Leslie Roper Day & Associates

Focus On Your Finances

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Dear Friends,

As we wrap up 2016 (and what a year it was), I enjoy looking forward with a clean slate. What can I do better in 2017? What should I stop doing and what should I start doing? More importantly, whose life can I touch for good? That's a better resolution than my perennial one of going to bed on time.

I wish you all a very Happy New Year!

Leslie

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Will vs. Trust: Is One Better Than the Other?

When it comes to planning your estate, you might be wondering whether you should use a will or a trust (or both). Understanding the similarities and the differences between these two important documents may help you decide which strategy is better for you.

What is a will?

A will is a legal document that lets you direct how your property will be dispersed (among other things) when you die. It becomes effective only after your death. It also allows you to name an estate executor as the legal representative who will carry out your wishes.

In many states, your will is the only legal way you can name a guardian for your minor children. Without a will, your property will be distributed according to the intestacy laws of your state. Keep in mind that wills and trusts are legal documents generally governed by state law, which may differ from one state to the next.

What is a trust?

A trust document establishes a legal relationship in which you, the grantor or trustor, set up the trust, which holds property managed by a trustee for the benefit of another, the beneficiary. A revocable living trust is the type of trust most often used as part of a basic estate plan. "Revocable" means that you can make changes to the trust or even end (revoke) it at any time. For example, you may want to remove certain property from the trust or change the beneficiaries. Or you may decide not to use the trust anymore because it no longer meets your needs.

A living trust is created while you're living and takes effect immediately. You may transfer title or "ownership" of assets, such as a house, boat, automobile, jewelry, or investments, to the trust. You can add assets to the trust and remove assets thereafter.

How do they compare?

While both a will and a revocable living trust enable you to direct the distribution of your assets and property to your beneficiaries at your death, there are several differences between these documents. Here are a few important ones.

- A will generally requires probate, which is a public process that may be time-consuming and expensive. A trust may avoid the probate process.
- In order to exclude assets from probate, you must transfer them to your revocable trust while you're living, which may be a costly, complicated, and tedious process.
- Unlike a will, a trust may be used to manage your financial affairs if you become incapacitated.
- If you own real estate or hold property in more than one state, your will would have to be filed for probate in each state where you own property or assets. Generally, this is not necessary with a revocable living trust.
- A trust can be used to manage and administer assets you leave to minor children or dependents after your death.
- In a will, you can name a guardian for minor children or dependents, which you cannot do with a trust.

Which is appropriate for you?

The decision isn't necessarily an "either/or" situation. Even if you decide to use a living trust, you should also create a will to name an executor, name guardians for minor children, and provide for the distribution of any property that doesn't end up in your trust. There are costs and expenses associated with the creation and ongoing maintenance of these legal instruments.

Whether you incorporate a trust as part of your estate plan depends on a number of factors. Does your state offer an informal probate, which may be an expedited, less expensive process available for smaller estates? Generally, if you want your estate to pass privately, with little delay or oversight from a probate court, including a revocable living trust as part of your estate plan may be the answer.

Key Retirement and Tax Numbers for 2017

Every year, the Internal Revenue Service announces cost-of-living adjustments that affect contribution limits for retirement plans, thresholds for deductions and credits, and standard deduction and personal exemption amounts. Here are a few of the key adjustments for 2017.

Retirement plans

- Employees who participate in 401(k), 403(b), and most 457 plans can defer up to $18,000 in compensation in 2017 (the same as in 2016); employees age 50 and older can defer up to an additional $6,000 in 2017 (the same as in 2016).
- Employees participating in a SIMPLE retirement plan can defer up to $12,500 in 2017 (the same as in 2016), and employees age 50 and older will be able to defer up to an additional $3,000 in 2017 (the same as in 2016).

IRAs

The limit on annual contributions to an IRA remains unchanged at $5,500 in 2017, with individuals age 50 and older able to contribute an additional $1,000. For individuals who are covered by a workplace retirement plan, the deduction for contributions to a traditional IRA is phased out for the following modified adjusted gross income (AGI) ranges:

	2016	2017
Single/head of household (HOH)	$61,000 - $71,000	$62,000 - $72,000
Married filing jointly (MFJ)	$98,000 - $118,000	$99,000 - $119,000
Married filing separately (MFS)	$0 - $10,000	$0 - $10,000

Note: *The 2017 phaseout range is $186,000 - $196,000 (up from $184,000 - $194,000 in 2016) when the individual making the IRA contribution is not covered by a workplace retirement plan but is filing jointly with a spouse who is covered.*

The modified AGI phaseout ranges for individuals making contributions to a Roth IRA are:

	2016	2017
Single/HOH	$117,000 - $132,000	$118,000 - $133,000
MFJ	$184,000 - $194,000	$186,000 - $196,000
MFS	$0 - $10,000	$0 - $10,000

Estate and gift tax

- The annual gift tax exclusion remains at $14,000.
- The gift and estate tax basic exclusion amount for 2017 is $5,490,000, up from $5,450,000 in 2016.

