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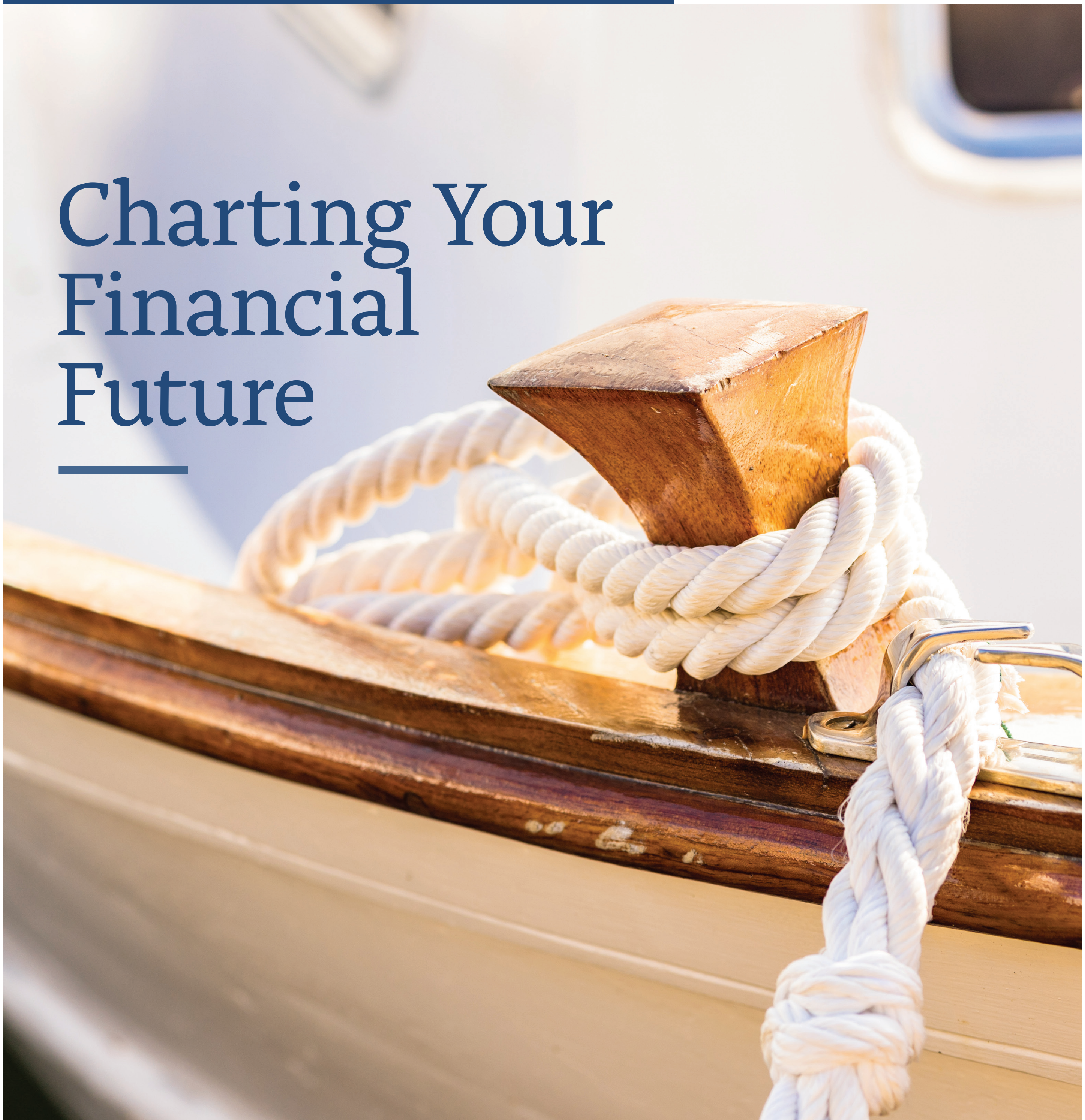

Charting Your Financial Future

Retirement Planning

401(k) Rollovers: Consolidation factors to consider.

By Eva Stark, JD, LL.M.

The average 50-year-old has held 11.9 jobs since reaching adulthood,[1] and younger generations may hold even more jobs by the time they reach the same age. As a result, in the absence of planning, an individual's retirement savings can become scattered among a multitude of accounts and be easily forgotten. Consolidating retirement accounts can help manage accounts and track progress toward retirement goals. However, before rolling over an old pre-tax 401(k) account into a new employer's 401(k) plan or a traditional IRA, several important factors must be considered.

