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Financial Planning Strategies

A Financial Planning Update

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Mr. Kennedy's investment philosophy is the same that he has practiced over the last decade: securities markets are efficient and advisors primarily add value by coordinating the asset allocation for clients based upon risk tolerance, objectives, and time horizons. The firm has constructed 5 models for clients that vary in risk to meet the goals of each client. The firm primarily uses passive mutual funds in each model and uses select actively managed funds for bond, commodity, and real estate exposure. ITI uses several research resources, including many that were used over the last 20 years, to assist with the recommended asset allocation and the appropriate funds to utilize in each model.

Mr. Kennedy is an Investment Advisor Representative of ITI Financial Management, LLC. Investment services are offered through ITI Financial Management, LLC, a registered investment adviser with the state of Missouri.

Traditional IRAs—Forgotten, But Not Gone

With the number of financial products available in today's retirement savings marketplace, the traditional **Individual Retirement Account (IRA)** can get easily overlooked, despite the potential for tax deferral and income tax deduction for individuals under the age of 70½. Here are some categories of savers who may benefit from a traditional IRA retirement savings account:

Individuals without a retirement plan. Single taxpayers who are not part of an employer-sponsored retirement plan (e.g., **401(k) plan**) may benefit the most from using a traditional IRA. The same holds true for married taxpayers whereby neither spouse is a participant in an employer-sponsored retirement plan. Each individual can then contribute up to $5,500 in 2018 ($6,500 for individuals who are age 50 and older) annually to an IRA without meeting any income eligibility requirements, and may deduct their entire contribution for income tax purposes.

Some individuals covered under an employer-sponsored plan. Any individual who is a participant in an employer-sponsored retirement plan may contribute up to $5,500 in 2018 ($6,500 if age 50 and older) to an IRA, but whether or not that contribution can be *deducted* for income tax purposes depends on the taxpayer's **adjusted gross income (AGI)**. Deductions in 2018 phase out for single filers with **modified AGIs (MAGIs)** between $63,000 and $73,000, and for married couple joint filers with MAGIs between $101,000 and $121,000.

Working children. One commonly overlooked savings opportunity is for a working child to start making contributions to his or her own IRA. Many high school- and college-aged students work part-time during the summer, school vacations, and even the school year. In addition to instilling excellent saving habits, contributing to an IRA at an early age can give a child a significant head start in saving for retirement.

Individuals who are retiring or changing jobs. An IRA can allow an individual who is retiring to postpone taxation of his or her retirement plan proceeds. Likewise, an IRA can achieve similar tax benefits for individuals who are changing employers. A special type of traditional IRA—the **rollover IRA**—is used to accept the plan proceeds upon termination of employment. When properly executed, a rollover IRA avoids current income taxation, any unnecessary withholding of taxes by the former employer, and the 10% Federal income tax penalty for early withdrawals. It also allows the IRA owner to actively manage his or her IRA assets.

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Steps to Help Ensure Estate Planning Success

For many people, more time and attention are devoted to building their estate than to planning for its ultimate disposition. Understandably, enjoying the fruits of your labor is often more interesting than planning for what might happen when you are no longer here.

However, the Internal Revenue Service (IRS) is interested in your estate, and a lack of estate planning could, at the very least, create stress for your heirs and, more importantly, increase your estate tax liability. With this in mind, here are six estate conservation strategies that can help you avoid some unnecessary pitfalls:

1. **Keep detailed records.** After you die, your heirs will need to sort out your financial affairs. You can help them by maintaining detailed records and letting them know where to find your will, insurance policies, bank statements, and other important documents.
2. **Keep your will up to date.** A will is the most basic legal estate planning document, through which you can specify how your property is to be distributed at your death. In addition, you can appoint an **executor**, who will coordinate the process of probate, the preparing and filing of final income and estate tax returns, and the distribution of assets. Without a will (**intestate**), the state will determine the distribution of assets according to state inheritance laws.
3. **Plan beyond your will.** A will arranges your estate *after* your death. However, incapacity during your lifetime may affect your ability to make financial and health care decisions. A **durable power of attorney** designates someone to make financial decisions on your behalf, even in the event of incapacity. A **living will** states your wishes for the use of life-sustaining measures under specified conditions. A **health care proxy** (also known as a **medical power of attorney**) designates someone to make important health care decisions on your behalf. A complete estate plan encompasses both lifetime and post-mortem planning.
4. **Take advantage of the applicable exclusion amount.** In 2018, each taxpayer may transfer up to approximately $11.2 million (the estate tax **applicable exclusion amount**) in assets to non-spousal heirs without estate taxation. Your entire estate can pass to your spouse tax free under the unlimited marital deduction. As a result of the enactment of the American Taxpayer Relief Act of 2012, if one spouse dies and does not use the full exemption amount, the remainder can be used by the surviving spouse. With this "portability" option, spouses do not have to split assets between them, or be concerned about who holds the title on various assets.
5. **Use the annual gift tax exclusion.** In 2018, an individual can give away up to $15,000 per year ($30,000 in the case of joint gifts made by a married couple) to an unlimited number of recipients tax free. For individuals with large estates, a regular gifting strategy using this annual exclusion may be an attractive way to transfer appreciating assets, which would otherwise have the potential to increase estate taxes if left in the estate.
6. **Consider life insurance.** Life insurance is often used as a funding method for estate taxes. However, proceeds of life insurance policies are includable in your gross estate for purposes of calculating estate taxes. Consider using an **irrevocable life insurance trust (ILIT)**, which removes the insurance from your estate and therefore potential estate tax exposure.

