www.efallc.com

evergreen
FINANCIAL ASSOCIATES

Second Quarter 2016

Guide...Protect...Preserve

Four Retirement Planning Rules Of Thumb To Bend

The online Merriam-Webster dictionary offers two definitions for "rule of thumb":

- A method or procedure based on experience and common sense,
- A general principle regarded as roughly correct but not intended to be scientifically accurate.

In other words, although rules of thumb can be useful guidelines, they're not gospel on any particular issue. This is especially important to remember when you're trying to set aside enough money to last comfortably through your retirement years. And while some traditional rules of thumb that have been followed faithfully for decades may serve as starting points, they're not infallible. Consider these four examples:

1. Save one million dollars for retirement. How much will you and your spouse need to live on in retirement? That's the age-old question. In recent years, some people have seized on a million dollars as the magic number to strive for. It's a nice round figure and, after all, can't a millionaire afford an upscale lifestyle in retirement?

But a million dollars doesn't go as far as it used to. Suppose you take an income of 4% of your savings annually—another rule of thumb for using retirement savings (see below). That's just $40,000 a year, and there will be even less if you dig into your nest egg to buy a winter "snowbird" home, for example, or take a few exotic vacations. And people are living longer these days, so you may need money to sustain you for 25 or 30 years, not 20 or less.

Another option that can be used is to set aside an amount roughly equal to eight times your ending salary (or even higher). So, if you're pulling down $200,000 just before retirement, you should have $1.6 million (8 x $200,000) in your coffers. That may be a preferable goal—but even then, a 4% withdrawal will give you only $64,000 a year.

2. Replace 80% of your pre-retirement income. This rule of thumb has been amended to make some concessions for a higher cost of living. Previous estimates often were predicated on replacing 70% or 75% of your salary with savings from retirement plans at work and IRAs, investment earnings, Social Security benefits, and other sources. Again, this rule of thumb may work for some people, but not for everyone, and replacing 80% of a high salary could require very substantial savings. You want to have 80% of that $200,000 in income? That's $160,000 a year, and could require savings of $4 million or more.

Moreover, the 80% rule ignores certain variables, such as health-care needs, lifestyle choices, and family obligations. It may be more helpful to go beyond rules of thumb to estimate what your expenses really may be in retirement and work backward to figure

(Continued on page 4)

When Will New College Grads Be Able To Retire?

At what age can today's college graduates expect to retire? According to new research released by NerdWallet, an online site offering personal finance information, the average projected retirement age for new college graduates has jumped to 75—more than a decade later than the current average retirement age of 62.

NerdWallet has been calculating likely retirement ages for college grads since 2013. It had determined initially that the average retirement age was 73. But recent increases in rent costs and student debt are setting back millennials even further. For instance, NerdWallet says that the typical debt load carried by students after graduation has surged from $29,400 in 2014 to $35,050 in 2015. At the same time, wages have barely budged. The average salary for grads was $45,487 in 2014 (the last year for which this data was available) as compared to $44,259 in 2012.

The overall figures are daunting. Rising expenses could translate into $684,474 in lost retirement savings for 2015 grads. That's up almost $125,000 from the $560,657 figure for the class of 2012.

The best solution is to save early and often. Once you land your first job, set up a "rainy day fund" for emergencies and begin contributing to a 401(k) or other retirement plan as soon as you're eligible. If you haven't started yet, today's the day!

Mary Jane Callaghan & Mitch Glicksman

SS Benefits: Tax Danger Ahead!

If you thought you left your tax troubles behind at retirement, think again. There are still plenty of tax minefields for retirees to avoid. For instance, you run the risk that the Social Security benefits you receive will be subject to federal income tax. And the higher your income for the year is, the greater the tax.

The IRS offers a safe haven for retirees who have "provisional income" (PI) below a specified level. If you stay below the threshold, you don't have to pay any tax on your benefits. But watch out if you cross into the "50% zone" for income above the threshold and further into the "85% zone" above a second threshold. The taxes that you may owe are computed on line 20b of your Form 1040.

There's no tax if your PI is under $25,000 for single filers and $32,000 for joint filers. For this purpose, PI is the total of (1) your adjusted gross income (AGI); (2) your tax-exempt interest income (usually from municipal bonds); and (3) one-half of the Social Security benefits you received during the year. Suppose you're a joint filer with an AGI of $25,000, $1,000 in municipal bond income, and you got $10,000 in Social Security benefits—your total PI of $31,000 ($25,000 + $1,000 + $5,000) is under the threshold.

However, if your PI exceeds this first threshold, you're taxed either on one-half of your benefits or 50% of the amount of your PI that exceeds the threshold, whichever is less. So if a single filer has a PI of $30,000, including $10,000 in Social Security benefits, his or her tax would be based on 50% of the PI above the threshold—half of $5,000, or $2,500—rather than the $5,000 representing half of the Social Security benefits.

But there's a second threshold that can result in more of your benefits being taxed. If your PI is greater than $34,000 for single filers or $44,000 for joint filers, you're swept into the 85% zone and may be taxed on 85% of your benefits. But that's it. No more than 85% of your benefits will ever be taxed.

