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7 Financial Steps Forward In A Second Marriage

Marrying again after divorce or the death of a spouse may offer great personal benefits. But it also can lead to financial complications, especially if you have children from your first time around.

However, the blessed event doesn't have to be ruined by family squabbles. Discussing matters openly and deploying a range of estate planning strategies can help you develop a plan that meets your needs. Here are seven steps to help move you along:

1. Open the lines of communication. Before you tie the knot, be up-front about your concerns and preferences. Talk to each other about your intentions and how you expect to pass along assets to other family members, including any children and grandchildren. You might find it helpful to include an impartial person, such as your financial advisor, to "broker" the talks.

Consider this checklist of points to discuss:

- Existing financial obligations (for example, a promise to pay for a grandchild's education);
- Plans for future support and funding for retirement;
- Guardianship of any minor children; and
- A prenuptial agreement protecting your personal interests.

2. Conduct an inventory. Now is a good time to compile a list of your assets. This may include: stocks, bonds, mutual funds, and other investments; amounts that you've transferred to trusts; retirement plan and IRA funds; and proceeds that will be available from life insurance policies. Also, review any agreements made during the course of your first marriage. For instance, if you were required to name your then- spouse as the beneficiary of your retirement plan accounts, you may have less flexibility than you thought.

3. Consider the variables. Not everything is cut and dried. It's up to you to decide which assets, if any, you will comingle with your new spouse's. Keep in mind, though, that the laws of your state also may come into play. For instance, in community property states, the law presumes that assets will be owned jointly. But most states mandate "equitable distribution," calling for property to be distributed fairly, but not necessarily equally. Also, you'll want to factor in your age and health status, as well as those of your spouse.

4. Pay attention to titles. The way that property is titled, both prior to marriage and after, can have a profound effect. For example, setting up accounts as joint tenants with rights of survivorship (JTWROS) will make it clear that assets will go directly to the other named person, such as your spouse, when you die. But if a title names you as the sole legal owner of assets, they'll pass to your estate and not

(Continued on page 4)

Study Up On Earnings Test For Social Security Benefits

The Social Security retirement benefits you'll receive can supplement your income from other sources, but there's a catch: Benefits may be reduced if you're still working. It all has to do with the Social Security "earnings test."

Generally, you can begin collecting Social Security benefits as early as age 62, but the longer you wait to start, the larger your monthly benefit will be. In addition, until you reach what Social Security considers your "full retirement age" (FRA), you may lose part of your benefits if you're still on the job. (If you were born in 1943, or later, your FRA will range from 66 to 67.) Short of that age, your benefits will be reduced to the extent your earnings exceed an annual limit.

This earnings limit is adjusted annually. If you'll hit FRA after 2016, the exempt amount in 2016 is $15,720. For every $2 you make above that limit, you'll lose $1 in benefits.

If you'll reach FRA during 2016, the annual exempt amount is $41,880, but it applies only to what you earn before the month you attain FRA. In this case, you'll lose $1 of benefits for every $3 over the limit. Anything you make during or after the month you hit FRA won't reduce your Social Security payments.

Every situation is different, but you generally should wait to apply for benefits until you can pass the earnings test. Keep an eye on the limits.

Tune Into The Tax Break For NUA

NUA isn't the latest channel available on your cable TV system. It stands for "net unrealized appreciation"—a little-known gem of a tax break for those who take payouts in the form of company stock from a 401(k) or other employer-sponsored retirement plan.

This tax law provision lets you benefit twice: once when you pay the tax on the plan distribution and once when you sell the stock.

If you receive a retirement plan distribution in company stock, you'll be taxed only on what you initially paid for it. You won't have to pay tax on any subsequent gains in value—known as net unrealized appreciation, or NUA. In contrast, cash distributions from your 401(k) normally are taxed as income, at rates up to 39.6%.

And what happens when you sell the shares you received from your retirement plan? Then you will be taxed on the difference between what you paid for the stock and its sale price. But that profit will be taxed at capital gains rates, and if it qualifies as a long-term gain—because you've owned the stock longer than one year—the maximum tax rate is only 15% (or 20% if you're in the top 39.6% ordinary income tax bracket).

