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Same-Sex Marriage Law Alters Key Tax Rules

On June 26, 2013, the U.S. Supreme Court handed down its landmark decision in *Windsor v. U.S.,* declaring that section 3 of the Defense of Marriage Act (DOMA) is unconstitutional. That section, which legally defined "marriage" for federal purposes as a union between a man and a woman, is now gone. Same-sex couples now have new financial and tax rules that they could benefit from significantly.

In the majority opinion, Justice Anthony Kennedy pointed out that the Supreme Court ruling affects more than a thousand federal statutes. We can't cover all of the implications of the new law, but here are five key areas where the change can have a significant impact:

1. Income taxes. Now, same-sex couples will be eligible to file joint tax returns and claim the same benefits as other joint filers. Although filing jointly may save tax dollars for some couples, others in high tax brackets likely will pay more tax, thanks to the so-called marriage penalty, which is a quirk of the tax code that can penalize joint filers. The new law also could affect state incomes taxes, although it's not yet clear how that will play out. Additional guidance from the IRS and individual states is expected.

2. Estate taxes. The same principles affecting federal and state income taxes also extend to estate and gift taxes, and the demise of DOMA opens new estate planning opportunities for same-sex couples. For instance, either spouse now may benefit from the federal marital deduction, which lets most spouses inherit an unlimited amount from each other with no estate tax liability. That provision leaves intact the generous estate tax exemption ($5.25 million in 2013) that can be used to transfer assets to other heirs. The "portability" provision of the federal law also now applies to same-sex couples, enabling the estate of a surviving spouse to use any remaining unused portion of the other spouse's exemption. Other provisions, such as a limited exemption for non-citizen spouses ($143,000 in 2013), also apply. State estate laws also will be affected, though not uniformly.

3. Employee benefits. The *Windsor* ruling will result in numerous complexities involving employee benefits, such as health insurance, for same-sex couples. For instance, a non-working spouse of an employee now may be eligible for insurance coverage or extended benefits under COBRA. While same-sex couples will be treated the same way as traditional married couples in terms of federal statutes, differences still may exist under state laws.

4. Retirement plans and IRAs. The ruling will create many changes relating to employer-sponsored

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It's Never Too Early To Get Stared

It is somewhat unusual for Colleen and Rob to agree to interviews with the press. We believe that most financial planning issues are too complex to lend themselves to short sound bites.

However, when a reporter from *Boulder Magazine* contacted Colleen and asked what young people just starting out should be doing to get their finances on a sound footing, we decided to respond. You can find the interview in the Winter/Spring issue.

Colleen offered these pearls of wisdom for young people (but most are applicable regardless of age):

- Spend less than you make. This may seem obvious, but it is the main driver of all the rest of the issues.
- Don't try to live the lifestyle of your parents (or neighbors). They're at a different stage in life and likely have very different income and expenses than you.
- Avoid consumer debt. It will derail the best-laid plans.
- Saving. Saving earlier is better than saving later (due to the magic of compound interest).
- Don't be afraid to get started. If you wait until you learn everything about finances, you'll never start at all.

If you're just starting out, or know someone who is, we'd be glad to help.

