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FINANCIAL ASSOCIATES

Fourth Quarter 2014

Guide...Protect...Preserve

It Certainly Was Five Years For The History Books

Time passes fast, and you might not have noticed the extraordinary financial history we all witnessed in the past five years.

The second quarter of 2014 marked the sixth year — and the sixth quarter — in a row in which stocks climbed higher. It was a bull-market run sure to be talked about for at least a few generations to come.

Five years is a good, long stretch. In this case, it was a great, long stretch. The end of the first half of 2014 marked the bull market's fifth anniversary.

It was a five-year about-face from the financial-crisis trough. When stock prices rose from the S&P 500's intraday low of 666 on March 9, 2009, stocks were less than two percentage points shy of tripling!

Looking at the performance of a broad range of asset classes over the five-year period ended June 30, 2014, the dispersion in returns is startling. At the top are Master Limited Partnerships, global REITs and the S&P 500 with gains of +230%, +158% and 137%, respectively. The euro currency has actually declined fractionally in value versus the U.S. dollar over the past five years, and crude oil and most other commodities are approximately flat. The bond total return indexes, both U.S. Treasury and municipals, are a smidge more than +30%, or about +6% per year.

Over the course of the five-year period ended June 30, 2014, investors experienced unprecedented volatility in gold, as it shot from approximately $900 to $1800 before settling lately around $1300. The gold predictions said that QE would ultimately result in massive inflation and debasement of the U.S. dollar. Happily, such predictions have come undone as inflation and bond yields have trended much lower than anybody, including the Federal Reserve, had anticipated.

All this positive news has to make you wonder how much longer the good times can last. Only three out of the 23 bull markets since 1900 lasted six years or longer. However, the S&P 500 index gained 4.7% in the second quarter of 2014, soaring after a brief sell-off in early April on Ukraine-Russian tensions. And, as the end of the third quarter of 2014 approached, the bull run

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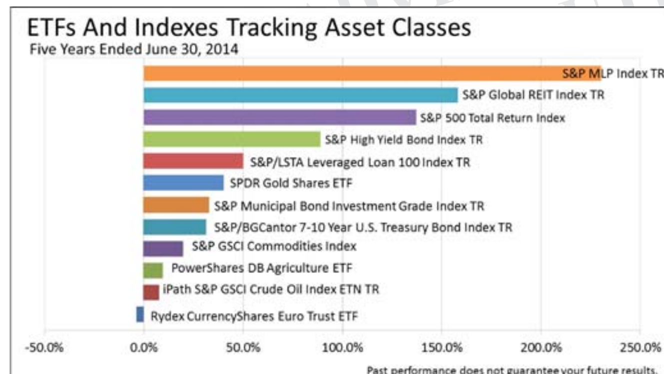

Want To Get A Copy Of Your Credit Report? It's Free!

Are you inundated with telephone calls, online offers, and other come-ons offering you a report on your credit rating? Don't pay anything for this service because you're legally entitled to some freebies.

For starters, there are three major credit bureaus operating in the U.S.: Experian, Equifax, and TransUnion. Each one compiles your credit history and summarizes the findings into a report. Under the Fair Credit Reporting Act (FCRA), you can obtain a free copy from each credit bureau once a year.

The credit report will include information on where you live, how you pay your bills, and whether you have been sued or ever have filed for bankruptcy. This data is available at a price to others—insurance companies, landlords, employers, and the like—to help them evaluate your creditworthiness.

How do you request a free copy? It's easy. The three bureaus have centralized their operations. Simply log on to www.annualcreditreport.com, call1-877-322-8228, or complete the Annual Credit Report Request Form and mail it to Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281.

Be aware of imposters. Don't use any other service and don't even try to contact an individual bureau. And, most importantly, don't provide any personal information that someone could use to scam you.

Mary Jane Callaghan & Mitch Glicksman

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Keeping A 529 Plan Rolling Along

If you were thinking ahead, you may have set up a tax-advantaged Section 529 plan for your first child at an early age. Once your kid is ready for college, you'll reap the rewards of your foresight.