By preparing in advance, your wishes for property distribution can be executed upon your death. Be sure to consult with your qualified tax, legal, and financial professionals to help ensure your strategies are consistent with your overall objectives. $

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Non-spousal beneficiaries of an existing IRA. Since 2010, non-spousal beneficiaries are permitted to directly roll over funds inherited from employer-sponsored retirement plans into inherited IRAs. According to the IRS, retirement plan distributions to a non-spouse beneficiary are

subject to many of the same rules that apply to other eligible rollover distributions. Retirement plan sponsors must offer a non-spouse beneficiary the option of making a direct rollover, or a trustee-to-trustee transfer, of eligible rollover distributions to an inherited IRA. This means the transfer is made from the retirement plan to the IRA, and not to the beneficiary.

What about the Roth IRA?

While income taxes are due when IRA distributions are taken, Roth IRA contributions are made with after-tax dollars and earnings accumulate tax free. In contrast to the traditional IRA, Roth IRAs have neither an age limit for contributions nor minimum distribution requirements. However, both traditional and Roth IRAs have a minimum age for distributions: 59½.

Does the Roth IRA eliminate the need for a traditional IRA? Well, that depends on the situation. It is possible for some taxpayers to be eligible for and contribute to both a Roth IRA and a traditional IRA. It is important to note, however, that the IRA contribution limit ($5,500 in 2018 or $6,500 for those age 50 and older) applies to the total of all IRAs that a person may hold in a given tax year.

Is the Traditional IRA an Option for You?

When determining if an IRA is appropriate for *your* situation, you need to evaluate the following: 1) whether you are eligible to make a deductible contribution; 2) if comparable savings opportunities exist elsewhere (e.g., your employer-sponsored 401(k) plan); and 3) the current and long-term tax benefits.

Traditional IRAs may have been overlooked as viable retirement savings vehicles in recent years, but may still serve a valuable purpose for your unique financial situation. Be sure to consult a qualified financial professional to help you determine your retirement savings opportunities, and formulate your savings strategy for the future. $

What Causes Inflation?

Inflation, defined as the increase in the average price level of *all* goods and services, is often caused by changes in supply and demand on a broad scale. For example, suppose business is booming, unemployment is low, and workers' wages are increasing. As a result, consumers have more disposable income, and therefore are able to purchase more goods and services. Average prices will tend to rise due to the increase in *demand* for all goods and services.

Suppose the economy is suffering. As unemployment rises and wages remain stagnant, consumers are unable to buy additional goods and services. In response, production slows down and prices rise in order to cut losses. In this case, average prices increase due to a decrease in the *supply* of all goods and services.

In addition to creating higher costs for goods and services, inflation creates depreciation in currency values. As prices go up, the purchasing power of your income—dollar for dollar—decreases; that is, more dollars are needed to purchase the same amount of goods and services. In time, your personal savings and investments will have to work harder to keep up with or exceed inflation. It is important to consider inflation as you continue to save for retirement and make major purchasing decisions. $

Use a Mortgage When Lending Large Amounts to Your Children

Parents often find that once their children are grown and have left home, they may still require financial help. Although adult children may earn their own money, the cost of living and the acquisition of such things as a home may be beyond their means. As a result, many parents may want to provide a "lending" hand. While large loans from parents to offspring are quite common, it is important to pay attention to the tax rules that apply to such transactions.

Liening on Your Child

One beneficial way to establish a loan is to make sure that your child can receive a deduction for the interest he or she pays to you. To accomplish this you must prove to the Internal Revenue Service (IRS) that your loan is a mortgage. Unlike other types of interest, mortgage interest secured by a principal residence is still fully deductible. Have an attorney draw up a mortgage agreement so you can take a lien on your child's house. This method is generally used for substantial loans over $10,000.

Setting Rates

With that completed, you can set the interest rate you want to charge. If you use a fair market rate, the tax rules are straightforward. You pay income tax on the amount of interest you receive and your child deducts that amount from his or her income. The IRS determines fair market interest rates monthly.

However, if you charge your child a below market rate or no interest at all, the tax accounting becomes more complex. In fact, you may pay tax on more interest than you actually receive—and a gift tax, as well. On the other hand, your child could deduct more than he or she actually pays you.

A Case in Point

Here's how it works: Suppose you lend your child $150,000 at 3% interest when the market rate is 4%. Your child pays you $4,500 a year in interest instead of a fair market amount of $6,000. Under the IRS rules, you still have to pay income tax on the full $6,000, and your child can deduct all $6,000 even though he or she didn't actually pay that amount. The IRS then considers the $1,500 difference as a *gift* from you to your child subject to gift tax rules. As long as that amount—combined with any other gifts to your child that year—remains below the $15,000 annual gift tax exclusion in 2018 ($30,000 for joint husband and wife gifts), you won't have to pay gift taxes.

An offer of financial help from a parent can make a big difference in setting a child off on the road to homeownership. However, before making a loan to any of your children, be sure to establish the required payback interest rate and schedule, so the benefits you provide your child do not negatively affect your own personal financial situation. $

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