PLAN INVESTMENT OPTIONS. One potential drawback to 401(k) plans is that investment options are limited to those offered by the plan. As a result, it is important to compare the investment selections offered by both the old and the new employer's plan before making a rollover decision. IRAs typically offer a much broader array of investment options for more customized investment strategies.

FEES. A 401(k) plan may charge fees such as administrative fees, investment fees, advisory fees and individual service fees (such as fees charged for setting up a loan). On the other hand, some 401(k) plans have low fees and offer low-cost "institutional shares" that are not available for IRAs. Before rolling funds out of a 401(k) plan, it is important to understand its fee structure.

Many employees pay little to no attention to fees, but a small difference in fees can have a substantial impact over a working career. While an employee has no control over the fees charged by his or her 401(k) plan, an individual may select among a multitude of financial institutions for an IRA to find the best value for his or her investment needs.

CREDITOR PROTECTION. 401(k) plans are ERISA qualified retirement plans that are typically protected from judgment creditors. Some limited exceptions include ex-spouses under a Qualified Domestic Relations Order (QDRO) and federal tax debts. In contrast, IRAs are not ERISA protected, although many states protect them under their exemption statutes. While some states offer full protection of IRAs, others may offer more limited protection, such as by capping the amount protected at a certain dollar amount. For those with asset protection concerns, it may be prudent to contact an attorney before rolling funds out of a 401(k) plan.

EARLY RETIREMENT. For individuals who plan to retire early, leaving funds in a 401(k) plan may help avoid the 10% early withdrawal penalty. An individual who leaves an employer after attaining age 55 may generally withdraw funds from that employer's 401(k) plan penalty free. In contrast, funds in an IRA may only be accessed penalty free after age 59½.

1 "Number of Jobs, Labor Market Experience, and Earnings Growth Among Americans at 50: Results from a Longitudinal Survey." Bureau of Labor Statistics. August 24, 2017. Available at https://www.bls.gov/news.release/pdf/nlsoy.pdf

EXTENDED CAREER. Many 401(k) plans will allow employees working past age 70½ to forego required minimum distributions. In contrast, an IRA owner must take required minimum distributions, regardless of employment status. For those who anticipate extending their careers, rolling funds into a new employer's 401(k) may help achieve additional tax deferral.

LOANS. While some 401(k) plans permit loans, IRAs do not. Individuals who desire to take loans from a 401(k) plan should review their plan documents to determine if loans are permitted. Loans must typically be repaid within 60 days of termination of employment, otherwise, income tax and a 10% early withdrawal penalty may apply.

WITHDRAWALS. IRA funds may generally be withdrawn at any time. 401(k) funds may typically only be withdrawn if employment is terminated, the employee attains age 59½, or the employee becomes eligible for a hardship withdrawal under plan rules. While some 401(k) plans allow "in-service distributions," this is not always the case. Early withdrawals either from an IRA or a 401(k) plan will typically trigger income taxes and an additional early withdrawal penalty of 10%. A handful of exceptions to the penalty (but not the tax) may be available, which differ slightly for IRAs and 401(k) plans.

NET UNREALIZED APPRECIATION. The rollover of company stock from a 401(k) plan into an IRA will generally cause the loss of preferential tax treatment on net unrealized appreciation. Company stock may be withdrawn from the 401(k) plan so that only the basis in the stock is taxed at ordinary income tax rates, while the gains (i.e., the net unrealized appreciation) are taxed at capital gains rates. To preserve this preferential treatment, it is important not to overlook company stock when considering a rollover.

Summary.

Over a working career, an employee may accumulate multiple retirement accounts. Evaluating whether and when to roll over funds into a new 401(k) plan or an individual retirement account may be a complex financial decision with potential pitfalls for the uninformed. The expertise of a trusted financial professional may be very valuable when making such an important decision.

Eva Stark, JD, LL.M.

Eva joined The Nautilus Group in 2014 to assist with the development of estate and business plans. She also performs advanced tax research. Eva graduated summa cum laude with a BS in economics and finance from The University of Texas at Dallas. She earned her JD, with honors, from Southern Methodist University, where she served as a student attorney and chief counsel at the SMU Federal Taxpayers Clinic. She received her LL.M. in taxation from Georgetown University Law Center. Prior to joining Nautilus, Eva worked in private practice in tax controversy, business law, and litigation.

Estate planning with blended families

By Patricia Annino, Esquire

Blended families have a unique advantage when it comes to estate planning. In a blended family, one or both parents may have experienced a life changing event, such as divorce or the death of a spouse. The experience of having gone through such an event brings a hard dose of reality to everyday life, and makes it easier to have discussions about planning because experience has shown that it is better to be prepared.

