FISCAL TIMES

Rios Financial Newsletter

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SEASONS GREETINGS & HAPPY HOLIDAYS - With 2013 coming to a close our financial markets have improved, however we are still in an economic recovery. Real Gross National Product is moving forward very slowly as unemployment is still very high. Therefore, I believe that a balanced approach for investment portfolios is the proper course of action as we move into 2014. Accordingly, I have repositioned most portfolios to be better positioned to handle the market ups and downs that are anticipated for the coming year. Overall I remain bullish, but do not expect a steady, continued climb of the markets as we have seen for most of 2013. I believe a "middle of the road" approach is best suited in an attempt to capture the market upswings and to minimize the downswings. Most portfolios have seen good, steady growth in 2013 and I want to ensure the highest possibility of the same success going forward.

Hope you have a GREAT HOLIDAY season! www.riosandassociates.com

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Year-End Tax Tips for Small Business Owners

With the end of 2013 on the horizon, now may be an ideal time for business owners to review their tax strategies. If you're a business owner, here are just a few points to consider as you get ready to file your return.

Eligible equipment purchases and real estate investments

A number of tax provisions face possible expiration in 2013, unless extended by Congress. For this reason, business owners may want to consider making purchases and/or improvements now rather than putting them off until next year.

- **Internal Revenue Code (IRC) Section 179 expensing limit:** IRC Section 179 allows a small business owner to deduct, or "expense," certain qualified property placed into service during the tax year. If the total cost of the qualifying property placed into service during the year exceeds a certain dollar amount (the "investment ceiling"), the deduction limit will be reduced on a dollar-for-dollar basis. In 2013, the total amount that can be deducted is limited to $500,000, and the investment ceiling is $2 million. In 2014, those amounts are scheduled to drop to $25,000 and $200,000, respectively.
- **Qualified real property:** Up to $250,000 of qualified real property, which can include leasehold improvement property, retail improvement property, and restaurant property, may be included as IRC Section 179 property for purposes of the expense deduction above. Special depreciation rules also apply to this property. Both the IRC Section 179 and depreciation provisions expire at the end of 2013, however.
- **50% bonus depreciation:** This provision allows business owners to take a first-year bonus depreciation deduction of 50% of the cost of a qualified item, over and above the standard first-year depreciation amount. The provision will not apply after 2013.

When it comes to those deductions, it's best to consult a tax advisor to help you determine the best strategy for your business. See IRS Publication 946, How to Depreciate Property, for more information.

Work Opportunity Tax Credit

Another temporary provision is slated to expire at the end of this year, unless renewed by Congress: the Work Opportunity Tax Credit, which allows employers a credit of up to 40% of an eligible new hire's first-year wages (subject to a maximum credit limit). In order to claim the credit, new hires must be qualified and come from specific "targeted groups," including recipients of aid to families with dependent children or the supplemental nutritional aid program; veterans; ex-felons; residents who live in certain communities; vocational rehabilitation referrals; and SSI recipients. For more information, visit the IRS website (www.irs.gov) and review Form 8850 and its associated instructions.

Home office deduction

Finally, a new provision this year could benefit those who work out of their home. According to the U.S. Bureau of Labor Statistics, in 2010 there were 18.3 million home-based businesses (Source: "Home-Based Business Guide," Department of State, Family Liaison Office, November 2010). Yet the IRS recently reported that the number of taxpayers who claimed home office deductions in 2010 was just 3.4 million (Source: IRS news release, January 15, 2013). That may be why in 2013, the IRS launched its simplified home office deduction process. This "safe harbor" is designed to cut time and paperwork associated with taking the deduction. While the eligibility requirements do not change, the method of calculation does. Business owners may now choose to deduct $5 per square foot of eligible office space, up to a 300-foot ($1,500) maximum. The IRS has estimated that this safe harbor will save small businesses about 1.6 million hours each year in tax preparation time.

What's in Store for Health-Care Reform in 2014

Increase in small business tax credit

The maximum tax credit available to qualifying small employers (no more than 25 full-time equivalent employees) that offer health insurance to their employees increases to 50% of the qualifying employer's premium costs (35% for tax-exempt employers) on January 1, 2014. This is an increase from the maximum credit of 35% (25% for tax-exempt employers) that began in 2010.

While the Affordable Care Act (ACA) became law in 2010, several of the more substantive provisions of the law don't take effect until 2014. Here's a review of some of the key parts of the ACA that are scheduled to begin in 2014.

Individual mandate

The ACA imposes a shared responsibility mandate, which requires that most U.S. citizens and legal residents of all ages (including children and dependents) have minimum essential health coverage or pay a penalty tax, unless otherwise exempt. The monthly penalty is equal to the greater of a declared dollar amount ($95 in 2014) or a percentage of the individual's gross income.