But the tax breaks for NUA aren't automatic. The distribution must be:

- Made from a "qualified" retirement plan sponsored by your employer. (IRAs don't count.)
- Because of a triggering event—you died or became disabled, you reached age 59½, or you stopped working for the company sponsoring the plan.
- Taken in a single tax year.

Assuming you qualify, though, the tax savings for NUA can be substantial. Suppose that during the past 20 years, hypothetical investor Jane Doe has acquired 20,000 shares of company stock in her 401(k). The stock originally was bought for $5 a share, but now it's worth $50 a share, or a total of $1 million.

If Jane sells the stock within the 401(k) and then takes a cash distribution of the proceeds, the entire $1 million will be taxed as ordinary income. If Jane is in the 39.6% tax bracket, she'll be hit with a federal income tax bill of $396,000 (39.6% of $1 million). But if she instead takes the distribution as stock, not cash, she'll be taxed only on her original cost of $100,000, and she will pay only $39,600.

Now suppose that Jane sells the stock immediately for $1 million. Her $900,000 gain ($1 million - $100,000) is taxed as long-term capital gain at the maximum 20% rate, giving her a tax bill of $180,000. Add that to the $39,600 she paid on the distribution, and her total taxes are $219,600—or $176,400 less than she would have paid if she'd sold the stock inside her retirement plan. ●

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.

Five Tax-Smart Ways To Transfer Your Wealth

If you're like most well-to-do people, one of your main financial objectives is to transfer wealth to your heirs with a minimum of tax erosion. Several estate planning techniques could help you move closer to that elusive goal. Consider these five opportunities:

1. Lifetime gifts. One of the simplest wealth transfer methods also can be one of the most effective. By giving away property to other family members during your lifetime, you remove those assets from your taxable estate. If you plan carefully, you can make direct gifts without incurring any gift tax liability. And you also may be able to leave assets to your heirs under favorable tax conditions.

The primary tax breaks are:

- An annual gift tax exclusion covering transfers of up to $14,000 per year per recipient ($28,000 for gifts by a married couple). You can make these gifts to as many people as you like.
- In addition, everyone is entitled to transfer a total of $5.45 million in 2016 (the amount is indexed to inflation) in lifetime gifts and bequests without tax consequences.
- Inherited property benefits from a "step-up" in basis—the value of the assets, for calculating taxable investment gains, is what they're worth at the death of the person who made the bequest, rather than when he or she acquired them. That can reduce future taxes. (But note that lifetime gifts don't get a step-up.)

2. Intra-family loans. Usually, you can lend up to $10,000 to a child or another relative with no strings attached—and no questions asked by the IRS. You don't even have to charge interest. However, if the borrowed amount exceeds $10,000 and you don't charge a reasonable interest rate, the IRS will consider the amount you didn't charge as interest income to you. One exception is that on loans of $100,000 or less, the amount of interest you're treated as receiving annually for tax purposes is limited to the child's net investment income for the year.

3. Dynasty trusts. This type of trust is designed to span several generations. You transfer selected assets—say, a combination of stocks, bonds, and real estate—to a trust managed by an independent trustee, usually a professional or financial entity. The trust may be created during your lifetime or through your will. Once the trust is established, it is irrevocable, so you give up control over the assets and the right to change beneficiaries. Depending on the terms, income may continue to accumulate within the trust or be paid out to beneficiaries. The trustee also may have discretion to use part of the principal for the health, education, support, and maintenance of the beneficiaries, or under other circumstances.

4. GRATs. With a grantor-retained annuity trust (GRAT), you transfer assets into the trust while retaining the right to receive annual annuity payments for a specified number of years. When the GRAT term ends, the remaining assets are distributed to the beneficiaries you named. The annuity payments you receive during the term of the GRAT and resulting gift tax value is calculated using a government rate for this purpose, which is currently relatively low. So while you continue to receive annuity payments based on that low rate during the GRAT term, if trust assets grow at a faster rate, the beneficiaries will benefit when they receive the balance remaining at the end of the trust term.

