needs a will. Typically, a will is the centerpiece of an estate plan and covers everything from appointing guardians for young children and addressing estate tax issues to determining who will receive your most valuable assets. A will gives you the opportunity to spell out who will inherit the beach house or expensive jewelry as well as other items of sentimental value.

A properly executed will is legally enforceable, so it's crucial that yours meets all of the technicalities of your jurisdiction. If you have significant assets you'll probably need to hire an attorney to draw up the document. It's likely that it will need to be updated in the future as your family circumstances change.

2. Personal property memorandum. Your will likely won't cover every last trinket you own, and it's a hassle to revise it all the time for minor changes. A personal property memorandum can supplement a will and may be referred to in the will itself. The memorandum can list all of your personal assets and your intended beneficiary for each item.

More than half of the nation's states have laws recognizing a personal property memorandum as legally binding. To avoid confusion, include a detailed description of your property. Make sure your executor has an official copy of both the will and the memorandum.

3. Letter of instruction. This is the last piece of the puzzle. Although a letter of instruction isn't legally binding, it can clarify certain issues and provide additional guidance to your heirs. The letter may include:

- The location of important documents, such as your will, insurance policies, titles, and deeds;
- Details of cemetery plots and funeral arrangements;
- Contacts for legal, tax, and financial information;
- A list and descriptions of all financial assets, including savings and checking accounts, stocks, bonds, and retirement accounts;
- The location of your tax returns for the past three years;
- The location of safe deposit boxes and keys; and
- Other special requests (for example, preferences for grandchildren attending college).

Last, but not least, your family members need to know about these three documents and where to find them. ●

Life Insurance Is Triple Tax Winner

We're not saying that life insurance is the greatest thing since sliced bread. But this financial planning concept—which seemingly has been around forever, perhaps since before sliced bread—does offer significant tax benefits. In fact, permanent life insurance is a three-way tax winner.

For simplicity, this article will focus on whole life, one of several kinds of life insurance. Typically, a whole life policy remains in force as long as you continue to pay the premiums. Meanwhile, the policy builds a "cash value" you can borrow against. You also could surrender the policy and receive its "surrender value." If you keep paying premiums, or if the policy is paid up, your beneficiaries will receive a death benefit when you die. That money, which usually is available a short time after the death, can help sustain a family during a time of financial need.

What about federal income taxes? Although Congress has chipped away at many traditional tax shelters, the main benefits of life insurance remain intact. Generally, it provides at least three significant tax breaks:

- There's no income tax when you acquire the policy.
- There's no income tax on the cash value building within the policy.
- There's no income tax when the death benefit is paid to beneficiaries.

That makes life insurance completely exempt from income tax. This generous tax treatment is especially attractive to upper-income taxpayers. Due to recent tax law changes, the top income tax rate is now 39.6%, and you might have to pay an extra 3.8% Medicare surtax on a portion of your investment earnings. When you add the surtax to the top tax rate, you could be paying tax on some of your income at a 43.4% rate, not even counting state income taxes. It's not unusual for those in high-tax states

5 Steps To Protect The Digital Assets You Own

We're living in a digital world. Nowadays, those important papers that you used to stash in a file cabinet or a safe deposit box often are created and stored electronically. That can remove some of the clutter of having lots of paper around, and it also may be good for the environment. Plus, it gives you easier access to information you need. But advanced technology also may result in problems you may not have considered.

Your heirs could face particularly thorny issues. What will happen to all of your electronic documents and files when you die? Who will have access to them? How will family members be able to find your user names and passwords? What about your photos and music? Will your social media accounts live on forever or will someone take them down? What about bills and insurance premiums you've been paying online? How about information that you want to remain confidential? Those and many other similar questions need to be addressed.

There also could be problems in other situations. Suppose you're severely incapacitated and your oldest child starts to handle your financial affairs online. As far as the financial institutions are concerned, you're still the person logging onto the account and making the transactions. Is it legal for your child to step in if a financial institution doesn't have a durable power of attorney on file? Are there any other restrictions?

State laws are continuing to evolve in this area, so there are no definitive answers, and you could be subject to rules that you agreed to when you signed up for various internet accounts—even if you paid scant attention to the fine print.

Nevertheless, it makes sense to do what you can to safeguard your digital assets while you're in good health. Putting aside the legal technicalities for the moment, here are five steps that could provide some measure of protection:

1. Make a list of passwords and accounts. The first thing to do is to make sure your loved ones have access to your user names and passwords, or that they know where to find that information if it's needed. And try to remember to update your list when you are prompted to change a password for security purposes. It won't do much good to give someone a list of expired passwords.

2. Use a password manager. Along the same lines, it can be difficult managing all of your electronic accounts, even under the best circumstances. A simple solution is to use an online password manager service. Once you enroll with the service, a single password grants access to all of your accounts.

3. Provide authority under your will and durable power of attorney. Don't forget to coordinate the management of your digital assets with your overall estate plan. This may require some additions or modifications to your existing will and durable power of attorney. If you don't have a power of attorney in place, now is a good time to create this document. It enables a designated party to act on your behalf in a multitude of situations.

