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Four Points to Consider When Setting a Retirement Income Goal

College Saving: How Does a 529 Plan Compare to a Roth IRA?

Can I convert my traditional IRA to a Roth IRA in 2018?

Will a government pension reduce my Social Security benefits?

# Client Newsletter

## Advice For Life

### Mid-Year Planning: Tax Changes to Factor In



tax cuts that apply to individuals) expire at the end of 2025. Here are some of the significant changes you should factor in to any mid-year tax planning. You should also consider reviewing your situation with a tax professional.

#### New lower marginal income tax rates

In 2018, there remain seven marginal income tax brackets, but most of the rates have dropped from last year. The new rates are 10%, 12%, 22%, 24%, 32%, 35%, and 37%. Most, but not all, will benefit to some degree from the lower rates. For example, all other things being equal, those filing as single with taxable incomes between approximately \$157,000 and \$400,000 may actually end up paying tax at a higher top marginal rate than they would have last year. Consider how the new rates will affect you based on your filing status and estimated taxable income.

#### Higher standard deduction amounts

Standard deduction amounts are nearly double what they were last year, but personal exemptions (the amount, \$4,050 in 2017, that you could deduct for yourself, and potentially your spouse and your dependents) are no longer available. Additional standard deduction amounts allowed for the elderly and the blind remain available for those who qualify. If you're single or married without children, the increase in the standard deduction more than makes up for the loss of personal exemption deductions. If you're a family of four or more, though, the math doesn't work out in your favor.

#### Itemized deductions — good and bad

The overall limit on itemized deductions that applied to higher-income taxpayers is repealed, the income threshold for deducting medical expenses is reduced for 2018, and the income

limitations on charitable deductions are eased. That's the good news. The bad news is that the deduction for personal casualty and theft losses is eliminated, except for casualty losses suffered in a federal disaster area, and miscellaneous itemized deductions that would be subject to the 2% AGI threshold, including tax-preparation expenses and unreimbursed employee business expenses, are no longer deductible. Other deductions affected include:

- **State and local taxes** — Individuals are only able to claim an itemized deduction of up to \$10,000 (\$5,000 if married filing a separate return) for state and local property taxes and state and local income taxes (or sales taxes in lieu of income).
- **Home mortgage interest deduction** — Individuals can deduct mortgage interest on no more than \$750,000 (\$375,000 for married individuals filing separately) of qualifying mortgage debt. For mortgage debt incurred prior to December 16, 2017, the prior \$1 million limit will continue to apply. No deduction is allowed for interest on home equity loans or lines of credit unless the debt is used to buy, build or substantially improve a principal residence or a second home.

#### Other important changes

- **Child tax credit** — The credit has been doubled to \$2,000 per qualifying child, refundability has been expanded, and the credit will now be available to many who didn't qualify in the past based on income; there's also a new nonrefundable \$500 credit for dependents who aren't qualified children for purposes of the credit.
- **Alternative minimum tax (AMT)** — The Tax Cuts and Jobs Act significantly narrowed the reach of the AMT by increasing AMT exemption amounts and dramatically increasing the income threshold at which the exemptions begin to phase out.
- **Roth conversion recharacterizations** — In a permanent change that starts this year, Roth conversions can't be "undone" by recharacterizing the conversion as a traditional IRA contribution by the return due date.



## Four Points to Consider When Setting a Retirement Income Goal



*Although there are certainly no guarantees that any future plans will pan out as expected, taking time now to assess these four points can help you position yourself to pursue a comfortable retirement.*

*All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.*

No matter what your age or stage of life, targeting a goal for monthly retirement income can seem like a daunting task. Following are four considerations to help you get started.

### 1. When do you plan to retire?

The first question to ponder is your anticipated retirement age. Many people base their target retirement date on when they're eligible for full Social Security benefits, and for today's workers, "full retirement age" ranges from 66 to 67. Other folks hope to retire early, while still others want to work as long as possible. As you think about your anticipated retirement date, keep the following points in mind.

