



Korbitz Financial Planning Newsletter

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Happy Halloween! This past week has certainly been spooky for those along the east coast. Our thoughts and prayers are with those who were in the path of the storm.

One week from today we will have elected our next President. At this point it is far too close to call in terms of who that will be. That is all the more reason to vote. I urge everyone to go to the polls and cast your ballot next Tuesday (or before, if you have early voting available to you.) We must exercise our right to vote in order to protect it.

On a personal note, I completed my second marathon earlier this month. I was able to set a new Personal Record (meaning I was faster than last year.) More importantly, I achieved another goal that I had, enjoyed doing so, and recovered quickly. What goal have you set for the next year? One of mine is for a safe and enjoyable backpacking trip with my son in New Mexico next summer.

I hope you enjoy the newsletter.

Eric

October 2012

Year-End Investment Planning and the Fiscal Cliffhanger

Withdrawals from Traditional IRAs

Four Retirement Planning Mistakes to Avoid

Do I need to file a gift tax return?

Year-End Investment Planning and the Fiscal Cliffhanger

Investment planning at the end of 2012 revisits issues that have complicated the planning process for the last two years--tax cut extensions and spending cuts designed to reduce the U.S. budget deficit. Uncertainty about both and whether they will lead to what's been called a "fiscal cliff" in 2013 is likely to affect year-end investment planning yet again.

Despite the uncertainties--or perhaps because of them--it might be worth starting early to look at various "what-if" scenarios in case you need to make last-minute changes to your portfolio. Even though you may not be sure of exactly what will happen in 2013, here are some factors to keep in mind as you plot your year-end strategy.

Review timing of your investment sales

As of January 1, tax brackets are scheduled to return to their pre-2001 levels. That means the current six tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) are scheduled to become five (15%, 28%, 31%, 36%, and 39.6%). Also, absent further changes, the maximum tax rate on long-term capital gains, currently at 15%, will increase to 20% (10% for those in the 15% tax bracket); those in the 10% or 15% marginal income tax bracket, who now pay a 0% rate on capital gains, will lose that special rate. Finally, qualified dividends, now taxed at a maximum of 15%, will once again be taxed at ordinary income tax rates.

Another factor for high-income individuals in 2013 is a new 3.8% Medicare contribution tax on some or all of the net investment income of individuals with a modified adjusted gross income over \$200,000 (\$250,000 for married couples filing jointly, and \$125,000 for couples filing separately).

Ordinarily, higher rates in 2013 might suggest taking profits in an investment before those higher rates go into effect. However, the November election could affect the scheduled expiration date of those tax cuts, or even whether they expire at all. As a result, it's especially important this year not to let tax considerations be the sole factor in any investment decision. If you're uncertain about a sale, remember that another way to minimize

capital gains taxes is to harvest investment losses that may offset gains.

Consider the potential economic impact of 2013

The nonpartisan Congressional Budget Office has warned that the tax increases and the roughly \$109 billion in spending cuts could hamper an already sluggish economic recovery. Also, a 2% reduction in the Social Security portion of the payroll tax is scheduled to expire in January, leaving consumers with less to spend. Though there has already been talk about revisiting the spending cuts and tax cut expirations, you might want to consider how your portfolio might be affected.

Some companies are highly sensitive to economic cycles; others offer products and services that people need regardless of how the economy is doing and generally suffer less from a downturn (though any industry or company can have its own challenges). Also, the spending cuts could disproportionately affect some specific industries, such as defense, and companies that rely heavily on government contracts.

Interest rates and European instability

Partly because of the Federal Reserve's monetary policy and partly because of the European debt situation, interest rates have been at historic lows in recent months. This has meant higher prices for U.S. Treasury bonds, because bond yields move in the opposite direction from bond prices. However, investors who have relied on Treasuries for income and now want to roll over the proceeds of maturing bonds might be disappointed with available rates, which the Federal Reserve expects to remain low well into 2014. If that's the case for you, you may need to explore supplemental sources of investment income, or reexamine your Treasury holdings to see whether they now represent too much of your portfolio.

Even if you decide to wait and see what happens at year-end, planning for multiple scenarios now could help improve any last-minute decisions.

Withdrawals from Traditional IRAs



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Why you should think twice

Financial professionals generally recommend using your retirement funds for one purpose only--retirement. Why? Because frequent dips into your retirement funds will reduce your ultimate nest egg. Plus, there will be less money available to take advantage of the twin benefits of tax deferral and any compound earnings. Depleting your retirement funds too soon can create a dire situation in your later years.

And then there are taxes. If you've made only deductible contributions to your traditional IRA, then all the funds in your account are subject to federal income tax when you withdraw them. They may also be subject to state income tax. If you've made any nondeductible (after-tax) contributions to your IRA, then each withdrawal you make will consist of a pro-rata mix of taxable (your deductible contributions and any earnings in your account) and nontaxable (your nondeductible contributions) dollars.