There are, however, obstacles when it comes to planning in this type of family. Children in a blended family may be yours, mine and ours. Psychologically, the parents (and ghosts of deceased or divorced parents) are always in the room. Unresolved emotional issues are also often present and they are an undercurrent for any ongoing discussions, sometimes making planning a bit tricky.

One of the most significant lightning rods is the house the family lives in. There are important decisions one must make, such as who will live there, who can sell it, who will pay the continuing expenses, and what happens if one spouse dies and the survivor remarries.

These are often very difficult choices but in my experience, the longer the marriage, the more comfortable family members become with the decisions. The choices are trickier if it is the same house the children of one spouse grew up in. When that happens, the children have a natural claim to the memories in that house and there is a psychology of ownership. A child may feel that the other family members are intruders in his or her space. For this reason, many couples sell their respective homes and buy a new one together that neither family previously lived in, while other couples decide that if one dies, the survivor can only stay for a limited time.

Of all the issues a blended family may face, this is one of the most important for the underlying family dynamic. A lot of care and thought should go into making these decisions.

In the early stages of planning, it is very easy to fall into the trap of focusing on what happens when both spouses die. However, it is very important to back up and first think about what happens when one spouse becomes disabled or dies. If one becomes disabled, who has the legal authority to make medical care decisions? If they lose the ability to handle their financial affairs, pay bills, make deposits, withdrawals, investment decisions, file tax returns, who will have that responsibility? Is it the other spouse or the adult children? A combination? A neutral party? These are very important issues to resolve.

Although we would all prefer to be Scarlett O'Hara and say, "Why worry about this today — tomorrow is another day," we must understand that the time to make these decisions is when there is no crisis.

In many states, there is no automatic preference for a spouse to have legal authority, which can lead to conflict between a spouse and an adult child in the emergency room or the bank.

It is also vital, from a psychological point of view, that the decision is not left in default for others to resolve during a crisis.

When thinking this through, you also need to think about any inherent conflict in the selection. This can happen, for example, if you name one person as your health care agent, responsible for your medical decisions, but you give someone else the authority to access or make the financial decisions. This leads to one person trying to make decisions about medical care and its cost without coordination with the financial side.

Perhaps another thing to consider would be how the spouse, with a fixed inheritance, may make medical care decisions regardless of the financial consequences, whereas children, who will be receiving the bulk of the assets, may want to manage care differently.

Moreover, before addressing how the children will receive assets, one must think about what happens at the death of the first spouse. When the first spouse dies, does the other spouse automatically receive his or her life insurance, retirement plan, or joint account? What does he or she receive in trust and who is the trustee? What are the debts, income sources and assets? What are you free to leave to whomever you want, and what are you restricted on?

Consider the ages of the spouses and the children from each marriage. For instance, if the age gap between the second spouse and the children from the first marriage is not significant, it may not be a good idea to leave the assets in trust for the second spouse's lifetime and then have them pass to the children. If the spouse lives to life expectancy, this could mean the children may be in effect disinherited.

Sometimes, it is better to "conquer and divide" at the death of the first spouse. This means figuring out what the surviving spouse should receive and what the children should receive, and giving it to them instead of keeping the blended family financially entangled.

This is also a case where life insurance can help as it can, if structured properly, provide liquidity tax free to the children of the deceased spouse while leaving other assets intact.

Once those questions are all answered, the conversation can turn to what happens when something happens to both parents.

Who do your assets pass on to, and who do your spouse's assets pass on to? In what proportions? What are the estate taxes and who is paying them? This is also where life insurance may be helpful in allocating and covering any estate tax burden due.

Planning for the blended family is complex because it involves both technical and sometimes emotionally charged issues — whether above the surface or not. This is something you should take the time to think through and remember to revise your plans as life evolves.

Patricia Annino is a nationally recognized authority on estate planning and taxation, with more than 30 years of experience serving the estate planning needs of families, individuals, and owners of closely held and family owned businesses. She has written five books and also writes a monthly column for AICPA's CPA Insider, a newsletter sent to more than 320,000 CPAs. Patricia is a graduate of Smith College (A.B.), Suffolk University School of Law (J.D.) and Boston University School of Law (L.L.M. in Taxation). She is a Fellow of the American College of Trust and Estates Council, and a member of the Board of Directors of Family Firm Institute, the Board of Directors of Business Families Foundation, and the Advisory Board of the Indiana University Women's Philanthropy Institute.

Business Planning

Asset protection strategies help protect small businesses and their owners.

By Eva Stark, JD, LL.M.

In today's economy, it is not uncommon for an individual's "gig" or "side hustle" to grow into a full-time business opportunity. Something that starts out as a part-time activity or just a hobby may quickly blossom into a profitable business.

