

SA-KG ADVISORS QUARTERLY



Avoid These 6 Mistakes In Stretch IRA Planning

As talk of the possibility of tax reform continues in Washington, there's an increased focus on the rules for "stretch IRAs." This retirement planning technique, which enables you to preserve assets in an inherited IRA for an extended period, could be targeted in a larger tax reform package. For the time being, however, stretch IRA planning remains a viable option for many people.

But to use a stretch IRA successfully, you'll need to follow a number of important rules and avoid common mistakes made by those who inherit IRA assets.

If you own an IRA, you must take required minimum distributions

(RMDs) annually beginning in the year after you reach age 70½. Otherwise, you'll be hit with a stiff IRS penalty. Those distributions are taxed at your rate for ordinary income—which could be as high as

39.6%—and are based on a calculation that considers the account balance at the end of the previous year and your life expectancy (or your joint life expectancies with your spouse).

However, beneficiaries who inherit your IRA can arrange for RMDs based on their own life expectancies, unless they choose to empty the account more quickly. Stretching out the IRA over the

longer time can help preserve wealth for younger generations.

With those basics in mind, consider these six common mistakes in stretch IRA planning:

Mistake #1: Your account is titled improperly. When someone dies and IRA assets are inherited, it's crucial to ensure that the account name is titled correctly. For example, if someone other than your spouse inherits your IRA, your name should remain on the inherited IRA account title and it must be indicated that it is an inherited IRA by using the words "beneficiary" or "beneficiary IRA" or "inherited IRA."

Mistake #2: You fail to take RMDs. If the IRA account holder already was taking RMDs at the time

of death, inheritors will need to make sure that the RMD is withdrawn for the year in which the account holder died. Failing to meet this requirement triggers a penalty

equal to 50% of the amount that should have been withdrawn.

Mistake #3: You, as the primary beneficiary, fail to utilize a disclaimer when appropriate. A qualified disclaimer is a legal document that effectively says you choose not to receive the IRA assets, which then will pass to the contingent beneficiaries listed on the IRA paperwork. This



Don't Be Caught Red-Handed By The Wash Sale Rule

It often makes sense to "harvest" capital losses from securities transactions to offset capital gains. Any losses that exceed your gains can offset up to \$3,000 of ordinary income for the year.

But not all investment losses are deductible. Under the "wash sale rule," a capital loss is disallowed if you acquire substantially identical securities within 30 days of the sale. This rule often trips up unwary investors.

When are securities "substantially identical?" The definition is murky, but stocks and bonds of different companies are not substantially similar. However, buying and selling shares of mutual funds within the same family could trigger the rule.

Fortunately, it's relatively easy to avoid making wash sales. You simply can wait more than 30 days to acquire substantially identical securities. Or if you want to pounce now on a particular offering, you could do that and wait more than 30 days to sell the original shares.

Be careful not to get boxed in by the wash sale rule at the end of the year. Allow yourself enough time to sell your shares.

If a loss is denied, at least there's a silver tax lining: The amount of the disallowed loss is added to the basis of the new securities, and that will have the effect of decreasing your taxable gain or increasing your deductible loss on a future sale.

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How You Can Manage Risk Aversion

During the early part of 2017, the stock market was rolling merrily along, with the Dow Jones Industrial Average (DJIA) breaking through the 20,000-point barrier for the first time. But the “Trump bump” won’t last forever and some prognosticators are forecasting eventual doom and gloom. In all likelihood, the stock market will continue to experience ups and downs, just like it has throughout its history.

Regardless of whether the market is going up or down, or staying relatively stable, your portfolio should reflect your personal aversion to risk. Primarily, there are three types of risk to address in this overall philosophy:

1. Risk of loss of principal:

This is the risk of losing the money you initially invested. Say you buy a stock for \$1,000 that jumps to \$1,200 before it falls back to \$900. If you sell the stock at that point, you will have lost \$100 of principal.