All your traditional IRAs (including SEPs and SIMPLE IRAs) are treated as a single IRA when you calculate the taxable portion of a withdrawal. So you can't just transfer all your nondeductible contributions into a separate IRA, and then withdraw those funds tax free. And, if you're not yet age 59½, the taxable portion of your withdrawal may be subject to a 10% federal early distribution tax (your state may also apply a penalty tax).

10% early distribution penalty

To discourage early withdrawals from IRAs, federal law imposes a 10% tax on taxable distributions from IRAs prior to age 59½. Not all distributions before age 59½ are subject to this penalty, however. Here are the most important exceptions:

- Distributions due to a qualifying disability
- Distributions to your beneficiary after your death
- Distributions up to the amount of your tax-deductible medical expenses
- Qualified reservist distributions
- Distributions to pay first-time homebuyer expenses (up to \$10,000 lifetime)
- Distributions to pay qualified higher education expenses

- Certain distributions while you're unemployed, up to the amount you paid for health insurance premiums
- Amounts levied by the IRS
- Distributions that qualify as a series of substantially equal periodic payments (SEPPs)

The SEPP exception to the early distribution penalty

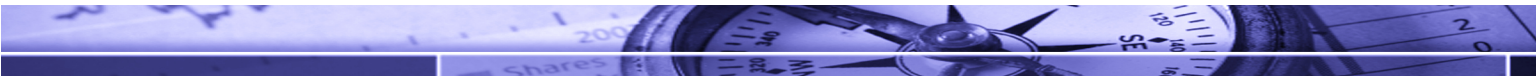
The SEPP exception allows you to withdraw funds from your IRA for any reason, while avoiding the 10% penalty tax. But the rules are complex, and this option is not for everyone. SEPPs are amounts you withdraw from your IRA over your lifetime (or life expectancy) or the joint lives (or joint life expectancy) of you and your beneficiary. You can take advantage of the SEPP exception at any age.

To avoid the 10% penalty, you must calculate your lifetime payments using one of three IRS-approved distribution methods and take at least one distribution annually. If you have more than one IRA, you can take SEPPs from just one of your IRAs or you can aggregate two or more of your IRAs and calculate the SEPPs from the total balance. You can also use tax-free rollovers to ensure that the IRA(s) that will be the source of your periodic payments contain the exact amount necessary to generate the payment amount you want based on the IRS formulas.

Even though SEPPs are initially determined based on lifetime payments, you can change--or even stop--the payments after five years, or after you reach age 59½, whichever is later. For example, you could start taking SEPPs from your IRA at age 50, without penalty, and then, if you no longer need the funds, reduce the payments (or stop them altogether) once you reach age 59½.

Short-term loan

If you only need funds for a short period of time you may be able to give yourself a short-term loan by withdrawing funds from your IRA, and then rolling those dollars back into the same or a different IRA within 60 days. However, watch the deadline carefully, because if you miss it, your short-term loan will instead be treated as a taxable distribution. And keep in mind that you can only make one rollover from a particular IRA to any other IRA in any 12-month period. A violation of this rule can also have serious adverse tax consequences.



Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference later. That's because the sooner you start saving, the more time your investments have to grow.

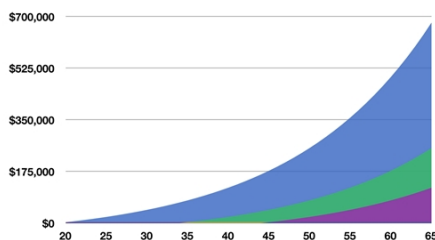
Four Retirement Planning Mistakes to Avoid

We all recognize the importance of planning and saving for retirement, but too many of us fall victim to one or more common mistakes. Here are four easily avoidable mistakes that could prevent you from reaching your retirement goals.

1. Putting off planning and saving

Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference later. That's because the sooner you start saving, the more time your investments have to grow.

The chart below shows how much you could save by age 65 if you contribute \$3,000 annually, starting at ages 20 (\$679,500), 35 (\$254,400), and 45 (\$120,000). As you can see, a few years can make a big difference in how much you'll accumulate.



Note: Assumes 6% annual growth, no tax, and reinvestment of all earnings. This is a hypothetical example and is not intended to reflect the actual performance of any investment.

Don't make the mistake of promising yourself that you'll start saving for retirement as soon as you've bought a house or that new car, or after you've fully financed your child's education--it's important that you start saving as much as you can, as soon as you can.

2. Underestimating how much retirement income you'll need

One of the biggest retirement planning mistakes you can make is to underestimate the amount you'll need to accumulate by the time you retire. It's often repeated that you'll need 70% to 80% of your preretirement income after you retire. However, depending on your lifestyle and individual circumstances, it's not inconceivable that you may need to replace 100% or more of your preretirement income.

With the future of Social Security uncertain, and fewer and fewer people covered by traditional pension plans these days, your individual savings are more important than ever. Keep in mind that because people are living longer,

healthier lives, your retirement dollars may need to last a long time. The average 65-year-old American can currently expect to live another 19.2 years (Source: National Vital Statistics Report, Volume 60, Number 4, January 2012). However, that's the average--many can expect to live longer, some much longer, lives.