Note: *The employer's mandate to provide coverage for employees was also scheduled to begin in 2014; however, the requirement will not be enforced until January 2015.*

State Exchanges

The ACA requires that each state establish state-based American Health Benefit Exchanges for individuals and Small Business Health Options Program (SHOP) Exchanges for small employers. The Department of Health and Human Services will establish Exchanges in states that do not create the Exchanges. The general purpose of these Exchanges is to provide a single resource in each state for consumers and small businesses to compare health plans, get answers to questions, and enroll in a health plan that is both cost effective and meets their health-care needs.

Exchanges may only offer qualified health plans that cover essential benefits, limit out-of-pocket costs, and provide coverage based on four levels of cost sharing--bronze, silver, gold, and platinum. Also, tax credits and cost-sharing subsidies will be available to U.S. citizens and legal immigrants who buy health insurance through the health Exchanges.

Insurers must provide guaranteed issue and renewability of coverage

All individual and group plans must issue insurance to all applicants regardless of health status, medical condition, or prior medical expenses. Insurers must renew coverage for applicants even if their health status has changed. Grandfathered individual plans are exempt from these requirements. Grandfathered plans are those that were in existence prior to the enactment of the ACA (March 2010) and have not been significantly altered in subsequent years.

In the past, insurers used pre-existing medical condition provisions to deny coverage for care related to the condition (pre-existing condition policy exclusion), increased the premium to cover the condition, or denied coverage altogether. Beginning January 1, 2014, the ACA prohibits insurers in group markets and individual markets (with the exception of grandfathered individual plans) from imposing pre-existing condition exclusions.

In keeping with the guaranteed availability of coverage, insurers may not charge individuals and small employers higher premiums based on health status or gender. Premiums may vary only based on family size, geography, age, and tobacco use.

Essential health benefits

All nongrandfathered small group and individual health plans must offer a package of essential health benefits from 10 benefit categories. The categories include ambulatory patient services, emergency services, hospitalization, laboratory services, maternity and newborn care, mental health and substance abuse treatment, prescription drugs, rehabilitative services and devices, preventive and wellness services, and pediatric services, including dental and vision.

Other policy provisions

The ACA also imposes several requirements and eliminates other provisions commonly found in insurance policies:

- Group and individual policies (including grandfathered plans) may not impose waiting periods longer than 90 days before coverage becomes effective.
- Annual deductible for small group (fewer than 50 full-time equivalent employees) health plans (excluding grandfathered plans) must not exceed $2,000 per insured and $4,000 per family. These amounts are indexed to increase in subsequent years.
- The most you'll pay annually for out-of-pocket expenses (deductibles, coinsurance, and co-pays) for all individual and group health plans (excluding grandfathered plans) cannot exceed the maximum out-of-pocket limits for health savings accounts ($6,350 for individual/$12,700 for family in 2014).
- All group health plans and nongrandfathered individual health plans can no longer impose annual or lifetime dollar limits on essential health benefits.

RIOS AND ASSOCIATES, INC.

Should You Roll Your 401(k) to an IRA?

****Certain investments may not be right for everyone, and some may have adverse tax consequences, so be sure to consult your financial professional.***

If you're entitled to a distribution from your 401(k) plan (for example, because you've left your job, or you've reached age 59½), and it's rollover-eligible, you may be faced with a choice. Should you take the distribution and roll the funds over to an IRA, or should you leave your money where it is?

Across the universe

In contrast to a 401(k) plan, where your investment options are limited to those selected by your employer (typically mutual funds or employer stock), the universe of IRA investments is virtually unlimited. For example, in addition to the usual IRA mainstays (stocks, bonds, mutual funds, and CDs), an IRA can invest in real estate, options, limited partnership interests, or anything else the law (and your IRA trustee/custodian) allows.*

You can move your money among the various investments offered by your IRA trustee, and divide up your balance among as many of those investments as you want. You can also freely move your IRA dollars among different IRA trustees/custodians--there's no limit on how many direct, trustee-to-trustee IRA transfers you can do in a year. This gives you the flexibility to change trustees as often as you like if you're dissatisfied with investment performance or customer service. It also allows you to have IRA accounts with more than one institution for added diversification.

However, while IRAs typically provide more investment choices than a 401(k) plan, there may be certain investment opportunities in your employer's plan that you cannot replicate with an IRA. And also be sure to compare any fees and expenses.

Take it easy

The distribution options available to you and your beneficiaries in a 401(k) plan are typically limited. And some plans require that distributions start if you've reached the plan's normal retirement age (often age 65), even if you don't yet need the funds.

With an IRA, the timing and amount of distributions is generally at your discretion. While you'll need to start taking required minimum distributions (RMDs) from your IRA after you reach age 70½ (and your beneficiary will need to take RMDs after you die), those payments can generally be spread over your (and your beneficiary's) lifetime. (You aren't required to take any distributions from a Roth IRA during your lifetime, but your beneficiary must take RMDs after your death.) A rollover to an IRA may let you and your beneficiary stretch distributions out over the maximum period the law permits, letting your nest egg enjoy the benefits of tax deferral as long as possible.

The RMD rules also apply to 401(k) plans--but a special rule allows you to postpone taking distributions until you retire if you work beyond age 70½. (You also must own no more than 5% of the company.) This deferral opportunity is not available for IRAs.

