July 2017 Newsletter

Tax Reform and more

Korbitz Financial Planning LLC

Eric S. Korbitz, CPA/PFS, CFP®
PO Box 170049
Milwaukee, WI 53217
414-979-1040
Eric@KorbitzFinancialPlanning.com
www.KorbitzFinancialPlanning.com

I am focusing most of this newsletter on issues that affect those in or about to enter college (or their parents) as well as issues that arise after leaving college.

First though, I feel compelled to comment on the prospect of tax reform, so I am covering this in the first article.

The second article discusses 4 things to do in the 4 years before college (something that is on the top of my mind now, as my oldest child is off to college next month.)

The third article discusses what can come after college, and it is not their first job. It is the implication of student loan debt.

Finally, the articles on page four discuss milestones of today's college age generation versus those of a generation ago.

I hope these articles provide food for thought. Please let me know if you have any questions.

Happy Summer.

Eric

July 2017 Newsletter

Tax Reform

The prospect of tax reform has been in the news lately, so I thought it might be helpful to provide you with some context on this issue.

If you want to understand why tax reform is so difficult, pick up a copy of T.R. Reed's book "A Fine Mess." I just finished reading it. The publication of this book was timely, given the recent introduction of what is being called Tax Reform in the House.

I have been a student of taxes and tax reform since I was a college undergraduate in the early 1980s. As T.R. Reed points out, major tax reform has happened about every 32 years in the U.S. Yes, we are due for a re-write of the Internal Revenue Code of 1986, the current law of the land.

Tax Reform is difficult. How difficult? Well, I have a cartoon on my desk which illustrates the problem with 3 Rubik's Cubes. The first, labeled "Rubik's Cube" is the traditional 3 x 3 x 3 cube (9 blocks per side). The second, labelled "Health Care Overhaul" is much larger, a 16 x 16 x 16 cube. Finally, the last, is labelled "Tax Code Overhaul" and I would estimate its size as a 30 x 30 x 30 cube. Do you see what I mean?

Mr. Reed discusses what he refers to as "Broad Based Low Rate" (BBLR) tax reform. This means that almost all income is taxed, but at a low rate. Why will it be difficult to achieve BBLR as Mr. Reed likes to call it? I will use my own tax return as an example. Let's take a look at the tax "breaks" that I take advantage of on my tax return. To obtain the lowest possible rate would require the elimination of virtually all of these.

Here we go:

- I am exempt from paying Federal taxes on earnings from Municipal Bonds.
- I pay a lower tax rate on Qualified Dividends than I do on interest income.
- I deduct my contributions to a Health Savings Account, since I have a High Deductible health insurance plan.
- I deduct contributions to my 401(k) retirement plan.
- I deduct all of my health insurance premiums, as a self-employed business owner.
- I deduct state income taxes (I live in Wisconsin, so this is not a small thing.)
- I deduct my real estate taxes (I live in Milwaukee County, so this is not a small thing either.)
- I deduct the interest I pay on my mortgage.
- I deduct the money we donate to various civic, educational and religious organizations.
- I deduct an amount referred to as the "personal exemption" because there are 4 of us in our house.
- I expect to take a credit for some of the tuition I pay for my son to attend the University of Wisconsin in 2017.

Multiply those deductions and tax breaks by the millions of people in the US who benefit from them, and you get a small sense of why Tax Reform is so difficult. There is also a very strong and well funded lobby behind each and every one of those deductions listed above.

I do not expect to see any significant tax legislation in 2017. Given that the Congress was only able to pass the American Health Care Act in the House, and it has gone nowhere in the Senate, I do not think Congress will be able to put together and pass tax reform any time soon.

Infographic: 4 Things to Do in the 4 Years Before College

College is a huge financial undertaking. With costs increasing every year and the prospect of too much student debt at the forefront of many families' minds, it's more important than ever to be an educated college consumer. Go into the planning process wisely with these four steps.

1

Take stock of your savings

A few years before you need to start paying tuition bills is a good time to look at your college savings. How much have you saved? Are you currently making monthly contributions? Can you increase them? How much will you have saved by the time your child graduates from high school?

2

Get familiar with financial aid...

Get an estimate of your expected family contribution (EFC) by filling out the federal government's FAFSA4caster tool at www.fafsa.ed.gov. Your EFC will depend on your family's income, assets, and household information, like the number of children you'll have in college at the same time.