2. Risk of loss of purchasing power: You may be willing to limp along with modest returns, but you’re losing money if the inflation rate exceeds your rate of return. For instance, if you acquire a bank CD

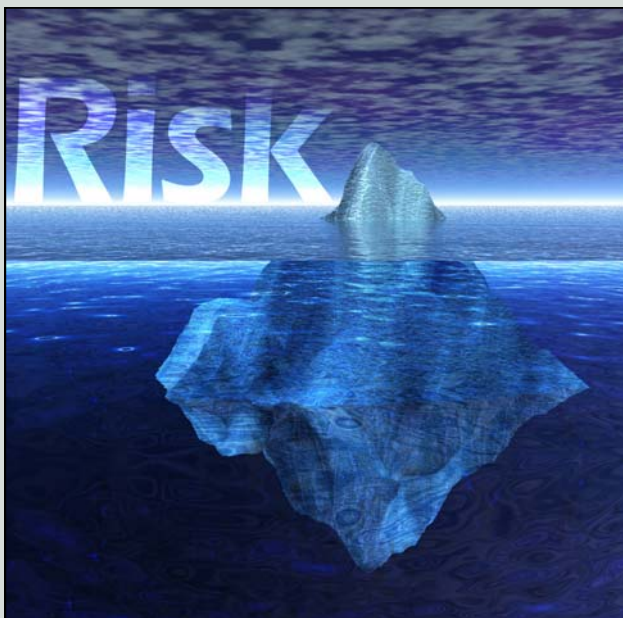
paying a 2% annual rate and inflation rises to 3.5%, you’re losing 1.5% in the purchasing power of that investment.

savings, especially given recent increases in life expectancies.

Risk assessment surveys can provide some insights. Typically, an analysis will reveal that you tend to be either a conservative, moderate, or aggressive investor, within certain ranges. Your portfolio should reflect this characterization.

If you indicate a more conservative bent, you may want to fine-tune your investments accordingly, taking into account asset allocation and diversification methods. Again, these strategies do not offer any guarantees, nor do they protect against losses in declining markets, but they remain fundamentally sound.

Other potential ideas are to weight your portfolio more heavily to bonds than you did in your younger days. The technique of “bond laddering,” with bonds maturing at different dates, is a variation on this theme. Similarly, conservative investors may emphasize dividend-paying stocks and blue chips, as well as mutual funds and exchange traded funds (ETFs) offering diversification. Every situation is different. Reach out to us to address your specific concerns. ●



3. Risk of outliving your savings:

Is your investment plan overly conservative? Remember that the stock market historically has outperformed most comparable investments over long periods, although there are no absolute guarantees. Therefore, you’re likely to fare better with a well-devised investment plan than you would if you stuffed your money under a mattress. Otherwise, you might outlive your

Sowing Tax Seeds For Capital Gains

Most investors know all about the tax reasons for “harvesting” capital losses. But if you’re considering a sale of assets that have gained in value, keep in mind that harvesting long-term capital gains can offer tax advantages as well.

Capital gains and losses from securities transactions, as well as other dispositions of capital assets, are used to offset each other. Thus, if you’re showing a net capital gain for the year, you might realize a loss, especially at the end of the year. The loss can negate the gain plus up to \$3,000 of highly taxed

ordinary income. And any leftover losses can be carried over to use the following year.

On the other side of the ledger, short-term capital gains from sales of securities you’ve held for a year or less are taxed at ordinary income rates. But gains that qualify as long-term—from selling securities you’ve held longer than one year—are taxed under special rules.

If you’re in one of the two lowest ordinary income brackets of 10% and 15%, your maximum tax rate on long-term capital gains is 0%. If you’re in higher brackets, the news isn’t quite as good, but in most cases

long-term gains still are taxed at just 15%. And even if you’re in the top income bracket of 39.6%, your maximum tax rate on long-term capital gains is 20%.

Suppose you’re a joint filer with taxable income of \$100,000 this year. That puts you in the 28% bracket. Harvest a long-term capital gain of \$10,000 from a securities sale, and you’ll owe tax of \$1,500. That compares with a tax bill of \$2,800 if you realize a \$10,000 gain on short-term holdings.

But even long-term gains count as “net investment income” (NII) and could be subject to an

5 Ways To Help You Pay For Higher Education

The cost of sending children to college remains daunting, and annual increases in the price tag for higher education have outpaced the overall inflation rate for years. According to the College Board, yearly hikes in college costs during the past decade have averaged roughly 5%, while consumer prices in general have risen less than 3% a year.

But parents can take advantage of several college savings tools to help meet this steep challenge. Consider these five possibilities:

1. Section 529 plans: Section 529 plans, sponsored by U.S. states, encourage families to set aside funds for the future education expenses of beneficiaries. The contribution limit usually is at least \$300,000. As long as certain requirements are met, your investment can grow without current taxes, and distributions made for qualifying college expenses—including tuition, fees, books, supplies, equipment, and room and board for full-time students—also are tax-free.

There are two main types of Section 529 plans: (1) prepaid tuition plans that let you prepay the cost of attending college years down the road at current rates and (2) college savings plans, whose assets are invested according to your preferences.

