



# April 2016

## Newsletter

### Tax Season Lessons Learned

#### Real Estate Taxes

One of the biggest problems I saw this year related to real estate taxes. The issues that I ran into generally revolved around real estate taxes not being paid in December, 2015, but rather in January, 2016. Most individuals use an accounting method referred to as "cash basis" which means that income is taxable to you in the year that you receive the cash, and expenses are deductible in the year you pay them. This goes for real estate taxes too. They are only deductible in the year they are paid.

Most taxpayers are best served by paying their real estate taxes the same way each year (always in December, or always in January) so that the real estate tax deduction is similar each year. The two general causes for real estate taxes not being paid consistently in the same month are:

1. The client simply forgets to pay them,
2. The client has their real estate taxes escrowed by their mortgage company, and the mortgage company fails to pay the real estate taxes on a timely basis.

If you have trouble remembering when to pay the taxes, set a reminder on your calendar, computer or phone.

If you have a mortgage, and your real estate taxes are escrowed, see if your mortgage company will release you from the escrow. You should still "self escrow" the real estate taxes, but you can control when they are paid.

#### Not Maximizing Pre-Tax Savings

I continue to see clients who have the ability to maximize their pre-tax savings in 401k or 403B plans NOT reach the \$18,000 (under age 50) or \$24,000 (age 50 and over) annual limit. Now is a good time to check to see if you are on track. Look at your last pay check, take the 401k or 403B contributions year-to-date through March 31st and multiply by 4. If the result is at or above the limit for your age, you are on track to maximize your savings.

#### Required Minimum Distributions (RMD)

Distributions are required from most retirement plans on an annual basis for those over age 70 ½ AND for those who have inherited these types of accounts. I am seeing more and more clients with inherited retirement plans. Since the IRS penalty for failing to take your RMD is 50% of what you should have taken, it is critical that this happen on a timely basis. Distributions must generally be taken by December 31st of the year in question. I recommend establishing an automatic distribution from your retirement plan custodian. Most have the ability to do this.

#### Charitable Contribution Documentation

The IRS and the Tax Court have gotten more stringent on documentation of charitable contributions. Knowing and following the rules can avoid the potential loss of the deduction, as well as potential interest and penalties.

Here is a short summary of the charitable documentation rules:

1. Contributions less than \$250 require a bank record OR a receipt from the organization showing the date and amount of the contribution.
2. Contributions of \$250 or more require a receipt from the organization which meets the following requirements: It is written, it says whether you received anything in exchange for the contribution, it lists the value of any goods or services you received for making the contribution, and it contains a statement that the only benefit you received was an intangible religious benefit, if that was the case.
3. You must have the appropriate receipt in your possession before you file your return.

This article is intended to help you to ensure that you have taken care of the items listed above well in advance of preparing and filing your 2016 tax return. Please let me know if you have any questions about any of these issues.

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#### Clients and Friends:

The calendar says spring is here, and mother nature has been somewhat fickle about that, with cold and snow showers one week, and 70 degree weather the next.

Since I just finished my annual "tax season" I am sharing some lessons learned with you in my first article. The items discussed apply to many taxpayers, so I would urge you to read it.

The second article discusses how biases we have can influence our investment decisions. This is another reason for all investors to have an Investment Policy Statement.

The third article talks about the cost of living in various locales. Clients will periodically talk to me about moving to another state, and this article provides some good background information.

Finally the two articles on the fourth page discuss digital technology. This is another reminder for us all to guard our information carefully, and to be careful when asked to share it.

Eric

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##### Tax Season Lessons Learned

Investor, Know Thyself: How Your Biases Can Affect Investment Decisions

Cost of Living: Where You Live Can Affect How Rich You Feel

I'm thinking about storing financial documents in the cloud. What should I know?

## Investor, Know Thyself: How Your Biases Can Affect Investment Decisions



*In psychology, "heuristics" refers to the mental decision-making short-cuts that individuals develop over time based on past experiences. While heuristics can be helpful in avoiding unnecessary deliberation, they can also lead to misleading biases that can derail even the most well-thought-out financial plan.*

Traditional economic models are based on a simple premise: people make rational financial decisions that are designed to maximize their economic benefits. In reality, however, most humans don't make decisions based on a sterile analysis of the pros and cons. While most of us do think carefully about financial decisions, it is nearly impossible to completely disconnect from our "gut feelings," that nagging intuition that seems to have been deeply implanted in the recesses of our brain.

Over the past few decades, another school of thought has emerged that examines how human psychological factors influence economic and financial decisions. This field--known as behavioral economics, or in the investing arena, behavioral finance--has identified several biases that can unnerve even the most stoic investor. Understanding these biases may help you avoid questionable calls in the heat of the financial moment.

### Sound familiar?

Following is a brief summary of some common biases influencing even the most experienced investors. Can you relate to any of these?

