The FINANCIAL SUCCESS Library

Money Minute

Financial Planning & Investing Newsletter

"Smart Ideas for Secure Finances"

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5 Questions - Taxes, IRAs, Life Insurance, College Savings Plans, etc.

From time to time, I accumulate a back log of questions from conversations and e-mails with clients, readers and friends. In this month's feature story, I'd like to share five recent questions and answers that have come up, covering topics ranging from 401(k) participation and IRAs to college savings plans and life insurance. Enjoy!

1.) The company I work for announced that it is suspending 401(k) matching contributions. Is it still worth it for me to contribute?"

The biggest draw of 401(k)s is without a doubt the matching employer contributions. Absent those, you should take a close look at one of two other options that will both likely give you access to superior investment options.

A Traditional IRA or a Roth IRA will both allow you to save for your retirement, and either will allow you a much greater selection of investments compared to your 401(k). Traditional IRAs - so long as your contributions are tax-deductible - are taxed just like your 401(k) in that you'll contribute pre-tax dollars to the account and pay taxes on your contributions and the investment growth when you withdraw the money during retirement. A Roth IRA works in reverse; you pay tax now on the dollars that you contribute, but all withdrawals of contributions and investment growth are tax-free so long as you wait until retirement age (age 59 1/2) to make withdrawals.

As long as you meet the income qualifications, you can put a total of $5,500 per year in either type of IRA ($6,500 if you are 50 or older, or will turn 50 this year). If you want to save more than this annually, I'd reconsider your 401(k) and/or a taxable brokerage account.

2.) My husband and I have 3 kids under the age of 6. My parents expressed an interest in buying life insurance policies for each of the kids. Is this a good idea?"

Your parents are probably referring to buying each of your kids a whole life insurance policy. These policies have a savings component in addition to providing life insurance coverage that lasts their entire lives. My guess is that your parents would pay the premiums for these policies for the next 10-15 years, then make these policies known to your kids at some point and gift them to the kids (maybe at high school or college graduation?). The build up of cash value could then be withdrawn by your kids, or they could continue to pay the policy premiums themselves.

I'm not opposed to this idea, but a more direct way for your parents to save a few dollars for your kids would be to use a UTMA/UGMA account and simply invest $25 - $50 per month (whatever the insurance premium would be) into an investment account. With this arrangement, there would be no drag based on the cost of insurance, and all money would go to savings. There would almost certainly be more saved for the kids taking this route.

3.) I'd like to increase the amount I save for retirement each month. Can I contribute to both a Roth IRA and a Traditional IRA?"

As long as you meet the requirements for both, you can contribute to both a Roth IRA and a Traditional IRA. The catch is that you are still only allowed to

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QUOTE OF THE MONTH

Be courteous to all, but intimate with few, and let those few be well tried before you give them your confidence.

~George Washington
1st U.S. President
(1732 - 1799)

DID YOU KNOW ?

30-year old David Staley recently broke a world record by running for 12 consecutive hours on a treadmill, traveling 81.62 miles. The feat was accomplished at the University of Denver.

Source: Time.com

Potpourri ---Stock, Company & Market News and Notes---

GM to Pay $900 Million Penalty, VW Admits Cars Programmed to Cheat, etc.

General Motors will pay a $900 million fine and admit criminal wrongdoing related to its handling of the faulty ignition switches installed on many of its cars. A recall of the ignition switches affected 2.6 million vehicles, and the faulty switches were linked to 124 deaths and 275 injuries. The company is taking a $575 million charge this quarter to settle some 1,400 lawsuits related to the defective switches. The fine paid to the government was less than expected. **Toyota** paid a $1.2 billion fine last year to settle charges related to unintended acceleration in its vehicles. Part of the court's lenience was based on GM setting up a victims compensation fund, which will pay out up to $625 million.