**If you plan to retire early**, you'll need significant resources to provide income for potentially decades. You can typically tap your employer-sponsored retirement plan without penalty as early as age 55 if you terminate your employment, but if you try to access IRA assets prior to age 59½, you will be subject to a 10% early withdrawal penalty, unless an exception applies. In both cases, regular income taxes will apply. Also consider that you generally won't be eligible for Medicare until age 65, so unless you are one of the lucky few who have employer-sponsored retiree medical benefits, health insurance will have to be funded out of pocket.

**If you plan to delay retirement**, consider that unexpected circumstances could throw a wrench in that plan. In its 2017 Retirement Confidence Survey, the Employee Benefit Research Institute (EBRI) found that current workers plan to retire at a median age of 65, while current retirees reported a median retirement age of 62. And although four in 10 workers plan to work until age 70 or later, just 4% of retirees said this was the case. Why the difference? Nearly half of retirees said they retired earlier than planned, with many reporting unexpected challenges, including their own health concerns or those of a family member.<sup>1</sup>

### 2. How long will your retirement last?

The second important consideration, which builds on the first, is how long your retirement might last. Projected life spans have been lengthening in recent decades due in part to advancements in medical care and general health awareness. According to the National Center for Health Statistics (NCHS), a 65-year-old woman can expect to live 20.6 more years, while a 65-year-old man can

expect to live 18 more years.<sup>2</sup> To estimate your own life expectancy based on your current age and health profile, visit the online longevity calculator created by the Society of Actuaries and American Academy of Actuaries at [longevityillustrator.org](http://longevityillustrator.org).

### 3. What will your expenses look like?

The third consideration is how much you will need to meet your basic living expenses. Although your housing, commuting, and other work-related expenses may decrease in retirement, other costs — including health care — will likely rise.

In 2017, EBRI calculated that Medicare recipients with median prescription drug expenses may need about \$265,000 just to pay for basic medical expenses in retirement.<sup>3</sup> And that doesn't even include the potential for long-term care. According to the Department of Health and Human Services (HHS), 52% of people over age 65 will need some form of long-term care during their lifetimes, which could add another \$69,000, on average, to the out-of-pocket costs.<sup>4</sup>

In addition, remember to account for the impact inflation will have on your expenses over time. For example, say you need an estimated \$50,000 to cover basic needs in your first year of retirement. Ten years later, at a 3% annual inflation rate (the approximate historical average as measured by the consumer price index), you would need more than \$67,000 to cover those same costs.

### 4. How much can you accumulate?

This is perhaps the most important consideration: How much can you *realistically* accumulate between now and retirement based on your current savings rate, timeframe, investment portfolio, and lifestyle? Once you project your total accumulation amount based on current circumstances, you can gauge whether you're on track or falling short. And if you appear to be falling short, you can begin to think about how to refine your strategy, either by altering your plans for retirement (e.g., delaying retirement by a few years), saving more, or investing more aggressively.

<sup>1</sup> EBRI Issue Brief, March 21, 2017

<sup>2</sup> NCHS Issue Brief, Number 293, December 2017

<sup>3</sup> EBRI Notes, January 31, 2017

<sup>4</sup> HHS, "Long-Term Services and Supports for Older Americans: Risks and Financing Research Brief," February 2016



## College Saving: How Does a 529 Plan Compare to a Roth IRA?



### 529 plan assets surpass \$300 billion mark

As of September 2017, assets in 529 plans totaled \$306 billion.

Source: Strategic Insight, 529 College Savings & ABLE, 3Q 2017 529 Data Highlights

#### Note

Investors should carefully consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. Specific information is available in each plan's official statement. Keep in mind that there is the risk that 529 plan investments may not perform well enough to cover costs as anticipated. Also consider whether your state offers any 529 plan state tax benefits and whether they are contingent on joining your own state's 529 plan. Other state benefits may include financial aid, scholarship funds, and protection from creditors.