In order to estimate how much you'll need to accumulate, you'll need to estimate the expenses you're likely to incur in retirement. Do you intend to travel? Will your mortgage be paid off? Might you have significant health-care expenses not covered by insurance or Medicare? Try thinking about your current expenses, and how they might change between now and the time you retire.

3. Ignoring tax-favored retirement plans

Probably the best way to accumulate funds for retirement is to take advantage of IRAs and employer retirement plans like 401(k)s, 403(b)s, and 457(b)s. The reason these plans are so important is that they combine the power of compounding with the benefit of tax deferred (and in some cases, tax free) growth. For most people, it makes sense to maximize contributions to these plans, whether it's on a pre-tax or after-tax (Roth) basis.

If your employer's plan has matching contributions, make sure you contribute at least enough to get the full company match. It's essentially free money. (Some plans may require that you work a certain number of years before you're vested in (i.e., before you own) employer matching contributions. Check with your plan administrator.)

4. Investing too conservatively

When you retire, you'll have to rely on your accumulated assets for income. To ensure a consistent and reliable flow of income for the rest of your lifetime, you must provide some safety for your principal. It's common for individuals approaching retirement to shift a portion of their investment portfolio to more secure income-producing investments, like bonds.

Unfortunately, safety comes at the price of reduced growth potential and the risk of erosion of value due to inflation. Safety at the expense of growth can be a critical mistake for those trying to build an adequate retirement nest egg. On the other hand, if you invest too heavily in growth investments, your risk is heightened. A financial professional can help you strike a reasonable balance between safety and growth.

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Do I need to file a gift tax return?

If you transfer money or property to anyone during any year without receiving something of at least equal value in return, you may need

to file a federal gift tax return (Form 709) by April 15 of the next year. If you live in one of the few states that have a gift tax, you may also need to file a gift tax return with your state.

Some gifts aren't taxable and generally don't require a gift tax return. These exceptions include:

- Gifts to your spouse that qualify for the marital deduction.
- Gifts to charities that qualify for the charitable deduction. (Filing is not required as long as you transfer your entire interest in the property to qualifying charities. However, if you are required to file a return to report gifts to noncharitable beneficiaries, all charitable gifts must be reported.)
- Qualified transfers exclusion amounts paid on behalf of anyone, either directly to an educational institution for tuition or directly to a provider for medical care.

- Annual exclusion gifts totaling \$13,000 or less for the year to any one individual. (However, you must file a return to split gifts with your spouse. But, if your spouse is not a U.S. citizen, the annual exclusion is increased to \$139,000 in 2012 for gifts to your spouse.)

If your gift isn't exempt from taxation, you'll need to file a gift tax return. But that doesn't mean that you have to pay gift tax. Generally, each taxpayer is allowed to make taxable gifts totaling \$5,120,000 (scheduled to drop to \$1 million in 2013) over his or her lifetime before paying gift tax. Filing the gift tax return helps the IRS keep a running tab on that \$5,120,000 basic exclusion amount (sometimes referred to as an exemption).

If you made a gift of property that's hard to value (e.g., real estate), you may want to report the gift, even if you're not required to do so, in order to establish the gift's taxable value. If you do, the IRS generally has only three years to challenge the gift's value. If you don't report the gift, the IRS can dispute the value of your gift at any time in the future.

What happens to my property if I die without a will?

If you do not have a will, your property will generally pass by state law under the rules for intestate succession. Under



intestate succession, the state essentially makes a will for you. The state laws for intestate succession specify how your property will pass, generally in certain proportions to various persons related to you. These laws vary from state to state.

The intestate succession laws generally favor spouses and children first. For example, a typical state law might specify that your property pass one-half or one-third to your surviving spouse, with the remainder passing equally to all your children. If you don't have children, your spouse might take all in many states; in other states, your spouse might have to share the estate with your brothers and sisters or parents.

But not all property passes by will or intestate succession. Whether or not you have a will, some property passes automatically to a joint owner or to a designated beneficiary. For example, you can transfer property such as IRAs, retirement plan benefits, and life

insurance by naming a beneficiary. Property that you own jointly with right of survivorship will automatically pass to the surviving owners at your death. Property held in trust will pass to your beneficiaries according to the terms you set out in the trust.

So, only property that does not pass by beneficiary designation, joint ownership, will, or trust passes according to state intestacy laws. You should generally use beneficiary designations, joint ownership, and wills and trusts to control the disposition of your property, so that you, rather than the state, determine who receives the benefit of your property.

Even if it seems like all your property will be transferred by beneficiary designation, joint ownership, or trust, you should generally have a will. You can designate in the will who will receive any property that slips through the cracks.

And, of course, you can do other things in a will as well, such as name the executor of your estate to carry out your wishes as specified in the will or name a guardian for your minor children.