ClientLine®

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MANAGING TAXES on Your Retirement Savings

The money you save and invest in your traditional individual retirement account (IRA) or 401(k) plan can compound tax deferred for as long as you keep the money in your retirement account. Unfortunately, however, you'll have to pay income taxes on withdrawals. How can you manage the taxes on your retirement savings? These strategies could help.

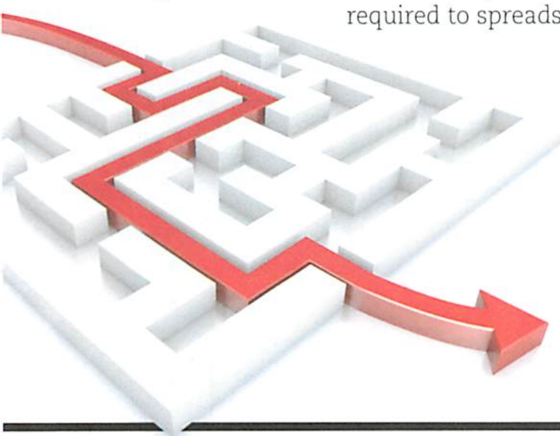
MAINTAIN YOUR TAX DEFERRAL

Cashing out a 401(k) means you may end up owing a 10% early withdrawal penalty as well as income taxes, leaving you with significantly less money to spend or reinvest. Instead, keep the money in the plan or roll it into another employer's tax-deferred retirement plan or an IRA.

FOCUS ON RMDS

Generally, you are obligated to start taking annual required minimum distributions (RMDs) from your tax-deferred accounts after you reach age 70½. If you fail to make a required withdrawal, you'll face a penalty of 50% of the amount that should have been withdrawn.

Taking smaller distributions before you are required to spreads the tax bill over a greater number of years, which could keep you in a lower tax bracket. A tax projection can help you see if this strategy might be beneficial.



OPEN A ROTH IRA

With a Roth IRA, contributions are nondeductible but earnings are potentially tax free. Roth IRA owners can qualify for tax-free withdrawals of earnings once they reach age 59½ (or meet other conditions) and have had a Roth IRA for five years. By allocating a portion of your retirement savings to a Roth IRA, you are positioning yourself for tax-free investment growth and withdrawals.*

CONSIDER TAX RATES

If you hold equities in a retirement account, any gains will be taxed at your regular — likely higher — income tax rate upon withdrawal from your account. It's generally preferable from a tax-reducing standpoint to focus on keeping more highly taxed income-producing securities, such as bonds, in retirement accounts.

* Eligibility for Roth IRA contributions depends on income. There are no income restrictions on converting a traditional IRA to a Roth IRA, but a conversion does result in taxable income.

Withholding Medicare Tax

A 2013 tax law change requires high earners to pay an extra 0.9% Medicare tax in addition to the standard 1.45% Medicare tax that all employees pay. The 0.9% tax applies to joint filers with wages greater than $250,000, married individuals filing separately who earn more than $125,000, and all others who earn $200,000 or more.

If you have employees in these pay ranges, it is your *responsibility* to timely withhold the correct *amounts from their pay*. You are not required to notify an employee when you begin withholding the additional tax, but you should begin withholding in the pay period in which an employee's wages exceed $200,000 and not earlier. And since the definition of "wages" for the additional 0.9% Medicare tax is the same as for the regular tax, be sure to include taxable noncash fringe benefits in the calculation.

Home Office **TAX TIPS**

Working from home can potentially deliver some attractive tax advantages. If you qualify for the home office deduction, you can deduct all direct expenses and part of your indirect expenses involved in working from home.

Direct expenses are costs that apply only to your home office. The cost of painting your home office is an example of a *direct expense. Indirect* expenses are costs that benefit your entire home, such as rent, deductible mortgage interest, real estate taxes, and homeowners insurance. You can deduct only the business portion of your indirect expenses.

WHAT SPACE CAN QUALIFY?

Your home office could be a room in your home, a portion of a room in your home, or a separate building next to your home that you use to conduct business activities. To qualify for the deduction, that part of your home must be one of the following.

Your principal place of business. This requires you to show that you use part of your home exclusively and regularly as the principal place of business for your trade or business.

A place where you meet clients, customers, or patients. *Your home office* may qualify if you use it exclusively and regularly to meet with clients, customers, or patients in the normal course of your trade or business.

A separate, unattached structure used in connection with your trade or business. A shed or unattached garage might qualify for the home office deduction if it is a place that you use regularly and exclusively in connection with your trade or business.

A place where you store inventory or product samples. You must use the space on a regular basis (but not necessarily exclusively) for the storage of inventory or product samples used in your trade or business of selling products at retail or wholesale.

If you set aside a room in your home as your home office and you also use the room as a guest bedroom or den, then you won't meet the "exclusive use" test.

SIMPLIFIED OPTION

If you prefer not to keep track of your expenses, there's a simplified method that allows qualifying taxpayers to deduct $5 for each square foot of office space, up to a maximum of 300 square feet.

Client PROFILE • • • •

Oscar has been looking into starting a computer consulting business. He's realized, though, that he lacks the financial resources he needs to turn his dreams into reality. He believes that the only way his business will become a reality is if he finds a partner.

Finding a suitable business partner is not always easy. Oscar wants a partner whose professional skills complement but don't overlap his own. That's why it's important that he spends the time getting to know the person well and to feel comfortable expressing his ideas and expectations before entering into a written partnership agreement.

