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Who's Afraid Of The Big, Bad Medicare Surtaxes?

Now that the U.S. Supreme Court has upheld the constitutionality of the health-care law supported by President Obama—officially the "Patient Protection and Affordable Care Act of 2010"—two new Medicare surtaxes are set to take effect next year, barring any other legislation from Congress.

Although these "add-on" taxes could affect your tax liability for years to come, few people seem to be paying much attention to their imminent arrival—and could miss out on the chance to minimize their impact. Here's a quick review of the basic rules:

- Beginning in 2013, a 0.9% Medicare tax will apply to the earned income of joint filers with income above $250,000 or $200,000 for single filers.

The standard tax law definition of "earned income" is used here. That means the 0.9% surtax applies to wages and other forms of employer-based compensation, such as commissions, but not to "unearned" income, such as capital gains and dividends.

For instance, suppose you have annual wages of $350,000 and file a joint tax return with your spouse. You also receive $50,000 in investment income in 2013. You'll have to pay the 0.9% Medicare surtax on the $100,000 in wages in 2013 that exceed the $250,000 threshold. So the extra tax will come to only $900 (0.9% of $100,000). The $50,000 of investment income isn't subject to this surtax.

- Also beginning in 2013, a 3.8% Medicare surtax applies to the lesser of your net investment income or the amount by which your modified adjusted gross income (MAGI) exceeds $250,000 if you're filing jointly and $200,000 for single filers.

The health-care law defines "net investment income" to include interest, dividends, royalties, rents, gains from dispositions of property, and income from passive activities. But it doesn't cover tax-exempt interest or distributions from traditional and Roth IRAs and qualified retirement plans such as 401(k) plans, 403(b) plans, and pension plans. Yet while IRA and qualified retirement distributions are excluded from the definition of net investment income, receiving such distributions likely will increase your MAGI for the year, possibly triggering or increasing the amount of the surtax.

Also keep in mind that because of the way it's structured, the 3.8% Medicare surtax could apply to someone who has relatively little in the way of investment income. Consider the following examples.

Example 1: A single taxpayer has $210,000 of MAGI in 2013 consisting of $195,000 of wages and only $15,000 of net investment income. Nevertheless, he still must pay the 3.8% Medicare surtax because his MAGI exceeds the $200,000 threshold for single filers by $10,000. The tax comes to $380 (3.8% of $10,000).

Example 2: A married couple has

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Colleen Knopinski And Rob Fauver Named 5-Star Wealth Managers

We're pleased to announce that both Colleen and Rob have been selected as 2012 Five Star Wealth Managers for the Denver area. As Rob says "That's 100% of our senior advisors." If you get a chance, pick up the November issue of 5280 Magazine to read more about the award. Less than 4% of the wealth managers in the Denver area were chosen.

To receive the award, a wealth manager must satisfy 10 objective eligibility and evaluation criteria. In addition to such factors as appropriate credentials and favorable regulatory and complaint histories, the criterion we are most proud of is client retention. Our client retention rate is over 97% since we started our practice six years ago.

As we noted when Colleen received the award in 2010, it is great to be publicly recognized, but what is most important to us is the service we provide to our clients, whether it is developing financial strategies to meet future goals or managing investment assets for the long term.

We're committed providing expert financial advice to our clients. However, it is also important that they are an integral part of the planning process. We have found that our client-centered approach to financial planning and investment management leads to the most successful outcomes.

If you are interested in customized financial planning and investment management, give us a call or visit our website, www.kffainc.com.

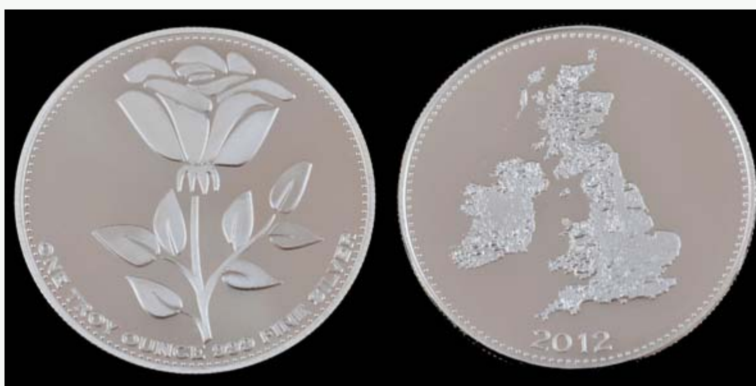
Colleen & Rob

Two Investment Principles In Tandem

Diversification and asset allocation are twin building blocks of a solid investment foundation. Though the concepts are closely related, understanding each rather than just mixing them together can help you make the most of both. Consider these basics:

