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Hello!

It's that time of year.....don't forget about Tom's 16th Annual Sports Memorabilia Auction benefiting local families battling cancer. The auction will be held on April 2nd at Hebron. It's a great evening for a great cause. If you would like tickets or more information about the event, please contact our office. We hope to see you there!

Your GFS Team

March 2016

GERHART FINANCIAL SERVICES, INC.

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VISION.LEADERSHIP.VALUES

Life Insurance and Terminal Illness

What if you were faced with the heart-wrenching news that you were terminally ill? How would you provide for the continued financial support of your family and loved ones? How would you and your family pay for the expenses related to your medical care and comfort? Your life insurance policy may be a valuable resource for you and your family. Not only can you use life insurance to provide a source of income to your survivors for their short- and long-term needs, but you also may be able to receive proceeds from the policy while you're still alive to help meet the expenses related to your illness.

Obtain more life insurance

Even if your health takes a turn for the worse, you may be able to increase your life insurance death benefit without providing evidence of insurability. Increasing the death benefit may provide greater financial support to your survivors after you die. Here are some ways you may be able to increase your death benefit without regard to your health.

If you purchased a guaranteed insurability rider as part of your existing life insurance policy, you may have the option of buying a higher death benefit. However, these riders generally offer the ability to purchase more coverage only on specific dates. Often, the rider may no longer be available after a certain age. Also, optional riders are available for an additional fee and are subject to contractual terms, conditions, and limitations as outlined in the policy.

If your policy pays dividends, you may be able to use those dividends to buy fully paid-up additional life insurance. It's important to understand that no matter how they're used or applied, dividends may be taxable to you as ordinary income if the dividends received, plus all previous nontaxable distributions from the policy, exceed the total of all premiums paid for the policy.

Caution: *Any guarantees are contingent on the claims-paying ability and financial strength of the issuing company.*

Use life insurance for cash

If your life insurance has a cash-value component, you may be able to access that cash to help meet costs associated with your illness, including lost wages, uninsured medical expenses, and respite care. One way to access the cash value is by surrendering the policy. However, if you surrender your policy prematurely, there may be surrender charges and income tax implications, as well as the loss of the death benefit that could be helpful to your survivors.

Or you may be able to borrow against the policy's cash value. But the loan will reduce the policy's cash value and death benefit, could increase the chance that the policy will lapse, and might result in a tax liability if the policy terminates before your death.

Your life insurance policy may come with an accelerated benefit rider. As a result of your illness, you may be eligible to receive some, or all, of the face amount of the policy in advance of your death, either in a lump sum or in installments. You also may be able to take less money than the full amount available to you so that some of the death benefit will be payable to your survivors. Usually, you can use the proceeds however you wish. Rules differ for the tax treatment of accelerated death benefits paid to the terminally ill.

You may have added a critical illness life insurance (CILI) rider to your existing policy. CILI pays benefits to you when you are chronically or terminally ill. You can use the money you receive to pay for your daily living expenses, increased medical costs, or any other way you choose. However, the amount you receive (with terminal illness, often 100% of the policy's face value) will reduce or eliminate benefits payable to your survivors. In addition, there may be tax consequences arising out of payments received from CILI. For more information on the tax treatment of CILI benefits, consult your tax advisor.

Can You Get to a Million Dollars?

In trying to accumulate $1 million (or any other amount), you should generally consider how much you have now, how much you can contribute in the future, how much you might earn on your investments, and how long you have to accumulate funds. But remember, there are no guarantees--even when you have a clearly defined goal. For example, the market might not perform as expected, or you may have to reduce your contributions at some point.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Review your progress periodically and be prepared to make adjustments when necessary.

Often in life, you have investment goals that you hope to reach. Say, for example, you have determined that you would like to have $1 million in your investment portfolio by the time you retire. But will you be able to get there?

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Current balance--your starting point

Of course, the more you have today, the less you may need to contribute to your investment portfolio or earn on your investments over your time horizon.

Time (accumulation period)

In general, the longer your time horizon, the greater the opportunity you have to accumulate $1 million. If you have a sufficiently long time horizon and a sufficiently large current balance, with adequate earnings you may be able to reach your goal without making any additional contributions. With a longer time horizon, you'll also have more time to recover if the value of your investments drops. If additional contributions are required to help you reach your goal, the more time you have to target your goal, the less you may have to contribute.

The sooner you start making contributions, the better. If you wait too long and the time remaining to accumulate funds becomes too short, you may be unable to make the large contributions required to reach your goal. In such a case, you might consider whether you can extend the accumulation period--for example, by delaying retirement.

Rate of return (earnings)

In general, the greater the rate of return that you can earn on your investments, the more likely that you'll reach your investment goal of $1 million. The greater the proportion of the investment portfolio that comes from earnings, the less you may need to contribute to the portfolio. Earnings can benefit from long time horizons and compound rates of return, as returns are earned on any earlier earnings.