But what happens when your son or daughter graduates? If there's still money in the plan, your tax savings don't have to stop there. If you have other children, you could designate one of them to be next in line as the 529 plan beneficiary, and then choose another and another . . . possibly even extending the plan's benefits to your grandchildren!

Section 529 plans, sponsored and operated by individual states, encourage families to set aside funds for future education expenses of the younger generation. As long as certain requirements are met, the money invested in the plan can grow without any erosion by taxes; and distributions that go to pay qualified college expenses—including tuition, fees, books, supplies, equipment, and room and board for full-time students—are completely tax-free.

There are two main types of plans: prepaid tuition plans and college savings plans. A prepaid tuition plan enables you to lock in rates at an in-state public college, whereas a college savings plan gives you more flexibility—the money can be used at a public or private college of your choice—but doesn't offer guarantees.

Keep in mind that it doesn't matter which state's college savings plan you choose, because no matter where it's set up, you can choose where to spend money from the account. But there could be an advantage to using your home state's plan. More than half of the 50 states offer a state tax deduction or credit for Section 529 plan deposits made by residents.

Now suppose your daughter is finishing college and your son is poised to attend next fall. Assuming some funds are left in the account, you can simply switch the beneficiary designation for the 529 plan to the younger child. Typically, a plan will allow one such change each year. If a younger child will enter college before the older one graduates, you might want to set up a separate account.

Although a plan can continue indefinitely, with your grandchildren eventually becoming beneficiaries, it terminates when the latest beneficiary reaches age 30. Of course, if there's a gap—say, your youngest child turns 30 and you have no grandchildren—you still can set up a new plan for a grandchild in the future.

A final bonus: There's a special gift tax break for 529 plans. Not only are transfers to 529s considered gifts that qualify for the annual gift tax exclusion ($14,000 in 2014), you can make up to five years worth of contributions in one year. And your spouse can do the same. Together, you could transfer up to $140,000 into a child's or grandchild's 529 entirely exempt from gift tax. ●

Social Security: Taxes In And Out

It seems like the IRS has you coming and going on Social Security. While you are working for a living, you must pay taxes into the system to provide benefits for current retirees. Then, when you finally retire, you're entitled to receive retirement benefits but they might be subject to tax as well.

Don't confuse the two taxes. The Social Security tax you pay as an employee is a payroll tax that applies to wages, commissions, and other compensation as part of the FICA tax. An employee's combined FICA rate for Social Security and Medicare in 2014 is 7.65% on the first $117,000 of compensation and 1.45% (Medicare only) above that. But the tax that may apply to Social Security benefits you get in retirement is a federal income tax that is reported along with other items on Form 1040. It's more complicated than the payroll tax.

Here's how it works: You're liable for tax on Social Security benefits if your provisional income (PI) exceeds certain thresholds in the tax law. For this purpose, PI is the total of (1) your adjusted gross income (AGI), (2) your tax-exempt interest income (for example, from municipal bonds), and (3) one-half of the Social Security benefits you received. For example, if the combined AGI of you and your spouse is $100,000 and you collect $5,000 in municipal bond income and $20,000 in Social Security benefits, your PI is $125,000 ($100,000 + $5,000 + $20,000).

There are actually two thresholds for computing the tax on Social Security benefits.

Threshold 1: For a PI between $32,000 and $44,000 ($25,000 and $34,000 for single filers), you're taxed on the lesser of one-half of your benefits or 50% of the amount by which PI exceeds $32,000 ($25,000 for single filers).

Threshold 2. For a PI greater than

Why Give Securities To Charity Instead Of Cash?

Want to make a sizable donation to your favorite charity? Of course, you could write out a big, fat check to the organization and claim a current tax deduction for your generosity. But you might fare even better, when taking taxes into account, by donating securities that have appreciated in value. As a bonus, you won't have to sell anything or dip into your cash to pay for the gift.

