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SUMMER 2016

Tax Planning and Retirement

Taxes can have a big impact on your retirement. When many retirees think about how much money they might need to sustain their lifestyle in retirement, they often neglect to think about taxes. While it's true that your tax burden will likely be lower in retirement than it was when you were working, the government doesn't let you off the hook completely. That's why it's wise to start your retirement tax planning years — if not decades — in advance. By being smart about how you invest and from where you'll draw your income in retirement, you'll be better prepared for a secure future. Here are some tips to get you started.

Don't Forget about Social Security

Social Security is a significant source of income for many retirees. But don't expect this retirement cornerstone to come to you tax free. Some people are surprised to learn that Social Security benefits are taxable. What portion of your Social Security benefit is subject to tax depends on your overall income for the year. People who receive all of their retirement income from Social Security usually don't need to pay taxes on their benefits. But if you have other sources of income, like withdrawals from an IRA or 401(k) people, you may have to pay.

To find out if your Social Security is taxable, you have to figure out your combined income. Simply add up your adjusted gross income, nontaxable interest received, and half of your yearly Social Security benefit. If you are married and that number falls between $32,000 and $44,000 (between $25,000 and $34,000 for single individuals), you may pay tax on up to half of your Social Security. If it's more than $44,000 ($34,000 if single), up to 85% of your benefit may be taxable.

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Should You Defer Income Taxes?

Should you pay income taxes now or are you better off delaying income taxes until after retirement? This is the basic decision when choosing between a traditional deductible individual retirement account (IRA) and a Roth IRA. With the Roth options, you are paying taxes now so you can take qualified distributions income-tax free. With the traditional IRA, you are delaying taxes until distributions are taken.

The standard advice is to consider whether your tax bracket will be higher or lower in retirement. If you are likely to be in a higher tax bracket, you'll usually benefit from the Roth options. If you're likely to be in a lower bracket, you may benefit more from the traditional IRA.

It may be prudent to use tax diversification for your portfolio. With tax diversification, you invest in a number of investment vehicles with different tax ramifications. For instance, you might invest in a Roth IRA, from which qualified distributions can be taken with no tax consequences; a 401(k) plan, wherein you save taxes now and pay ordinary income taxes on qualified distributions; and taxable accounts, in which a maximum capital gains tax of 20% must be paid on sales of appreciated investments. During retirement, you can monitor your tax situation and withdraw money from the assets that make the most sense in any particular year. ❍❍❍

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Tax Planning

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Consider the Tax Implications of Relocating

Many people plan to pull up stakes in retirement. But before you sell the house and pack the moving van, make sure you understand how living in another state (or even another country) may affect your taxes. Some U.S. states are friendlier to retirees than others. For example, Alaska has no state income tax and no sales tax, though the climate may not be to everyone's liking. Nevada is a warm-weather state that also doesn't have an income tax, making it a popular destination for retirees. Some states offer special perks just for retirees. Georgia, for example, doesn't tax Social Security income and also exempts $65,000 of retirement income for people over the age of 65. Other states have much higher tax burdens.

Consider Tax-Diversified Investments

When saving money for retirement, many people focus on putting as much as they possibly can into tax-deferred retirement accounts like 401(k) plans. That's not a bad strategy, but it probably shouldn't be your only approach to saving for retirement. That's because you will have to pay taxes on your 401(k) plan withdrawals. If all your savings are in a 401(k) plan or similar account, you won't have any choice about paying that tax. But if you can save money in other accounts like a Roth IRA, you will also have an option for tax-free income in retirement. It may even be smart to have some of your investments in regular taxable accounts, since income on these investments is taxed at a lower capital gains rate.

If you don't already have money in a Roth IRA, you may want to consider a Roth IRA rollover. This involves moving money from your tax-deferred retirement account to a tax-free account (though you'll have to pay any taxes owed when the rollover happens). That's not the right move for everyone, however, so talk to your financial advisor about whether a Roth rollover would be appropriate for your situation.

Have a Plan for RMDs

If you have retirement savings in a 401(k), Roth 401(k), IRA, or similar accounts, you are required to start making withdrawals when you turn age 70½. The amount you must take out every year is based on your total savings and life expectancy. You need to make withdrawals whether or not you actually need the money; and if your required minimum distributions (RMDs) are particularly high, they may even bump you into a higher tax bracket. Some people may choose to start making withdrawals from the 401(k) plan earlier than age 70½ if those withdrawals will be taxed at a lower rate. If they don't yet need the money, they can invest it elsewhere. In other cases, it may make sense to do a rollover to a Roth IRA, since it is the one type of retirement account that isn't subject to RMDs.

