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CLIENT PLANNING ADVISORY

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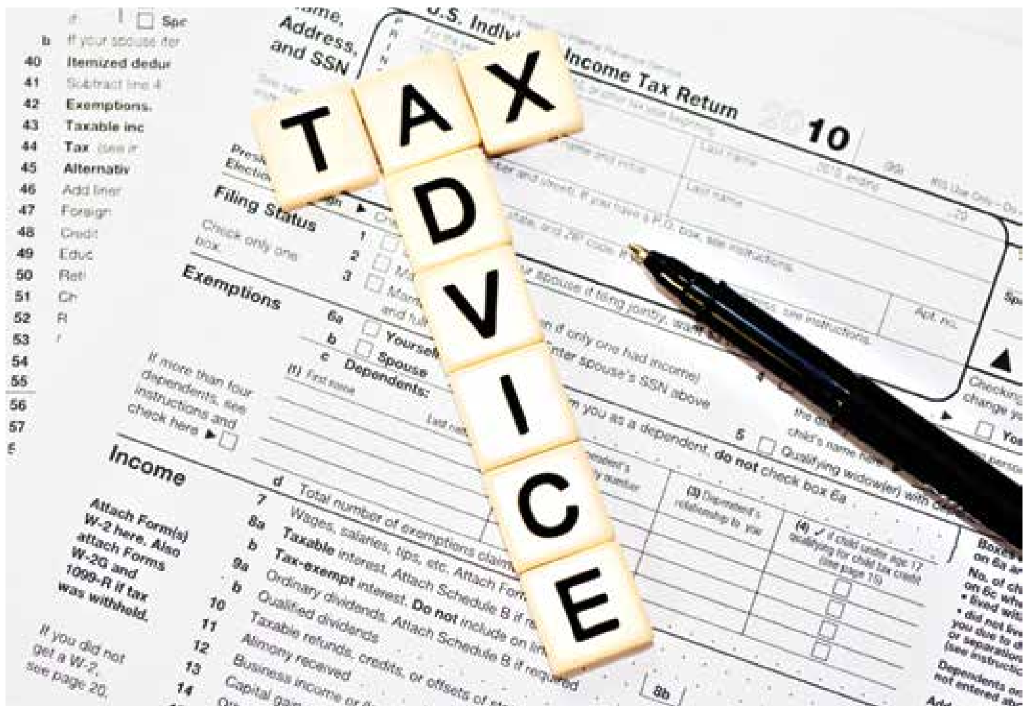
DID YOU KNOW

COLLEGE EDUCATION

Among parents who are saving for their kids' college education, 45% are using a regular savings account to do so. Including multiple responses, 31% of parents are using a 529 account, designed to fund higher education, and 30% are using their own 401(k) accounts, which are meant to be retirement plans.

Source: T. Rowe Price



QTIP Trusts Still Offer Advantages

For many people, trusts can play a role in estate planning. Indeed, a qualified terminable interest property (QTIP) trust may offer benefits to married couples. That's especially true for people who are in a second (or even a third) marriage, because a QTIP trust can prevent a second spouse from disinheriting children from a first marriage.

EXTENDING CONTROL

A QTIP trust allows the creator (grantor) to provide funds for a surviving spouse and also name the final beneficiaries.

Example 1: Dwight Emerson's will calls for the establishment of a QTIP trust, to be funded with most of his assets. His second wife, Flo, will be entitled to all of the income from the QTIP trust, for as long as she lives. At Flo's death, the assets remaining in the trust will go to Gregg Emerson and Helen Jenkins, Dwight's children from a prior marriage.

Thus, Flo will be assured of cash flow for the rest of her life. However, she won't be able to direct the QTIP trust assets to her own children, also from a prior marriage. Dwight can be sure that his children will receive whatever is left in the trust after Flo's death.

This process can go both ways. Flo's will also can create a QTIP trust for her assets, so that Dwight would receive lifetime income if he is the surviving spouse, yet Flo's children would ultimately get the trust assets.

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Deducting IRA Contributions

The deadline for 2015 IRA contributions is April 18, 2016. Workers and their spouses who were under age 70½ at year-end 2015 can each contribute up to $5,500, or $6,500 for those 50 and older. For traditional IRAs, income limits don't apply.

That is, those named can make contributions of these amounts to a traditional IRA. Whether those contributions will be tax-deductible is another matter. In any case, investment earnings inside an IRA will be untaxed until money is withdrawn.

DEDUCTION LIMITS BASED ON PLAN PARTICIPATION

Worker not covered by plan — If a worker was not covered by an employer's retirement plan in 2015, IRA contributions are deductible. Income is not an issue.