Where a business activity is conducted, limiting liability from that activity is an important consideration. In the absence of planning, an accident, or a dispute with a customer, supplier or an employee, can not only wipe out business profits but also put the business owner's personal assets at risk. Fortunately, proper planning may limit exposure and avoid a nightmare scenario.

CONDUCTING BUSINESS IN A LIMITED LIABILITY ENTITY

One of the first lines of defense from business liabilities is to conduct any business activity in a limited liability entity. A limited liability entity—such as a corporation, a limited liability company (LLC), a limited partnership (LP), limited liability partnership (LLP), limited liability limited partnership (LLLP) or similar entity—can create a "firewall" between the business owner's business activity and personal assets.

The specific business activity, management structure, expected growth potential and tax considerations will determine what entity type makes the most sense under the circumstances.

ASSESSING THE NEED FOR MULTIPLE ENTITIES

Just as an entity may create a firewall between business activities and a business owner's personal assets, segregating different business lines and business assets into separate entities may create firewalls between such activities and assets as well. For example, a manufacturer that owns its warehouses and transports its products may be taking on unnecessary risk if all assets are owned and all activities are conducted inside a single limited liability entity. A single trucking accident and a judgment against the company could put all of the company's assets at risk (warehouses, manufacturing equipment, bank accounts, etc.). However, if the company is divided into several entities (a manufacturing company, a transportation company and a real estate holding company, for example) it may be possible to isolate the liability within the transportation company.

To set up such separation, three entities would typically be created and the entities would execute contracts (e.g., rental agreements and contracts for transportation services) with one another. The manufacturing company could lease the warehouses from the real estate holding company and hire the transportation company to transport its goods. Proper documentation (contracts, governing documents), capitalization, insurance and governance can help ensure that courts will respect such segregation of one entity from another and from the business owner's personal assets.

LIMITING LIABILITY THROUGH CONTRACT

Written contracts with clients, suppliers, lenders, etc. may help avoid disputes over pricing, payment terms, or quality expectations, and spell out each party's obligations to limit surprises.

Where a dispute does arise, a contract may often limit damages to amounts paid under the contract or provide for liquidated damages (e.g., a set dollar amount). State law varies widely when it comes to the ability to limit liability and damages through contract, so having contracts drafted and reviewed by a competent business attorney is key.

INSURANCE

Carrying adequate insurance is also key to protecting assets of the business and the personal assets of the business owner. Without sufficient insurance to satisfy liabilities, a creditor will be tempted to explore strategies for accessing a business owner's personal assets. Additionally, a business that is poorly capitalized (given the specific business activity involved) or a business's failure to carry adequate insurance may bolster a creditor's argument for piercing the corporate veil.

Generally, where the corporate veil is pierced, the court or creditor may ignore the firewall between the business and the business owner's personal assets, exposing such personal assets to creditors. For example, a business owner who runs a "transportation company" that leases its trucks from the owner, owns no other assets, and carries no insurance would likely not be respected by a court as a separate entity and a liability from a trucking accident involving the business would likely not be isolated within the business.

PERSONAL ASSET PROTECTION

In addition to limiting business liabilities, business owners should consider positioning personal assets for creditor protection. Various state and federal laws protect certain types of assets from creditors. These "exempt" assets may include home equity, qualified plan balances, individual retirement accounts, annuities, life insurance death benefits and cash values, as well as some miscellaneous assets (e.g., a personal vehicle, burial plot, gun, livestock, etc.).

What is exempt and the degree to which it may be exempt varies greatly by state. For example, certain states protect an unlimited amount of life insurance cash values as well as death benefits both from the creditors of the insured and the beneficiary.

Other states may limit the protection of cash values to a specific dollar amount and may limit the protection of death benefits based on the relationship of the beneficiary to the insured or other factors.

In addition to taking advantage of exemptions, a business owner may be able to enhance creditor protection of personal assets by placing both exempt and nonexempt assets in a trust for the benefit of the business owner's spouse or children.

An increasing number of jurisdictions also allow protection for certain self-settled trusts (trust created by an individual for the individual's own benefit). Successful asset protection planning requires planning ahead and having a trust in place before the liability exists.

Having a part-time gig or hobby blossom into a great business opportunity can be very exciting. When this happens, it makes sense to take steps to minimize risk both for the business owner as well as for the business itself.

The right professionals (attorneys, financial advisors, accountants) can help spot opportunities to ensure that the business, and the business owner's balance sheet, continue to grow.