However, higher rates of return are generally associated with greater investment risk and the possibility of investment losses. It's important to choose investments that meet your time horizon and tolerance for risk. And be realistic in your assumptions. What rate of return is realistic given your current asset allocation and investment selection?

Amount of contributions

Of course, the more you can regularly contribute to your investment portfolio (e.g., monthly or yearly), the better your chances are of reaching your $1 million investment goal, especially if you start contributing early and have a long time horizon.

Contributions needed

Now that the primary factors that affect your chances of getting to a million dollars have been reviewed, let's consider this question: At a given rate of return, how much do you need to save each year to reach the $1 million target? For example, let's assume you anticipate that you can earn a 6% annual rate of return (ROR) on your investments. If your current balance is $450,000 and you have 15 more years to reach $1 million, you may not need to make any additional contributions (see scenario 1 in the table below); but if you have only 10 more years, you'll need to make annual contributions of $14,728 (see scenario 2). If your current balance is $0 and you have 30 more years to reach $1 million, you'll need to contribute $12,649 annually (see scenario 3); but if you have only 20 more years, you'll need to contribute $27,185 annually (see scenario 4).

Scenario	**1**	**2**
Target	$1,000,000	$1,000,000
Current balance	$450,000	$450,000
Years	15	10
ROR	6%	6%
Annual contribution	$0	$14,728

Scenario	**3**	**4**
Target	$1,000,000	$1,000,000
Current balance	$0	$0
Years	30	20
ROR	6%	6%
Annual contribution	$12,649	$27,185

Note: *This hypothetical example is not intended to reflect the actual performance of any investment. Actual results may vary. Taxes, fees, expenses, and inflation are not considered and would reduce the performance shown if they were included.*

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Earn Too Much for a Roth IRA? Try the Back Door!

If you have taxable compensation, you can contribute up to $5,500 to an IRA in 2016, or $6,500 if you'll be 50 or older by the end of the year. You can't contribute to a traditional IRA for the year you turn 70½, or thereafter.

To be eligible for tax-free qualified distributions from a Roth IRA, you must satisfy a five-year holding period and, in addition, one of the following must apply: you have reached age 59½ by the time of the withdrawal, the withdrawal is made because of disability, or the withdrawal is made to pay first-time homebuyer expenses ($10,000 lifetime limit from all IRAs).

It's not clear how long the back door is going to remain open. There have been suggestions that this is a loophole that should be legislatively closed.

Background

Roth IRAs, created in 1997 as part of the Taxpayer Relief Act, represented an entirely new savings opportunity--the ability to make after-tax contributions that could, if certain conditions were met, grow entirely free of federal income taxes. These new savings vehicles were essentially the inverse of traditional IRAs, where you could make deductible contributions but distributions would be fully taxable. The law also allowed taxpayers to "convert" traditional IRAs to Roth IRAs by paying income taxes on the amount converted in the year of conversion.

Unfortunately, the law contained two provisions that limited the ability of high-income taxpayers to participate in the Roth revolution. First, the annual contributions an individual could make to a Roth IRA were reduced or eliminated if his or her income exceeded certain levels. Second, individuals with incomes of $100,000 or more, or whose tax filing status was married filing separately, were prohibited from converting a traditional IRA to a Roth IRA.

In 2005, however, Congress passed the Tax Increase Prevention and Reconciliation Act (TIPRA), which repealed the second barrier, allowing anyone to convert a traditional IRA to a Roth IRA--starting in 2010--regardless of income level or marital status. But TIPRA did not repeal the provision that limited the ability to make annual Roth contributions based on income. The current limits are set forth in the chart below:

Phaseout ranges for determining ability to fund a Roth IRA in 2016*	
Single/head of household	$117,000-$132,000
Married filing jointly	$184,000-$194,000
Married filing separately	$0-$10,000
***Applies to modified adjusted gross income (MAGI)**	

Through the back door...

Repeal of the provisions limiting conversions created an obvious opportunity for high-income taxpayers who wanted to make annual Roth contributions but couldn't because of the income limits. Those taxpayers (who would also run afoul of similar income limits that prohibited them from making deductible contributions to traditional IRAs) could simply make nondeductible contributions to a traditional IRA and then immediately convert that traditional IRA to a Roth IRA--a "back door" Roth IRA.

The IRS is always at the front door...

For taxpayers who have no other traditional IRAs, establishment of the back-door Roth IRA is essentially tax free. Income tax is payable on the earnings, if any, that the traditional IRA generates until the Roth conversion is complete. However, assuming the contribution and conversion are done in tandem, the tax impact should be nominal. (The 10% penalty tax for distributions prior to age 59½ generally doesn't apply to taxable conversions.)