529 plans were created 22 years ago, in 1996, to give people a tax-advantaged way to save for college. Roth IRAs were created a year later, in 1997, to give people a tax-advantaged way to save for retirement. But a funny thing happened along the way — some parents adapted the Roth IRA as a college savings tool.

#### Tax benefits and use of funds

Roth IRAs and 529 plans have a similar tax modus operandi. Both are funded with after-tax dollars, contributions accumulate tax deferred, and qualified distributions are tax-free. But in order for a 529 plan distribution to be tax-free, the funds *must* be used for college or K-12 education expenses. By contrast, a qualified Roth distribution can be used for anything — retirement, college, travel, home remodeling, and so on.

In order for a distribution from a Roth IRA to be tax-free (i.e., a qualified distribution), a five-year holding period must be met *and* one of the following must be satisfied: The distribution must be made (1) after age 59½, (2) due to a qualifying disability, (3) to pay certain first-time homebuyer expenses, or (4) by your beneficiary after your death.

For purposes of this discussion, it's the first condition that matters: whether you will be 59½ or older when your child is in college. If the answer is yes (and you've met the five-year holding requirement), then your distribution will be qualified and you can use your Roth dollars to pay for college with no tax implications or penalties. If your child ends up getting a grant or scholarship, or if overall college costs are less than you expected, you can put those Roth dollars toward something else.

But what if you'll be younger than 59½ when your child is in college? Can you still use Roth dollars? You can, but your distribution will not be qualified. This means that the earnings portion of your distribution (but not the contributions portion) will be subject to income tax. (Note: Just because the earnings portion is subject to income tax, however, doesn't mean you'll necessarily have to pay it. Nonqualified distributions from a Roth IRA draw out contributions first and then earnings, so you could theoretically withdraw up to the amount of your contributions and not owe income tax.)

Also, if you use Roth dollars to pay for college, the 10% early withdrawal penalty that normally applies to distributions before age 59½ is waived. So the bottom line is, if you'll be younger than 59½ when your child is in college and you use Roth dollars to pay college expenses, you might owe income tax (on the earnings portion of the distribution), but you

won't owe a penalty.

If 529 plan funds are used for any other purpose besides the beneficiary's qualified education expenses, the earnings portion of the distribution is subject to income tax *and* a 10% federal tax penalty.

#### Financial aid treatment

At college time, retirement assets aren't counted by the federal or college financial aid formulas. So Roth IRA balances will not affect financial aid in any way. (Note: Though the aid formulas don't ask for retirement plan *balances*, they typically do ask how much you *contributed* to your retirement accounts in the past year, and colleges may expect you to apply some of those funds to college.)

By contrast, 529 plans do count as an asset under both federal and college aid formulas. (Note: Only parent-owned 529 accounts count as an asset. Grandparent-owned 529 accounts do not, but withdrawals from these accounts are counted as student income.)

#### Investment choices

With a Roth IRA, your investment choices are virtually unlimited — you can hold mutual funds, individual stocks and bonds, exchange-traded funds, and REITs, to name a few.

With a 529 plan, you are limited to the investment options offered by the plan, which are typically a range of static and age-based mutual fund portfolios that vary in their level of risk. If you're unhappy with the market performance of the options you've chosen, under federal law you can change the investment options for your *existing* contributions only twice per calendar year (though you can generally change the investment options on your *future* contributions at any time).

#### Eligibility and contribution amounts

Unfortunately, not everyone is eligible to contribute to a Roth IRA. For example, your income must be below a certain threshold to make the maximum annual contribution of \$5,500 (or \$6,500 for individuals age 50 and older).

By contrast, anyone can contribute to a 529 plan; there are no restrictions based on income. Another significant advantage is that lifetime contribution limits are high, typically \$300,000 and up. And 529 plan rules allow for large lump-sum, tax-free gifts if certain conditions are met — \$75,000 for single filers and \$150,000 for married joint filers in 2018, which is equal to five years' worth of the \$15,000 annual gift tax exclusion.