1. **Anchoring** refers to the tendency to become attached to something, even when it may not make sense. Examples include a piece of furniture that has outlived its usefulness, a home or car that one can no longer afford, or a piece of information that is believed to be true, but is in fact, false. In investing, it can refer to the tendency to either hold an investment too long or place too much reliance on a certain piece of data or information.
2. **Loss-aversion bias** is the term used to describe the tendency to fear losses more than celebrate equivalent gains. For example, you may experience joy at the thought of finding yourself \$5,000 richer, but the thought of losing \$5,000 might provoke a far greater fear. Similar to anchoring, loss aversion could cause you to hold onto a losing investment too long, with the fear of turning a paper loss into a real loss.
3. **Endowment bias** is also similar to loss-aversion bias and anchoring in that it encourages investors to "endow" a greater value in what they currently own over other possibilities. You may presume the investments in your portfolio are of higher quality than other available alternatives, simply because you own them.
4. **Overconfidence** is simply having so much confidence in your own ability to select investments for your portfolio that you might ignore warning signals.
5. **Confirmation bias** is the tendency to latch onto, and assign more authority to, opinions that agree with your own. For example, you might give more credence to an analyst report that favors a stock you recently purchased, in spite of several other reports indicating a neutral or negative outlook.
6. The **bandwagon effect**, also known as **herd behavior**, happens when decisions are made simply because "everyone else is doing it." For an example of this, one might look no further than a fairly recent and much-hyped social media company's initial public offering (IPO). Many a discouraged investor jumped at that IPO only to sell at a significant loss a few months later. (Some of these investors may have also suffered from overconfidence bias.)
7. **Recency bias** refers to the fact that recent events can have a stronger influence on your decisions than other, more distant events. For example, if you were severely burned by the market downturn in 2008, you may have been hesitant about continuing or increasing your investments once the markets settled down. Conversely, if you were encouraged by the stock market's subsequent bull run, you may have increased the money you put into equities, hoping to take advantage of any further gains. Consider that neither of these perspectives may be entirely rational given that investment decisions should be based on your individual goals, time horizon, and risk tolerance.
8. A **negativity bias** indicates the tendency to give more importance to negative news than positive news, which can cause you to be more risk-averse than appropriate for your situation.

### An objective view can help

The human brain has evolved over millennia into a complex decision-making tool, allowing us to retrieve past experiences and process information so quickly that we can respond almost instantaneously to perceived threats and opportunities. However, when it comes to your finances, these gut feelings may not be your strongest ally, and in fact may work against you. Before jumping to any conclusions about your finances, consider what biases may be at work beneath your conscious radar. It might also help to consider the opinions of an objective third party, such as a qualified financial professional, who could help identify any biases that may be clouding your judgment.



### Americans on the move

Americans are picking up and moving again as the recession fades, personal finances improve, and housing markets recover. Counties in Florida, Nevada, and Arizona had larger influxes of people, while some counties in Illinois, Virginia, New York, and California saw more people moving out. (Source: The Pew Charitable Trusts, Americans Are on the Move--Again, June 25, 2015, www.pewtrusts.org)

## Cost of Living: Where You Live Can Affect How Rich You Feel

Do you find yourself treading water financially even with a relatively healthy household income? Even with your new higher-paying job and your spouse's promotion, do you still find it difficult to get ahead, despite carefully counting your pennies? Does your friend or relative halfway across the country have a better quality of life on less income? If so, the cost of living might be to blame.

The cost of living refers to the cost of various items necessary in everyday life. It includes things like housing, transportation, food, utilities, health care, and taxes.

### Single or family of six?

Singles, couples, and families typically have many of the same expenses--for example, everyone needs shelter, food, and clothing--but families with children typically pay more in each category and have the added expenses of child care and college. The Economic Policy Institute ([epi.org](http://epi.org)) has a family budget calculator that lets you enter your household size (up to two adults and four children) along with your Zip code to see how much you would need to earn to have an "adequate but modest" standard of living in that geographic area.

What areas have the highest cost of living? It's no secret that the East and West Coasts have some of the highest costs. According to the Council for Community and Economic Research, the 10 most expensive U.S. urban areas to live in Q3 2015 were:

Rank	Location
1	New York, New York
2	Honolulu, Hawaii
3	San Francisco, California
4	Brooklyn, New York
5	Orange County, California
6	Oakland, California
7	Metro Washington D.C./Virginia
8	San Diego, California
9	Hilo, Hawaii
10	Stamford, Connecticut

### Factors that influence the cost of living

Let's look in more detail at some of the common factors that make up the cost of living.

