NAPFA
Planning Perspectives

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NAPFA
THE NATIONAL ASSOCIATION OF PERSONAL FINANCIAL ADVISORS

"I have a Vanguard Target 2015 Retirement Account. I will be retiring in 2015. Should I move my money from the Target 2015 account to a less risky account for my retirement years? And, if so, will I have to pay taxes on the money when I move it?"

This is just one of the hundreds of questions asked by consumers during a "Jump-Start Your Retirement" online chat sponsored by NAPFA & Kiplinger. These quarterly chats are a way for you to get quick answers to your financial concerns while seeing what you can expect when you consult a Fee-Only advisor.

This year, NAPFA and Kiplinger offer four more "Jump-Start" sessions. You can sign up to participate through Kiplinger, and you can submit questions in advance on Twitter, using the hashtag #JumpStart. More information on how you can participate is available at napfa.org/JumpStartHotline.asp. (Past sessions can be found at live.kiplinger.com/#AllEvents.)

The dates for the 2015 sessions are:
- Feb. 19
- June 18
- Sept. 17
- Dec. 10

Kiplinger
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TAXES

Tax planning is an integral part of any comprehensive financial plan. Unfortunately, it's not something that many people think about until they start receiving tax forms in the mail toward the end of the year.

When you work with a Fee-Only financial planner, you can be sure that a tax discussion will happen long before ads for do-it-yourself tax begin software popping up. With the right preparation, you can streamline an otherwise tedious and time-consuming process and likely even save some money.

In this issue, David L. Blain, CFA discusses the impact of some updates to the IRS tax code. Another planner, Benjamin Dorsey, CPA, CFP®, CDFA™, MST, highlights some things you can do to reduce stress of filing in the future.

On page 4, David John Marotta, CFP®, AIF® puts the issue of taxation into an historical perspective. While they won't help you prepare your return, his thoughts might motivate you to pay closer attention to the impact that raising or lowering taxes can have.

Finally, you can read some of the questions that NAPFA members have received about taxes on NerdWallet.com's Ask an Advisor feature. Browsing the NerdWallet site will reveal thousands of questions on taxes and every other financial topic imaginable.

Consumer Resources
NAPFA offers a number of consumer resources. If you're reading this newsletter, then you've probably already been to napfa.org. At the top of the website, you can select "Public" to view the resources that NAPFA offers. A good place to start might be "How to Find an Advisor."

Here are some other resources that NAPFA offers:
- Videos on Fee-Only financial planning, comprehensive financial planning, the fiduciary standard, and "the power of trust," which forms the foundation of NAPFA's values.
- Books by NAPFA members have written on a wide range of topics.
- Webinars recorded during NAPFA events.

Also, you might want to bookmark FiGuide.com, a site where NAPFA members post on many different financial-planning topics.

Tax Tips and Changes for 2014

By David L. Blain, CFA, BlueSky Wealth Advisors, www.blueskywa.com

The IRS changes the tax code the way most of us change our socks. And while some of these "updates" can be troublesome, they often present tax-planning opportunities. Here are a few.

Deferring your tax liabilities generally means accelerating deductions into the current year and deferring income into the next (although the opposite may be equally true). There are plenty of income items and expenses you might be able to control, such as bonuses, consulting income, or self-employment income. On the deduction side, you might be able to accelerate state and local income taxes, interest payments, and real-estate taxes.

Many expenses can be deducted if they exceed a certain percentage of your adjusted gross income (AGI). By bundling itemized deductions into one year, you can exceed these AGI floors. For example, scheduling elective medical procedures in the same year can help you exceed the 10-percent AGI floor for medical expenses (7.5 percent for taxpayers 65 and older). To exceed the 2-percent AGI floor for miscellaneous expenses, consider bundling fees for legal advice, accounting service, or financial planning, as well as unreimbursed business expenses such as travel and vehicle costs.

Taxes are due throughout the year, so check your withholding and estimated tax payments now. Also, if you're facing a potential underpayment penalty, try increasing withholding on your salary or bonuses. Remember, a bigger estimated tax payment can still result in penalties for any underpayments from previous quarters.

Retirement accounts like a 401(k) or IRA offer excellent tax savings. 2014 contribution limits are $17,500 for a 401(k) and $5,500 for an IRA (not including catch-up contributions for those 50 and older). 2014 IRA contributions can be made up to the extended filing deadline of Oct. 15.

Converting a traditional IRA to a Roth allows you to pay tax on the conversion in exchange for no taxes in the future. If you converted your IRA this year, review the transaction. If the value went down, you have until the extended filing deadline in October to reverse the conversion. That way, you might be able to reconvert later and pay less tax.

You also have the choice of deducting state and local sales tax instead of state income taxes. This is especially valuable if you made large purchases such as a car, boat, or home. The IRS has a table to determine a standard sales-tax deduction so that you don't have to save your receipts during the year (you can add the sales tax from large purchases on top of the standard amount).

For tax year 2014, you can give up to $14,000 to as many people as you wish free of gift or estate tax. If you combine gifts with a spouse, you can give up to $28,000 per beneficiary.