Volkswagen AG has admitted that 11 million of its diesel cars worldwide were equipped with software that allowed the cars to cheat on emissions tests. The company is setting aside $7.3 billion to cover the cost of fixing the cars to comply with emissions standards and pay fines it expects to incur. There will also likely be civil lawsuits from customers. The affected cars' software was programmed to sense when the car was being tested for emissions and to turn on equipment that reduced emissions. Under other conditions, the software turned off that equipment to allow the cars to make more power and get better fuel economy but also produce more of the pollutant nitrogen oxide. The company's stock fell over 30% in the 2 days following the announcement. VW halted sales of cars with the 2.0 liter diesel engine in the U.S., and the EPA has ordered the company to recall all of the cars with that engine sold in the U.S. since 2009. CEO Martin Winterkorn resigned his post days after the news broke.

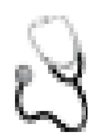
McDonald's announced it is rolling out an all-day breakfast menu at its 14,000+ U.S. stores starting on October 6 after years of requests by customers. The all-day breakfast menu, however, will be limited. Stores will only feature either McMuffin or biscuit sandwiches, not both. They will feature up to three varieties of each of the sandwiches, along with pancakes, sausage burritos, yogurt, oatmeal and hash browns at some locations. No bagels, bagel sandwiches or McGriddle sandwiches will be available. The limitations are due to a lack of grill space, according to the company. An estimated 25% of total sales at McDonald's comes at breakfast, with 33% at lunch and 42% at dinner. The company separately announced that it is turning to cage-free eggs for its stores over the next decade, turning away from chickens raised with antibiotics by 2017, and serving hormone free milk in its stores.

Apple announced its intentions to build an all-electric automobile by 2019. Self-driving technology is part of the long-term plans after the vehicle’s initial launch. Electric car sales currently make up only a tiny percentage of the global car market. The Tesla Model S and the Nissan Leaf have sold 15,100 and 12,400 units worldwide, respectively, over the first 8 months of the year. U.S. auto sales are expected to eclipse 16.5 million units in 2015 and 85 million worldwide. Ever-increasing emissions standards for gasoline-powered cars has led most major manufacturers to begin development of all-electric cars. Cheap gas, limited range and relatively high prices for electric vehicles have dampened sales in recent years.

Sam’s Club, owned by **Wal-Mart**, announced it will start accepting **American Express** credit cards on October 1. **Costco** and American Express ended their exclusive 16-year partnership earlier this year. Sam’s deal with AmEx is not exclusive. There are 650 Sam’s Clubs in the U.S. and Puerto Rico.

Hewlett-Packard will incur $1.8 billion in costs related to the break up of the company into two separate companies. By November 1, the company will split into HP Inc. and Hewlett-Packard Enterprise. The former will sell printers and PCs, and the latter will sell business software, networking gear and servers.


YOUR HEALTH




Doctors Push Back on Runaway Cancer Drug Prices

A recently-published editorial in the Mayo Clinic's journal highlights the growing discontent with expensive prescription drugs and treatments. The article, authored and supported by 118 oncologists at leading institutions, claims the average price of new cancer drugs in the U.S. increased by 500 - 1,000%, to more than $100,000 per year in 2012. New cancer drugs, which use a patient's immune system to fight tumors, cost roughly $150,000 per year. The pharmaceutical industry argues that its medicines, while sometimes expensive, provide great value to patients, and that high prices are needed to fund future research and development. The doctors in the editorial contend it is simple greed, that companies will price drugs at the highest cost the market will bear, and that health insurers have little financial interest in keeping costs down since they will simply raise premiums on individuals. Medicare is forbidden from negotiating directly with pharmaceutical companies under a 2003 law, which prevents it from using its huge buying power to drive down prices.

The doctors propose several changes in the article. They include changes to the law that would allow Medicare to negotiate prices directly with pharmaceutical companies, a standard practice in other countries with single-payer health care systems. They also propose legalizing the import of cancer drugs from other countries, where many drugs are far less expensive. They propose making it more difficult to prolong product exclusivity and preventing deals made with generic companies that prevent the market launch of lower cost generics.