When it makes sense, take steps to reduce your PI to reduce or completely avoid the tax on Social Security benefits. A few possibilities are:

- Realize capital losses that offset capital gains and other income.
- Invest in long-term growth stocks that don't produce current income.
- Consider annuities that offer growth for retirement without current taxable income.
- Life insurance, too, offers possibilities for future income without tax consequences.
- If you're eligible, contribute to an IRA or an employer-sponsored retirement plan. ●

When To Use An Installment Sale

Do you own commercial or investment real estate you're planning to sell? If the property has appreciated in value since you bought it, and you've been writing off your initial cost through depreciation deductions, you could owe a hefty tax on the transaction. What's more, you might not be able to find a buyer that can come up with all of the cash—at least not at your asking price.

You may be able, however, to kill two birds with one stone. An installment sale of commercial or investment real estate can let you defer the tax over several years, reducing the overall tax bite. In addition, the buyer can spread out the payments. There are no special conditions; the tax law specifies only that the payments must be made over two or more years.

Except for the effect of having the sale happen gradually, the basic tax rules for real estate transactions continue to apply. If you make a profit, it will be taxed as a capital gain. If you've held the property for more than one year, your long-term capital gain will be taxed at a maximum rate of 15%, or 20% if you're in the top ordinary income tax bracket of 39.6%. You also may be liable for the 3.8% surtax on net investment income.

You generally will owe tax on a portion of your gain in the year of the sale and the remainder in the years during which you receive the installment payments. The taxable portion is based on something called the "gross profit ratio"—your gross profit from the real estate sale divided by the price. Suppose that you sell a commercial building, your gain is $1 million, and the gross profit ratio is 60%. If you receive $250,000 a year, you are taxed on $150,000 (60% of $250,000) of the proceeds annually. Assuming a 20% long-term capital gain tax rate (and excluding any net investment income surtax), your tax each year on the installment sale is

Women Have Better Credit Scores, But Lower Ratings

A new study shows that women have higher credit scores on average than men yet have lower average credit ratings than men. Why? Pay disparity between men and women is part of the reason but there also are other causes, according to a January study by Credit Sesame, a free Internet-based credit reporting agency.

Credit Sesame says that among its members, the average credit score for men is 630, compared to 621 for women. Also, Credit Sesame notes that men actually owe more on average than women; the average man in its database has debts totaling $25,225, while the average woman owes just $21,171.

How can men owe more and still have better credit scores? Income likely has a lot to do with it, says Linda Sherry, a spokesperson for Consumer Action, a nonprofit consumer advocacy and education organization. "We know that men have higher salaries than women, on average, for the same positions," Sherry says. "Those men may have more (ability) to take out more credit (than women)."

Credit Sesame adds that its statistics show men have lower debt-to-income ratios than women, which means that, while their debt is higher, their incomes are higher, too. Among its members, 23% of men report that they earn more than $75,000 a year. Only 18% of women say the same.

The cost of living also may be higher for women than it is for men. Women often have to pay more for similar products, says Melinda Opperman, a certified credit counselor and senior vice president for community outreach and industry relations at Springboard Nonprofit Consumer Credit Management, Inc. "Many products that are marketed 'just for women' are no different than products for men, but cost more," Opperman says. Doctors also tend to order more tests for women than they do for men. "All of these kinds of things add up, and leave women with less money to pay the credit card bills than their male counterparts," she adds.

Credit Sesame says women also tend to use more of the credit that's available to them than men do, with 59% of its female members using more than 70% of their available credit, compared to 57% of men who borrow that much. Meanwhile, 28% of men use less than 30% of their total credit, while only 25% of women do so.

Credit utilization – the amount of your credit card balances compared to your credit limits – is another important factor in your credit score. So the fact that men use less of their available credit is another reason for their higher credit scores.

Women also are more likely than men to have serious trouble managing their debt, according to the data. The report says 57% of men have no accounts in collections, while only 53% of women are free of this stain on their credit histories. Women are more likely than men to end up in a situation where their debt seems to have spiraled out of control. About 18% of women have five or more accounts in collections, compared to 14% of men who are in the same boat.

For both men and women, credit scores tend to improve with age. Still, in all age groups, men's scores are better than women's — and their advantage grows as they get older. According to Credit Sesame's data, men ages 35 to 44 have an average credit score of 623, while women in this age group have an average score of 614. By ages 55 to 64, men have pulled further ahead, with an average score of 661, compared to women's average score of 651. And men ages 65 and up are doing even better compared to their female peers: men in this group have an average score of 705, while women over 65 have an average score of 690.

The income gap could partly explain this trend, too. If men start out making more, their advantage will grow over the course of their careers as they get raises on a higher base salary.

It's also still the case that women are more likely than men to take time away from work to take care of their families.

That means men are more likely to have been working steadily throughout their careers, earning promotions and raises as they go, while women are more likely to have taken a few years off, worked part-time for a period, or deferred promotions to care for their kids or aging parents. ●

$30,000 (20% of $150,000).

