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Dear Friends:

Unless you've been imitating the proverbial ostrich, it will come as no surprise to you that the financial markets are off to a rocky start in 2016. I'll say only that a correction such as this provides important confirmation of the diversifying strategies we use in the portfolios we construct. Nonetheless, it always hurts to see our portfolio balances decline.

On a much more positive note, I'm happy to report that the next time you call or visit the office, you're likely to meet our newest team member, Whitney Saunders. After being stationed with her husband for several years at Marine Corps bases in California and North Carolina, Whitney and her family have recently returned to her childhood home of Michigamme. She will be responsible for coordinating the work we do with retirement plans and marketing, among other things.

Jesse

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Changes to Social Security Claiming Strategies



The Bipartisan Budget Act of 2015 included a section titled "Closure of Unintended Loopholes" that ends two Social Security claiming strategies that have become increasingly popular over the last

several years. These two strategies, known as "file and suspend" and "restricted application" for a spousal benefit, have often been used to optimize Social Security income for married couples.

If you have not yet filed for Social Security, it's important to understand how these new rules could affect your retirement strategy. Depending on your age, you may still be able to take advantage of the expiring claiming options. The changes should not affect current Social Security beneficiaries and do not apply to survivor benefits.

File and suspend

Under the previous rules, an individual who had reached full retirement age could file for retired worker benefits--typically to enable a spouse to file for spousal benefits--and then suspend his or her benefit. By doing so, the individual would earn delayed retirement credits (up to 8% annually) and claim a higher worker benefit at a later date, up to age 70. Meanwhile, his or her spouse could be receiving spousal benefits. For some married couples, especially those with dual incomes, this strategy increased their total combined lifetime benefits.

Under the new rules, which are effective as of April 30, 2016, a worker who reaches full retirement age can still file and suspend, but no one can collect benefits on the worker's earnings record during the suspension period. This strategy effectively ends the file-and-suspend strategy for couples and families.

The new rules also mean that a worker cannot later request a retroactive lump-sum payment for the entire period during which benefits were

suspended. (This previously available claiming option was helpful to someone who faced a change of circumstances, such as a serious illness.)

Tip: If you are age 66 or older before the new rules take effect, you may still be able to take advantage of the combined file-and-suspend and spousal/dependent filing strategy.

Restricted application

Under the previous rules, a married person who had reached full retirement age could file a "restricted application" for spousal benefits after the other spouse had filed for Social Security worker benefits. This allowed the individual to collect spousal benefits while earning delayed retirement credits on his or her own work record. In combination with the file-and-suspend option, this enabled both spouses to earn delayed retirement credits while one spouse received a spousal benefit, a type of "double dipping" that was not intended by the original legislation.

Under the new rules, an individual eligible for both a spousal benefit and a worker benefit will be "deemed" to be filing for whichever benefit is higher and will not be able to change from one to the other later.

Tip: If you reached age 62 before the end of December 2015, you are grandfathered under the old rules. If your spouse has filed for Social Security worker benefits, you can still file a restricted application for spouse-only benefits at full retirement age and claim your own worker benefit at a later date.

Basic Social Security claiming options remain unchanged. You can file for a permanently reduced benefit starting at age 62, receive your full benefit at full retirement age, or postpone filing for benefits and earn delayed retirement credits, up to age 70.

Although some claiming options are going away, plenty of planning opportunities remain, and you may benefit from taking the time to make an informed decision about when to file for Social Security.

Can You Get to a Million Dollars?



In trying to accumulate \$1 million (or any other amount), you should generally consider how much you have now, how much you can contribute in the future, how much you might earn on your investments, and how long you have to accumulate funds. But remember, there are no guarantees—even when you have a clearly defined goal. For example, the market might not perform as expected, or you may have to reduce your contributions at some point.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Review your progress periodically and be prepared to make adjustments when necessary.

Often in life, you have investment goals that you hope to reach. Say, for example, you have determined that you would like to have \$1 million in your investment portfolio by the time you retire. But will you be able to get there?

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Current balance--your starting point

Of course, the more you have today, the less you may need to contribute to your investment portfolio or earn on your investments over your time horizon.

Time (accumulation period)

In general, the longer your time horizon, the greater the opportunity you have to accumulate \$1 million. If you have a sufficiently long time horizon and a sufficiently large current balance, with adequate earnings you may be able to reach your goal without making any additional contributions. With a longer time horizon, you'll also have more time to recover if the value of your investments drops. If additional contributions are required to help you reach your goal, the more time you have to target your goal, the less you may have to contribute.

The sooner you start making contributions, the better. If you wait too long and the time remaining to accumulate funds becomes too short, you may be unable to make the large contributions required to reach your goal. In such a case, you might consider whether you can extend the accumulation period--for example, by delaying retirement.

