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Weathering the Storm: Are You Prepared?

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

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HOLLANDER & LONE, L.L.C.

H&L's eAdvisor

Keeping You Informed. Getting You Ready.

Due Date Approaches for 2017 Federal Income Tax Returns

Tax filing season is here again. If you haven't done so already, you'll want to start pulling things together — that includes getting your hands on a copy of your 2016 tax return and gathering W-2s, 1099s, and deduction records. You'll need these records whether you're preparing your own return or paying someone else to prepare your tax return for you.

Don't procrastinate

The filing deadline for most individuals is Tuesday, April 17, 2018. That's because April 15 falls on a Sunday, and Emancipation Day, a legal holiday in Washington, D.C., is celebrated on Monday, April 16. Unlike in some years, there's no extra time for residents of Massachusetts or Maine to file because Patriots' Day (a holiday in those two states) falls on April 16 — the same day that Emancipation Day is being celebrated.

Filing for an extension

If you don't think you're going to be able to file your federal income tax return by the due date, you can file for and obtain an extension using IRS Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return. Filing this extension gives you an additional six months (to October 15, 2018) to file your federal income tax return. You can also file for an extension electronically — instructions on how to do so can be found in the Form 4868 instructions.

Filing for an automatic extension does not provide any additional time to pay your tax. When you file for an extension, you have to estimate the amount of tax you will owe and pay this amount by the April filing due date. If you don't pay the amount you've estimated, you may owe interest and penalties. In fact, if the IRS believes that your estimate was not reasonable, it may void your extension.

Note: *Special rules apply if you're living outside the country or serving in the military and on duty outside the United States. In these circumstances you are generally allowed an automatic two-month extension (to June 15, 2018) without filing Form 4868, though interest will be owed on any taxes due that are paid after April 17. If you served in a combat zone or qualified hazardous duty area, you may be eligible for a longer extension of time to file.*

What if you owe?

One of the biggest mistakes you can make is not filing your return because you owe money. If your return shows a balance due, file and pay the amount due in full by the due date if possible. If there's no way that you can pay what you owe, file the return and pay as much as you can afford. You'll owe interest and possibly penalties on the unpaid tax, but you'll limit the penalties assessed by filing your return on time, and you may be able to work with the IRS to pay the remaining balance (options can include paying the unpaid balance in installments).

Expecting a refund?

The IRS is stepping up efforts to combat identity theft and tax refund fraud. New, more aggressive filters that are intended to curtail fraudulent refunds may inadvertently delay some legitimate refund requests. In fact, since last year's tax filing season, the IRS has been required to hold refunds on all tax returns claiming the earned income tax credit or the refundable portion of the child tax credit until at least February 15.[1]

Most filers, though, can expect a refund check to be issued within 21 days of the IRS receiving a return.

[1] IRS.gov (IR-2017-181, IRS Encourages Taxpayers to Check Their Withholding; Checking Now Helps Avoid Surprises at Tax Time, October 30, 2017)

Weathering the Storm: Are You Prepared?

Severe weather can test even the most seasoned homeowners. And while storm hazards such as power outages, downed trees, and flooding can result in costly damage to your home, they can also put your family's safety at risk. The key to making it through a storm safely is to be prepared.

Protect your home

Before a storm arrives, you'll want to take proactive steps to prevent damage to your home, such as:

- Cleaning your gutters and downspouts so that water can flow freely away from your home
- Inspecting and repairing roof shingles and flashing to prevent water damage
- Trimming overhanging tree limbs
- Securing loose objects (e.g., grills and patio furniture)
- Parking your car and storing any heavy equipment (e.g., lawnmower) inside a garage
- Investing in storm windows, doors, and shutters

Have an emergency plan/stock up on supplies

A severe storm can cause power outages that last for days. It can also result in downed power lines, fallen trees, and flooding that make roads impassable. You'll want to have an emergency plan that identifies a place nearby where you can safely stay if you lose power for an extended period of time.