Please call if you'd like to discuss this in more detail. ❍❍❍

Recent Employment Trends

During the recession of December 2007 to June 2009, unemployment rates rose from 5% to 9.5%, peaking at 10% in October 2009. Since that period, unemployment has gradually dropped each year, with an average of 5.3% in 2015, a seven-year low more closely resembling prerecession unemployment figures. Economists generally agree that a healthy unemployment rate is 4–6%, arguing that a 0% unemployment rate is impossible because of the inevitability of frictional employment, a term used to account for people in between jobs; and structural employment, which accounts for workers without the skills necessary to fill current jobs.

Traditionally, low unemployment correlates to higher wages. When unemployment rates are high, wages are low and vice versa. In the spring of 2014, a report by the United States Conference of Mayors showed that in spite of unemployment rates rebounding, wages were down an average of 23% when compared to wages prior to the 2008–2009 recession. This is nearly double the wage gap following the 2001–2002 recession. Some economists are concerned that because these stagnant wages are inconsistent with increased productivity, many workers have been asked to do more for less pay.

Another figure to consider when looking at employment rates in the U.S. is the underemployment rate. The underemployed are people working in positions that fall below their actual skill or salary capacity, such as an accountant working as a waiter, along with the number of workers employed part-time but seeking full-time positions. The underemployment rate reported by the Bureau of Labor Statistics includes unemployed people as well. In 2015, the U.S. underemployment rate was at nearly 15%.

Unemployment and underemployment can negatively impact the economy in several ways. Reduced wages means reduced disposable income, translating to less overall spending and slower growth for businesses. Additionally, more people collecting unemployment benefits can hamper economical growth. And some economists assert that prolonged unemployment can lead to decreased incentive to find new employment. ❍❍❍

Estate-Planning Considerations for Your Children

It takes special care to create an estate plan that efficiently distributes your assets and meets your goals for every person and cause important to you. But no part of the process means more to most people than that which involves their children.

To help organize this process, it is useful to think of children in three categories: minors, young adults, and fully grown adults with spouses and children of their own.

Minor Children

Children from infancy through high school have a different set of needs than children of other ages. One is simply to be able to rely on an income for daily needs that approximates your income in case you're no longer there for them. Since the parents of young children usually don't have large savings or net worth, the challenge is to provide an instant estate for which life insurance may be the best answer.

There are a number of rules of thumb for how much life insurance to buy — from four to 10 times your annual income. The right amount should be the result of a thorough needs analysis of your entire family, including:

- How much do you already have saved?
- Will your spouse be able to work full- or part-time? If so, what will child care cost?
- Will your children go to public or private elementary and secondary schools?

- How much will your children need in college funds?
- How much will your spouse need for retirement, and how much of that will he/she be able to accumulate on his/her own?

After you determine how much life insurance to buy, you need to think about who will raise your children if you and your spouse both die before they become adults. This calls for naming a guardian in both of your wills. If you don't have a will, a state court will appoint a guardian for you, and it may not be someone you or your spouse would have wanted for this role. In addition, parents might also wish to designate a person to manage the children's assets. It can be the same person as the guardian; but designating an unrelated third party who can be charged with thinking only of your children's welfare appeals to some people.

Among the other major decisions you have to make is whether and how to split your assets between your surviving spouse and your children, and if you leave some assets directly to your children, how to determine the split among them. Often, it may make sense to leave all or most of your assets to your spouse and, for assets you bequeath to your children, divide them evenly. But this might overlook such considerations as children with special medical needs or abilities.

Young Adults

Once children reach the age of majority, a new set of considerations enters the picture. By this age, your children no longer require a guardian and are legally capable of spending their money any way they want — and therein lies a potential problem. You may leave $250,000 for college but instead, your children decide to skip college.

One way to control how the inheritance is spent is to establish a trust with a schedule for distributions. One option is to delay a full distribution until they reach a certain age, like 25 or 30. Another choice is to give them a series of partial distributions at ages that make sense to you given what you know about your child. Another strategy that is becoming increasingly popular is the incentive trust. This vehicle makes payouts contingent upon your child's achievement of specific accomplishments — like maintaining a certain grade point average, graduating from college, marrying, or buying a home.

