Year End Tax Tips

As we approach the end of 2016 here are a few year-end tax tips for savvy investors who want to pay Uncle Sam less come April 15th.

Tax Loss Harvesting: If you have accounts with losses, this might be a good time to trigger that loss in order to offset tax gains somewhere else.

Pay Spring Tuition: If your child is in college you may want to consider paying for a spring semester before the end of the year. You may be eligible for an education tax credit by doing so.

Roth IRA Conversions: If you want to convert your IRA to a Roth IRA, it must be done before the end of the calendar year. Keep in mind that converting a Roth actually creates more tax, but there are often long term advantages to doing so.

Make Your HSA Contribution: If you have a high deductible health insurance plan, be sure to fund your HSA prior to January 1st to avoid federal income tax on that amount.

Ramp Up Medical Spending: Many people can deduct qualified medical expenses that exceed 10% of their adjusted gross income for the year, so you might want to start adding things up to get you over the 10% mark. Things like glasses, hearing aids and medical tests all count towards reaching the deduction.

Give Some Money Away: One great way to potentially shrink your tax bill is to donate to a qualified charity. Give from the heart and get a tax deduction in return – it’s a win-win!

Of course everyone’s situation is unique, and you need to check with your own tax preparer to understand the effects (if any) of these tips. Hopefully one of them will help keep a little more money in your own pocket this year!

The Sterk Financial Team has specialized programs for financial planning and investment management. Call us to learn how we help create financial clarity and confidence.

Upcoming Seminars

Retirement Readiness
January 12, 2107 6 pm
Sioux City Country Club

Portfolio Management Techniques
February 28, 2107 6 pm
Sioux City Country Club

Listen to Money Guide with Mary Sterk
On KSCJ 1360 AM/94.9 FM Talk Radio
Saturday Mornings, 7:30-8 a.m.
Are You Ending 2016 Healthy, Wealthy, and Wise?

Although the year is drawing to a close, you still have time to review your finances. Pausing to reflect on the financial progress you made in 2016 and identifying adjustments for 2017 can help you start the new year stronger than ever.

**How healthy are your finances?**

Think of a year-end review as an annual physical for your money. Here are some questions to ask that will help assess your financial fitness.

- Do you know how you spent your money in 2016? Did you make any progress toward your financial goals? Look for spending habits (such as eating out too much) that need tweaking, and make necessary adjustments to your budget.

- Are you comfortable with the amount of debt that you have? Any end-of-year mortgage, credit card, and loan statements will spell out the amount of debt you still owe and how much you’ve been able to pay off this year.

- How is your credit? Having a positive credit history may help you get better interest rates when you apply for credit, potentially saving you money over the long term. Check your credit report at least once a year by requesting your free annual copy through the federally authorized website annualcreditreport.com.

- Do you have an emergency savings account? Generally, you should aim to set aside at least three to six months’ worth of living expenses. Having this money can help you avoid piling up more credit-card debt or shortchanging your retirement or college savings because of an unexpected event such as job loss or illness.

- Do you have an adequate amount of insurance? Your insurance needs may change over time, so it’s a good idea to review your coverage at least once a year to make sure it still meets your needs.

**How wealthy are you really?**

It’s easy to put your retirement savings on autopilot, especially if you’re making automatic contributions to a retirement account. But market swings this year may have affected your retirement account balances, so review any statements you’ve received. How have your investments performed in comparison to general market conditions, against industry benchmarks, and in relation to your expectations and needs? Do you need to make any adjustments based on your own circumstances, your tolerance for risk, or because of market conditions?

Finally, look for ways to save more. For example, if you receive a pay increase this year, don’t overlook the opportunity to increase your employer-sponsored retirement plan contributions. Ask your employer to set aside a higher percentage of your salary.

**How wise are you about financial matters?**

What you don’t know can hurt you, so it’s time to honestly assess your financial picture. Taking into account your income, savings and investments, and debt load, did your finances improve this year? If not, what can you do differently in 2017?

What are your greatest financial concerns? Do you have certain life events coming up that you need to prepare for, such as marriage, buying a home, or sending your child off to college? You can’t know everything, so don’t put off asking for assistance. It’s a wise move that can help you prepare for next year’s financial challenges.

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*All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.*

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### Year-End Financial Checklist

- Review your benefits during your employer’s open enrollment season, and make any necessary changes before your employer’s deadline.
- Review your contributions to your flexible spending account (FSA) before the use-it-or-lose-it deadline (this may be the end of the year—check with your employer).
- Update estate planning documents such as wills, trusts, and health-care directives to account for life changes.
- Review and update beneficiaries for your financial accounts and insurance policies.
- Make year-end donations to charity. If you itemize, these may help reduce your taxable income for 2016.*
- Consider gifts to family members. For 2016, you may give up to $14,000 to each individual without owing gift taxes.*
- Begin organizing your financial records for tax time.
- Check your Social Security Statement at ssa.gov to find out about future benefits.*

*Talk to a tax professional for help with your individual situation.*
If your employer-sponsored retirement savings plan allows pretax, after-tax, and/or Roth contributions, which should you choose?

**Pretax: Tax benefits now**

With pretax contributions, the money is deducted from your paycheck before taxes, which helps reduce your taxable income and the amount of taxes you pay now. Consider the following example, which is hypothetical and has been simplified for illustrative purposes. **Example(s):** Mark earns $2,000 every two weeks before taxes. If he contributes nothing to his retirement plan on a pretax basis, the amount of his pay that will be subject to income taxes would be the full $2,000. If he was in the 25% federal tax bracket, he would pay $500 in federal income taxes, reducing his take-home pay to $1,500. On the other hand, if he contributes 10% of his income to the plan on a pretax basis—or $200—he would reduce the amount of his taxable pay to $1,800. That would reduce the amount of taxes due to $450. After accounting for both federal taxes and his plan contribution, Mark’s take-home pay would be $1,350. The bottom line? Mark would be able to invest $200 toward his future but reduce his take-home pay by just $150. That’s the benefit of pretax contributions.