Personal exemption

The personal exemption amount remains at $4,050. For 2017, personal exemptions begin to phase out once AGI exceeds $261,500 (single), $287,650 (HOH), $313,800 (MFJ), or $156,900 (MFS).

Note: *These same AGI thresholds apply in determining if itemized deductions may be limited. The corresponding 2016 threshold amounts were $259,400 (single), $285,350 (HOH), $311,300 (MFJ), and $155,650 (MFS).*

Standard deduction

These amounts have been adjusted as follows:

	2016	2017
Single	$6,300	$6,350
HOH	$9,300	$9,350
MFJ	$12,600	$12,700
MFS	$6,300	$6,350

Note: *The 2016 and 2017 additional standard deduction amount (age 65 or older, or blind) is $1,550 for single/HOH or $1,250 for all other filing statuses. Special rules apply if you can be claimed as a dependent by another taxpayer.*

Alternative minimum tax (AMT)

AMT amounts have been adjusted as follows:

	2016	2017
Maximum AMT exemption amount		
Single/HOH	$53,900	$54,300
MFJ	$83,800	$84,500
MFS	$41,900	$42,250
Exemption phaseout threshold		
Single/HOH	$119,700	$120,700
MFJ	$159,700	$160,900
MFS	$79,850	$80,450
26% on AMTI* up to this amount, 28% on AMTI above this amount		
MFS	$93,150	$93,900
All others	$186,300	$187,800
*Alternative minimum taxable income		

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Pretax, Roth, or After-Tax Contributions: Which Should You Choose?

When choosing between pretax and Roth contributions, the general rule is to consider whether you think you will benefit more from the tax break today than you would from a tax break in retirement. Specifically, if you think you'll be in a higher tax bracket in retirement, Roth contributions may be more beneficial in the long run.

Generally, non-Roth after-tax contributions should be considered after reaching the maximum contribution amount for pretax and Roth options.

Keep in mind that distributions of earnings on non-Roth after-tax contributions will be subject to regular income taxes and possibly penalty taxes if not rolled over to a traditional IRA. IRS Notice 2014-54 clarifies the rules regarding rollovers of non-Roth after-tax plan contributions to a Roth IRA.

For more information specific to your situation, consult a qualified tax professional. (Working with a tax or financial professional cannot guarantee financial success.)

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If your employer-sponsored retirement savings plan allows pretax, after-tax, and/or Roth contributions, which should you choose?

Pretax: Tax benefits now

With pretax contributions, the money is deducted from your paycheck before taxes, which helps reduce your taxable income and the amount of taxes you pay now. Consider the following example, which is hypothetical and has been simplified for illustrative purposes.

Example(s): *Mark earns $2,000 every two weeks before taxes. If he contributes nothing to his retirement plan on a pretax basis, the amount of his pay that will be subject to income taxes would be the full $2,000. If he was in the 25% federal tax bracket, he would pay $500 in federal income taxes, reducing his take-home pay to $1,500. On the other hand, if he contributes 10% of his income to the plan on a pretax basis--or $200--he would reduce the amount of his taxable pay to $1,800. That would reduce the amount of taxes due to $450. After accounting for both federal taxes and his plan contribution, Mark's take-home pay would be $1,350. The bottom line? Mark would be able to invest $200 toward his future but reduce his take-home pay by just $150. That's the benefit of pretax contributions.*

In addition, any earnings made on pretax contributions grow on a tax-deferred basis. That means you don't have to pay taxes on any gains each year, as you would in a taxable investment account. However, those tax benefits won't go on forever. Any money withdrawn from a tax-deferred account is subject to ordinary income taxes, and if the withdrawal takes place prior to age 59½ (or in some cases, 55 or 50, depending on your plan's rules), you may be subject to an additional 10% penalty on the total amount of the distribution.

Roth: Tax benefits down the road

On the other hand, contributing to an employer-sponsored Roth account offers different benefits. Roth contributions are considered "after-tax," so you won't reduce the amount of current income subject to taxes. But qualified distributions down the road will be tax-*free.*

A qualified Roth distribution is one that occurs:

- After a five-year holding period and
- Upon death, disability, or reaching age 59½

Nonqualified distributions are subject to regular income taxes and a possible 10% penalty tax. However, because Roth contributions are made with after-tax dollars, a distinction is made between the portion of the distribution that represents contributions versus earnings on those contributions. If at some point you need to take a nonqualified withdrawal from a Roth 401(k)--due to an unexpected emergency, for example--only the proportion of the total amount representing earnings will be taxable.