But if a taxpayer owns other traditional IRAs at the time of conversion, the tax calculation is a bit more complicated because of the so-called "IRA aggregation rule." When calculating the tax impact of a distribution (including a conversion) from any traditional IRA, all traditional and SEP/SIMPLE IRAs a taxpayer owns (other than inherited IRAs) must be aggregated and treated as a single IRA.

For example, assume Jillian creates a back-door Roth IRA in 2016 by making a $5,500 contribution to a traditional IRA and then converting that IRA to a Roth IRA. She also has another traditional IRA that contains deductible contributions and earnings worth $20,000. Her total traditional IRA balance prior to the conversion is therefore $25,500 ($20,000 taxable and $5,500 nontaxable).

She has a distribution (conversion) of $5,500: 78.4% of that distribution ($20,000/$25,500) is considered taxable ($4,313.73), and 21.6% of that distribution ($5,500/$25,500) is considered nontaxable ($1,186.27).

Note: These tax calculations can be complicated. Fortunately, the IRS has provided a worksheet (Form 8606) for calculating the taxable portion of a conversion.

There's also a side door...

Let's assume Jillian in the example above isn't thrilled about having to pay any income tax on the Roth conversion. Is there anything she can do about it?

One strategy to reduce or eliminate the conversion tax is to transfer the taxable amount in the traditional IRAs ($20,000 in our example) to an employer qualified plan like a 401(k) prior to establishing the back-door Roth IRA, leaving the traditional IRAs holding only after-tax dollars. Many 401(k) plans accept incoming rollovers. Check with your plan administrator.

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How long will I have to pay for private mortgage insurance?

It depends. There are generally two ways that private mortgage insurance (PMI) can be removed from your mortgage loan. The first is if you request PMI cancellation directly from your lender. The second is through termination by your lender.

You can request PMI cancellation directly from your lender once you have reached the date when the principal balance of your mortgage is scheduled to fall to 80% of the original value of your home. You can find this date on the PMI disclosure form that was given to you when you first obtained your mortgage. The cancellation request can be made earlier if you have made additional mortgage payments that have reduced your principal balance to 80% at an earlier date. Your lender may also require you to meet certain other criteria in order to cancel your PMI, such as certification that there are no subordinate liens on the home and evidence that the property has not declined below the original value.

If you don't request PMI cancellation directly from your lender, your PMI could still be removed from your loan if it is terminated by your lender. Your lender is required to terminate PMI on the date when the principal balance on your loan is scheduled to reach 78% of the original value of your home or once you reach the midpoint of your loan's amortization schedule (e.g., year 15 of a 30-year loan), whichever occurs first.

Unfortunately, some mortgage companies don't always follow the rules pertaining to PMI termination and continue to collect PMI premiums from borrowers beyond the termination date. As a result, many borrowers find themselves paying unnecessarily for PMI. (Source: Private Mortgage Insurance Cancellation and Termination, Consumer Financial Protection Bureau Compliance Bulletin, August 2015) If you think you have reached, or are about to reach, the point in your loan where PMI cancellation or termination is a possibility, you should contact your mortgage lender for more information.

Keep in mind that the above rules regarding PMI apply to borrowers who are current on their loans and apply only to conventional mortgage loans closed on or after July 29, 1999.

Should I loan my child money for a down payment on a house?

For a lot of young people today, it's difficult to purchase a home without at least some financial assistance. As a result, many young adults turn to their parents or other family members for help with a down payment.

If you plan on lending your child money for a down payment on a house, you should try to assume the role of a commercial lender. Setting the terms of the loan in writing will demonstrate to your child that you take both your responsibility as lender and your child's responsibility as borrower seriously.

While having an actual loan contract may seem too businesslike to some parents, doing so can help set expectations between you and your child. The loan contract should spell out the exact loan amount, the interest rate and a repayment schedule. To avoid the uncomfortable situation of having to remind your child that a payment is due, consider asking him or her to set up automatic monthly transfers from his or her bank account to yours.

This type of loan documentation is also important for IRS purposes because there may be potential income and gift tax issues with these types of loans. For example, interest paid by your child will be considered taxable income, and if adequate interest is not charged for the loan, special imputed interest rules may apply.

If you don't feel comfortable lending your child money, you may want to consider making a smaller, no-strings-attached gift that doesn't have to be repaid. Currently, you can gift up to $14,000 annually per person under the gift tax exclusion. However, if you do gift money for a down payment, your child's lender may still require him or her to put up some of his or her own money, depending on the type of mortgage chosen.

Keep in mind that lending money to family members can be a tricky proposition. Before entering into this type of financial arrangement, you should take the time to carefully weigh both the financial and emotional costs.

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