PARTNERS
WEALTH MANAGEMENT
Fourth Quarter 2014
(630) 778-8088/info@partnerswealth.com

10 Ways To Skirt A Penalty Tax On Plan Payouts

There are a lot of benefits to salting away money in an employer's retirement plan, whether it is a 401(k) or a pension or profit-sharing plan. Your contributions can grow and compound without being eroded by taxes until you're ready to use the money.

But suppose you're in your 50s and contemplating early retirement or you need funds for another reason. Is there a way to gain access to the money in your plan without paying a steep tax price? Normally, if you're under age 59½, you have to pay full income taxes on plan withdrawals, plus a 10% penalty tax. However, several exceptions in the tax law may give you a little leeway.

These 10 possibilities all are written right into Section 72(t) of the tax code:

1. Distributions made to an estate or beneficiary. If you're the plan participant, you won't be around to enjoy this exemption, but it could help your heirs. It doesn't matter if you die before that age 59½ cutoff. The usual 10% tax penalty doesn't apply to any retirement plan payout made after a participant's death.

2. Distributions made because of disability. This applies if you suffer a disabling illness or injury, but only if the disability is total and permanent.

3. Distributions made to cover post-secondary education expenses. These costs include education for you, your spouse, your children, or even your grandchildren. Eligible education expenses include tuition, fees, books, and supplies.

4. Distributions made to cover deductible medical expenses. This exception applies only to unreimbursed medical expenses that exceed the annual tax-deduction threshold—now 10% of adjusted gross income.

5. Distributions made to the IRS. If the taxman comes after you, pay him with money out of your plan before age 59½ without the 10% penalty.

6. Qualified reservist distributions. Generally, this applies to a reservist in the U.S. armed forces who is called to active duty for at least 180 days.

7. Substantially equal periodic payments (SEPPs). If you take a series of SEPPs over your life expectancy, or over the life expectancy of you and a beneficiary or beneficiaries, there's no penalty for withdrawing money before the usual cutoff. Once you begin distributions, they must continue for at least five years or until you reach age 59½, whichever is longer. The IRS offers

(Continued on page 4)

Our Growing Team

In October we welcomed Joe Bonfiglio to our growing team as an Associate. Joe joins PWM with over 15 years of experience in the commercial leasing industry. Most recently, he managed the contracts department for one of the largest independent equipment lessors in the United States. Joe's keen attention to detail and service-oriented background will assist PWM in our continual efforts to provide best-in-class service and support for our clients.

Joe will be working with our advisors to develop planning reports and client recommendations; serving as a project manager of our five step wealth management process. With a dedication to managing efficiency, he is responsible for data integrity and WealthBuilder administration.

A graduate of American Intercontinental University with a BS/BA in Accounting and a minor in Finance, Joe's enthusiasm and experience will add to our clients' quality of service.

John

Taking RMDs Into Your Own Hands

IRS rules on required minimum distributions (RMDs) are aimed at people who can afford to pile up savings in tax-favored retirement accounts without ever again having to take out most of that money. In most cases, however, you eventually have to start taking annual RMDs whether you want to or not. But moves you make at year-end can help reduce the tax damage.

Although savings in employer-sponsored retirement plans such as 401(k)s, as well as in traditional IRAs, can grow without being eroded by current taxes, eventually the money must come out. RMDs have to begin by April 1 of the year after the year in which you turn 70½. (Roth IRAs are exempt from RMDs.) Then you must take an RMD by December 31 every year. Those withdrawals generally are taxed at ordinary income tax rates.

If you're still working full-time at a company you don't own, you may be able to postpone withdrawals from that company's plan until retirement. But this exception doesn't apply to IRAs.

The amount of the RMD is based on life expectancy tables and the value of your accounts on the last day of the previous tax year. Suppose you're 75 and the value of all your IRAs on December 31 of last year was $500,000. If your spouse is the sole beneficiary and he or she isn't at least 10 years younger than you are, the withdrawal factor under the appropriate table is 22.9. With an online calculator, you can determine that your RMD for the current tax year is $21,834.