With an aging baby boomer population in the U.S., Medicare's board of trustees estimates that expensive new drugs will drive Medicare's prescription drug costs higher by 9.7% per year in the coming decade.

*Source(s): WebMD.com, Wall Street Journal

Readers' Q&A

Questions? E-mail to Brad@R1FinancialGroup.com

Q. "I have various mutual funds in my IRA that I've had for years. Some say they are A-shares, some say C-shares. What does this mean?"

-Jim – Dallas, TX

A. The A- vs. C- shares refer to the expenses of the fund. A- and C- shares carry sales commissions (a.k.a. loads) that compensate the broker who sells you the fund. A-shares generally carry a 5.00% up-front sales charge, then lower on-going charges, usually 0.25% per year. C-shares generally carry no up-front sales charge but have a 1.00% on-going commission. It seems odd that you have both share classes in one account.

Many mutual funds do not carry any sales charges or commissions at all. These are referred to as "no-load" funds, and you may be better off with these. These funds will often carry lower annual expenses. If you are still in contact with the broker who sold you those mutual funds, I'd ask about this. If not, I'd find a financial advisor that you can pay to select / manage a portfolio for you and provide financial and investment advice for a fee as opposed to paying commissions. Any registered investment advisory (RIA) firm, including mine, should be able to do this for you. Among other differences, an RIA will have a fiduciary duty to act in your best interest. The fee model is generally considered a more sensible model than the commission model. Good luck!

Q. "I started repaying my student loans about two years ago and elected a 25-year payback period to keep the monthly payment low. The interest rate is 6.55%. I can afford to pay it off sooner though. Should I?"

-Kristen – Plano, TX

A. Here are some numbers for you to consider: let's say you had $50,000 of student loans to start. On a 10-year payment schedule, you'd pay $569.01 per month and pay $18,281 in total interest over 10 years. On a 25-year payment schedule, you'd pay $339.17 per month and pay $51,750 in total interest over 25 years. Big difference! Of course, with the 25-year loan, you'd have an extra $230 in your pocket each month. You could save/invest that money each month, and depending on your rate of return, you may be better off taking the longer repayment period.

Some other questions for you are: do you currently have an emergency fund ($10,000 - $20,000) on hand just in case? Do you have other big expenses coming up in the near future (house down payment, etc.)? If you have some potential unfunded cash needs coming up and/or don't have an emergency fund saved up, you may want to take care of those first.

Also, keep in mind that the interest on your student loan may be tax-deductible (up to $2,500 per year) even if you don't itemize deductions. Your income must be less than $80K (single filer) / $160K (married/joint filer) to fully qualify. If you fit into these limits, your effective interest rate is closer to 5%.

Financial Planning Corner

*Personal Finance *Insurance Planning *Investments *<u>*Retirement Savings*</u> *Education Savings *Retirement Income Planning

<u>Highlighted Topic</u>: **Roth IRA (Part 2) - Income limits, Roth conversions**

<u>What You Should Know</u>:

- Last month, I discussed the benefits of setting up and contributing to a Roth IRA...namely tax-free growth and withdrawals from the account during retirement. I also noted that Roth IRAs have income limits. If you have an adjusted gross income (AGI) of greater than $183,000 for married couples or $116,000 for single filers, you are restricted from fully contributing to a Roth IRA.
- If you do find yourself above these income numbers, fear not. You can still utilize a Roth IRA. The rules state that <u>anyone, regardless of income, can do what is called a "Roth IRA conversion</u>." This means moving money from a traditional IRA (to which anyone can contribute regardless of income) into a Roth IRA. The money in a traditional IRA can come from recent contributions, from an old workplace retirement plan or from an existing traditional IRA. In any case, current law allows individuals to move money into a Roth IRA so long as they pay any taxes owed now.
- A direct contribution to a Roth IRA or a Roth IRA conversion will both result in tax-free future investment growth and tax-free withdrawals during retirement.