Diversification. This is the method of spreading out investment dollars among different categories, or "baskets," in order to reduce your overall risk. For instance, even if you're 99% sure that a particular stock is about to take off, you don't want to invest your life's savings in only one stock. There's still a chance it will tank, leaving you in a financial hole you may never get out of. Similarly, you want to avoid putting all of your investment dollars in a single basket—stocks, bonds, or copper, say—no matter how fundamentally sound the category may seem.

Diversification may work because different kinds of investments tend to rise and fall at different times. If you hold a variety of investments, some may do well when others stumble. Additional benefits can come from diversifying within categories—by spreading your stock investments over many industries and also holding shares in foreign companies. By the same token, you'll probably want to own different kinds of bonds with various maturities. Yet while broad diversification may help your investments weather a worst-case scenario, it can't protect you from losses, especially in a declining market.



Asset Allocation. Closely related to diversification, asset allocation goes a few steps further. Here, you seek to divide your holdings among major investment categories based on a set percentage for each category. Because each group has a unique combination of historical risks and returns, it's expected that each also will perform differently in the future.

This is diversification with a little more science. Because it's likely that if one category loses value, another may be on the upswing while a third holds steady, devoting an appropriate percentage of your portfolio to each can keep your portfolio in balance.

Yet there's also a lot of art involved in asset allocation. Choosing the best percentages for your circumstances requires looking at several variables, such as your objectives, age, health status, amount of assets, and tolerance for risk. And because your goals are likely to shift, allocations need to be reevaluated and adjusted periodically. Typically, your choices will become more conservative as you near or reach retirement.

Asset allocation provides a rigorous method for achieving diversification in your investment portfolio. Having the two ideas working smoothly together can help you move closer to your financial goals. ●

Five Financial Steps For Widows

Barbara Weinglass is still in shock. Three months ago, her husband, Marty, unexpectedly passed away at age 67. Marty had been retired for less than two years and the couple was finally getting to do some of things they'd long dreamed about, including traveling and spoiling the grandchildren. To complicate matters, Marty had always handled all of the couple's financial affairs. Now Barbara, 65 years old, is left to pick up the pieces on her own. Her two children are doing what they can, but they live far away and have their own lives to lead.

It's a common scenario, so at least Barbara has some company. And she can begin to move into the next phase of her life by taking these five sensible steps.

1. Meet with a financial advisor. The initial meeting should be a "get to know you" session. If possible, encourage adult children to attend. You may need to discuss some immediate problems—is there enough to keep paying the mortgage?—as well as the emotional support you may need. At this point, it's crucial to make sure bills are paid on time—a necessity often neglected in the aftermath of a sudden death.

2. Avoid any knee-jerk reactions. While a spouse may not be able to postpone all decisions during a time of grief, acting too quickly on important matters could be worse than doing nothing at all. For instance, deciding to put a home up for sale, give extra-generous gifts to other family members, or buy or sell large investments all might be moves you'll regret later. Take a deep breath and assess your options.

3. Review the financial landscape. Do an accounting of assets, liabilities, sources of income, and living expenses. Collect all of your financial statements and begin to develop a long-range plan that sets

Where Retirees Live, And Why

Do you know where you will live after you retire? You might decide to stay in your current home, move to a smaller place, or relocate to be closer to your children. You could opt for a warmer climate—or for someplace colder. You may settle in another state, or even another country. There are so many possibilities it can seem confusing to sort through them all.

Your first consideration, of course, is what will be best for you. What you can afford, whether you're in good health, what your spouse wants—all of those have to be factored into your decision. If your mortgage is paid off, staying put could be the most economical option. Of course, downsizing could put spending money in your pocket or pad your retirement account. Maybe you need to provide financial help to your children, grandchildren, or even your parents. Other considerations include state income taxes and proximity to family members.