Example 1: Nora Dixon, age 29, works for a small computer graphics company that does not offer a retirement plan to its employees. Nora's husband Oliver, also 29, is a physical therapist who is not covered by a retirement plan. Both Dixons can deduct traditional IRA contributions up to $5,500 each for 2015, no matter how much they earn.

Worker covered by plan — However, for workers who were covered by an employer plan, income will determine deductibility. To deduct the maximum amount as a single filer, your modified adjusted gross income (MAGI) for 2015 must be $61,000 or less; you can take a partial deduction with MAGI up to $71,000. Over $71,000 of MAGI, single filers who are covered by an employer plan can't deduct any IRA contribution. (For plan-participating married people filing jointly, the 2015 MAGI ceilings are $98,000 for a maximum deduction and $118,000 for a partial deduction.)

Example 2: Paul and Rhona Benson, both age 44, are each covered by a retirement plan at their jobs. The Bensons had MAGI of $108,000 in 2015. That's 50% of the way through the phase-out range for joint tax returns. Thus, Paul and Rhona can each contribute up to $5,500 to traditional IRAs for 2015, and they can each take a $2,750 tax deduction: 50% of the maximum.

One spouse covered by plan — Among married couples with higher incomes, one spouse might be able to deduct all or part of an IRA contribution. That would be the case if one spouse is covered by an employer plan, but the other spouse isn't. The spouse who is not covered can deduct a full 2015 IRA contribution with joint MAGI up to $183,000, or a partial deduction with MAGI up to $193,000.

Example 3: Sheila Ford, age 65, is covered by an employer plan at work, while her husband Greg, 68, is retired. Their 2015 MAGI is $175,000. Both Fords can make a $6,500 traditional IRA contribution for 2015. However, because their joint MAGI is over $118,000, Sheila can't take any tax deduction. Greg, on the other hand, is not covered by an employer plan, so he can take a full $6,500 tax deduction because their joint MAGI is under $183,000.

Note that traditional IRA contributions are available only to workers and spouses under age 70½. In this example, Greg would not be able to make any IRA contribution if he were age 72, for example.

THE ROTH ALTERNATIVE

A taxpayer that can make a deductible traditional IRA contribution can instead make a contribution to a Roth IRA. Roth IRA contributions are never tax-deductible. However, after you've had a Roth IRA for five years and reach age 59½, all distributions are tax-free. Our office can go over the tax aspects with you to help you decide between a nondeductible Roth IRA and a potentially tax-deductible traditional IRA contribution. ❍

QTIP Trusts continued from page 1

ASSET PROTECTION

What's more, a QTIP trust can provide asset protection.

Example 2: Kirk and Laurie Miller are married with grown children. Both Millers have wills calling for all of their assets to go into QTIP trusts. The surviving spouse will get all the trust income; in addition, the local bank named as trustee will be instructed to provide the survivor with additional funds from the trust, if necessary for ordinary living expenses, such as health care. Then, the remainder ultimately will go to their children.

With this arrangement, a remarriage after the death of the first spouse won't lead to their children being disinherited. Control of the assets by a trustee will reduce the chance of depletion through squandering or unwise investments by the surviving spouse.

TAX BENEFITS

Historically, QTIP trusts were used to defer estate tax to the death of the second spouse. With the federal estate tax exemption now at $5.43 million per person, scheduled to rise with inflation, federal estate tax is not a concern for many people.

Nevertheless, many states have their own estate tax or inheritance tax, with lower exemption levels. A couple with combined net worth of $3 million or $4 million might wind up owing substantial amounts of state tax at death, so tax deferral through a QTIP trust could be valuable. State rules regarding QTIP trusts vary greatly, however, so the applicable state's rules must be reviewed carefully when determining whether to use a QTIP trust. In addition, couples with combined net worth well in excess of $10 million may have federal estate tax exposure, so a QTIP trust could be worthwhile for them.

ADDRESSING CONCERNS

Just as any well-drafted trust may offer advantages, trusts also require time and expense to create and maintain. Moreover, a QTIP trust poses specific issues in addition to the usual cautions about using a knowledgeable attorney to set it up.

With a QTIP trust, the executor will have to make a required election after the grantor's death. A separate state election also may be required to get QTIP tax treatment. Thus, if you create a QTIP trust, the trustee you name should be prepared to make a well-considered election.

You also should prepare your heirs for QTIP consequences. Your spouse, for example, should know that income will flow life-long, but access to the trust principal will be limited. If your children will be the ultimate beneficiaries, they should understand they'll have to wait for their inheritance, perhaps for many years. You might want to provide a more immediate source of funds to your children through insurance on your life or through a bequest outside of the trust.