2. Custodial accounts: A traditional

way of saving for college is to set up a custodial account under your state's Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA). With these accounts you, or another custodian, manage the funds for the child's benefit until the child reaches the age of majority in the state. The advantages of Section 529 plans have tended to overshadow this approach in recent years.

There also are potential "kiddie tax" complications with custodial accounts. Under this rule, unearned income of a dependent child under age 24 may be taxed at the top tax rate of the child's parents to the extent that the child's income exceeds an annual threshold (\$2,100 for 2017). This tax provision can eat into the amount being saved for college.

3. Minors' trusts: A minor's trust, authorized by Section 2503(c) of the tax code, is designed to provide funds for beneficiaries to use to pay for college. Like custodial accounts, minors' trusts have been around for a long time, but their popularity has waned because of the influx of Section 529 plans. Unlike custodial accounts, the trust can be set up to continue past the state's age of majority, as long as the beneficiaries

don't exercise a limited right to withdraw funds.

With a minor's trust, trust income is taxed directly to the trust, so this arrangement avoids any kiddie tax problems. However, trust tax brackets are narrow, and significant investment earnings may be taxed at the top rate of 39.6%.

4. Coverdell Education Savings Accounts: Coverdell Education Savings Accounts (CESAs) operate like IRAs for education expenses.

Withdrawals used to pay qualifying expenses are tax-free to the beneficiaries. However, the contribution limits pale next to those of Section 529 plans. The maximum annual contribution limit for a beneficiary is just \$2,000

and hasn't been increased in years.

Nevertheless, CESAs do offer some advantages. For one thing, unused assets can be rolled over tax-free for multiple beneficiaries. Furthermore, the funds in CESAs can pay for elementary and secondary schools as well as colleges. For this reason, such plans sometimes are used to supplement a Section 529 plan.

5. Financial aid: Finally, don't overlook the role that financial aid can play in helping pay for your child's education. Even relatively affluent families may qualify for some financial aid, so it makes sense to apply.

At the very least, students should fill out the Free Application for Federal Student Aid (FAFSA) provided by the federal government. To complement the FAFSA, some schools also may require the student to submit another form, the CSS Financial Aid PROFILE. And certain colleges and state agencies may request additional forms. Colleges use the information in these documents to calculate their financial aid offers.

Financial aid can come in several forms—as loans, grants, and scholarships. Generally, these benefits are tax-free to the students who receive them, although there are certain exceptions, particularly when financial aid involves work-study programs. ●



additional 3.8% surtax. That tax applies to your NII or the amount by which your modified adjusted income exceeds \$200,000, or \$250,000 for those who file jointly, whichever is less. That extra tax could reduce the advantage of harvesting long-term gains.

And if you do realize a long-term gain, think twice before taking a loss on another holding to offset that gain. Capital losses are more valuable if they're used to absorb

highly taxed short-term gains. If you've already taken a loss, you may want to consider whether it would make sense to use it by harvesting a short-term gain.

These rules could change, if and when Congress passes any of the tax reforms currently being debated. As possible changes come into focus, we can help you decide whether to make specific

transactions you're contemplating this year. ●





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strategy may be preferable if you don't need the money and you intend to pass along the inherited assets to younger beneficiaries eventually. Doing it now means RMDs will be based on the new owners' longer life expectancies.

Mistake #4: You fail to analyze contingent beneficiaries when using a disclaimer. It's important to consider all relevant financial and tax factors before agreeing to pass up inherited IRA assets through a disclaimer. This is not a casual decision. Consider whether the contingent beneficiaries in fact will be able to stretch out the IRA longer under their life expectancies and look at their tax consequences. Younger contingent beneficiaries may be in a

lower tax bracket than you are, and if they pay the taxes that could reduce the overall tax bite.

Mistake #5: You take a lump-sum distribution. Some people think they're required to take a lump-sum distribution from an inherited IRA to empty the account immediately. That's simply not true. If you need the money, go ahead and take it. But if you don't have a pressing need, going the stretch IRA route could enable you to preserve wealth longer and generally will reduce tax liability.

A large lump-sum distribution could rocket you into a higher tax

bracket and force you to lose more of the inheritance in taxes.

Mistake #6: You fail to analyze spousal rollovers. Current tax law

offers greater flexibility to spouses who inherit an IRA. They can roll over inherited assets into their own IRA accounts and set up payouts calculated on their own life expectancies. However, a rollover isn't always the optimal approach for spouses. For instance, if a surviving spouse is under age 59½, payouts from the IRA will trigger



the 10% penalty tax for early withdrawals, on top of the regular income tax owed. ●