Colleen & Rob

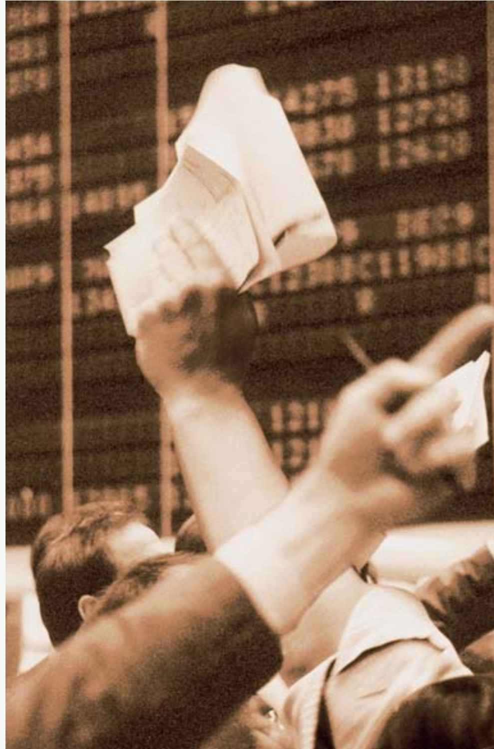
Don't Chase After The Market News

Did you read the newspaper today or check the news online? Invariably, the stock market will be heading up or down, with the movement triggered by anything from company earnings announcements to a change in economic indicators or even a political event such as the recent U.S. government shutdown. And, more often than not, financial pundits may respond by urging investors to buy or sell something.

But you can drive yourself crazy, if you haven't already, by making stock market decisions based on what just has occurred or what you think will happen next. In fact, chasing after the news is a common investment mistake. There are at least four good reasons to avoid this temptation like the plague:

1. The stock market usually moves ahead of the news.

There was no "all clear" signal that the severe stock market downturn of 2008-2009 had abated. But the market hit bottom on March 9, 2009, and embarked on a long, profitable climb even as other financial news remained dire. Typically, stocks move about six months ahead of economic developments, reflecting the collective knowledge, trends, and inclinations of investors. If you try to beat the market by reacting to the latest news, you'll probably be much too late to benefit.



2. You don't have all the necessary information.

Markets tend to move based on the decisions of mutual fund managers or professional analysts who monitor and interpret financial data for a living. They have a lot more information than you do, and they get it much sooner than you—and millions of others like you—who will hear it on television or find it on the Internet. That puts you at a decided disadvantage.

3. You can't believe all the hype.

In this electronic age, media reports are often prone to hyperbole, as the pressure to generate interest from a fickle public continues to increase. That could lead producers to overreact to news tidbits or sensationalize minor events. One small incident usually doesn't portend a complete economic collapse, so take reports of impending doom with a grain of salt. It isn't likely that the sky is falling!

4. Market timing is difficult, if not impossible.

To be successful at market timing, you have to be extremely skilled or lucky, or both. Over the long term, buying or selling based on what you hear or read almost never beats a consistent, methodical long-term approach. It's better to make investment decisions based on financial particulars rather than on instincts and hunches.

Building a diversified portfolio combining stocks, bonds, and other investments can help you progress toward your financial goals—and it can help you stop worrying about what you hear on the news. ●

What To Do When You're Suddenly Widowed

If your spouse should suddenly pass away, you could find yourself overwhelmed—not just emotionally, but also by a host of financial decisions. Your financial situation is probably about the last thing you'd want to be thinking about, and many things could wait, at least for a little while. Indeed, after such a dramatic event in life, it's probably best not to rush into anything. However, time isn't always on your side, and some decisions may be required immediately—especially if you have not planned properly. And sooner or later, you'll need to address certain financial issues. Here are some practical suggestions that may be helpful:

Deadlines. After losing a loved one, it can be easy to neglect deadlines. You'll generally need to file an estate tax return for your spouse within nine months of death, for example, and you still must file a federal income tax return for the year of death by April 15. Don't let letters from places like the IRS and financial institutions fall to the bottom of a pile. Missing deadlines can cost you dearly.

Retirement Accounts. Review benefit options for 401(k)s, pensions, and other retirement accounts. You'll likely need to decide between taking a lump sum or periodic distributions, rolling the funds into an IRA, or leaving the plan assets where they are. Each option has pros and cons.

Cash-Flow. Estimate your expenses for the next five to 10 years. Will you be paying for one or more children to attend college? When do you expect to retire, and what sort of lifestyle do you envision? This requires a thorough analysis of your finances and also might entail adjusting your investment strategy.