If you have multiple IRAs, you can take the money from any one of them or from several in whatever proportions you choose. But the penalty for failing to take the full RMD is severe—equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and any lesser amount you did withdraw). For instance, if you failed to make any withdrawal in the example above, the penalty would be $10,917, plus regular income tax.

Finally, taking an RMD can trigger other tax complications, including liability under the 3.8% "net investment income" (NII) tax. Although RMDs don't count as NII, they do increase your overall taxable income—and that, in turn, can make you subject to the NII tax.

One way to begin reducing your exposure to RMDs is to convert funds in traditional IRAs to a Roth IRA. Because Roth IRAs are exempt from RMD rules, you'll have more protection for the future, even though you'll owe tax on the conversion for the year in which it occurs. Another potential strategy is to transfer funds to a life insurance trust that isn't subject to the RMD rules. Just keep in mind that such arrangements generally require professional assistance.

The main point is that you don't have to sit back and accept dire tax consequences. Some astute year-end planning can give you more room to maneuver. ●

Fly Below The Tax Radar At Year-End

The IRS often zooms in on upper-income taxpayers, especially those who buy and sell a lot of investments, and with good reason: These taxpayers have the most to gain or lose because the stakes are high. However, you can reduce the chances for an unhappy tax landing by flying below the "tax radar."

There are three key tax thresholds to think about in 2014. If you stay below those lines, you're more likely to end up with a reduced tax bill. Let's examine each one:

1. Ordinary income tax rates. Under the graduated tax structure, there are seven tax rates that range from a low of 10% to a high of 39.6%. Even if you're in the top tax bracket, you benefit from the lower brackets, but once your income rises into the top bracket—in 2014, when it exceeds $457,600 as a joint filer or $406,750 as a single filer—any additional taxable income will be subject to the 39.6% rate. Deferring some income to 2015 could help, especially if you expect to be in a lower tax bracket next year.

2. The Pease and PEP rules. Under the Pease rule, named for the congressman who introduced this provision, most itemized deductions are reduced by 3% of the amount that your adjusted gross income (AGI) exceeds a dollar threshold, though the total reduction can't be more than 80%. Personal exemptions are reduced by the PEP (personal exemption phaseout) rule by 2% for each $2,500 (or a portion of that amount) that your AGI goes over the same threshold—$305,050 of AGI for joint filers and $254,200 for single filers.

3. The NII tax. There's now a 3.8% surtax that applies to the lesser of your "net investment income" (NII) or modified adjusted gross income (MAGI) that exceeds an annual threshold. Although NII includes most income items, distributions from IRAs and employer retirement plans are

Five Years For Financial History Books

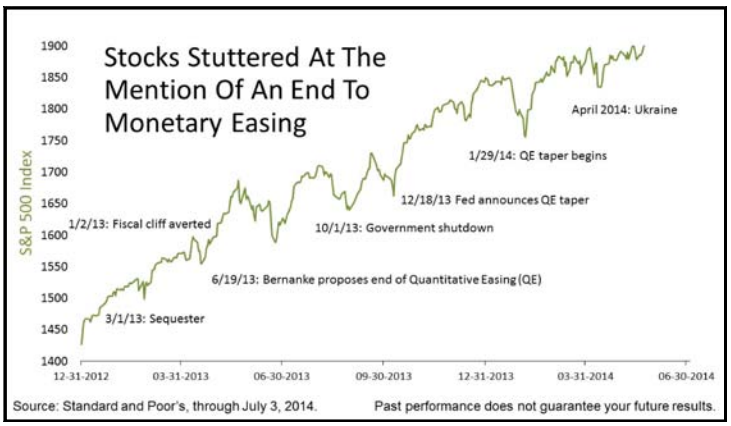
It was the sixth year -- and the sixth quarter -- in a row that stocks climbed higher -- a bull-market run so stunning that it is already assured to be talked about for at least a few generations to come.