The home-office deduction is a long-standing part of the tax code and can be very beneficial. Qualifying is simple, though the amount of this deduction has long been a source of controversy. Fortunately, the IRS has a new safe-harbor provision this year that allows you to deduct up to $5 per square foot of home office space up to $1,500 per year.

So-called "above-the-line" deductions are valuable because you deduct them before you calculate your AGI. These deductions are allowed in full and make it less likely that other tax benefits will be limited. Common above-the-line deductions include traditional IRA contributions, health savings account (HSA) contributions, and self-employed health insurance costs.

The end of the year is always a good time to assess your current financial situation and to plan for the future. You should think about cash flow, health care, retirement, investment, and estate planning. Make sure your wills, powers of attorney, and health-care proxies are up-to-date. Reconsider employer-sponsored programs that could reduce next year's taxable income. Finally, remember that HSAs and flexible spending accounts for dependent care or medical expenses allow you to use pre-tax dollars.

Being Prepared: The Best Kept Secret to Low-Stress Tax Return Filing

By Benjamin Dorsey, CPA, CFP®, CDFA™, MST Baltimore-Washington Financial Advisors www.bwfa.com

Another year is behind us, and April 15 looms on the calendar. Congress, meanwhile, continues to loom in the background, with last-minute tax legislation that could retroactively impact 2014. Forms such as your W-2 and consolidated investment statements have Jan. 31 and Feb. 28 release deadlines, respectively. Oh, and the issuers reserve the right to amend them in the future. It's easy to see how the dreaded filing deadline becomes more and more of a last-minute rush each year.

Here are some special items to note this year.

Affordable Care Act

All Americans will be affected in some manner by the Affordable Care Act. As a result of this act, the IRS released new tax forms for 2014. One of the most common forms will be Form 1095, which depicts the health-insurance coverage available to you from your employer. If you do not receive a 1095, you will need to answer additional questions regarding you and your family's health insurance coverage for 2014.

Medical Deductions

The amount of your medical expenses in most cases must now be more than 10 percent of your income before anything can be deducted (taxpayers 65 and older still have a threshold of 7.5 percent until tax year 2016). Before going through the hassle of organizing and adding up your medical expenses, determine whether it is likely that you will meet the 10-percent threshold to receive any benefit. If you are self-employed, you will need to know how much you paid for health insurance.

Charitable Contributions

All deductions of any amount must have a receipt. Any individual contribution greater than $250 must also have an acknowledgement letter from the charity, and the letter must be dated by the date your tax return is filed. The letter must show the date and amount of any individual contribution greater than $250, and it should specify whether any goods or services were received as part of the contribution.

Roth IRA Conversions

Taxpayers and tax professionals have continued to evaluate the benefit of converting traditional IRA accounts to Roth IRAs. Since these conversions are not a common annual occurrence for most taxpayers, it is imperative that you provide your tax professional with information related to any conversion completed in 2014. Additionally, if you expect lower income in 2015, it can be worthwhile to evaluate future conversions with your tax professional.

Children/Student Tax Returns

Because of the Affordable Care Act, it is imperative that students and dependent children not file their own return and claim their own dependency exemption. Allowing a child to file their own return, particularly a student, can cost the child and parent thousands of dollars in health-care penalties and/or credits.

Planning For 2015

Effective Jan. 1, 2013, the amount you can give to one person in a given year without gift-tax return filing requirements was increased to $14,000. That amount was not adjusted and will be the same in 2015. IRA contribution limits for taxpayers with taxable compensation will also stay the same for 2015: $5,500 for taxpayers younger than 50, $6,500 for taxpayers 50 and over. Annual 401(k) deferral limits to employer-sponsored retirement plans increased to $18,000, with a catch-up provision for taxpayers 50 and over of an additional $6,000.

If you don't use a tax organizer, try creating a checklist of items that are commonly used to prepare your return (W-2s, 1099s, K-1s, etc.). Many organizations make their forms available online as opposed to sending them by mail, so watch your email for tax data and forms. Finally, starting your return or sending your documents to your tax professional sooner rather than later will lead to a calmer pace as you approach the filing deadline.

Five Lessons from the Whiskey Rebellion

By David John Marotta, CFP®, AIF® and Megan Russell Marotta Wealth Management www.emarotta.com

Citizens are more willing to support tax increases when they believe someone else will be paying them, especially if they think that someone deserves it. Consequently, when looking for sources of revenue, government officials like to find an unpopular vice and slap a tax on it.

The earliest and first U.S. tax-inspired revolt was the 1791 Whiskey Rebellion. The federal government, just two years old, was $54 million in debt from the American Revolution. Another $25 million was owed by the states. Combined, the debt was the equivalent of $1.975 trillion in today's dollars.

Alexander Hamilton, the first secretary of the treasury, argued that the federal government should pay the entire debt to build national unity and strengthen the central government. He built a coalition of states eager to receive free federal money. Then he partnered with social reformers anxious to use a new excise tax to discourage alcohol consumption. The act became law, and President George Washington defined revenue districts and appointed tax collectors to each one.