In addition, you should gather the necessary supplies you'll need to stay safe both during and after a storm. The following are some items to put together in an emergency supply kit.

Food/supplies. Stock up on enough nonperishable food to sustain you and your family for several days. You'll also want to store other items that are specific to your family's needs, such as infant formula, diapers, pet food, clothing, and blankets.

First aid/medicine. Be prepared for any possible medical needs by having a first aid kit. Also talk to your doctor about obtaining an extra prescription for important medications you take such as heart and blood pressure medications, insulin, and asthma inhalers.

Communication/safety items. Make sure your cell phones and other methods of electronic communication are fully charged before the storm arrives. Also gather additional safety items, such as matches, flashlights, batteries, and an AM/FM radio.

Important documents/valuables. Place important documents, such as personal records (e.g., birth and marriage certificates), property records (e.g., insurance policies), medical records, financial information (e.g., bank or credit card information), and any valuables in a secure location that is easily accessible in case of an emergency.

Review your insurance coverage

Review all of your insurance policies (e.g., homeowners, renters, and auto) to make sure that you have appropriate coverage for your property and belongings. Your home and its contents should be insured to their full replacement cost, including any new additions, remodels, and furniture. To assist with post-storm insurance claims, be sure to take pictures/videos and make an inventory of your home and valuables in case they are damaged or destroyed.

Keep in mind that certain types of storm damage (e.g., flood and hurricane) may not be covered by a standard policy or may require you to pay a separate deductible. If you live in a high-risk storm area, you may need to purchase insurance specifically designed for floods and hurricanes. Contact your insurance agent to determine if you need to purchase additional insurance above and beyond traditional coverage.

After the storm

If your home suffers severe storm damage from a natural disaster, you may be eligible for immediate disaster relief funds and special programs through the Federal Emergency Management Agency (FEMA) and various state/local government agencies.

You'll also need to file a claim for storm damage with your insurance company. To make the claims process easier, take pictures to document the damage — both inside and outside of your home — as soon as possible. While your claim is being processed, take steps to prevent further damage (e.g., putting a tarp on a damaged roof), since the insurance company may not cover any additional damage that occurs after the storm passes.

Keep in mind that the process for filing an insurance claim can take time, especially if your home is in an area that has been impacted by a large-scale storm. As a result, you should contact your insurer with any questions you may have regarding the claims process.

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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How does working affect Social Security retirement benefits?

If you're thinking about working as long as possible to increase your retirement savings, you may be wondering whether you can receive Social Security retirement benefits while you're still employed. The answer is yes. But depending on your age, earnings from work may affect the amount of your Social Security benefit.

If you're younger than full retirement age and make more than the annual earnings limit ($17,040 in 2018), part of your benefits will be withheld, reducing the amount you receive from Social Security. If you're under full retirement age for the entire year, $1 is deducted from your benefit for every $2 you earn above the annual limit.

In the year you reach full retirement age, $1 is deducted from your benefit for every $3 you earn above a different limit ($45,360 in 2018).

Starting with the month you reach full retirement age, your benefit won't be reduced, no matter how much you earn.

Earnings that count toward these limits are wages from a job or net earnings from self-employment. Pensions, annuities, investment income, interest, and veterans or other government benefits do not count. Employee contributions to a pension or a retirement plan do count if the amount is included in your gross wages.

The Social Security Administration (SSA) may begin to withhold the required amount, up to your whole monthly benefit, as soon as it determines you are on track to surpass the annual limit. However, even if your benefits are reduced, you'll receive a higher monthly benefit at full retirement age, because the SSA will recalculate your benefit and give you credit for any earnings withheld earlier. So the effect that working has on your benefits is only temporary, and your earnings may actually increase your benefit later.

These are just the basics, and other rules may apply. The Retirement Earnings Test Calculator, available at the Social Security website, ssa.gov, can help you estimate how earnings before full retirement age might affect your benefit.

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, for more information.

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