<u>Brad's Opinion</u>: Roth conversions are a smart move in a lot of situations. Be sure to calculate and plan for any taxes you may owe prior to completing a Roth conversion. Feel free to contact my office for more information.

5 Questions - Taxes, IRAs, Life Insurance, College Savings, etc.

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contribute a total of $5,500 per year ($6,500 if you are 50 or older, or will turn 50 this year) between the two IRAs. It would be nice if you could contribute more, but under the current rules you are limited to this amount. With a traditional IRA, anyone can contribute the full amount. Whether you can deduct your contribution on your tax return is a matter of whether you are covered by a workplace retirement plan, your adjusted gross income, and - if you're married and file your taxes jointly - these same questions/answers for your spouse. With a Roth IRA, you don't get to deduct your contributions on your taxes no matter what. Eligibility for a Roth IRA is dependent on your adjusted gross income (AGI) only (joint income if you're married filing jointly). See this month's Financial Planning Corner for details.

The next question you should consider is which type of IRA is best for you. A Roth IRA will allow you to receive tax-free growth on your investments and be a source of tax-free income during retirement, making it the more logical complement to a workplace retirement plan. Workplace plans like 401(k)s are generally funded with tax-deductible dollars and will be fully taxable at withdrawal.

Feel free to contact me for more information about eligibility rules for both IRA types.

4.) "I'd like to set aside some money for my son's future college expenses. He is currently 3 years old, and I'd like to put about $25,000 in an account for him. Is a 529 college savings plan best?"

529 college savings plans are the default option for many people when saving for college because the investment growth can be withdrawn completely tax-free...as long as funds are used to pay for college costs. This huge benefit is all most people need to hear before they're sold on the idea of a 529 plan. And I agree....this is a huge benefit. There are, however, a number of downsides to 529 plans that make them less attractive and that you should consider. First – if funds are not used for college expenses, the account owner will owe income tax plus a 10% penalty on the investment growth, which could total as high as 49.6% currently. (A withdrawal of investment growth in an amount equal to a scholarship your child gets will only be subject to income tax. No 10% penalty will apply.) Another downside to 529 plans is their relatively limited investment options. You'll be limited to the 10-20 investment choices found in each plan, which are sponsored by states, and you are only allowed to make two "strategy" changes per year. If you're an active investor hoping to make changes often or invest in stocks or bonds directly, 529 plans are not a good choice.

A regular taxable investment account has none of these downsides or limitations and is definitely an alternative worth considering. The downside is that you'll pay income and capital gains tax on the dividends and investment growth in the account along the way. You'll need to weigh the pros and cons of these and other options in order to make a decision, and keep in mind you could use both of the options listed above.

5.) How do people manage pay no income tax? Doesn't everyone pay taxes on money they earn?

When you hear politicians or others in the media talk about how 35 - 45% of taxpayers don't pay any income tax, they are referring to federal income tax only. Federal income tax liability is determined on your annual tax return (Form 1040). However, you are correct in saying that everyone pays taxes based on income they earn. Everyone pays 6.2% of their gross wages towards Social Security. This tax extends to the first $118,500 of a person's earnings (limit increases annually), known as the Social Security wage base. Everyone also pays 1.45% of their gross wages towards Medicare (no earnings limit). In total, this adds up to 7.65%. Employers also pay 7.65% toward these items on behalf of employees. Self-employed individuals pay the sum of these amounts, or 15.3% total.

Federal income tax is reduced to zero for many workers based on deductions, credits, and exemptions.

Please feel free to contact my office with questions related to any of the topics above. As always, consult your financial and tax advisors before making any investment decisions.

Market and Economic News

-The final revision to economic growth (measured by gross domestic product - GDP) for the 2nd quarter of 2015 was raised to +3.9%, up from initial readings of +2.3% and +3.7%. We will get a first look at 3rd quarter GDP at the end of October.

-August's Bureau of Labor Statistics employment report showed a gain of 173,000 jobs after a revised 245,000 gain in July. The unemployment rate dropped to a low 5.1%.

