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How Will Your Retirement Distributions Be Taxed?

Your retirement income likely will come from a variety of sources. For example, there are Social Security as well as brokerage accounts, employer-sponsored retirement plans, traditional and Roth IRAs, and tax-deferred annuities, among other possibilities. With so many choices at your disposal, you'll need to decide when to tap each of those sources, and taxes will be one key factor in making those decisions.

The conventional wisdom is to withdraw funds from taxable accounts early in retirement in order to preserve tax-sheltered assets for as long as possible, letting the funds continue to grow without being eroded by current taxes. But that's not a hard and fast rule. You'll need to come up with a balanced approach which factors in all of your personal circumstances, including your tax situation. Here are tax considerations for several potential income sources:

Brokerage accounts. Because these investment accounts aren't tax-deferred, how they're taxed depends on particular assets. Stock dividends and bond interest will be taxed when you

receive them. If you sell stocks to raise cash, the sale will be taxed as a short- or long-term capital gain depending on how long you've held the shares. If you've owned them for more than a year, they'll be considered long term and taxed at a preferential rate of 15% for most investors and 20% for those in the highest (39.6%) tax bracket for ordinary income. Short-term gains are taxed as ordinary income. In addition, you might be liable for a 3.8% Medicare surtax that applies to the lesser of your "net investment income" (capital gains, dividends, and other investment-related income) and the amount by which your modified adjusted gross income (MAGI) exceeds \$200,000 for single filers and \$250,000 for joint filers. Capital gains from brokerage accounts could trigger or increase liability for the 3.8% surtax.

Employer-sponsored retirement plans. Most distributions from "qualified" retirement plans, such as 401(k)s and 403(b)s, are taxed at ordinary income rates. That rule applies to the part of your withdrawal representing pre-tax contributions and earnings (often the entire amount).

Although such distributions aren't considered net investment income for calculating the 3.8% surtax, they do increase your MAGI and could make you liable for that extra tax.

Traditional IRAs. Like your withdrawals from employer-sponsored retirement plans, distributions from a

Sharpening The Saw

In April, Colleen – along with 300 other advisors – was fortunate to attend the third annual Shareholders Service Group (SSG) conference (Rob got to stick around the office). As our custodian, SSG supports us in our business as an investment advisor. If you're not one of our clients, you've probably never heard of SSG since SSG only works with registered investment advisors and not the public. We chose SSG for our clients' accounts because its approach is different from competitors (such as Charles Schwab and TD Ameritrade).

SSG has a progressive and pure approach to RIA custody in the same way Knopinski & Fauver has a progressive, fee-only approach to investment management.

Shareholders Service Group is smaller than Schwab or TD Ameritrade but their conference attracted A-list speakers and vendors. Colleen has been attending professional conferences for more than twenty years but the SSG conferences have a different feel – the advisors have a passion for client service and independent thinking.

Conference topics included "Risk, Uncertainty, and Probability" and "Fiduciary and Privacy Conflicts with Impaired Clients". (We learn this stuff so you don't have to!)

We have a keen desire to keep up with the best information in the business and a conference is a great way to get away from the day-to-day tasks and take a look at the big picture.

Colleen & Rob



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Are You Being Socially Responsible?

How can you invest to make money with a clear conscience about your investment choices? The concept of “socially responsible investing” (SRI) – also known as socially conscious, mission, ethical, or green investing – has taken hold in this country. According to a recent report by the Forum for Sustainable and Responsible Investment, a nonprofit group known as US SIF, it represents more than one out of every six dollars of managed assets in the U.S., accounting for as much as \$6.57 trillion.

But SRI requires more than a mere promise to recycle newspapers and bottles or to be kinder to strangers. SRI investors use three basic principles to guide their choices:

1. ESG. First and foremost, SRI advocates look to invest in companies that demonstrate values the advocates hold near and dear to their hearts. This might include beliefs about the environment, consumer issues, religious protection, and human rights, to name just a few. These areas of concern often are summarized as “environmental, social, and governance,” or ESG.

2. Shareholder advocacy. This involves attempting to discourage corporate decisions that could affect the core values of ESG adversely. Proponents hope to convince companies to improve their practices



and policies and act as good corporate citizens while still delivering long-term growth. These goals may be accomplished through various means, including starting a dialogue, filing of resolutions for shareholder votes, educating the public, and attracting media attention to hot-button issues.

3. Community investing. This has become the fastest growing aspect of SRI with an estimated \$61.4 billion in assets under management in 2014. With community investing, capital is

directed to communities, here and abroad, that are seeking to provide services such as housing, education, health care, and child care.

Socially responsible investors come from all walks of life. They may range from people investing in mutual funds that specialize in choosing companies that have what are considered to be appropriate ethical and environmental practices to hospitals that won't invest their endowments in tobacco companies to public pensions emphasizing a commitment to reduce greenhouse gas emissions and to factor climate change into strategic planning.