Once he finds someone he wants to work with, Oscar and his prospective partner can discuss the specifics of their financial arrangement. Key issues to determine include how much each will invest, who will own what percentage of the business, and how and when each of them will be paid. If Oscar prefers an equal ownership arrangement but doesn't have enough funds to contribute initially, he may be able to negotiate terms that will adjust his ownership percentage in exchange for providing services to the partnership.

The partnership agreement should also include exit clauses. It will be important to address what will happen if one partner wants to leave the business or if both partners want to get out.

Choosing the right partner is critical. Taking the time to work out the details of a partnership arrangement in advance can help promote a successful business relationship.

Client Profile is based on a hypothetical situation. The solutions we discuss may or may not be appropriate for you.

Incorporation Pros & Cons

Are you starting a new business? If you are considering incorporating your business, you should consider the following pros and cons before you make a decision.

PROS

When you incorporate a business, the assets of the corporation are separated from your personal finances. The advantage of this is that your personal assets can be shielded from creditors of your business. Another advantage is that your business can issue stock, which, in turn, can attract investors interested in investing in your business.

CONS

In order to maintain the legal separation, you have to keep corporate assets separate from your personal assets, hold periodic shareholder meetings, and file various government-mandated reports, such as a separate tax return for the company. Establishing and maintaining these corporate formalities can be time-consuming and costly. Incorporation also means that you'll have to factor in the potential double taxation of income — you pay tax on corporate earnings distributed to you by the corporation as dividends in addition to having the corporation pay tax on its earnings.

GIVING Carefully

We are a nation of givers. *Giving USA* reports that individual Americans contributed $258.5 billion to charities in 2014. If you plan on contributing to charity anytime soon, it may be wise to spend a little time making sure your money reaches the people you want it to go to. These tips can help you investigate the charities you plan to help.

CHECK ITS STATUS

Is the charity qualified to receive tax-deductible contributions? This is critical if you want to claim a federal income tax deduction for your contributions to the organization. You can check out a charity's status at *www.irs.gov/charities-non-profits/exempt-organizations-select-check*.

UNDERSTAND ITS MISSION

Each charity has a mission statement that describes what help it provides and to whom. Read the mission statement to confirm that it aligns with your goals and your values.

DO SOME RESEARCH

The charity's most recent IRS Form 990S will provide you with information about its administrative expenses and how much the charity's executives are paid. You can also visit websites like *www.charitynavigator.org* for additional information about an organization's efficiency. Generally, efficient charities spend 25% or less of their budget on administrative expenses.

TALK TO PEOPLE

If possible, talk to individuals involved with the charity about how effective it has been in reaching goals and benchmarks. If a charity lacks a record of accomplishing its stated goals, you may need to reconsider your support.

....Q&A

Q **I have two young children. Are there advantages to opening a Section 529 plan to save for their college educations?**

A Investment earnings in a 529 plan accumulate tax deferred and will not be subject to federal income taxes when withdrawn to pay for a beneficiary's qualified higher education expenses. You are not locked in to choosing the plan offered by your state of residence — many Section 529 plans are open to nonresidents. However, some states offer their residents tax incentives for investing in an in-state plan. Your contributions to a Section 529 plan are not limited by your income. Additionally, if your child does not attend college, you can generally change the beneficiary to another qualifying family member without losing tax benefits.

Q **I want to pay my three employees bonuses this year. Will I have to withhold taxes on those payments?**

A The IRS considers bonuses to be "supplemental wage payments" and requires employers to withhold income taxes from them. Supplemental wages are defined as compensation paid in addition to regular wages and also include vacation pay, back pay, severance pay, overtime, commissions, and taxable fringe benefits. Generally, there are two ways of taxing bonuses: the optional flat-rate method, which allows employers to simply withhold a uniform 25% of the bonus, and the aggregate method, which requires combining the bonus and regular wages for withholding purposes.

ClientLine ITEMS • • • •

> **THE YOUNGER COMPANIES ARE, THE MORE JOBS THEY CREATE, IRRESPECTIVE OF THEIR SIZE.** That's the conclusion of a recent study published by the National Bureau of Economic Research. The study, *Who Creates Jobs? Small vs. Large vs. Young,* concludes that start-up firms generate the surge of jobs that earlier research attributed to small companies.

> **ERRORS ON ONE'S CREDIT REPORT CAN CREATE PROBLEMS** when it comes time to apply for financing. Yet, 27.06% of those surveyed checked their credit report or credit score less than once a year, according to a September 2015 survey of 1,611 people conducted by Qualtrics and CreditRepair.com. The survey also found that 23.59% of respondents did not know if there was an error on their credit report.

> **ROTH 401(K) CONTRIBUTIONS HAVE BECOME MORE WIDELY AVAILABLE** and are currently permitted in 62% of retirement plans, according to the *58th Annual Survey of Profit Sharing and 401(k) Plans* conducted by the Plan Sponsor Council of America.

> **CAN PERSONAL BIASES HAVE AN IMPACT ON THE AMOUNT PEOPLE ACTUALLY SAVE FOR RETIREMENT?** A recent study says "yes." Economists from Stanford University, the University of Minnesota, the London School of Economics, and Claremont Graduate University have identified two biases as obstacles to saving for retirement. The first is a tendency to procrastinate regarding decisions that may benefit an individual in the long run but also involve short-term costs, such as saving for retirement. The second bias is the failure to perceive the power of compounding investment returns and how this builds wealth over time.