3

... and net price calculators

Colleges differ in the amount of merit and need-based financial aid they offer. To get an idea of how generous a college is, run the net price calculator available on every college website to get an estimate of what your out-of-pocket costs will be at that college. This 10-minute endeavor can help you compare the cost of different colleges in an apples-to-apples way.

4

Have a frank conversation with your child about college costs

Share how much you expect to have saved and how much you will be able to contribute each year during college. When talking about loans, make sure your child knows exactly what the monthly payment will be after graduation for different loan amounts. Help your child avoid excessive borrowing.

Student Loan Debt: It Isn't Just for Millennials

The intersection of student loan debt and Social Security benefits

Since 2001, the federal government has collected about $1.1 billion from Social Security recipients to cover unpaid federal student loans, including $171 million in 2015 alone. During that time, the number of Americans age 50 and older who have had their Social Security benefits reduced to pay defaulted federal student loans has risen 440%.

Source: The Wall Street Journal, Social Security Checks Are Being Reduced for Unpaid Student Debt, December 20, 2016

It's no secret that today's college graduates face record amounts of debt. Approximately 68% of the graduating class of 2015 had student loan debt, with an average debt of $30,100 per borrower — a 4% increase from 2014 graduates.[1]

A student loan debt clock at finaid.org estimates current outstanding student loan debt — including both federal and private student loans — at over $1.4 trillion. But it's not just millennials who are racking up this debt. According to the Consumer Financial Protection Bureau (CFPB), although most student loan borrowers are young adults between the ages of 18 and 39, consumers age 60 and older are the fastest-growing segment of the student loan market.[2]

Rise of student debt among older Americans

Between 2005 and 2015, the number of individuals age 60 and older with student loan debt quadrupled from about 700,000 to 2.8 million. The average amount of student loan debt owed by these older borrowers also increased from $12,100 to $23,500 over this period.[3]

The reason for this trend is twofold: Borrowers are carrying their own student loan debt later in life (27% of cases), and they are taking out loans to finance their children's and grandchildren's college education (73% of cases), either directly or by co-signing a loan with the student as the primary borrower.[4] Under the federal government's Direct Stafford Loan program, the maximum amount that undergraduate students can borrow over four years is $27,000 — an amount that is often inadequate to meet the full cost of college. This limit causes many parents to turn to private student loans, which generally require a co-signer or co-borrower, who is then held responsible for repaying the loan along with the student, who is the primary borrower. The CFPB estimates that 57% of all individuals who are co-signers are age 55 and older.[5]

What's at stake

The increasing student loan debt burden of older Americans has serious implications for their financial security. In 2015, 37% of federal student loan borrowers age 65 and older were in default on their loans.[6] Unfortunately for these individuals, federal student loans generally cannot be discharged in bankruptcy, and Uncle Sam can and will get its money — the government is authorized to withhold a portion of a borrower's tax refund or Social Security benefits to collect on the debt. (By contrast, private student loan lenders cannot intercept tax refunds or Social Security benefits to collect any amounts owed to them.)

The CFPB also found that older Americans with student loans (federal or private) have saved less for retirement and often forgo necessary medical care at a higher rate than individuals without student loans.[7] It all adds up to a tough situation for older Americans, whose income stream is typically ramping down, not up, unlike their younger counterparts.

Think before you borrow

Since the majority of older Americans are incurring student loan debt to finance a child's or grandchild's college education, how much is too much to borrow? It's different for every family, but one general guideline is that a student's overall debt shouldn't be more than his or her projected annual starting salary, which in turn often depends on the student's major and job prospects. But this is just a guideline. Many variables can impact a borrower's ability to pay back loans, and many families have been burned by borrowing amounts that may have seemed reasonable at first glance but now, in reality, are not.

A recent survey found that 57% of millennials regret how much they borrowed for college.[8] This doesn't mean they regretted going to college or borrowing at all, but it suggests that it would be wise to carefully consider the amount of any loans you or your child take out for college. Establish a conservative borrowing amount, and then try to borrow even less.

If the numbers don't add up, students can reduce the cost of college by choosing a less expensive school, living at home or becoming a resident assistant (RA) to save on room costs, or graduating in three years instead of four.