In addition, any earnings made on pretax contributions grow on a tax-deferred basis. That means you don’t have to pay taxes on any gains each year, as you would in a taxable investment account. However, those tax benefits won’t go on forever. Any money withdrawn from a tax-deferred account is subject to ordinary income taxes, and if the withdrawal takes place prior to age 59½ (or in some cases, 55 or 50, depending on your plan’s rules), you may be subject to an additional 10% penalty on the total amount of the distribution.

**Roth: Tax benefits down the road**

On the other hand, contributing to an employer-sponsored Roth account offers different benefits. Roth contributions are considered “after-tax,” so you won’t reduce the amount of current income subject to taxes. But qualified distributions down the road will be tax-free.

A qualified Roth distribution is one that occurs:
- After a five-year holding period
- Upon death, disability, or reaching age 59½

Nonqualified distributions are subject to regular income taxes and a possible 10% penalty tax. However, because Roth contributions are made with after-tax dollars, a distinction is made between the portion of the distribution that represents contributions versus earnings on those contributions. If at some point you need to take a nonqualified withdrawal from a Roth 401(k)—due to an unexpected emergency, for example—only the proportion of the total amount representing earnings will be taxable.

**After-tax: For those who are able to exceed the limits**

Some plans allow participants to make additional after-tax contributions. This plan feature helps those who want to make contributions exceeding the annual total limit on pretax and Roth accounts (in 2016, the limit is $18,000; $24,000 for those age 50 or older). As with a traditional pretax account, earnings on after-tax contributions grow on a tax-deferred basis.

If this option is offered (check your plan documents), keep in mind that total employee and employer contributions cannot exceed $53,000, or $59,000 for those 50 and older (2016 limits).

Another benefit of making after-tax contributions is that when you leave your job or retire, they can be rolled over tax-free to a Roth IRA, which also allows for potential tax-free growth from that point forward. Some higher-income individuals may welcome this potential benefit if their income affects their ability to directly fund a Roth IRA.

In addition to rolling the proceeds to a Roth IRA, participants may also (1) leave the assets in the original plan, (2) transfer assets to a new employer's plan, or (3) withdraw the funds (which in some cases could trigger a taxable event).
Do I need to make any changes to my Medicare coverage for next year?

During the Medicare Open Enrollment Period that runs from October 15 through December 7, you can make changes to your Medicare coverage that will be effective on January 1, 2017. If you’re satisfied with your current coverage, you don’t need to make changes, but you should review your options before you decide to stay with your current plan.

Your Medicare plan sends two important documents every year that you should review. The first, called the Evidence of Coverage, provides information about what your plan covers and its cost. The second, called the Annual Notice of Change, lists changes to your plan for the upcoming year that will take effect in January. You can use these documents to evaluate your current plan and decide whether you need different coverage. You should also review the official government handbook, Medicare & You 2017, which is available electronically or through the mail. It contains detailed information about Medicare that should help you determine whether your current plan is right for you.

As you review your coverage, here are a few points to consider:
• What were your health costs during the past year, and what did you spend the most on?
• Will your current plan cover all the services you need and the health-care providers you need to see next year?
• Does your current plan cost more or less than other options? Consider premiums, deductibles, and other out-of-pocket costs such as copayments or coinsurance costs; are any of these costs changing?
• Do you need to join a Medicare prescription drug plan? When comparing plans, consider the cost of drugs under each plan, and make sure the drugs you take will still be covered next year.

If you have questions about Medicare, you can call 1-800-MEDICARE or visit the Medicare website at medicare.gov. You can use the site’s Medicare Plan Finder to see what plans are available in your area and check each plan’s overall quality rating.

Should I accept my employer's early-retirement offer?

The right answer for you will depend on your situation. First of all, don’t underestimate the psychological impact of early retirement. The adjustment from full-time work to a more leisurely pace may be difficult. So consider whether you’re ready to retire yet. Next, look at what you’re being offered. Most early-retirement offers share certain basic features that need to be evaluated. To determine whether your employer’s offer is worth taking, you’ll want to break it down.

Does the offer include a severance package? If so, how does the package compare with your projected job earnings (including future salary increases and bonuses) if you remain employed? Can you live on that amount (and for how long) without tapping into your retirement savings? If not, is your retirement fund large enough that you can start drawing it down early? Will you be penalized for withdrawing from your retirement savings?

Does the offer include post-retirement medical insurance? If so, make sure it’s affordable and provides adequate coverage. Also, since Medicare doesn’t start until you’re 65, make sure your employer’s coverage lasts until you reach that age. If your employer’s offer doesn’t include medical insurance, you may have to look into COBRA or a private individual policy.

How will accepting the offer affect your retirement plan benefits? If your employer has a traditional pension plan, leaving the company before normal retirement age (usually 65) may greatly reduce the final payout you receive from the plan. If you participate in a 401(k) plan, what price will you pay for retiring early? You could end up forfeiting employer contributions if you’re not fully vested. You’ll also be missing out on the opportunity to make additional contributions to the plan.

Finally, will you need to start Social Security benefits early if you accept the offer? For example, at age 62 each monthly benefit check will be 25% to 30% less than it would be at full retirement age (66 to 67, depending on your year of birth). Conversely, you receive a higher payout by delaying the start of benefits past your full retirement age--your benefit would increase by about 8% for each year you delay benefits, up to age 70.