Insurance. Don't ignore insurance concerns. Typically, a surviving spouse inherits most, if not all, of the other spouse's assets and will be the primary

Do You Know The Basics Of 401(k) Plans?

How much do you know about your 401(k) plan? Often, even though employer-sponsored retirement plans may make up the bulk of employees' retirement savings, participants understand less than they need to about how this savings vehicle works. Here's a primer covering 10 crucial facts:

1. You benefit from tax-favored treatment. For starters, contributions to your account are made on a pre-tax basis. For example, if you earn $100,000 a year and elect to defer $10,000 to the plan, you're taxed on only $90,000. What's more, the money you've contributed will grow, without taxes, inside the plan until you withdraw it.

2. There's an annual limit on how much you can contribute. The normal ceiling, adjusted each year for inflation, remains $17,500 for 2014. Plus, you can sock away an extra $5,500 a year (also adjusted for inflation) if you're age 50 or older. That adds up to as much as $23,000 for 2014. However, other tax law limits could affect your overall contribution.

3. Your employer may choose to match part of your contribution. Obviously, you're reducing your take-home pay when you defer part of your salary, but companies often help offset that deduction. You might get a matching contribution with your employer kicking in, say, 50 cents for each dollar you put in for up to 6% of your pay. If you earn $100,000 and contribute $10,000 annually, that could add an extra $3,000 to your account each year (half of the first 6% of salary that you contribute).

4. Participation may be automatic. Increasingly, employers use an automatic enrollment feature that adds you to its 401(k) plan unless you opt not to participate. That encourages you to save for retirement and helps companies avoid penalties that may be applied if too few lower-paid employees sign up. The initial default-deferred amount might be 3% of your salary, and some companies now add an "escalator clause" that automatically increases later deferrals.

5. You have a wide array of investment choices. How should you invest the funds in your 401(k)? You'll normally be able to choose from among a dozen or more standard options that may include several "target date" mutual funds, which adjust their allocations as you get nearer to retirement. If you don't make your own selections, a default option may be triggered.

6. You're penalized if you take out money early. You'll generally have to pay a 10% penalty on withdrawals you make prior to age 59½, unless a special tax law exception applies. That's in addition to the regular income tax that applies to all withdrawals.

7. You're penalized if you take out money too late. You must begin taking "required minimum distributions" (RMDs) from your 401(k), based on life expectancy tables, in the year after the year in which you turn age 70½. The penalty for not doing that is stiff—50% of the amount you should have taken. But you may be able to postpone RMDs if you're still working full-time and you own less than 5% of your employer.

8. You may be able to "Rothify." Some company plans now offer the opportunity to use a Roth 401(k). Just as with a Roth IRA, you make contributions on an after-tax basis, but withdrawals during retirement normally won't be taxed. At companies that offer this option, you can divide your contribution between regular and Roth accounts as you choose.

9. You have several options when you leave the company. When you leave your job, you can take a lump-sum payout from your account—which will trigger income tax and a penalty if you're under 59½—leave the money where it is, or roll it over to another company's plan or to an IRA. With a rollover, you won't owe any tax as long as the transfer is completed within 60 days of leaving. To avoid 10% withholding, make a trustee-to-trustee rollover.

10. You'll owe fees that may vary widely from plan to plan. If your 401(k) charges high administrative or investment management fees, those could siphon off a significant portion of your investment earnings. The lower the "expense ratio" of the mutual funds you select, the less you'll pay in fees. Index funds that passively track market benchmarks can be especially inexpensive.

Make sure you have all of the information you need to make smart choices about your account. ●

or sole beneficiary of life insurance death benefits. This is a time to consider what you can do to protect your children's future. Meanwhile, in light of your changed situation, review all of your insurance policies. Be sure your health, disability, long-term care, umbrella and other polices still meet your needs.

Retirement. After losing a spouse, your retirement goals may change. You may want to consider retiring earlier or later. How much in Social Security benefits will you receive based on earnings history? Social Security is complicated, and you'll need to gather all of the facts to make good decisions.