Rate of return (earnings)

In general, the greater the rate of return that you can earn on your investments, the more likely that you'll reach your investment goal of \$1 million. The greater the proportion of the investment portfolio that comes from earnings, the less you may need to contribute to the portfolio. Earnings can benefit from long time horizons and compound rates of return, as returns are earned on any earlier earnings.

However, higher rates of return are generally associated with greater investment risk and the possibility of investment losses. It's important to choose investments that meet your time horizon and tolerance for risk. And be realistic in your assumptions. What rate of return is realistic given your current asset allocation and investment selection?

Amount of contributions

Of course, the more you can regularly contribute to your investment portfolio (e.g., monthly or yearly), the better your chances are of reaching your \$1 million investment goal, especially if you start contributing early and have a long time horizon.

Contributions needed

Now that the primary factors that affect your chances of getting to a million dollars have been reviewed, let's consider this question: At a given rate of return, how much do you need to save each year to reach the \$1 million target? For example, let's assume you anticipate that you can earn a 6% annual rate of return (ROR) on your investments. If your current balance is \$450,000 and you have 15 more years to reach \$1 million, you may not need to make any additional contributions (see scenario 1 in the table below); but if you have only 10 more years, you'll need to make annual contributions of \$14,728 (see scenario 2). If your current balance is \$0 and you have 30 more years to reach \$1 million, you'll need to contribute \$12,649 annually (see scenario 3); but if you have only 20 more years, you'll need to contribute \$27,185 annually (see scenario 4).

Scenario	1	2
Target	\$1,000,000	\$1,000,000
Current balance	\$450,000	\$450,000
Years	15	10
ROR	6%	6%
Annual contribution	\$0	\$14,728

Scenario	3	4
Target	\$1,000,000	\$1,000,000
Current balance	\$0	\$0
Years	30	20
ROR	6%	6%
Annual contribution	\$12,649	\$27,185

Note: This hypothetical example is not intended to reflect the actual performance of any investment. Actual results may vary. Taxes, fees, expenses, and inflation are not considered and would reduce the performance shown if they were included.



Earn Too Much for a Roth IRA? Try the Back Door!



If you have taxable compensation, you can contribute up to \$5,500 to an IRA in 2016, or \$6,500 if you'll be 50 or older by the end of the year. You can't contribute to a traditional IRA for the year you turn 70½, or thereafter.

To be eligible for tax-free qualified distributions from a Roth IRA, you must satisfy a five-year holding period and, in addition, one of the following must apply: you have reached age 59½ by the time of the withdrawal, the withdrawal is made because of disability, or the withdrawal is made to pay first-time homebuyer expenses (\$10,000 lifetime limit from all IRAs).

It's not clear how long the back door is going to remain open. There have been suggestions that this is a loophole that should be legislatively closed.

Background

Roth IRAs, created in 1997 as part of the Taxpayer Relief Act, represented an entirely new savings opportunity--the ability to make after-tax contributions that could, if certain conditions were met, grow entirely free of federal income taxes. These new savings vehicles were essentially the inverse of traditional IRAs, where you could make deductible contributions but distributions would be fully taxable. The law also allowed taxpayers to "convert" traditional IRAs to Roth IRAs by paying income taxes on the amount converted in the year of conversion.

Unfortunately, the law contained two provisions that limited the ability of high-income taxpayers to participate in the Roth revolution. First, the annual contributions an individual could make to a Roth IRA were reduced or eliminated if his or her income exceeded certain levels. Second, individuals with incomes of \$100,000 or more, or whose tax filing status was married filing separately, were prohibited from converting a traditional IRA to a Roth IRA.

In 2005, however, Congress passed the Tax Increase Prevention and Reconciliation Act (TIPRA), which repealed the second barrier, allowing anyone to convert a traditional IRA to a Roth IRA--starting in 2010--regardless of income level or marital status. But TIPRA did not repeal the provision that limited the ability to make annual Roth contributions based on income. The current limits are set forth in the chart below:

Phaseout ranges for determining ability to fund a Roth IRA in 2016*	
Single/head of household	\$117,000-\$132,000
Married filing jointly	\$184,000-\$194,000
Married filing separately	\$0-\$10,000
*Applies to modified adjusted gross income (MAGI)	

Through the back door...

Repeal of the provisions limiting conversions created an obvious opportunity for high-income taxpayers who wanted to make annual Roth contributions but couldn't because of the income limits. Those taxpayers (who would also run afoul of similar income limits that prohibited them from making deductible contributions to traditional IRAs) could simply make

nondeductible contributions to a traditional IRA and then immediately convert that traditional IRA to a Roth IRA--a "back door" Roth IRA.

The IRS is always at the front door...