Any depreciation you claim on the property must be recaptured as ordinary income to the extent it exceeds the amount allowed under the straight-line depreciation method. However, spreading out the tax over a number of years will take greater advantage of the 15% tax rate on long-term capital gain.

Finally, there's one other potential tax pitfall. If the sale price of your property (other than farm or personal property) exceeds $150,000, you'll have to pay interest on the tax that is deferred to the extent that your outstanding installment obligations exceed $5 million.

While installment sale treatment on your tax return is automatic, you can opt out if that suits your purposes—for example, if your income was otherwise low for the year. In that case, the entire gain is taxable in the year of the sale. But these rules are complicated, so be sure to get expert tax advice about your situation. ●

Estate And Gift Tax: Foreign Matters

Usually, gift tax is paid by the person who makes the gift—not the recipient—while estate taxes essentially come out of the amount heirs get. However, under a little-known provision in the tax code—Section 2801—tax may be owed by the recipients of "covered" gifts and bequests from "covered expatriates." In these circumstances, if you get the money, you may have to pay the tax.

The IRS recently issued temporary regulations involving Section 2801 that could affect your estate plan if you, or a family member, are an expatriate.

For starters, consider the normal rules for estates and gifts. The unlimited marital deduction typically shelters transfers of money or property between spouses. Also, every U.S. citizen benefits from a generous $5.45 million (inflation-indexed for 2016) combined estate and gift tax exemption as well as an annual gift tax exclusion that in 2016 is $14,000 per recipient.

Furthermore, your estate plan may incorporate benefits such as the portability provision that lets the estate of a surviving spouse use any leftover portion of the estate tax exemption of the first spouse to die. Another popular choice, called a qualified terminable interest property (QTIP) trust, may be used to provide annual income to a surviving spouse, with the trust principal going to the children.

The new regulations include the following key definitions:

- A "covered gift" is a taxable gift as defined under the tax code.
- A "covered bequest" is property that generally would have been included in an expatriate's estate if he or she were a U.S. citizen or resident.
- A "covered expatriate" is someone who in 2016 has an average annual net income tax liability greater than $160,000 for the previous five tax years; has a net worth of $2 million or more; or has failed to certify under penalty of perjury that he or she has complied with all U.S. tax obligations for the past five years.

But the regulations also provide several notable exceptions to the Section 2801 rules. For instance, gifts reported on a timely gift tax return filed by an expatriate are exempt as long as the gift tax is paid. A similar exception is available for property reported on an estate tax return if the estate tax is paid. Also, a covered expatriate's "qualified disclaimers" of property and charitable donations that qualify as deductions for estate or gift tax purposes are exempt.

Finally, the proposed regulations exclude gifts and bequests that would qualify for the unlimited marital deduction, including a gift or bequest made to a QTIP trust where a proper election has been made.

When appropriate, examine the potential for Section 2081 liability. Typically, your estate plan may be revised to take advantage of exceptions under the rules, such as creating a QTIP trust. Contact us for more details. ●

Rules Of Thumb To Bend

(Continued from page 1)

out how much you will have to accumulate and earn annually to meet your objectives.

3. Save at least 10% of your income for retirement. The old belief is that you should pay yourself first before you pay anyone else. This rule of thumb mandates that you set aside at least 10% of your salary each year no matter what is happening in your life. For a simplified example, if you earn $150,000 a year and thus set aside $15,000 a year in a tax-deferred vehicle such as a 401(k) plan, you will have $1,470,081 after 30 years if you earn an annual 7% return. (This example is hypothetical and not indicative of any particular investments.)

There are two problems here. First, there's no guarantee that saving 10% a year will give you what you need in retirement. The second is that it may be difficult to maintain that discipline, especially if you're raising a family during your peak earning years. If your saving flags during those years or if you can't start saving until later in life, the 10% rule is very likely to give you less than you need.

4. Withdraw no more than 4% annually from your nest egg. At first blush, this principle makes perfect sense for anyone planning on a long lifetime in retirement. In theory, if you withdraw 4% a year and earn more—say, 7% or 8%, as a hypothetical example—you should be able to sustain your nest egg throughout retirement as long as inflation remains relatively low.

But there are no guarantees of what interest rate you will earn, and you might have to use more than 4% some years. Furthermore, during a sharp market downturn, taking out even the minimum 4% could put you in a deeper hole that could be hard to dig out of.

Where do you stand? Although these four guidelines can be helpful, a better idea is to work out a comprehensive plan for your future. We would be glad to provide the retirement planning assistance you need. ●

Evergreen Financial Associates, LLC • www.efallc.com
Mitch Glicksman • 8180 North Hayden Road, Suite D203, Scottsdale, AZ 85258 • Toll Free: 888.865.4449 • Phone: 480.951.6536 • Fax: 480.922.3007
Mary Jane Callaghan • 300 C Lake Street, Ramsey, NJ 07446 • Phone: 201.934.1818 • Fax: 201.934.4040