Eva Stark, JD, LL.M., joined The Nautilus Group in 2014 to assist with the development of estate and business plans. She also performs advanced tax research. Eva graduated summa cum laude with a BS in economics and finance from The University of Texas at Dallas. She earned her JD, with honors, from Southern Methodist University, where she served as a student attorney and chief counsel at the SMU Federal Taxpayers Clinic. She received her LL.M. in taxation from Georgetown University Law Center. Prior to joining Nautilus, Eva worked in private practice in tax controversy, business law, and litigation.

Plan now for far-ranging 2018 tax reforms.

By Ariel A. Marin, JD, LL.M., CFP®

The Tax Cuts and Jobs Act of 2017 made sweeping changes to the nation's income tax laws starting this year, yet many of these changes may not be apparent until taxpayers embark upon their 2018 filings next spring. In some cases, the new rules may come as a shock, with the opportunity to maneuver then lapsed. It is therefore important to keep in mind some of the most significant changes impacting individual filers as they track expenses, maintain records, and plan with an eye towards tax efficiency.

Notably, income tax rates have been generally reduced, while applicable income thresholds have increased. Taxpayers may be well served by reviewing estimated payments and withholding to avoid overpayment. Note that many payroll firms recently made adjustments for employee withholding based on updated IRS guidelines. While rates are broadly lower, taxpayers should heed the adage: what Congress giveth with one hand, it taketh away with the other.

In exchange for reduced rates, many common deductions have been reduced or eliminated. Chief among them include:

- Elimination of personal exemptions;
- A $10,000 maximum cap for the deduction for state and local taxes (including property taxes, as well as state sales taxes if elected in lieu of state income taxes);
- A reduction in the level of indebtedness on a primary residence that is eligible for the mortgage interest deduction (down to $750,000 from $1,000,000 of mortgage debt); and
- Elimination of miscellaneous itemized deductions subject to the 2% of the adjusted gross income (AGI) floor—popular deductions here include unreimbursed employee expenses, tax prep fees and investment advisory fees.

To offset the loss of the personal exemption (for larger families at least), taxpayers with children under age 17 are eligible for an expanded child tax credit of $2,000 per child. This credit is increased from the prior $1,000, and the threshold for phaseout is increased significantly (from $110,000 married filing jointly to $400,000 – single filers now face a $200,000 threshold, up from the prior $75,000).

While the cap on state and local taxes will hit individuals in high income tax states the hardest, changes in the alternative minimum tax (AMT) may help. Many individuals in high tax states find themselves subject to the AMT, since state taxes are added back when computing such tax. While the widely despised AMT was not repealed as some had hoped, the exemption and applicable phase-out level were increased significantly. As a result, the changes may cancel each other out, leaving no net tax increase for many.

In a sigh of relief for some, the reduced mortgage debt level for interest deductions applies to new (post 12/15/2017) mortgages—existing mortgages or refinances of existing mortgages are generally grandfathered. The home equity loan interest deduction, however, was eliminated in many contexts, regardless of when the debt was incurred.

A notable exception applies for home equity loans used for capital improvements to the home, so long as total mortgage debt does not exceed the applicable $750,000/$1,000,000 threshold. Another limited exception applies for interest deductible under a separate tax rule (e.g., to obtain a taxable investment). In such case, the taxpayer can make a special election to treat the debt as "not secured by a qualified residence" —once made, though, the election is irrevocable unless the IRS consents to revoke the election.

Notably, the charitable deduction was not altered with tax reform—in fact, generous donors may claim a larger deduction for cash gifts to public charities, with the applicable AGI limit increased from 50% to 60%. Many taxpayers may forgo itemized deductions altogether, though, with the higher standard deduction, which increased from $6,500 single / $13,000 married-joint to $12,000 single / $24,000 married-joint.

While this increase will hopefully not discourage charitable giving, it will greatly simplify the tax preparation process for many (and perhaps reduce those pesky, now non-deductible, tax preparation fees).

While these are just some of the most common individual tax return items, myriad other tax rules were impacted significantly within the 429 legislative pages. Other items of potential significance include:

- Elimination of personal casualty and theft losses (unless incurred in a federally declared disaster area);
- Elimination of the alimony deduction (*for agreements entered into after December 31, 2018*); and
- Repeal of the health insurance individual mandate starting in 2019 (or rather the elimination of the "shared responsibility payment" penalty for failure to obtain compliant insurance). The 3.8% Medicare surtax remains intact (at previous thresholds).

Of equal significance with this latest reform is the continued grand legislative tradition of temporary tax provisions—nearly all changes impacting individuals are scheduled to automatically sunset and revert to prior law beginning in 2026, unless Congress acts to extend such rules. As with "who shot JR?," taxpayers are left in suspense yet again.

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