-As of this writing, all major stock market indices are currently sitting in negative territory for the year, down 7 - 9% so far in 2015.

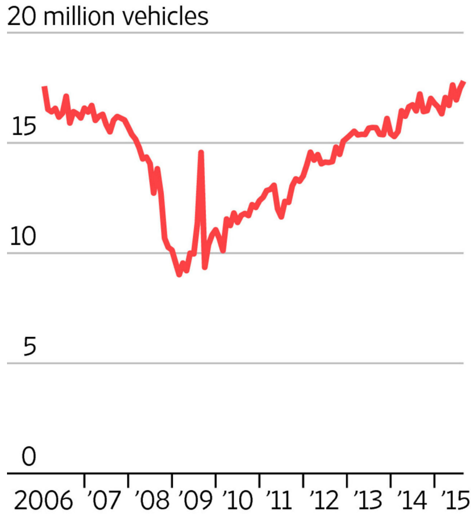
At a Glance...

(as of September 29) **DJIA** – 16,051 **S&P 500** – 1,889 **NASDAQ** – 4,564 **10-yr T-note** – 2.08%

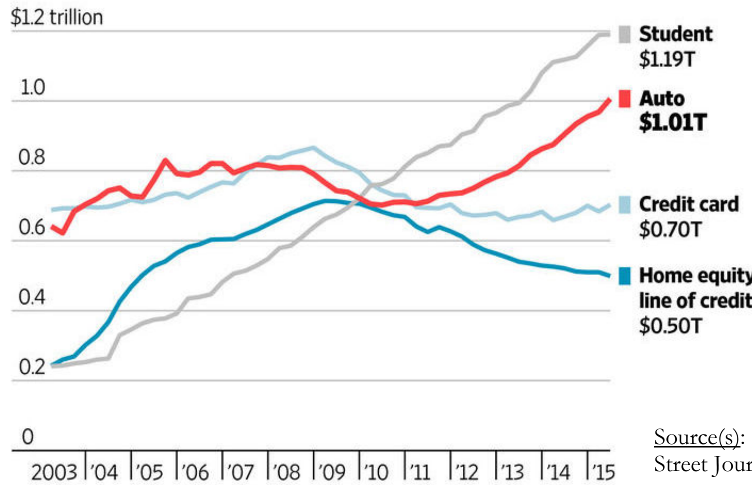
August Vehicle Sales in U.S. Reach Fastest Pace in 10 Years

The pace of light vehicle sales (cars, pickup trucks and SUVs) hit a 10-year high in August, reaching a seasonally adjusted annual rate of 17.8 million vehicles. This is the fastest pace of sales since July 2005, and total outstanding auto loans eclipsed the $1 trillion mark for the first time ever.

U.S. Light Vehicle Sales
(2006 - Present)



Total Outstanding Debt by Category
(2003 - Present)



Source(s): Wall Street Journal

Low gas prices have led to strong truck and SUV sales for Ford and GM in particular, and the continued availability of low financing rates has helped the industry as a whole. $119 billion in auto loans originated in the 2nd quarter of this year alone, a record. Overall indebtedness is lower now than before the recession due to declines in home loans (not pictured) and credit card debt. Delinquency rates (90 days or more past due) on auto loans and mortgages are very low currently: 2.5% for mortgages and 3.4% for auto loans, the lowest since 2007. Total mortgage debt is by far the largest category of debt in the U.S. and currently stands at almost $10 trillion. New foreclosure notices are at their lowest level in the past 16 years, the entire period for which records are available.

Cheap gasoline has led to more driving and more auto-related deaths. The U.S. is on pace for 40,000 auto-related deaths this year, a 14% increase over 2014, and a projected 3.10 trillion miles driven, an increase of almost 3% over last year. Insurance premiums have increased and will continue to increase as a result. GEICO and Allstate, two major players in the auto insurance industry, have requested premium hikes from regulators in multiple states over the past year. Rate increases have averaged 3.9% at Allstate.

