TAX YEAR
2018

Financial Planning Guide

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Personal Financial Planning

Budgeting

Steps to manage income and expenses include the following.

- Identify monthly outflows as living expenses, savings, and discretionary. Eliminate unnecessary expenses from the discretionary category. If further cuts need to be made, reduce living expenses by obtaining a less expensive auto or home. Reduce savings as a last resort. Track income and expenses monthly and review every six months.
- Establish an emergency fund equal to six months of income saved.
- Save on private mortgage insurance by putting at least 20% down on a home mortgage.

Education Funding

Several tax advantages are available to help save for education expenses.

- Savings bond interest may be tax free if used for qualified education expenses.
- Coverdell education savings accounts (ESAs) provide tax-deferred growth and tax-free distributions for qualified education expenses.
- Qualified Tuition Programs (529 plans) provide tax-free distributions for qualified tuition expenses.
- A gift of low-basis stock allows the individual's child to sell the stock and use the proceeds to fund education expenses. This is beneficial when the individual is in a higher tax bracket and the student is in a lower tax bracket.
- Roth IRAs can be used as a savings vehicle for education purposes. Contributions are removed from a Roth IRA without tax or penalty. Parents and grandparents fund the Roth IRA with the intention of removing the contribution and gifting that amount to the student. If the student does not go to college, or has the costs covered by other means, the contributions can stay in the Roth IRA without concern for tax or penalty.
- Cash-value life insurance can also be used as a funding mechanism for college expenses.

Insurance

The purpose of insurance is to transfer the risk of loss to a third party to prevent catastrophic financial loss should that risk become a reality. For this reason, people choose to insure the larger risks and take on the smaller potential losses at their own risk.

- Liability insurance protects from financial loss due to specific incidents that create a liability. Automobile and homeowner insurance are examples of insurance that provide liability protection.
- Health insurance provides financial protection from medical costs associated with illness and/or injury.
- Disability insurance provides for income replacement in the event a person is unable to work due to injury or illness.
- Long-term care insurance protects financial assets and income in the event a person is confined to a long-term nursing home or needs in-home care for an extended period of time.
- Life insurance provides for an immediate lump-sum amount of money in the event of the insured's death. The purpose of life insurance is to provide income replacement in the event the income earner dies.

➲ ***Planning Tip:*** *Individuals should ask their auto and home insurance agent about purchasing umbrella liability protection. The cost is economical and it can provide additional protection from a liability loss.*

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Investment Planning

Stocks, bonds, money markets, mutual funds, commodities, real estate, and options are the most common types of investments. Most financial professionals will recommend diversifying an investment portfolio across the different spectrum of investments. Investors need to be aware of the risks involved with any investment.

- ***Market risk.*** This is the risk that the value of the investment will be below the purchase price when or if it needs to be sold.
- ***Inflation risk.*** If the increase in value of an investment is less than the increase in the inflation rate, the future purchasing power will be less.
- ***Liquidity risk.*** Not all investments can be sold at a moment's notice. Some investments do not have a marketplace where they can be sold.
- ***Interest rate risk.*** If an individual buys an interest-bearing investment and interest rates go up, the current investment value can decrease.
- ***Tax risk.*** Buying and selling repeatedly for a profit will lead to taxable gains. The tax paid presents a risk to the investment value.
- ***Political risk.*** Specifically, when investing globally, political changes within a country can decrease investment values.
- ***Currency risk.*** Fluctuations in world currencies will cause investment values to rise or fall, independent from the true value of the investment.

Income Tax Planning

In addition to the economic logic that a financial transaction must have, it is important to evaluate the tax consequences of those transactions.

Basis and Holding Period

Knowing the basis and holding period in advance of a transaction can prevent costly tax consequences. Selling highly-appreciated assets will increase the amount of tax owed. Selling investments that are below basis can provide tax benefits by allowing a dollar-for-dollar reduction against capital gains. In addition, individuals are allowed to write off investment losses in excess of gains up to $3,000 per year. Any amount not used can be carried forward to future tax years.

Example: *Val owns the following shares of stock.*

	Stock A	*Stock B*	*Total*
Cost	$1,000	$3,000	$4,000
FMV	$4,000	$1,000	$5,000
Unrealized gain/loss	$3,000	($2,000)	$1,000

Val wants to make a $5,000 charitable donation by selling her stock and contributing the cash to charity. If she sells both stocks and donates the proceeds, she will generate a taxable capital gain of $1,000 and take a charitable deduction of $5,000. Instead of selling both stocks, Val could gift stock A to the charity, along with the proceeds from the sale of stock B. Her tax result would be a capital loss of $2,000 from the sale of stock B and a charitable deduction of $5,000 ($4,000 FMV of stock A, plus $1,000 proceeds from the sale of stock B). She thus avoids paying tax on the $3,000 appreciation on stock A while achieving the same charitable deduction.

Annuity or Life Insurance Exchanges

A life insurance or annuity contract can be exchanged to a different life insurance or annuity contract without the exchange becoming taxable. Limitations may apply.

Early Retirement

Early retirees (before age 59½) are allowed to take distributions from retirement plans and avoid the 10% additional tax. In order to do so, they must follow certain rules.

- Distributions must be taken at least annually in substantially equal amounts.
- Distribution amounts are determined by life expectancy of the recipient.
- Distributions must be taken for a minimum of five years beginning with the year of the first distribution. If, at the end of the five years, the recipient has not yet attained the age of 59½, he or she must continue the distributions until attaining age 59½.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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