There's a simple tax incentive for donating stock rather than cash. If you write a check, you generally can write off the exact amount on your federal income tax return, subject to an overall charitable limit of 50% of your adjusted gross income for the year (AGI). However, if you donate securities, you can deduct the fair market value (FMV) of the investments on the date of the contribution and avoid being taxed on the profit you would have made if you'd sold that holding.

In other words, you (and your charity) would benefit from the stock's appreciation without being taxed on it. It's as if your gains never occurred—except for the tax break you would get to enjoy.

But this works only if you've held an investment for more than a year. That's the definition of "long term" for calculating taxes on capital gains. With donations of stock that would have produced a short-term gain if you had sold it, your deduction is limited to your basis in the stock, which is usually what you paid for your shares. So there's no tax reward for giving away stock you've acquired within the year, no matter how much its price may have increased.

Let's take a look at two hypothetical examples to see the tax difference.

Example 1: Suppose you acquired ABC Co. stock nine months ago for $10,000. The stock is now worth $15,000. If you donate the ABC stock to a charity, your deduction is limited to your basis, or $10,000. There's no tax benefit from the $5,000 of appreciation in value. In fact, you would be giving that away for nothing.

Example 2: Suppose you acquired XYZ Co. stock two years ago for $5,000 that is now worth $15,000. In this case, if you donate your XYZ shares to charity, your deduction is based on its FMV, or $15,000. You would get to deduct the entire $15,000 even though you only paid $5,000 for the stock.

These rules lead to rules of thumb that can help you decide which investments to donate. For tax purposes, it's generally best to give the long-term holdings that have gained the most in value. But it makes little tax sense to donate stock that has moved up only a small amount, especially if you've owned it for a year or less. These differences may be especially important to donors in high tax brackets.

If you donate stock that has lost value, your deduction will be based on the stock's FMV. In this case, it usually makes sense tax-wise to sell the stock first and then donate the proceeds to charity. This way, you can claim a capital loss that you could use to offset capital gains from other securities sales.

There are a few other tax wrinkles to consider when you're thinking about giving securities to charity. That 50%-of-AGI limit applies only to cash gifts, whereas charitable gifts of property can't amount to more than 30% of your AGI for the year—though you can carry over any excess to subsequent tax years. In addition, some itemized deductions for high-income taxpayers, including those for charitable contributions, may be reduced by the "Pease rule." Generally, this reduction is equal to 3% of deductions exceeding an annual threshold amount (indexed for inflation), but the reduction is capped at 80% of your total deduction. For 2014, the threshold for the Pease rule is $254,200 of AGI for single filers and $305,050 for those who file jointly.

Finally, there's more at stake here than just taxes. Investment factors, too, come into play, and it's usually better to choose stocks that you feel may have reached peak value than those that may continue to rise. You also may want to keep stocks that pay solid dividends. And there could be consequences relating to your estate plan and assets you might want to leave to your heirs instead of donating to charity.

The best approach is to consider all the significant factors before giving securities to a charity. We can help you coordinate your decisions with other aspects of your investment and estate plans. ●

$44,000 ($34,000 for single filers), you're taxed on 85% of the amount by which PI exceeds $44,000 ($34,000 for single filers) plus the lesser of the amount determined under the first tier or $6,000 ($4,500 for single filers). Silver lining: You'll never owe tax on more than 85% of your total benefits.

These two thresholds aren't indexed annually for inflation. If your PI exceeds a relatively low level of $32,000 ($25,000 for single filers), you'll owe the tax year in and year out. And you'll get hit with the higher tax rate every year that your PI exceeds just $44,000 ($34,000 for single filers).

What can you do about it? You might lower your PI by harvesting capital losses to offset capital gains or deferring taxable income to the following year. But remember that the income from tax-free municipal bonds counts against you in the calculation of PI. Consider all the relevant factors, including the potential tax implications for Social Security benefits, in your investment decisions. ●

Key Aspects Of Key-Person Insurance

Life insurance is a crucial part of most personal estate plans, but it also could be very important for your business. "Key-person" insurance can help ensure continuity and solvency if someone who plays a top role in your company should die unexpectedly. The proceeds could cover the cost of hiring and training a replacement and pay off outstanding bills or loans called in by anxious creditors.