In particular, mutual funds taking these approaches have experienced rapid growth during the past few years. According to US SIF, the number of ESG mutual funds in the U.S. grew from 333 to 456 from 2012 to 2014, with assets under management increasing from \$641 billion to \$1.93 trillion.

Before you jump on the SRI bandwagon, make sure this is the right path for you. We can help you investigate all the possibilities. ●

You Know You're Getting Old When You Get RMD Notice

Growing older is something everyone must face, even if it's only one day at a time. But what is old, and how do you know when you get there? One way is when you get a notice that you have reached the year of your 70th birthday and must begin taking required minimum distributions from your 401(k) or other retirement plan or a traditional IRA account. This is a wakeup call, and a shock, for some people.

Here is a typical notice from an IRA custodian. Sent this year, it reads, “Federal tax law requires that you receive taxable payments from your

traditional IRA every year once you reach age 70½. These payments are called required minimum distributions (RMDs). If the RMD is not taken, the IRS could assess a 50% excess accumulation penalty tax on the amount of the payment that should have been distributed but was not. According to our records, you have a traditional IRA with us and will attain age 70½ in 2015.”

Owners of Roth IRAs do not receive these notices because there's no tax deduction for Roth contributions—that money already has been taxed—and withdrawals therefore are tax-free.

A woman who recently received a RMD notice called her IRA custodian and exclaimed that she was shocked into reality about her age when she received the notice. “Even though I was of course aware of my age at one level, the notice shocked me into reality that indeed I am getting old.” Although still working, she said she plans to retire after she takes her first withdrawal by April of 2016. By law, RMDs may be taken as late as April of the year following the year a person turns 70½.

Now, back to the question of how old is old. According to statistics compiled by the Organization for

Modern Portfolio Theory: Does It Still Work?

Modern portfolio theory (MPT), introduced more than half a century ago by Nobel-laureate Harry Markowitz, is all about diversification. It's based on the notion that over the long term, a properly balanced group of investments will perform better than any single holding would do on its own. MPT looks at the historical returns and volatility of stocks, bonds, and other assets to create a portfolio mix that can maximize expected returns based on how much risk an investor is willing to take. The riskier a portfolio is, the higher its potential return may be.

For decades, MPT has been a bedrock principle for creating investment portfolios. Asset managers have used it for the mutual funds they run, and financial advisors have put it to work in choosing investments for their clients. But in recent years, particularly since the economic crisis and market meltdown that began in 2008, MPT has come under fire. Many people contend that it no longer works. They point to the fact that in 2008 and 2009, almost every kind of investment lost value, and that even perfectly diversified portfolios let investors down.

Yet the idea that MPT has outlived its usefulness—and that it failed during the recent financial crisis—ignores the reality that an analysis of market history

confirms, says independent economist Fritz Meyer. Modern portfolio theory remains “the best mousetrap yet devised” for managing investments, Meyer says, and he analyzes 40 years of market performance data, from 1970 to 2010, to prove his point.

Meyer looked at what would have happened to a portfolio, created in 1970, that was divided evenly among seven kinds of assets: cash; large-cap U.S. stocks; small-cap U.S. stocks; non U.S. stocks; U.S. bonds; real estate; and commodities. Maintaining an equal exposure to those asset classes would have yielded an average annual return of more than 10% during the subsequent 40 years, compared with just under 10% a year for the Standard & Poor's 500. Yet the diversified portfolio would have had half the volatility of the S&P, according to Meyer.

So why are so many people convinced that MPT doesn't work in today's markets? Meyer suggests that in many cases, it may be because investors succumbed to the natural human tendency to stop the pain during a bear market and sold their holdings at what turned out to be the worst possible time. “Our generation has learned a very important investment truth the hard way,” says Meyer. And many of those who got out of the market in 2008 or 2009 remain on the sidelines, he says, waiting until they

regain their confidence. In the meantime, of course, they have missed out on several years of strong market gains.

Another problem, Meyer says, is the tendency to confuse modern portfolio theory with “buy and hold”—the idea that simply staying the course with investment choices will produce the best results over the long haul. MPT may indeed resemble a buy-and-hold strategy, Meyer notes, because an investor who subscribes to MPT will remain fully invested. But that doesn't mean that a portfolio will sit there unmanaged no matter what occurs in financial markets.

Even an investment portfolio run according to the principles of MPT will need periodic changes, Meyer says. Rebalancing holdings to keep them in line with their original portfolio percentages is especially important, and ought to be done either quarterly or annually, according to Meyer. Without such adjustments, assets that were performing well would soon make up an outsized proportion of overall holdings, and the portfolio's returns could suffer when stocks, for example, then lose ground during an investment cycle. Beyond rebalancing, other kinds of shifts may also be made to MPT portfolios based on an analysis of economic or industry factors.

Meyer is skeptical of the alternatives to MPT that many advisors and investors have turned to recently. Absolute return strategies, tactical asset allocation, and attempting to time the market simply don't work, he says, and though fleeing stocks and other comparatively risky assets during market swings may seem like a good idea, it can put investors in a hole that it will be difficult to dig themselves out of. Meyer notes that some who sold out during the worst of the recent bear market may have had to postpone retirement or permanently reduce their standard of living.