Note: *Distributions from 401(k)s and IRAs may be subject to federal income tax, and a 10% early distribution penalty (unless an exception applies). (Special rules apply to Roth 401(k)s and Roth IRAs.)*

Gimme shelter

Your 401(k) plan may offer better creditor protection than an IRA. Assets in most 401(k) plans receive virtually unlimited protection from creditors under a federal law known as ERISA. Your creditors cannot attach your plan funds to satisfy any of your debts and obligations, regardless of whether you've declared bankruptcy. (Note: individual (solo) 401(k) plans and certain church plans are not covered by ERISA.)

In contrast, traditional and Roth IRAs are generally protected under federal law only if you declare bankruptcy. Federal law currently protects your total IRA assets up to $1,245,475 (as of April 1, 2013)--plus any amount you roll over from your 401(k) plan. Any creditor protection your IRA may receive in cases outside of bankruptcy will generally depend on the laws of your particular state. If you're concerned about asset protection, be sure to seek the assistance of a qualified professional.

Let's stay together

Another reason to roll your 401(k) funds over to an IRA is to consolidate your retirement assets. This may make it easier for you to monitor your investments and your beneficiary designations, and to make desired changes. However, make sure you understand how Federal Deposit Insurance Corporation (FDIC) and Securities Investor Protection Corporation (SIPC) limits apply if you keep all your IRA funds in one financial institution.

Fools rush in

- While some 401(k) plans provide an annuity option, most still don't. By rolling your 401(k) assets over to an IRA annuity, you can annuitize all or part of your 401(k) dollars.
- Many 401(k) plans have loan provisions, but you can't borrow from an IRA. You can only access the money in an IRA by taking a distribution, which may be subject to income tax and penalties.

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What is asset allocation?

Each type of investment has specific strengths and weaknesses that enable it to play a specific role in your overall investing strategy. Some investments may offer growth potential. Others may provide regular income or relative safety, or simply serve as a temporary place to park your money. And some investments may even serve to fill more than one role. Because you likely have multiple needs and desires, you probably need some combination of investment types, or asset classes.

Balancing how much of each asset class should be included in your portfolio is a critical task. That balance between growth, income, and safety is called your asset allocation, and it can help you manage the level and types of risks you face.

The combination of investments you choose can be as important as your specific investments. Your mix of various asset classes, such as stocks, bonds, and cash alternatives, generally accounts for most of the ups and downs of your portfolio's returns.

Ideally, your portfolio should have an overall combination of investments that minimizes the risk you take in trying to achieve a targeted rate of return. This often means balancing more conservative investments against others that are designed to provide a higher potential return but that also involve more risk. However, asset allocation doesn't guarantee a profit or eliminate the possibility of investment losses.

Someone living on a fixed income, whose priority is having a regular stream of money coming in, will probably need a very different asset allocation than a young, well-to-do working professional whose priority is saving for a retirement that's 30 years away. Even if two people are the same age and have similar incomes, they may have very different needs and goals, and your asset allocation should be tailored to your unique circumstances.

And remember, even if your asset allocation was right for you when you chose it, it may not be right for you now. It should change as your circumstances do and as new ways to invest are introduced. A piece of clothing you wore 10 years ago may not fit now; you just might need to update your asset allocation, too.

What rate of return should I expect from stocks?

That depends on many factors, including your time frame and the types of stocks involved. Many retirement planning calculators project a portfolio's future value based on historical returns. However, past performance is no guarantee of future results, and you should take any such assumptions with a grain of salt.

You may have heard that stocks have historically averaged a 10% return. However, be careful about relying too much on that number. First, the figure on which that statement is based--9.8%--reflects the compounded annual total return of the S&P 500 between 1926 and 2012. Is your time frame likely to be that long? Second, equities' performance in recent years hasn't been as robust. The last time the S&P's compounded annual 10-year total return was 9.8% or more was 2004; from 1999 to 2008 it was negative for the first time in decades, and from 2003 to 2012, it was 7.1%.*

Third, that 7.1% was the index's nominal return; it doesn't take into account inflation or taxes. As of April, the annual inflation rate was a little over 1%, according to the Bureau of Labor Statistics. That would cut that 7.1% to just over 6%. And a 1% inflation rate is very low; over the last 20 years, it has averaged roughly 2.4% a year, which would mean an inflation-adjusted return under 5%. That's less than half the often-quoted 10% average, not including any taxes owed.

What would that mean to a hypothetical $100,000 portfolio? Even if you managed to achieve a 9.8% nominal return compounded annually for 10 years, adjusting it for 2.4% inflation would mean a projected balance of almost $255,000 would actually be worth roughly $200,000 before taxes. That's a pretty substantial gap.

Returns for stocks other than the large caps of the S&P 500 can be different. Still, when planning for income or long-term goals, focusing on real returns could help keep your expectations realistic.

*Calculations based on total returns compounded annually through December 2012 on the S&P 500 Index, which is an unmanaged market-cap weighted index composed of the common stocks of 500 leading companies in leading U.S. industries. It is not available for direct investment.

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