Lesson 1: Beware politicians who ask your permission to pick another person's pocket. Hamilton thought a tax on alcohol would be a sneaky way to make the rich pay off the debt. He was wrong.

Frontier farmers often had excess grain that they turned into whiskey, which was easier to ship. Whiskey was one of the few cash crops for the frontier and a medium of exchange for businesses West of Appalachia. For the frontiersmen, this so-called sin tax was effectively taxing their currency.

To the average consumer, the tax was $1.50 a year. But to the farmers, the government was taking $6 of their annual $20 income. Thus in an attempt to tax liquor sales in Philadelphia, Congress effectively killed the entire economy of frontier farmers.

Lesson 2: The economy is complex. Advocates of big government believe controlling the economy is simpler than it is, whereas advocates of the free market have a humbler attitude toward our lack of ability to dictate everyone's behavior.

What made the taxation of 1791 worse is that many of these farmers were veterans of the Revolution, a war over onerous British taxes. In response to the new tax, some 7,000 frontiersmen rose up in western Pennsylvania to protest, convincing their delegates to petition the government with a list of grievances. The tax was reduced by a penny, but still no one paid it.

Lesson 3: If a law is not worth an army, it shouldn't be a law. Every government tax or regulation requires force or the threat of force to be meaningful. Legislators should ask themselves, "Is this law worth raising an army and fighting the citizens over?" If the answer is no, their vote should be the same.

Hamilton counseled Washington to put down the rebellion and inspire the fear of punishment in the new citizens. With an army of 13,500 men, hundreds of suspects were rounded up and detained. Twenty were put on trial. Two were convicted and later pardoned by Washington.

Lesson 4: The fairer the tax, the less violent the response. The fairest tax would be a head tax in which everyone owed the same amount. Anything more complex can pit one faction against another and incite rebellion.

When he became president in 1801, Jefferson repealed all internal taxes, including the Whiskey Tax. He also ran a surplus for his years in office, enabling him to pay down the debt from $83 million to $57 million by 1811. The discontent subsided.

Lesson 5, the take-away: Tax cuts can cause a government surplus, whereas tax increases can cause rebellions.

www.NAPFA.org

Ask An Advisor Anything

by Chris Hale, Managing Editor NAPFA Advisor

On the NerdWallet website, anyone can ask any question about finance, and a professional financial advisor—often more than one—will provide an answer. Advisors have answered thousands of questions since NerdWallet began offering its Ask an Advisor feature. Of the hundreds of advisors who participate, NAPFA members account for roughly one in five.

Here are some responses from NAPFA advisors on the issue of taxes.

Q: For the last few years, I have been using my father's accountant for the filing of my taxes, but the fee he is charging seems to be higher than average. Would you recommend I file via one of the online tax filing sites like TurboTax? Or should I use a tax professional?

Johanna Fox Turner CFP®, CPA, Mayfield, KY

A: Typical situations when you should consider using a CPA or EA:

- You own your own business
- You have a home office
- You have rental property
- Any time you have depreciable property
- You have a lot of investment transactions
- You need tax-planning advice
- You donate property worth over $500 to charitable organizations
- You get a K1 from a business or trust
- You have adjusted gross income (AGI) over $250,000

This is not a comprehensive list, but if you see yourself above, you probably should get professional help. Otherwise, TurboTax should be just fine. Many, if not most, tax preparers will tell you in advance what it will cost.

We will happily tell a prospect to use TurboTax if we can't add value, as we prefer to work with clients who need and value our expertise. Our minimum fee is $250 for a very basic return if someone just doesn't want to do it themselves (couple of W-2s), about the same as H&R Block. With anything added, such as a rental property, the minimum is $300. There are no further charges if the client needs to amend later or if the client is audited—it's included in their fee.

The amount that independent firms charge varies greatly, though, so ask in advance.

Good luck and I hope this helps!

Q: My father-in-law recently passed away, and my wife is the beneficiary of his 401(k). It's a substantial sum of money, but we don't really have a need for it right now. What are our options?

Russell Francis, CFP®, CPA, PFS, Beaverton, OR

A: If you don't need the money, your best option is to do a trustee-to-trustee transfer to an "inherited IRA" owned by your wife. There are no taxes on the transfer if the funds are directly transferred between trustees. Most brokerage firms and mutual fund companies will help you set up an inherited IRA and make the transfer.

Your wife will be required to take minimum distributions, which are taxable, but she can do so over her remaining life expectancy. The minimum amount is determined by the balance in the account, your wife's age, and the IRS Single Life Table, which can be found in the IRS Publication 590. The table's distribution period in each successive year is reduced by one. To determine the minimum distribution each year, you would divide the balance of the account on Dec. 31 of the previous year by the distribution period. To avoid tax surprises, be sure to have the proper tax withholding on the distributions.

Not all company 401(k) plans will allow transfers to an inherited IRA. In that case, you might be required to distribute all of it in one lump sum or within five years, depending on the distribution rules of the plan.

There are penalties for not taking the required minimum distributions. So if you're not comfortable making these calculations, be sure to check with your financial advisor or CPA.