In addition, you should discuss ongoing investment of trust assets with your chosen trustee. A QTIP trust must be invested to generate income to the surviving spouse, yet the trustee should attempt to provide a substantial amount to the ultimate beneficiaries as well. ❍

When Workers Are Independent Contractors

As business owners know all too well, hiring an employee costs more than just paying a salary. Employers generally provide benefits to employees, which can be expensive. Moreover, employers must pay a share of Medicare, Social Security, and state unemployment taxes.

None of the above applies when your company hires an independent contractor—a publicist to get your company's name in the news, for example, or a freelance website designer. You pay these people the agreed-upon amount and let them worry about funding their retirement or handling payroll tax. If that's the case, why not just use a group of independent contractors to work for your company and do with few or even no employees?

DEFINING THE DIFFERENCE

The answer is that the IRS is well aware of the advantages of using contractors. Therefore, the IRS has established rules governing how independent contractors are classified, as opposed to employees. Drilling down, the major difference is a matter of control.

Hiring an independent contractor to do a specific task is fine. You tell the contractor what you want done, and you pay for results. However, if you tell the worker how and when and where the work is to be done, you risk having that worker re-cast as an employee by the IRS.

In some cases, common sense will apply. If that freelancer works on your website while doing other paying jobs for other companies, chances are the IRS will go along with independent contractor classification. On the other hand, if you have a person who works from home as a freelancer but works only on your website, does it more or less full time, and takes direction from your IT people, you may have a difficult time treating him or her as a contractor.

If you have been misclassifying employees as contractors, the penalties can be steep. Our office can discuss your workers with you, letting you know how to proceed in order to legitimately treat them as independent contractors.

Why You Need a Will

You may think that your estate plan should include a will in order to handle the disposition of your assets. That's true: If you die "intestate," meaning without a will, some or all of your assets probably will be distributed according to state law.

In reality, though, having a will may have less of an impact on asset disposition than you think. That said, there are still multiple reasons why you should have a will.

BEYOND YOUR WILL

An IRA or any other tax-advantaged retirement account will pass to the beneficiary you've named. Assuming you have filled out the beneficiary designation form—and you haven't named your estate as the beneficiary—at your death that account will go to the individual or individuals or trust you've selected.

The same principle often applies to assets you own jointly.

Example 1: The principal residence of Walt and Vera Young is titled as joint tenants with right of survivorship (JTWROS). When one spouse dies, the other spouse will inherit the house as surviving co-owner. The outcome will be the same if any combination of people, related or not, own assets as JTWROS.

Similar situations apply to many other types of assets. Annuities and life insurance proceeds go directly to beneficiaries. Payable-on-death bank accounts and transfer-on-death investment accounts pass to beneficiaries as well. In addition, any bank or brokerage or mutual fund accounts held as JTWROS will be owned by the surviving owner or owners after one of the joint tenants dies.

Assets owned as JTWROS or with beneficiary designations won't be controlled by your will; in fact, an instruction in your will is likely to be ignored when it comes to JTWROS property or assets with a designated beneficiary.

Example 2: Martha Owens and her brother Ned Parker bought a vacation home together when they were young adults. They titled the property as JTWROS and never changed it. At Martha's death, her will included a bequest of her share of the house to her children, but it didn't matter. As the surviving co-owner, Ned was the one who inherited it.

Moreover, individuals increasingly are creating revocable trusts to hold assets during their lifetime. When the trust creator dies, assets in the trust will go to recipients under the terms of the trust document. Again, instructions in your will won't matter.

The message is that you should be careful in your estate planning.

ABATE PROBATE

Assets with JTWROS titling, with beneficiary designations or in a revocable trust pass directly to the surviving owners and beneficiaries without the time and expense of going through the probate process. Nevertheless, you still should have a will, even if you believe most of your assets won't be covered. People rarely have all of their assets titled in such a way that everything will pass outside of probate.

Some personal assets (including vehicles, collectibles and furnishings) probably will be owned outright at your death, rather than as JTWROS or in trust. Those assets should be listed in your will to make sure they wind up with the people or charities of your choice. Also, not all forms of joint ownership will have the same result as JTWROS. Property titled as tenancy in common, for instance, will pass under the terms of a will. Therefore, you should make sure your estate plan is in sync with the way your property is titled.

NAMING NAMES

In your will, you also can name the executor who will wind up your financial affairs. That might include paying outstanding bills, arranging for tax returns to be filed, making the necessary notifications, and so on. If there is no relative or friend likely to perform those tasks effectively, you might name a professional adviser or a financial institution.

Moreover, if you have minor children when you create your will, you can name guardians who will raise them until they come of age, or alternatively, you can name those you wish to exclude. ❍

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