Adult Children

Many of the same kinds of considerations that apply to minors and young adults can also influence your decisions on how much money to leave to your adult children. Do they, their spouses, or their children have special medical needs? Have your adult children fallen on hard times or are they irresponsible with money and would only waste it? How many children do they have, and how much help will they need to finance their educations?

If your estate is much larger than you and your spouse's combined estate tax exemptions, you might want to shrink it with an aggressive campaign of gifts to your children and grandchildren. On the other hand, any funds you leave to your children might encumber them with estates equally as large as yours or larger with the same tax challenges. In this case, you might want to transfer some of your assets to a generation-skipping trust, which bypasses your children and names your grandchildren as the beneficiaries.

Don't go it alone when mulling over these decisions. Please call if you'd like to discuss this in more detail. ❍❍❍

Big Life Changes?

As your income changes and goals and circumstances shift, you need to update your financial plan accordingly. Here are five times when you may need to make big changes:

When You Get Married — Once you get married, you also need to marry your finances. The process should ideally start before you get married as you review your debts and income and talk about your goals as a couple. Together, you should make sure you're on the same page and working together to get to where you want to be.

When You Have Children — Having a baby means big changes to your life, including your finances. Child care issues can have a major impact on your finances. Other issues to consider include updating your insurance to include new dependents, setting up a college savings account, and ensuring you have adequate life insurance. It's also absolutely crucial that you have a will and other estate-planning documents so that your loved ones, including your children, are protected.

When You Change Jobs — To ensure that your career shifts result in steps up on the financial ladder, you'll want to review your financial plan. Making decisions about your retirement savings is paramount (such as whether you'll roll your money over to a new employer's plan or an IRA), but you'll also probably want to think about issues like insurance, other benefits, and taxes.

When You Get Divorced — If your marriage ends, a financial checkup is a must. Your income will probably be changing, which may necessitate changes in your budget. You will also need to think about changing the beneficiaries on your retirement and insurance plans, developing a new savings strategy, and more.

When You Retire — When you stop working, that doesn't mean your financial plan is off the hook. As you prepare for this major life change, you'll need to make sure you are prepared financially for life after full-time work.

This includes creating a retirement budget that fits your lifestyle and a plan for drawing down your savings in a responsible way. You'll also want to think about issues such as where you will live, end-of-life care, and estate planning.

If you've experienced a big life change recently and need financial guidance, please call.

Get Organized for Taxes

Plan Ahead. Now is the best time to save for goals that can benefit you during tax season and beyond, such as extra mortgage payments, college savings plans, charitable giving, or a boost in contributions to your qualified retirement plan.

Make a List. To serve as an ongoing reminder, make a list of applicable tax deductions and consider keeping it in plain sight on your refrigerator or office bulletin board.

Stay Organized. Keep track of deductible expenses, donations, and cash gifts in a designated tax deduction basket, file folder, or online storage system, where you can place everything that may be eligible as a deduction.

Do a Midyear Financial Review. Incorporate tax planning as part of your midyear financial review; accounting for income changes, unanticipated quarterly bonuses, investment gains and losses, or changes in family status.

Don't Go It Alone. Go to a professional who knows all the complex technicalities of tax planning; they can spot oversights, helping to maximize your refund and reduce your risk of audit.

Financial Thoughts

Last year, job growth nationwide was approximately 2%. The highest growth was 3.7% in Utah, and the lowest was -1.6% in North Dakota. The fastest growing industries were information services at 7.5%, nonretailers at 6.5%, warehousing and storage at 6.2%, and computer systems design at 5.8% (Source: *Money*, December 2015).

In a recent survey, approximately 55% of women said they know less than the average investor about financial markets and investing in general, while only 27% of men said so (Source: *Money*, December 2015).

In a study regarding investing for retirement, men saved an average of 6.8% in 401(k) plans while women saved slightly more at 7.0%. However, the average 401(k) balance for men was 55% higher than women ($123,262 versus $79,572), due to women's lower wages (Source: Vanguard, October 2015).

In a recent survey, 60% of respondents said caring for two aging adults is more demanding than caring for two children between the ages of 3 and 5. Experienced caregivers indicated that financial support and personal hygiene were the aspects of caregiving that caused the most anxiety (Source: *Financial Advisor*, December 2015).

FR2016-0224-0009