Whatever your situation, retirement is a momentous occasion, and the more you think about how you want it to play out—and the earlier you start planning—the more likely you'll have a satisfying life after work.

Not many years ago, retirement didn't last very long, and most people just lived out their days quietly. But times have changed. According to the U.S. Centers for Disease Control and Prevention, the average 65-year-old in 2009 could expect to live another 19 years—and that's more than one and a half years longer than in 2000. Active retirements have become the rule, not the exception, and many people continue to work at least part time.

Spurred by these trends, retirement communities have sprung up all across the country, even in cold-weather states. You can find retirement communities in the mountains, on the prairie, on lakes—just about anywhere, from sea to shining sea. They may be built for a few dozen residents, or many thousand. At The Villages near Ocala, Florida, more than 51,000 retirees live and scoot around in golf carts.

A retirement community can consist of just one kind of housing—condominiums or single-family homes, for instance—or you may be able to choose from among many different options. And these days, such places frequently call themselves active adult communities, dropping the word retirement to emphasize the physically active nature of today's senior lifestyles.

And life at a retirement community—by any name—can be very active indeed, with recreational choices that may include golf courses, tennis courts, bocce courts, Olympic-size swimming pools, spas, and boats and canoes. There could be walking trails, bike trails, community newspapers, stage shows (with seniors doing the acting), seminars on health and other topics, billiard tables, ceramics classes, photography clubs, computer clubs, and state clubs. You may get a place to store your boat or your recreational vehicle, and just about every retirement community has a clubhouse, complete with card rooms, craft rooms, bingo halls, dance halls, libraries, TV rooms, and, of course, an office staff ready to assist you. And because most communities have a minimum age requirement of 55 or so, you'll beliving with people mostly from your own generation—and you won't be disturbed by a lot of noisy children running around. (You can visit your grandchildren for that!)

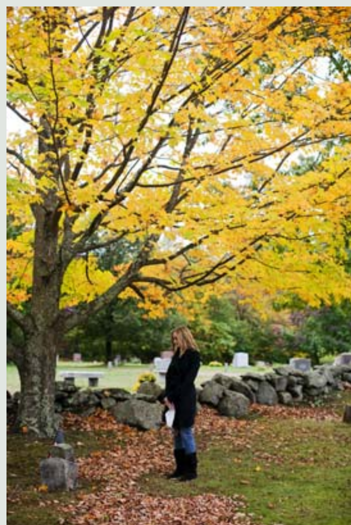
State clubs are amazingly popular in retirement communities. It seems that many people prefer mixing socially with others from their home states rather than with people from other parts of the country. Another surprising thing about state clubs is that those with the most members often don't represent the most populous Northern states. In Florida, the retirement-haven state, Michigan seems to lead all other states in retirement club membership.

All retirement communities have homeowner associations—and homeowner association fees that can range in cost from low to moderate to very expensive, depending on the types and numbers of amenities and services offered. Before choosing a place, be sure to consider not just the initial cost of buying a house or a condo but also all of the fees and other recurring expenses. You might rent a place first to try it out.

Yet while you may be reluctant to pay a hefty monthly homeowner association fee, it's likely to cover a host of convenient services ranging from basic cable TV and garbage collection to lawn maintenance, pest control, exterior painting and other maintenance, and roof repair. And if you've ever cut grass on a hot, muggy, Florida summer day, you might agree that lawn maintenance alone makes retirement community living worth the price! ●

some concrete financial goals. Of course, the financial advisor can be instrumental in this process.

4. Coordinate with professionals. Bring your attorney, accountant, and other professional advisors into the loop. The financial advisor can serve as the quarterback, but the best results are usually achieved through teamwork. Make sure financial and other plans are synchronized so everyone is pulling in the same direction.



5. Follow up with additional meetings. You should expect to meet several times with the financial advisor. Future sessions may focus on retirement needs, the allocation of investment assets, and changing needs for cash.

Finally, be aware that while well-intentioned friends may offer advice, you should rely on the professionals to see you through the ordeal. ●

Should You Consolidate Your IRAs?