The first half of 2014 marked the bull market's fifth anniversary. The most dramatic way to explain it: From the financial-crisis trough in stock prices to the S&P 500's intraday low of 666 on March 9, 2009 -- five years -- stocks are less than 2% shy of tripling!

Naturally, the bull's five-year anniversary spawned headline stories across all media questioning how much longer the good times could last. Only three out of the 23 bull markets since 1900 lasted six years or longer. The Standard & Poor's 500 stock index gained +4.7% in the second quarter of 2014, soaring after a brief sell-off in early April on Ukraine-Russian tensions.

In the year that ended June 30, 2014, the S&P 500 gained +22.0%. At quarter's end, it had been more than three years since the stock market had last experienced a -10% correction. More and more of the talking heads on TV began predicting a drop in stock prices.

As with all strong bull markets, almost no one expected this to happen. Who would have predicted such strong returns on U.S. stocks when the economy was struggling to emerge from the worst financial crisis since The Great Depression of the 1930s?



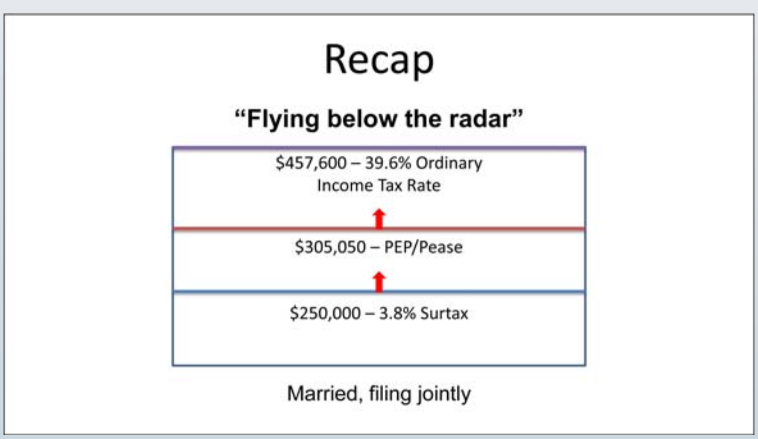
It's anyone's guess, of course, when the next -20% bear market correction will come. What we do know is that key fundamental conditions that have accompanied bear markets of the past are not evident today. These are: restrictive Fed policy, signs of increased likelihood of recession, stock market over-valuation, and irrational investor exuberance.

As for bonds, the big surprise in the second quarter of 2014 was that bond yields, once again, did not start trending higher on news of the impending end of Quantitative Easing, as had been so widely expected. In fact, the forecasts for rising bond yields have been very substantially off the mark for over three years, ever since well-known bond fund manager Bill Gross proclaimed in March of 2011 that yields are likely to go "higher, maybe even much higher" upon the end of QE2.

A big worry all quarter that caused stock some market jitters was the Federal Reserve's talk of "tapering," the winding down of the government stimulus program officially dubbed "quantitative easing (QE)." Under QE, the Fed had purchased $3 trillion of U.S. Treasury and Agency bonds, pushing bond yields down to stimulate the housing market, principally, and the economy more broadly. While stocks not long ago had sputtered at the mere mention of Fed tapering, by the end of the second quarter the market seemed to accept that a world without QE just might be okay. Economic data, meanwhile, continued to improve all through the quarter. ●

exempt. Nevertheless, the money you take from such plans still increases your MAGI for this calculation. The MAGI limit is $250,000 for joint filers and $200,000 for single filers. And while many tax law provisions rise when inflation does, this one doesn't.

Develop a year-end plan that is geared toward staying below these thresholds or at least as close to them as you can manage. In some cases, such as with the Pease and PEP rules or the NII tax, you may be able to avoid the tax complication altogether. Happy flying! ●



Amnesty Offer For Offshore Accounts

In 2009, the IRS created an amnesty program that let taxpayers confess their sins about offshore accounts. The program—known as the Offshore Voluntary Disclosure Program (OVDP)—has been successful. And now the IRS has tweaked the rules and opened the doors to more taxpayers.

