

## Roth IRA Conversions: The Time May Be Right

Perhaps you've thought about converting part of your traditional IRAs to a Roth IRA in the past, but you didn't pull the trigger. For instance, you might not have had the money available to pay the tax on a conversion without diluting your retirement assets. Or you may not have wanted pay that tax in a year in which you were in a high tax bracket.

Now, however, with the incoming Congress promising to enact significant tax cuts, the time may be right to convert to a Roth.

With a traditional IRA, contributions may be deductible from your taxable income, but not if you also participate in a retirement plan at work or earn too much to qualify for a deductible IRA. When you take distributions from a traditional IRA, usually during retirement, you're taxed at the rates for ordinary income on the portion representing tax-deductible contributions and earnings. Under current law, the top

ordinary income tax rate is 39.6%. In addition, if you withdraw from an IRA before you reach age 59½, you must pay a 10% penalty tax unless you qualify for a special exception.

Suppose you're age 55 and you take a fully taxable distribution of \$100,000 from your traditional IRA. If you're in the top 39.6% bracket, you'll owe tax of \$39,600, plus a penalty of \$10,000, for a total tax bill of \$49,600. Withdrawing that money also could have other adverse tax consequences, such as making you liable for a 3.8% surtax on net investment income.

Contributions to a Roth IRA, meanwhile, are never tax-deductible, but when you take a distribution from a Roth you've had for at least five years that income is completely tax-free and also exempt from the 10% tax penalty. The lure of future tax-free payouts is usually the driving force behind converting a traditional IRA to a Roth.

The downside of a conversion is

## Fate Of Fiduciary Rule Is Uncertain, But Count On Us

On February 3, 2017, President Trump issued an executive order on the controversial new "fiduciary rule," authorizing further review. It was scheduled to take effect on April 10, 2017. On March 2, 2017, the Department of Labor (DOL) extended the comment period for 60 days.

The new rule would require financial advisors and their firms to uphold certain fiduciary standards when they are compensated for investment advice and recommendations relating to retirement accounts such as 401(k)s and IRAs. Essentially, advisors and firms would have to represent that they're putting the best interest of clients before their own.

This "best interest" provision would have had to be included in a written contract that would say that the advice being offered is based on a client's particular needs.

After much discussion, the modified final rule covered some assets that were thought to have been excluded, such as variable annuities, and eliminated certain requirements on fee projections.

Although the ultimate fate of the rule is now up in the air, some firms have already implemented changes relating to the rule and are likely to stick with them.

Rest assured, regardless of how this plays out, our firm has your best interest at heart. Don't hesitate to contact us if you have any questions.

		Roth Conversions	
		Taxation of Roth IRA Distributions - Summary	
		Distribution within 5 years	Distribution beyond 5 years
Age < 59½	Income Tax: Yes (earnings only)	Income Tax: Yes (earnings only)	Income Tax: Yes (earnings only)
	10% Penalty: Yes (earnings & taxable portion of prior conversion amounts)	10% Penalty: Yes (earnings only)	10% Penalty: Yes (earnings only)
Age ≥ 59½	Income Tax: Yes (earnings only)	Income Tax: No	Income Tax: No
	10% Penalty: No	10% Penalty: No	10% Penalty: No

(Continued on page 4)

# Timely Tax Angles To Dividends

**N**ot all payouts to shareholders are “qualified dividends,” but those that are get favorable treatment in which they’re normally taxed at less than your rate for ordinary income.

But the tax rules for qualified dividends may go out the window if proposed tax reforms are enacted. The big question is whether you would fare worse under the new rules—or better.

Under current law, most dividends issued by domestic companies are qualified when paid out to shareholders and the owners of mutual funds. In some cases, qualified dividends also may come from foreign corporations, if their shares include publicly traded American Depositary Receipts (ADRs) or shares that are otherwise readily available on an established U.S. securities market.

The maximum tax rate on qualified dividends is only 15% for most investors. If you’re in the top ordinary income tax

bracket of 39.6%, the tax rate is 20%. Even better, though, investors in the two lowest ordinary income brackets of 10% and 15% benefit from a maximum 0% rate on qualified dividends.

To qualify for these reduced tax rates, shareholders of common stock and mutual funds must own the shares for more than 60 days, including the ex-dividend date (the annual date on which dividends are paid out). The holding period is 90 days for preferred stock. This can affect the timing of transactions if the ex-dividend date is approaching.

Other dividends, including most

dividends issued by foreign corporations, are taxed at ordinary income rates. Therefore, if you received \$1,000 in foreign dividends in 2016 and you’re in the top tax bracket of 39.6%, you must pay \$396 in tax on the dividends on your 2016 tax return. But even then, you may be eligible for a foreign credit or deduction that can offset tax paid on foreign dividends dollar for dollar.