**Housing.** When an area is described as having "a high cost of living," it usually means housing costs. Looking to relocate to Silicon Valley from the Midwest? You better hope for a big raise; the mortgage you're paying now on your

modest three-bedroom home might get you a walk-in closet in this technology hub, where prices last spring climbed to a record-high \$905,000 in Santa Clara County, \$1,194,500 in San Mateo County, and \$690,000 in Alameda County. (Source: *San Jose Mercury News*, Silicon Valley Home Prices Hit Record Highs, Again, May 21, 2015)

Related to housing affordability is student loan debt. Student debt--both for young adults and those in their 30s, 40s, and 50s who either took out their own loans, or co-signed or borrowed on behalf of their children--is increasingly affecting housing choices and living situations. For some borrowers, monthly student loan payments can approximate a second mortgage.

**Transportation.** Do you have access to reliable public transportation or do you need a car? Younger adults often favor public transportation and supplement with ride-sharing services like Uber, Lyft, and Zipcar. But for others, a car (or two or three), along with the cost of gas and maintenance, is a necessity. How far is your work commute? Do you drive 100 miles round trip each day or do you telecommute? Having to buy a new (or used) car every few years can significantly impact your bottom line.

**Utilities.** The cost of utilities can vary by location, weather, usage, and infrastructure. For example, residents of colder climates might find it more expensive to heat their homes in the winter than residents of warmer climates do cooling their homes in the summer.

**Taxes.** Your tax bite will vary by state. Seven states have no income tax--Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. In addition, property taxes and sales taxes can vary significantly by state and even by county, and states have different rules for taxing Social Security and pension income.

**Miscellaneous.** If you have children, other things that can affect your bottom line are the costs of child care, extracurricular activities, and tuition at your flagship state university.

### To move or not to move

Remember The Clash song "Should I Stay or Should I Go?" Well, there's no question your money will go further in some places than in others. If you're thinking of moving to a new location, cost-of-living information can make your decision more grounded in financial reality.

There are several online cost-of-living calculators that let you compare your current location to a new location. The U.S. State Department has compiled a list of resources on its website at [state.gov](http://state.gov).

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## I'm thinking about storing financial documents in the cloud. What should I know?

Cloud storage—using Internet-based service providers to store digital assets such as books, music, videos, photos, and even important documents including financial statements and contracts—has become increasingly popular in recent years. But is it right for you?

Opinions vary on whether to store your most sensitive information in the cloud. While some experts say you should physically store items you're not willing to lose or expose publicly, others contend that high-security cloud options are available.

If you're thinking about cloud storage for your financial documents, consider the following:

- Evaluate the provider's reputation. Is the service well known, well tested, and well reviewed by information security experts?
- Consider the provider's own security and redundancy procedures. Look for such features as two-factor authentication and complex password requirements. Does it have copies of your data on servers at multiple geographic locations, so that a

disaster in one area won't result in an irretrievable loss of data?

- Review the provider's service agreement and terms and conditions. Make sure you understand how your data will be protected and what recourse you have in the event of a breach or loss. Also understand what happens when you delete a file—will it be completely removed from all servers? In the event a government subpoena is issued, must the service provider hand over the data?
- Consider encryption processes, which prevent access to your data without your personal password (including access by people who work for the service provider). Will you be using a browser or app that provides for data encryption during transfer? And once your data is stored on the cloud servers, will it continue to be encrypted?
- Make sure you have a complex system for creating passwords and never share your passwords with anyone.



## What's the best way to back up my digital information?

In writing or speaking, redundancy is typically not recommended unless you're really trying to drive a point home. When it comes to your digital life, however, redundancy is not only recommended, it's critical.

Redundancy is the term used to refer to data backups. If you have digital assets that you don't want to risk losing forever—including photos, videos, original recordings, financial documents, and other materials—you'll want to be sure to back them up regularly. And it's not just materials on your personal computer, but your mobile devices as well. Depending on how much you use your devices, you may want to back them up as frequently as every few days.

A good rule to follow is the 3-2-1 rule. This rule helps reduce the risk that any one event—such as a fire, theft, or hack—will destroy or compromise both your primary data and all your backups.

1. Have at least three copies of your data. This means a minimum of the original plus two backups. In the world of computer redundancy, more is definitely better.

2. Use at least two different formats. For example, you might have one copy on an external hard drive and another on a flash drive, or one copy on a flash drive and another using a cloud-based service.
3. Ensure that at least one backup copy is stored offsite. You could store your external hard drive in a safe-deposit box or at a trusted friend or family member's house. Cloud storage is also considered offsite.

If a cloud service is one of your backup tactics, be sure to review carefully its policies and procedures for security and backup of its servers. Another good idea is to encrypt (that is, create strong passwords that only you know) to protect sensitive documents and your external drives.

So at the risk of sounding redundant (or driving the point home?), a good rule for data backup is to have at least three copies on at least two different formats, with at least one copy stored offsite. And more is always better.