[1] The Institute for College Access & Success, Student Debt and the Class of 2015, October 2016

[2-7] Consumer Financial Protection Bureau, Snapshot of Older Consumers and Student Loan Debt, January 2017

[8] *Journal of Financial Planning,* September 2016

Korbitz Financial Planning LLC
Eric S. Korbitz, CPA/PFS, CFP®
PO Box 170049
Milwaukee, WI 53217
414-979-1040
Eric@KorbitzFinancialPlanning.com
www.KorbitzFinancialPlanning.com

How do the economic milestones of young adults today compare with prior generations?

If you're the parent of a young adult who is still living at home, you might be wondering whether this situation is commonplace. According to a recent U.S. Census Bureau study, it is: One in three young people (ages 18 to 34) lived in their parents' home in 2015.

The Census Bureau study examines how the economic and demographic characteristics of young adults have changed from 1975 to 2016. In 1975, for example, less than one-fourth of young adults (ages 25 to 34) had a college degree. Young adults in 2016 are better educated — more than one-third hold a college degree (or higher) — but student loan debt has made it more difficult for them to obtain financial stability, let alone establish homes of their own in their 20s.

More young adults in 2016 had full-time jobs than their counterparts did in 1975. In particular, young women ages 25 to 34 are experiencing economic gains, with more than two-thirds in the workforce compared with less than half in 1975. Young women today are also earning more money than they did in 1975 — their median incomes have grown from nearly $23,000 in 1975 to more than $29,000 in 2016 (in 2015 dollars).

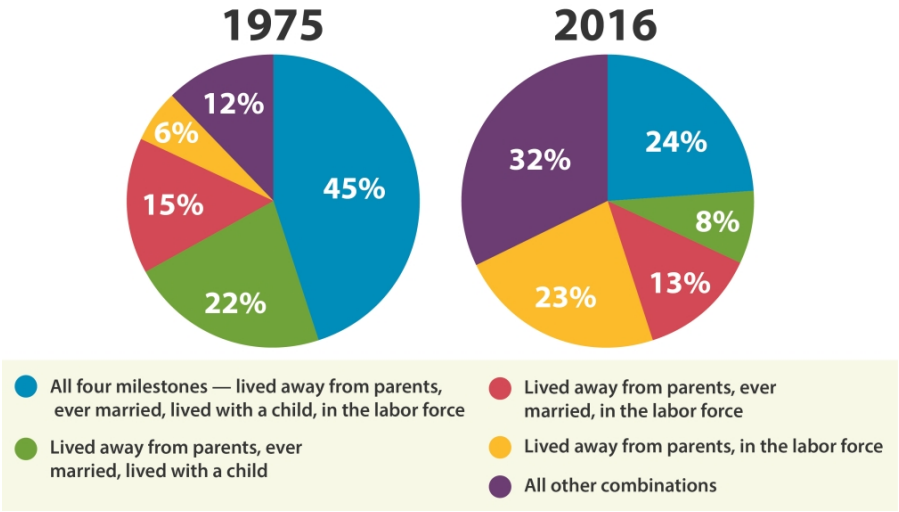
Despite the educational and economic advances that young adults have made over the last 40 years, many are postponing traditional adult milestones. In fact, a majority of young adults are not living independently of their parents. Of the 8.4 million 25- to 34-year-olds still living at home, one in four are not attending school or working. It's important to note, though, that this could be because they are caring for a family member or have health issues or a disability.

Compared to 40 years ago, the timing and accomplishment of milestones on the path to adulthood are much more diverse and complex today. To view the full report, visit census.gov.

Source: U.S. Census Bureau, "The Changing Economics and Demographics of Young Adulthood: 1975-2016," April 2017

Chart: Young Adult Milestones, 1975 vs. 2016

The following pie charts compare four common milestones of adulthood — getting married, having children, working, and living independently — achieved by young adults ages 25 to 34 in 1975 and 2016. The data indicates that the experiences of young people today are more diverse, with fewer accomplishing all four milestones in young adulthood. Instead, many young adults are delaying or forgoing some experiences (marrying and having children) in favor of others (living independently and gaining work experience).



Source: U.S. Census Bureau, "The Changing Economics and Demographics of Young Adulthood: 1975-2016," April 2017