Investments. Pull together all of the relevant records for your spouse's investments and any assets you held jointly. Once you know where you stand, be sure you understand all of the investments you own and are comfortable with the risk they entail. Set a long-term course for the future, but realize that adjustments may be needed now.

We're available to provide any assistance you need. ●

Reminders On Your Beneficiary Choices

Quick: Who are the beneficiaries of your retirement plan, life insurance policies, and investment accounts? Many people don't remember whom they named as a beneficiary or are uncertain. But it's important to know, especially if your circumstances have changed since you completed the original paperwork.

You probably carefully considered whom to designate as beneficiaries of your financial accounts and life policies when you initially established them. But you may have shoved the documents into a drawer and forgotten all about them.

Suppose your family situation has changed. Maybe you have remarried and you have children from an earlier union. Do you still want your former spouse to inherit anything? Should your new spouse be named as a beneficiary? Aging, death, divorce, and other life-events, including the birth of a child or a job-switch, make it wise to periodically review beneficiary choices and ensure your assets go to the people you want to benefit most.

One reason it's so important to get beneficiary designations right is that when you name a beneficiary on your retirement accounts and life insurance policies, those assets will be transferred without going through probate or facing other complications. Moreover, the designations for financial accounts and insurance policies trump whatever it may say in your will. So, even if you change your will to cut out an estranged relative, that person still could benefit unless the beneficiary designations also are changed. And if there are discrepancies, the matter could end up in court—probably the last thing you would want.

Furthermore, getting the beneficiaries right may affect estate taxes. For instance, if you name your spouse as the beneficiary of your 401(k) and IRAs, those accounts won't be included in your taxable estate (although the assets eventually could be subject to estate tax when your spouse dies).

Another money-saving idea that might surface from reviewing your beneficiaries: If you have more than one child and intend to divide your IRA proceeds evenly, you may be able to reduce taxes owed by splitting your account. For example, if you have three children, you can split an IRA into three individual IRAs, naming one child as beneficiary of each new IRA. As a result, your children can take distributions from their inherited IRAs based on their longer individual life expectancies, not yours.

Finally, if you name a charity as an account beneficiary, the asset will pass to the charity tax-free. In addition, your estate will be entitled to a charitable deduction, which may reduce or eliminate tax liability.

For these and other reasons, it's crucial to get beneficiary designations right, and to revise them when necessary as your circumstances change. Going to the trouble of regularly reviewing your designations could be time well spent. ●

Same-Sex Marriage Law

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retirement plans, IRAs, and Social Security. For instance, a 401(k) generally is required to pay a married participant's benefits in the form of a "qualified joint and survivor annuity," unless the participant elects otherwise. In addition, if a participant is married, funds in the account can be left to a non-spouse heir only with the consent of the spouse. Rules for "required minimum distributions" from retirement plans tend to be more favorable for married couples, and same-sex couples now should be able to take advantage of beneficiary rollover options when an IRA owner dies. Social Security benefits also will be affected.

5. Divorce. Like traditional married couples, same-sex couples who split up will face wide-ranging legal and financial consequences, and they may want to take precautions that could minimize the fallout. For example, spouses might decide to protect their retirement plan benefits with a qualified domestic relations order (QDRO). When a QDRO is used, a spouse has the right to share in benefits available to the other spouse, but the spouse who receives the benefits will be taxed on them. Otherwise, the spouse who earned the benefits would be liable for the entire amount of the tax.

Remember that the *Windsor* ruling applies only on the federal level—and that makes it essential to investigate possible implications under varying state laws. Under current rules, a marriage that is recognized in one state may not remain legally enforceable if a couple moves to a state in which same-sex marriages are not recognized—a confusing situation. Same-sex couples would do well to research the impact of DOMA and seek professional guidance because the rules are likely to be clarified in the months ahead and the financial consequences can be significant. ●

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