Everyone's financial situation is different, but people at various stages of life often share similar concerns. Here's a question from a client we encountered under such circumstances:

"I am in my 60s and recently retired from my full-time job. Over the years, I've opened several traditional IRAs and a Roth IRA. Also, I have a 'rollover IRA' with funds from a 401(k) at a previous job. Should I consolidate all of these IRAs into one for tax purposes, or should I just leave things the way they are?"

While there is no real tax benefit one way or the other, there is a trap to watch out for if you do consolidate. Combining the assets of your traditional IRAs into a single IRA could provide a few advantages, however.

For starters, it may be more flexible and cost-efficient to have just one IRA, as well as relieving you of considerable clutter if you're still receiving paper statements from all of your IRA custodians. Also, if one IRA has provided better investment returns than the other or offers other advantages, it might make sense to shift more funds to the IRA with those advantages. (Of course, past performance is no guarantee of future results.) And you may find it easier to coordinate your plans for retirement, and focus on your main objectives, with a consolidated IRA.

Moreover, consolidating accounts might help you avoid a complication that can arise when you start taking "required minimum distributions" (RMDs) from your traditional IRAs. The law mandates that you begin taking RMDs no later than Apri1 1 of the year following the year in which you turn age 70½. These withdrawals from your account, the amount of which is based on life expectancy tables, must continue annually for the rest of your life. If you have several IRAs, you'll have to choose the source of your annual RMD. It can come from one or multiple IRAs. But no matter how you arrange the distribution, the IRS treats it for tax purposes as coming from all of your IRAs on a "pro-rata" basis.

Let's say you have four IRAs with a combined value of $500,000, and this year you withdraw $20,000 from one of them. The applicable percentage is 4% ($20,000 divided by $500,000), so it's calculated as if you had withdrawn 4% of the balance in each IRA. Consolidating your IRAs would eliminate any confusion.

Finally, be aware that you can't commingle the funds in traditional and Roth IRAs. This is the trap we alluded to earlier. Because Roths have an edge over traditional IRAs—qualified Roth distributions are tax-free and you don't have to take lifetime mandatory distributions—you wouldn't want to put them together anyway. Should you consolidate all of your Roth IRAs? Many of the same considerations that apply to combining traditional IRAs also are applicable to Roths. ●

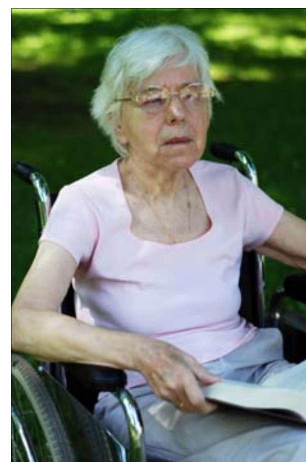
Big Bad Medicare Surtaxes

(Continued from page 1)

$325,000 of MAGI in 2013 consisting of $275,000 of wages and $50,000 of net investment income from capital gains and dividends. In this case, the 3.8% Medicare surtax applies to the $50,000 of net investment income, since that's less than the $75,000 by which their income exceeds the MAGI threshold of $250,000. Thus, the couple pays a surtax of $1,900 (3.8% of $50,000).

The 3.8% surtax can be particularly burdensome for an individual who has both high wages and significant investment income.

Example 3: A single taxpayer has $550,000 of MAGI in 2013 consisting of $350,000 in wages and $200,000 in investment income. The lower amount is the net investment amount, resulting in a surtax of $7,600 (3.8% of $200,000).



Note that the 3.8% surtax also applies to trusts and estates based on a threshold using the dollar amount for the top tax bracket for those entities. For 2013, the threshold is scheduled to be only $11,600. For example, if the net investment income of a trust is $111,600, the trust must pay the 3.8% surtax on the $100,000 excess, for an extra tax liability of $3,800 (3.8% of $100,000). And trusts and estates may already pay a hefty income tax on investment earnings, due to the compressed tax brackets.

What can you do to limit the damage? We may see a renaissance of financial planning strategies based on existing tax-minimizing strategies such as life insurance, tax-deferred annuities, and municipal bonds. But these techniques require a thorough analysis of your finances. They may be appropriate in some situations, but they're not for everyone.

Do you have a little more fear now about the new Medicare surtaxes? The reach of the law may be greater than you think. Schedule a meeting before year-end to develop a plan. ●

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