Key-person policies usually cover the owner and the president of the business—often the same person—and can be especially helpful if surviving family members plan to continue running the business. You also might want coverage for other employees who are essential to the operations.

Like other life insurance benefits, the proceeds from a key-person policy are exempt from income tax and generally won't be considered part of the key person's taxable estate. However, if the insured employee is the sole or controlling shareholder, the proceeds may be taken into account in determining the value of company stock for estate tax purposes.

How much key person insurance is needed for your business? Consider the following three methods for determining an appropriate amount:

1. Replacement costs. For these purposes, you'll need to calculate what your company would have to spend to train someone thoroughly to do the job of the person who died. That process is likely to take at least a year and may include salary as well as other expenses.

2. Multiple of salary. There are various rules of thumb about multiples of salary but you'll probably want to use at least a multiple of three. So if someone is making $250,000 a year you would need a key-person policy that would pay a minimum of $750,000.

3. Contribution toward earnings. Estimate what portion of your company's earnings can be attributed to the key person and then multiply that amount by the number of years needed for protection. For instance, if you attribute roughly $100,000 of annual earnings to a key employee, you would need $500,000 of coverage to protect that employee for a five-year period.

What happens if the key person leaves your company while the policy is in effect? Your business might sell the policy to the departing worker, or surrender it for its cash value, assuming that it is permanent insurance. There's no cash value available with a term-insurance policy, but term insurance is generally less expensive than whole life coverage and is usually preferable to having no insurance at all.

Your situation may include special circumstances affecting how much insurance you need. Work with your financial and insurance advisors to choose an appropriate policy. ●

It Was Five Years

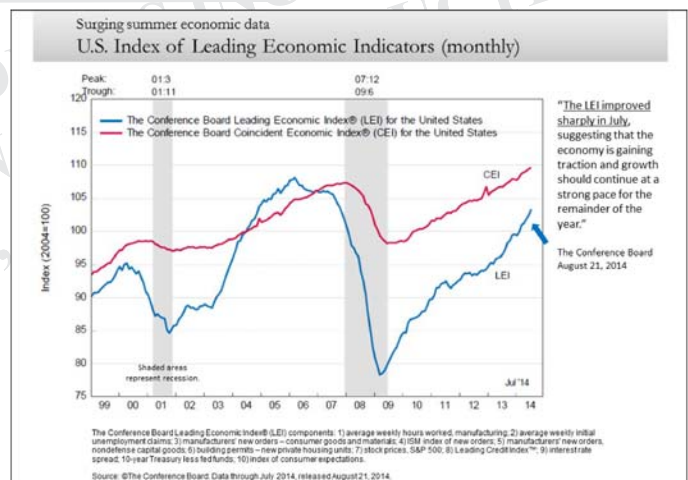
(Continued from page 1)

was chugging along, with the S&P 500 up a very respectable 8.8% with just 10 calendar days left in September.

As the third quarter neared an end, it had been well over three years since the stock market had last experienced a 10% correction. As usual, more and more of the talking heads on TV began predicting a drop in stock prices.

However, economic data suggested continued strength in the months and quarters ahead. The Conference Board's index of Leading Economic Indicators improved sharply in July, suggesting the economy was gaining traction. Growth should continue at a strong pace for the remainder of the year, according to the Conference Board data released August 21, 2014. Historically, the LEI has turned down definitively before a recession.

Indices are unmanaged and not available for direct investment. Investing in small companies involves greater risks than those associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity. Foreign securities have additional risks, including exchange rate changes, political and economic upheaval and the potential lack of strict financial and accounting controls and standards. Emerging markets involve still more risk. Fluctuations in the price of gold and precious metals often dramatically affect the profitability of the companies in the gold and precious metals sector. ●



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