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The information provided is not intended to be a substitute for specific individualized tax planning or legal advice. We suggest that you consult with a qualified tax or legal advisor.



## Can I convert my traditional IRA to a Roth IRA in 2018?

If you've been thinking about converting your traditional IRA to a Roth IRA, this year may be an appropriate time to do so. Because federal income tax rates were reduced by the Tax Cuts and Jobs Act passed in December 2017, converting your IRA may now be "cheaper" than in past years.

Anyone can convert a traditional IRA to a Roth IRA in 2018. There are no income limits or restrictions based on tax filing status. You generally have to include the amount you convert in your gross income for the year of conversion, but any nondeductible contributions you've made to your traditional IRA won't be taxed when you convert. (You can also convert SEP IRAs, and SIMPLE IRAs that are at least two years old, to Roth IRAs.)

Converting is easy. You simply notify your existing IRA provider that you want to convert all or part of your traditional IRA to a Roth IRA, and they'll provide you with the necessary paperwork to complete. You can also transfer or roll your traditional IRA assets over to a new IRA provider and complete the conversion there.

If you prefer, you can instead contact the trustee/custodian of your traditional IRA, have the funds in your traditional IRA distributed to you, and then roll those funds over to your new Roth IRA within 60 days of the distribution. The income tax consequences are the same regardless of the method you choose.<sup>1</sup>

The conversion rules can also be used to contribute to a Roth IRA in 2018 if you wouldn't otherwise be able to make a regular annual contribution because of the income limits. (In 2018, you can't contribute to a Roth IRA if you earn \$199,000 or more and are married filing jointly, or if you're single and earn \$135,000 or more.) You can simply make a nondeductible contribution to a traditional IRA and then convert that traditional IRA to a Roth IRA. (Keep in mind, however, that you'll need to aggregate the value of all your traditional IRAs when you calculate the tax on the conversion.) You can contribute up to \$5,500 to all IRAs combined in 2018, or \$6,500 if you're 50 or older.

<sup>1</sup> If you choose to receive the funds first and don't transfer the entire amount, a 10% early withdrawal penalty may apply to amounts not converted.



## Will a government pension reduce my Social Security benefits?

If you earned a government pension from a job not subject to Social Security tax withholding ("noncovered

employment") and are also eligible for Social Security benefits through a job where Social Security taxes were withheld, two provisions might reduce your benefits: the windfall elimination provision (WEP) and the government pension offset (GPO).

The WEP affects how a worker's Social Security benefit is calculated. If you're subject to the WEP, your benefit is calculated using a modified formula, possibly resulting in a benefit reduction. The amount of the reduction depends on the year you turn 62 and the number of years in which you had substantial earnings and paid into Social Security (no reduction applies to those with 30 years or more of substantial earnings). The reduction cannot be more than one-half of your pension from noncovered employment. Spousal and dependent benefits may also be reduced, but not survivor benefits.

The GPO may affect spousal or survivor benefits if the spouse or survivor earned a

government pension from noncovered employment. In this case, the GPO may reduce Social Security benefits by up to two-thirds of the amount of the pension.

For example, if you receive a \$900 monthly government pension and are eligible for a \$1,000 monthly Social Security spousal benefit, you would receive only \$400 per month from Social Security [\$1,000 minus \$600 (2/3 times \$900) equals \$400]. You would still receive your \$900 pension, so your combined benefit would be \$1,300.

Not all government employees are subject to these provisions. For example, federal employees under the Federal Employees Retirement System are exempt because they pay Social Security taxes on earnings. However, public-sector employees in some states do not pay Social Security taxes, and thus could be subject to the WEP. The GPO affects pensions from noncovered federal, state, or local government employment.

Rules and calculations for the WEP and the GPO are complex. Visit the Social Security website, [ssa.gov](http://ssa.gov), for more information.