For taxpayers who have no other traditional IRAs, establishment of the back-door Roth IRA is essentially tax free. Income tax is payable on the earnings, if any, that the traditional IRA generates until the Roth conversion is complete. However, assuming the contribution and conversion are done in tandem, the tax impact should be nominal. (The 10% penalty tax for distributions prior to age 59½ generally doesn't apply to taxable conversions.)

But if a taxpayer owns other traditional IRAs at the time of conversion, the tax calculation is a bit more complicated because of the so-called "IRA aggregation rule." When calculating the tax impact of a distribution (including a conversion) from any traditional IRA, all traditional and SEP/SIMPLE IRAs a taxpayer owns (other than inherited IRAs) must be aggregated and treated as a single IRA.

For example, assume Jillian creates a back-door Roth IRA in 2016 by making a \$5,500 contribution to a traditional IRA and then converting that IRA to a Roth IRA. She also has another traditional IRA that contains deductible contributions and earnings worth \$20,000. Her total traditional IRA balance prior to the conversion is therefore \$25,500 (\$20,000 taxable and \$5,500 nontaxable).

She has a distribution (conversion) of \$5,500: 78.4% of that distribution (\$20,000/\$25,500) is considered taxable (\$4,313.73), and 21.6% of that distribution (\$5,500/\$25,500) is considered nontaxable (\$1,186.27).

Note: These tax calculations can be complicated. Fortunately, the IRS has provided a worksheet (Form 8606) for calculating the taxable portion of a conversion.

There's also a side door...

Let's assume Jillian in the example above isn't thrilled about having to pay any income tax on the Roth conversion. Is there anything she can do about it?

One strategy to reduce or eliminate the conversion tax is to transfer the taxable amount in the traditional IRAs (\$20,000 in our example) to an employer qualified plan like a 401(k) prior to establishing the back-door Roth IRA, leaving the traditional IRAs holding only after-tax dollars. Many 401(k) plans accept incoming rollovers. Check with your plan administrator.



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Should I loan my child money for a down payment on a house?

For a lot of young people today, it's difficult to purchase a home without at least some financial assistance. As a result, many young adults turn to their parents or other family members for help with a down payment.

If you plan on lending your child money for a down payment on a house, you should try to assume the role of a commercial lender. Setting the terms of the loan in writing will demonstrate to your child that you take both your responsibility as lender and your child's responsibility as borrower seriously.

While having an actual loan contract may seem too businesslike to some parents, doing so can help set expectations between you and your child. The loan contract should spell out the exact loan amount, the interest rate and a repayment schedule. To avoid the uncomfortable situation of having to remind your child that a payment is due, consider asking him or her to set up automatic monthly transfers from his or her bank account to yours.

This type of loan documentation is also important for IRS purposes because there may be potential income and gift tax issues with these types of loans. For example, interest paid by your child will be considered taxable income, and if adequate interest is not charged for the loan, special imputed interest rules may apply.

If you don't feel comfortable lending your child money, you may want to consider making a smaller, no-strings-attached gift that doesn't have to be repaid. Currently, you can gift up to \$14,000 annually per person under the gift tax exclusion. However, if you do gift money for a down payment, your child's lender may still require him or her to put up some of his or her own money, depending on the type of mortgage chosen.

Keep in mind that lending money to family members can be a tricky proposition. Before entering into this type of financial arrangement, you should take the time to carefully weigh both the financial and emotional costs.



What do I need to know about the deductible on my auto insurance?

An auto insurance deductible is more than just a number. It represents the financial responsibility you have agreed to accept in the event of a covered loss. You and your insurance provider agree to share the risk, up to policy limits.

Say you're in an accident and there is \$2,500 worth of damage to your vehicle. You have a \$500 deductible. This means you pay \$500, while your auto insurance company pays the remaining \$2,000. Note that deductibles may not apply in all situations.

You might consider raising your deductible in order to lower your auto insurance premium. Generally, the higher the deductible you choose, the lower your premium cost. Be careful, though--the higher your deductible, the more you'll need to pay out of pocket toward repairs when you have a claim. You'll want your deductible to match with your budget so you will not have to worry about covering more than you can afford in the event of an accident.

Besides your budget, you should also think about your vehicle's overall value when choosing your deductible. Typically, auto policies have separate deductibles for collision and comprehensive coverages. For example, if your vehicle is damaged due to an accident or an event other than a collision (fire, vandalism, theft, or natural disaster), then you pay the corresponding deductible you chose for comprehensive coverage. But if your vehicle is older, it might not be worth repairing damage. In this case, you might decide to choose higher deductibles or even reduce or eliminate collision and/or comprehensive coverage.

You should feel comfortable with the financial risk represented by the deductible on your auto insurance and understand how to balance the risk with the cost of your premium. Take time to review your deductible amount, typically located on the declarations (front) page of your auto insurance policy. Choosing an appropriate deductible could help you cope with the stressful aftermath of an accident.



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