5. IDGTs. Often you might transfer assets to a trust and name loved ones as "income beneficiaries" who get the investment income the trust generates. That way, you'll avoid income tax on those future earnings. However, the trust will be taxed on that income, and the top 39.6% rate for trusts kicks in when income exceeds $12,400 in 2016. To avoid that result, the trust could be structured to be intentionally "defective," so that income is taxable to you instead of to the intentionally defective grantor trust (IDGT). The gift tax liability for transferring assets into the trust may be sheltered by the estate and gift tax exemption.

Other concepts, such as naming a trust as an IRA beneficiary, also can be helpful in certain situations. But the five listed here may help you achieve your goals.

Keep in mind, though, that trusts are complex, and you'll need professional assistance in structuring and implementing these estate planning ideas. ●

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% x $30,000 + $10,000 x 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. ●

Tax Rewards For Year-End Generosity

If you're looking for ways to cut your taxes before the end of the year, consider donating cash or property to a qualified charitable organization. Besides helping out a worthy cause, you can reduce your taxes for 2016, as long as you adhere to the rules. But there are several potential obstacles to overcome.

For starters, you generally can deduct the full amount of cash contributions to charity as long as the total doesn't exceed 50% of your annual adjusted gross income (AGI). (If you give more than that, you can carry the excess forward to future tax years.) Yet the IRS insists on strict recordkeeping for cash and cash-equivalent donations.

To claim a deduction, you have to be able to provide a bank record or a written communication from a qualified charitable organization, required for gifts of $250 or more. Such a notification must show the amount of the contribution, the date it was made, and the name of the charitable organization. And you need to have it in hand by the date you file your return or the date that it's due, plus any extensions.

Things get more complicated if you give gifts of appreciated property. Generally, such donations are limited to 30% of your AGI, with any excess deducted in future years. But if you donate securities that would have produced a long-term capital gain (on investments you'd held for more than a year) if you'd sold them, you can write off the property's fair market value (FMV) on the date of the donation. Otherwise, the deduction is limited to what you paid for the property.

Suppose you donate stock to a qualified charity in December. You acquired the shares for $3,000 two years ago and the FMV is $5,000 on the date of your donation. In this case, your deduction isn't limited to $3,000—you can deduct the entire $5,000, and you avoid paying taxes on the $2,000 that the shares appreciated.

Other special rules may come into play. For instance, if you donate artwork to charity, the art must be used to further the charity's tax-exempt function. So a gift to a museum that shows the art should qualify for a deduction.

Finally, keep in mind that most itemized deductions, including those claimed for charitable contributions, are reduced for high-income taxpayers under something known as the Pease rule. Your tax advisor can tell you more.

Charitable donations can be made through New Year's Eve and still qualify for a deduction in the current tax year. And if you make an online contribution on December 31 and charge it to a credit card, it still will count as having been made in 2016—even though you won't pay the bill until 2017. ●

7 Financial Steps Forward

(Continued from page 1)

directly to your spouse.

5. Name your beneficiaries. If you're entering a new marriage you'll likely need to amend your existing will or replace it entirely. In particular, it's important to review the beneficiaries you've named for various assets in the will. Also, take a look at the beneficiary designations in documents for all of your retirement plans, IRAs, and life insurance policies. Those beneficiary designations take precedence over whatever may be in your will.

6. Show some trust. Your estate plan may include one or more trusts, which can be useful in transferring wealth to children of an earlier marriage while imposing some constraints on the recipients. Here are a few possibilities:

Bypass trust: This vehicle could be designed to provide income to a surviving spouse, with the remainder of trust assets going to other designated family members.

Q-tip trust: With a qualified terminable interest property (Q-tip) trust, a surviving spouse may receive income, but not principal, when the owner dies, with children receiving the remainder from the surviving spouse's estate.

Spendthrift trust: As the name implies, this trust can be helpful in restricting beneficiaries' access to assets until they reach a specified age or meet other requirements.

7. Don't forget about taxes. Last, but not least, it makes sense for both of you to consider how to minimize estate tax on the federal and state levels. That likely means taking steps to use the generous estate tax exemption ($5.45 million in 2016) as well as the "portability" provision that can help spouses use exemption not used by their deceased partners. Such provisions could be included in trust documents or other estate planning devices.

The second time around, it's more important than ever to seek expert assistance from your estate planning advisors. Don't hesitate to contact us. ●

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