So how does potential tax reform figure in the mix? Under campaign proposals from President Trump, the favorable tax rates for qualified dividends would be repealed, but

investors would benefit from overall tax cuts. The seven-bracket structure would be scaled back to just three tax brackets with a top tax rate of 33%. It’s not yet clear what changes will be enacted, however, or how particular taxpayers might fare.

The best approach is to continue to monitor developments. We will pass along vital information. ●



# Teach Employees About Computer Scams

**C**omputer criminals seem to be stepping up their efforts to steal your personal and financial information—and your money.

The two most common approaches are the “tech support” scam, aimed primarily at individuals, and the “ransomware” scam, mostly used against businesses.

In a typical tech support scam, unsolicited phone callers say they are calling about “Windows,” the popular operating system of computer software giant Microsoft. Don’t believe it.

Microsoft says it never makes unsolicited phone calls about Windows computer problems.

Do not allow such a caller to take control of your computer. Hang up the phone immediately. This scam has been around since 2009.

Ransomware schemes have been around even longer, since 1989 when a disturbed biologist sent infected floppy discs to an AIDS conference sponsored by the World Health Organization.

This scam is aimed at businesses primarily because all it takes is for one employee to click on a link that then allows a scammer to take control of a business’s computer system by shutting down the system or paralyzing it with encrypted, unintelligible jargon.

The scammer then demands a

ransom, usually to be paid through an untraceable virtual currency such as bitcoin, to unlock the system and return it to normal.

The Federal Bureau of Investigation estimates that since 2015, U.S. companies have paid a total of \$25 million to ransomware scammers.

The ransomware scam can start with a phone call much like the ones used by tech support scammers. In such a case, an employee is urged to allow the caller to obtain access to a business’s computer system. Again, don’t do it! Ever!

Today’s version of the increasingly complicated scam also can start with a

# Four Tax-Wise Ways To Donate Gifts To Charity

**H**ow can you donate to charity? Let us count the ways.

Although there are many variations on these themes, there are four basic paths for making contributions to charitable organizations that let you take tax deductions while pursuing your philanthropic goals. They are:

**1. Direct contributions:** This is the easiest method. You simply write a check or make an online donation. If you're giving tangible property, such as artwork, you'll need to deliver it physically to the charitable group.

Most such contributions are fully deductible on your tax return, but there could be limitations on the size of your write-off based on your adjusted gross income (AGI) for the year:

- Contributions to public charities are limited to 50% of your AGI.
- Contributions of appreciated property (for example, publicly traded stocks) to public charities can't exceed 30% of your AGI.
- Contributions of appreciated property to private foundations are limited to 20% of your AGI.

But in all of these cases any amount that exceeds the limits can be claimed on the following year's return, and such "carryovers" may continue for up to five years.

**2. Donor-advised funds:** With a

donor-advised fund, you give your money to a fund that's set up with an institutional partner. There might be a minimum contribution amount, and the fund may charge fees to cover its costs. But one big advantage of this approach is that you can make a donation to the fund and get an immediate tax deduction and then decide later where you want your money to go.

Once you choose to give a specified amount to a particular charity, the fund will verify that the

organization is eligible to receive tax-deductible contributions. Once your grant is approved, the money goes to the group with an indication that it was

made on your recommendation. You also can request that your gift be made anonymously.

**3. Charitable gift annuities:** This approach is somewhat more sophisticated than direct gifts and donor-advised funds. A charitable gift annuity is a contract between a donor and a charity. You agree to transfer

money, securities, or other assets to the organization, which in turn agrees to make specified payments to "annuitants"—usually you or you and someone else you designate.

What are the tax consequences? As the donor, you're entitled to a charitable deduction in the year you make your donation to the charity that is adjusted to account for the expected payments you'll receive, based on your life expectancy and other factors.

**4. Charitable trusts:** There are two main types to consider: the charitable remainder trust (CRT) and the charitable lead trust (CLT).

With a CRT, you set up the trust and transfer selected assets

to it. The charity often acts as the trustee and manages the assets. During the trust term, you (or another beneficiary or beneficiaries you specify) receive regular payments from the trust. The CRT may last for a term of specified years or your lifetime. Finally, when the trust ends, the remaining assets from your contribution (the remainder) go to the charity. You get a current tax deduction based on the projected value of that remainder.

A CLT works the opposite way. You still transfer assets to the trust, but annual payments go to the specified charity, and the remainder at the end of the trust term goes to the beneficiaries you designated.

Regardless of whether you use a CRT or a CLT, the annual payments may be based on a fixed amount or a percentage of assets. Other special rules apply, so be sure to obtain expert guidance.

This is a brief overview of current rules. But these approaches could be affected by proposed tax changes. We'll keep you up to date on any changes. ●



"phishing" email that asks a business computer user to click on a link to a website, article, or photograph that appears to be legitimate.

Scammers, in fact, are adept at creating legitimate-looking company names, fake caller IDs, and bogus company logos.

Business owners may be able to avoid these pitfalls by educating their employees about ransomware scams and how they work.