Example(s): *In order to meet an unexpected financial need of $8,000, Tina decides to take a nonqualified hardship distribution from her Roth 401(k) account. Of the $20,000 total value of the account, $18,400 represents after-tax Roth contributions and $1,600 is attributed to investment earnings. Because earnings represent 8% of the total account value ($1,600 ÷ $20,000 = 0.08), this same proportion of Tina's $8,000 distribution--or $640 ($8,000 x .08)--will be considered earnings subject to both income taxes and a 10% penalty tax.*

However, keep in mind that tapping your account before retirement defeats its purpose. If you need money in a pinch, try to exhaust all other possibilities before taking a distribution. Always bear in mind that the most important benefit of a Roth account is the opportunity to build a nest egg of tax-free income for retirement.

After-tax: For those who are able to exceed the limits

Some plans allow participants to make additional after-tax contributions. This plan feature helps those who want to make contributions exceeding the annual total limit on pretax and Roth accounts (in 2016, the limit is $18,000; $24,000 for those age 50 or older). As with a traditional pretax account, earnings on after-tax contributions grow on a tax-deferred basis.

If this option is offered (check your plan documents), keep in mind that total employee and employer contributions cannot exceed $53,000, or $59,000 for those 50 and older (2016 limits).

Another benefit of making after-tax contributions is that when you leave your job or retire, they can be rolled over tax-free to a Roth IRA, which also allows for potential tax-free growth from that point forward. Some higher-income individuals may welcome this potential benefit if their income affects their ability to directly fund a Roth IRA.[1]

[1] In addition to rolling the proceeds to a Roth IRA, participants may also (1) leave the assets in the original plan, (2) transfer assets to a new employer's plan, or (3) withdraw the funds (which in some cases could trigger a taxable event).

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How can I pay off the credit card debt I racked up over the holidays?

It's a common occurrence once the holiday season winds down — you reluctantly look at your credit card statement and wince at all the purchases you made over the holidays. Fortunately, there's no need to panic. Consider using one of the following strategies to help pay it off.

Make a lump-sum payment. The best way to pay off credit card debt is with a single lump-sum payment, which would allow you to pay off your balance without owing additional interest. Look for sources of funds you can use for a lump-sum payoff, such as an employment bonus or other windfall. However, most individuals find themselves getting into credit card debt due to a lack of cash on hand in the first place, so this may not be an option for everyone.

Pay more than the minimum due. If it's not possible for you to pay off your balance entirely, always be sure to pay more than the required minimum payment due. Otherwise, you'll continue to carry the bulk of your balance forward without actually reducing your overall balance. You can refer to your monthly statement for more information on the impact that minimum payments will have on your credit card balance.

Prioritize your payments. If you have multiple credit cards that carry outstanding balances, another payoff strategy is to prioritize your payments and systematically pay off your credit card debt. Start by making a list of your credit cards and prioritize them according to their interest rates. Send the largest payment to the card with the highest interest rate. Continue making payments on your other cards until the card with the highest interest rate is paid off. You can then focus your repayment efforts on the card with the next highest interest rate, and so on, until they're all paid off.

Transfer your balances. Another option is to transfer your balances to a card that carries a lower interest rate. Many credit card companies offer highly competitive balance transfer offers (e.g., 0% interest for 12 to 24 months). Balance transfers may enable you to reduce interest fees and pay more against your existing balance. Keep in mind that credit cards often charge a fee for balance transfers (usually a percentage of the balance transferred).

I get so many credit card reward offers. How do I know which one to choose?

Credit card reward programs are more popular than ever. In order to keep up with such high demand in a competitive market, credit card companies are coming up with new and more enticing offers every day. How do you know which one to choose?

Are you the type of credit card user who likes to travel and/or frequent a particular hotel or airline? If so, then a travel rewards credit card might be the right option for you. Typically, a travel rewards card allows you to earn points (sometimes referred to as miles, depending on the card) for every purchase you make on the card. Typically, cards offer a reward that is equal to 1% of your purchase, which means that for every $100 you spend, you will earn 1 point or mile. Some credit card companies offer even greater incentives, such as double points for specific types of purchases or bonus points when you open up an account. Before signing up, however, be sure to read the fine print. Many travel rewards cards have specific rules that apply to point redemption and may charge a hefty annual fee.

Don't want the hassle that sometimes goes along with redeeming points on a travel rewards card? Consider a cash back rewards card. While not as thrilling as racking up points to take a trip to some far-off, exotic destination, cash back rewards cards may be better for individuals who aren't frequent travelers and who tend to use credit cards for everyday purchases. Most cash back rewards cards offer a flat cash reward on general purchases. Others offer higher rewards for different spending categories (e.g., dining or entertainment purchases). Consider your credit card spending habits to determine which cash back rewards card would be appropriate for you.

Finally, it's important to remember that rewards cards work best when you pay off your account balance each month. Be sure to charge only what you can afford to pay off and avoid spending over your budget just to earn more rewards. Otherwise, the unpaid balance you carry forward will create finance charges that may cancel out the value of any rewards you accumulate.

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