An interesting note about the U.S. vehicle sales chart (above left): notice the spike in sales during the summer of 2009. Do you remember the cause of that spike? That summer, the federal government's $3 billion "Cash for Clunkers" program was in place and caused a huge spike in vehicle sales. The program offered $2,500 to $4,500 rebates to individuals who traded in older cars for new, more fuel-efficient cars. The program was widely panned by critics.

Editorial: *How Would Jeb Bush, Donald Trump Undertake Tax Reform?*

Over the past several weeks, voters got an idea of what tax overhaul from the Republican party would look like if a Republican is elected to the White House in 2016. In early September, candidate Jeb Bush gave details about his tax plan. Later in the month, frontrunner Donald Trump revealed details about proposed tax law changes he would attempt to implement as president. Here are the major components of each candidate's plan:

Former Florida governor Jeb Bush's plan centers on reducing the current seven tax brackets to just three: a 10% bracket, a 25% bracket and a 28% bracket. The current brackets extend from 10% up to 39.6%. (Bush points out that his top tax bracket - 28% - is the same as contained in Ronald Reagan's 1986 tax reform.) Bush did not specify at what income level this highest tax bracket would begin, but the current 39.6% bracket starts at just over $464,000 of income

Editorial: *How Would Jeb Bush, Donald Trump Undertake Tax Reform?*

for married couples. While it seems like there would be a great deal of lost revenue, Bush argues that he would eliminate many tax deductions that upper-income taxpayers take. State and local taxes would no longer be tax-deductible. Charitable contributions would still be tax-deductible. Bush proposes capping all other tax deductions at 2% of a taxpayer's adjusted gross income (AGI). This would represent a significant reduction in the dollar amount of deductions many taxpayers claim.

According to Bush's campaign, 15 million people will no longer have any tax liability under Bush's plan because it doubles the standard deduction, which is taken by roughly two-thirds of taxpayers. His plan also expands the Earned Income Tax Credit, a refundable tax credit for lower-income workers. Other highlights include:

-Abolishing the estate tax, a.k.a. "death tax"

-Doing away with the alternative minimum tax (AMT)

-Ending employees' share of Social Security taxes for workers over age 67

-Reducing the corporate income tax rate from 35% to 20%

-Levying a one-time 8.75% tax on $2.1 trillion in overseas profits currently being hoarded by American companies that are trying to avoid corporate income taxes

Donald Trump's tax proposals are similar to Bush's in many ways, except they generally take every proposal a step further. Trump proposes a very low 15% corporate tax rate.

Trump proposes that no one making under $25,000 (single) or $50,000 (married) will pay any income tax.

This proposal alone would mean that 31 million new households would pay no tax. Currently, 36% of taxpayers pay no federal income tax. Trump's proposal would extend this figure to 50%, according to his campaign.

The highest tax bracket under Trump's proposal would be 25%. There would be a 0%, 10%, 15% and a 25% bracket. The 10% bracket would be for married couples earning between $50K and $100K, and the 25% bracket would kick in for married couples earning above $300,000. Trump would keep the mortgage interest deduction and deductions for charitable giving.

Though some of the details differ slightly, these Republican candidates' proposals are similar in that they aim to cut taxes further for the lowest income taxpayers, lower nominal tax rates for all taxpayers and simplify the tax code by doing away with (or sharply limiting) many deductions for individuals and businesses. Both men claim their tax plans are revenue-neutral, and that they will not cause deficit-spending to increase. Such claims are sure to draw very close scrutiny by Democrats leading up to the general election.

We have not heard detailed tax proposals from Democratic candidates, but the bits that have been made public involve increasing tax rates on investments (from Hillary Clinton, for example) and using the proceeds to make college more affordable. I'm sure we will see greater detail on this subject from Democratic front-runners in the coming months, and we will see if there are any noteworthy deviations from established party principles here. Nevertheless, voters not tied to one political party will almost certainly be able to use candidates' tax proposals as a way to differentiate the eventual nominees and help them cast their vote next fall.

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