First, tell your employees never to take an unsolicited phone call from a

stranger and then allow the caller access to your company's computer system.

Tell your employees not to rely on caller ID numbers to authenticate calls.

Also tell them about phishing emails that offer information or rewards if an enclosed link is clicked on.

Tell them never to click on a link from an unknown source, even if the email contains a legitimate-looking

company name and logo.

If your employees don't know the source of an email, tell them not to click on a link or attachment – ever! ●



# IRS Adjusts Retirement Plan Limits

Every year, the Internal Revenue Service (IRS) adjusts the amounts you can contribute to employer retirement plans and IRAs, based on inflation indexing. For 2017, the limits are slightly higher in some cases, while others stay the same. Here's a rundown on the key limits for participants:

## Limits that will change for 2017

**Defined contribution plans** – The limit on total annual additions to 401(k), profit-sharing plans, and other such vehicles is increased to \$54,000 for 2017 (up from \$53,000).

**Defined benefit plans** – The maximum size of the annual benefit for traditional pensions and related retirement plans increases to \$215,000 for 2017 (up from \$210,000).

**Annual compensation** – The maximum amount of compensation that can be taken into account for most employer retirement plan calculations increases to \$270,000 (up from \$265,000).

**Deductible IRA contributions** – Phase-outs in 2017 for deductible IRA contributions will reflect the following changes:

- For single filers participating in an employer plan, the phase-out range increases to between \$62,000 and \$72,000 for 2017 (up from \$61,000 and \$71,000).

- For an IRA contributor filing jointly who participates in an employer plan, the phase-out range increases to between \$99,000 and \$119,000 (up from \$98,000 through \$118,000).

- For an IRA contributor filing jointly whose spouse participates in an employer plan, the phase-out range increases to between \$186,000 and \$196,000 for 2017 (up from a range of \$184,000 to \$194,000).

**Roth IRA contributions** – For single filers, phase-outs for the ability to make contributions increase to a range of from \$118,000 to \$133,000 for 2017 (up from \$117,000 to \$132,000). For joint filers, the phase-out range increases to between \$186,000 and \$196,000 for 2017 (up from \$184,000 to \$194,000 for 2016).

## Limits that won't change in 2017

**Elective deferrals** – The deferral limit for those who participate in a 401(k), 403(b), most 457 plans, and the government's thrift savings plan remains at \$18,000 for 2017. The limit for catch-up contributions to these plans for participants age 50 or over remains at \$6,000.

**SIMPLE plan deferrals** – The limit on earnings deferrals to a SIMPLE plan remains at \$12,500 for 2017. The limit for catch-up contributions for participants age 50 or over holds steady at \$3,000.

**Highly compensated employees** – The dollar limit used to define highly compensated employees (HCEs) for employer plans stays at \$120,000 for 2017.

**IRA and Roth contributions** – The maximum amount you can contribute to traditional and Roth IRAs stays at \$5,500 for 2017. The \$1,000 limit on catch-up contributions for participants 50 or over isn't subject to inflation indexing. ●



## Roth IRA Conversions

*(Continued from page 1)*

that you're taxed on at least part of the amount you convert, just as if it were a distribution from a traditional IRA. If you're in the peak of your earning years and in the top 39.6% tax bracket, or close to it, you may owe a hefty tax for the conversion. Even if you spread out the conversion over several years, the cost may be too high to stomach. (If most of your contributions to the traditional IRA were not deductible, however, the tax hit of a conversion could be reduced considerably.)

But if tax rates indeed are reduced in 2017, a conversion might become more palatable. For example, if a three-tier structure of 12%, 25%, and 33% were adopted, someone who had been in the

39.6% bracket might save tens of thousands of dollars in taxes on a large conversion. This may be enough to convince you to convert this year, especially if you believe that tax rates might rise again in the future.

Of course, there's no guarantee that a tax cut will be enacted, and if you made a conversion assuming taxes would go down, you could be disappointed. In that case, though, you could decide to "recharacterize" your new Roth IRA back into a traditional IRA. With this technique you simply undo the conversion. As far as the IRS is concerned, it's as if it never had occurred.

What's more, you have plenty of time to decide if you want to recharacterize. The deadline is the tax return due date for the year of the

conversion plus extensions. In other words, if you convert in 2017, you have until October 15, 2018, to complete a recharacterization.

And there's nothing that says you couldn't choose to convert to a Roth IRA all over again. But the earliest you could do that is the beginning of the tax year following the tax year of the conversion or the end of a 30-day period beginning on the day of the recharacterization, whichever is later.

Yet while it's possible to undo a Roth conversion—and then to reconvert back to a Roth—it's better not to proceed based just on what you think is going to happen in Washington. We can help you weigh the factors of your situation as you weigh the pros and cons of a Roth conversion now or later. ●

Milestone Financial Planning, LLC

2 Commerce Drive • Bedford, NH 03110 • (603) 589-8010