4. Review vendor contracts. Check the terms of agreements you've signed with social media sites and other online entities. In some cases, matters will be taken out of your own hands. If you're not satisfied with the terms, you might opt to close the account or shift to a different provider. At the very least, develop a good understanding about how things will work in the event of your incapacitation or death.

5. Consider storage with an online company. Undoubtedly, your electronic files contain sensitive information you need to protect, such as your Social Security number and account numbers for securities and IRAs. If that information falls into the wrong hands, it could lead to a financial and logistical nightmare. That could be avoided if you use an online storage company to secure your data.

Technology can simplify our lives, but it also may result in unexpected complications. That's why it's important to do whatever is necessary to give family members the access they will need to handle your financial matters. ●

to exceed an overall 50% mark.

Note; If premiums aren't paid until the insured's death and the policy is surrendered or lapses, the amount previously borrowed is subject to income tax to the extent it exceeds basis.

What about federal estate tax? The proceeds will be included in your taxable estate if you own the policy or otherwise posses any "incidents of ownership," such as the right to change beneficiaries. But you can avoid that problem easily by transferring ownership of the policy to a life insurance trust. And even if death benefit proceeds are subject to estate tax, a generous \$5.43-million exemption in 2015 can cover the liability.

What will it cost? This varies widely, based on factors such as the amount of coverage, your age, medical condition, and family health history. But you should be able to find a policy with a reputable insurer that is affordable for your situation.

Of course, from an investment standpoint, you might achieve a better rate of return with other options. Nevertheless, life insurance, aided by the triple tax shelter, can be a productive part of your overall financial plan. ●

How Low Can Capital Gains Tax Go?

What's better than paying today's 15% or 20% maximum tax rates on long-term capital gains and qualified dividends? How about paying 0%? That's not a misprint. If you qualify, the tax on a portion or all of your net long-term capital gain is an absolute zero.

What's more, this unique tax break isn't necessarily reserved for people who don't make much money. In some cases, it also can benefit those who normally earn high incomes.

According to basic rules for taxing capital gains, short-term gains from selling stocks, bonds, or other capital assets that you've owned for a year or less are taxed at ordinary income rates reaching as high as 39.6%. If you've owned the assets for more than one year, your profit on a sale is treated as a long-term capital gain and taxed at a maximum of 15% for those in most tax brackets or 20% if you're in the top ordinary income bracket of 39.6%.

However, short-term and long-term gains for the year may be offset in whole or in part by losses you've taken on other asset sales.

Similar rules apply to "qualified" dividends that meet specified requirements, including that you've held the stock in question for at least 61 days.

But some investors can do even better than these favorable rates. If you are in either of the two lowest ordinary income tax brackets—with rates of 10% or 15%—your net long-term gains will be taxed at the 0% rate. This tax break often is available to young children and other investors who don't earn much in wages. But don't assume you can't jump on the bandwagon.

For example, suppose you earn an annual salary of $100,000 but you suffer a business loss of $50,000 from your S corporation in 2015. That leaves you with $50,000 in taxable income for the year to report on a joint tax return.

Under tax rates in effect for 2015, the upper threshold of the 15% tax bracket is $74,900. In other words, you can realize a long-term capital gain of up to $24,900 without passing that upper limit and without paying any tax on the gain. And if you realize a larger gain, you still can benefit from the 0% tax on the first $24,900.

Now is a good time to assess your personal situation for the year. If you're in line for the 0% tax rate and it otherwise makes good investment sense to sell assets on which you'll realize long-term capital gains, don't miss out on the opportunity. ●

7 Traps For IRA Owners

(Continued from page 1)

year you turn 70½.

5. You roll over to another IRA more than once a year. Although rollovers aren't taxed as long as they're completed within 60 days, you can make an IRA-to-IRA transfer only once during a 12-month period. Violation of this "once-in-a-year rule" results in a taxable transfer. Previously, the IRS treated this rule as applying separately to each IRA you own. However, because of a recent Tax Court case and a subsequent change in IRS rules, the once-a-year rule now applies to all IRAs. So if you make a transfer between any of your accounts, you won't be able to make another one until a year has passed.

6. You make the wrong choice for a spousal rollover. Spouses who inherit an IRA may elect to treat the IRA as their own, remain as a beneficiary of the deceased spouse's IRA, or "disclaim" the IRA so that it goes to a contingent beneficiary. This complex decision could have unintended tax consequences. For instance, if you inherit an IRA, you are under age 59½, and you need to make a withdrawal, designating the IRA as your own could result in a 10% tax penalty.

7. You ignore estate tax ramifications. IRA owners sometimes forget the estate tax implications of inherited IRAs. Because IRA assets will be included in your taxable estate, the person you designate as beneficiary can make a difference. Spouses normally can inherit an unlimited amount without owing estate taxes, but that money could be taxed when the second spouse dies. It pays to consider all of the possible implications when you work with your advisors to devise an estate plan that fits your situation.

By paying close attention to the rules, and sidestepping these traps, you can derive the maximize benefits from your IRAs. ●