Since 1969, taxpayers owning interests in, or signature authority over, foreign accounts have had to disclose them by filing a Report of Foreign Bank and Financial Accounts by June 30 of the subsequent year. For many years, it has been commonplace for investors to dodge taxes (illegally) by hiding assets in foreign banks shrouded in secrecy. Under the Foreign Account Tax Compliance Act (FATCA), taxpayers no longer can avoid disclosure of their foreign accounts by such foreign banks .

Under the prior iterations of the amnesty program, taxpayers were assessed a penalty equal to 20%, 25% or 27.5% of the highest aggregate balance in the unreported foreign bank accounts or the value of their foreign financial assets during the past eight tax years. The OVDP also requires taxpayers to file amended income tax returns and FBARs. Finally, they must pay back taxes, interest, and any applicable IRS penalties thereon.

The latest OVDP changes expand streamlined procedures and modify other aspects. Here's a brief summary:

1. **Streamlined procedures.** These procedures are now available to a wider population of U.S. taxpayers living outside the country and, for the first time, to some U.S. taxpayers who live here. The changes include:

- Eliminating a requirement that the taxpayer have $1,500 or less of unpaid tax per year;
- Eliminating a required risk questionnaire; and
- Requiring the taxpayer to certify that previous failures to comply were due to non-willful conduct.

For eligible U.S. taxpayers residing outside the U.S., all penalties will be waived. For eligible U.S. taxpayers residing in the U.S, the only penalty will be a miscellaneous offshore penalty equal to 5% of the foreign financial assets resulting in the tax compliance issue.

2. **OVDP modifications.** The IRS also made important modifications to the OVDP, including:

- Requiring additional information from taxpayers applying to the program;
- Eliminating the existing reduced penalty percentage for certain non-willful taxpayers in light of the expansion of the streamlined procedures;
- Requiring taxpayers to submit all account statements and pay the offshore penalty at the time of the OVDP application;
- Enabling taxpayers to submit voluminous records electronically rather than on paper; and
- Increasing the offshore penalty percentage from 27.5% to 50% where accounts were held in an institution publicly identified as under investigation by the IRS or the Department of Justice.

The OVDP may be an appropriate recourse for wayward taxpayers. Those who have been evading taxes illegally are urged to come forward. The alternative, should the IRS come knocking on your door, could include up to 300% FBAR penalties and criminal prosecution. ●

Ways To Skirt Penalty Tax

(Continued from page 1)

several options for calculating the amount of each payment.

8. Distributions upon "separation from service." When you leave your company—because you're retiring or switching jobs or because you've been fired—you're entitled to take penalty-free distributions from your plan. But you have to be at least age 55 to qualify—or 50 in the case of some government benefit plans.

9. Distributions made because of a divorce or separation. In this case, to avoid the 10% penalty, the money has to go directly to an alternate beneficiary or payee under a qualified domestic relations order (QDRO).

10. Distributions of dividends from a qualified employee stock ownership plan (ESOP). An ESOP, a type of stock bonus plan that has some features of a traditional pension plan, typically is funded with an employer's stock. The ESOP may allow cash payouts to participants that won't be subject to the normal 10% penalty.

What about distributions from a traditional or Roth IRA? The rules are similar, but with some exceptions. For instance, because these aren't employer-sponsored plans, early retirees who are age 55 can't use the exception when they separate from service. Also, payments made under a QDRO or dividend payouts through an ESOP don't apply.

But there are a few other penalty-free exceptions for IRA holders. For instance, you can use money from your traditional IRA to pay medical insurance premiums for yourself, your spouse, or a dependent while you're unemployed and you can spend IRA funds to meet qualifying first-time homebuyer expenses.

Remember—while these exceptions might help you avoid the 10% penalty tax for early withdrawals, if you take money from a 401(k) or a traditional IRA at any age you'll still owe federal income tax on that distribution. The money you withdraw generally will be taxed at ordinary income rates reaching as high as 39.6%. Be careful to manage your account so you can minimize the overall tax impact with an eye on reducing or eliminating the 10% penalty. ●