With a disciplined MPT approach, on the other hand, you're taking advantage of a powerful tool that has long proven its ability to maximize returns and minimize risks, Meyer concludes. ●

Economic Cooperation and Development (OECD), whose membership is composed of 36 nations, the average man in the U.S. as of 2011 could expect to live to age 76. Women in the U.S. the same year can expect to live to an average age of 81.

As far as longevity is concerned, the U.S. doesn't fare very well when compared to other nations. This country ranked No. 26 among the 36 OECD member nations, with an overall life expectancy for both genders of 78.7.



That's the bad news. Now, here's the good news: people are living longer as time passes.

Here's proof: according to statistics compiled by Infoplease, overall life expectancy in the U.S. in 2014 had moved up to 79.56 years.

Time is precious. Enjoy the rest of your life on earth. Proper retirement planning will help ensure your life's enjoyment after you reach “old age.”

We are more than happy to assist with your planning. ●

10 Easy Steps To Take If Opening A New Business

Starting a business involves planning, making key financial decisions, and completing a series of legal changes. As prepared by the Small Business Administration (SBA), these 10 easy steps can help you plan, prepare and manage your business:

Step 1: Write a Business Plan. Use the tools and resources that are offered by the SBA to create a business plan. A written guide prepared with help from the SBA will help you map out how you will start and run your business successfully.

Step 2: Get Business Assistance and Training. Take advantage of the SBA's free training and counseling services, from preparing a business plan and securing financing, to expanding or relocating a business.

Step 3: Choose a Business Location. Get advice on how to select a customer-friendly location and comply with zoning laws.

Step 4: Finance Your Business. Find government-backed loans, venture capital, and research grants to help you get started.

Step 5: Determine the Legal Structure of Your Business. Decide which form of ownership is best for you:

sole proprietorship, partnership, limited liability company (LLC), corporation, S corporation, nonprofit, or cooperative. It's wise to consult an attorney and an accountant before making a final decision on the legal structure of the business you plan to open.

Step 6: Register a Business Name ("Doing Business As"). Register your business name with your state government.

Step 7: Get a Tax Identification Number. Learn which tax identification number you'll need to obtain from the IRS and your state revenue agency.

Step 8: Register for State and Local Taxes. Register with your state to obtain a tax identification number, workers' compensation, and unemployment and disability insurance.

Step 9: Obtain Business Licenses and Permits. Get a list of federal, state, and local licenses and permits required for your business.

Step 10: Understand Employer Responsibilities. Learn the legal steps you need to take to hire employees.

The SBA also points out that a

number of programs are available to assist startups, micro businesses, and underserved or disadvantaged groups.

The following resources provide information to help specialized audiences start their own businesses:

- Environmentally friendly "green" business
- Home-based business
- Online business



- Self-employment
- Minority-owned business
- Veteran-owned business
- Woman-owned business

Finally, you can save money when starting or expanding a business by using government surplus. From commercial real estate and cars, to furniture, computers, and office equipment, find what you need for your business in one place.

Go to SBA.gov for help in following these 10 steps and for gaining access to the resources that are available for small businesses. You also should engage the assistance of an attorney and an accountant up front. ●

Retirement Will Be Taxed

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traditional IRA are taxed at ordinary income rates on a pro-rata basis. In other words, the portion representing deductible contributions and earnings is considered taxable income, but there's no tax on nondeductible contributions you may have made to the account.

Roth IRAs. The tax treatment for Roth IRAs is significantly different. For a Roth account you've had for at least five years, most distributions are completely exempt from federal income tax. That applies to withdrawals you make after age 59½ as well as those made because of death or disability or to cover first-time homebuyer expenses (up to a lifetime limit of \$10,000). And you can convert

a traditional IRA to Roth status, although the tax-deferred amount you convert will be taxed at ordinary income rates.

Tax-deferred annuities. As the name implies, these income-producing insurance products are exempt from tax until you begin taking distributions. Then, if you take a lump sum payout from a nonqualified annuity, you'll owe ordinary income tax on the difference between the amount you paid into the annuity and its value when you receive the payment. But you also could choose "annuitized" payments that may continue for as long as you live. In that case, only the portion of the payment representing earnings in the annuity account is taxable. Taxation of variable annuities, whose payouts are based on investment earnings, is more complex,

so be sure to get advice from your tax professional about such distributions. Finally, payments aren't considered investment income for the purpose of computing the 3.8% Medicare surtax but the portion that counts as income will increase your MAGI.

There are a few additional tax considerations you'll need to take into account. Most distributions from tax-sheltered accounts before age 59½ will be hit with a 10% tax penalty, on top of the regular income tax, unless a special exception applies. Also, you are generally required to begin taking "required minimum distributions" (RMDs) from employer-sponsored plans, traditional IRAs, and tax-deferred annuities after age 70½, but there are no lifetime RMDs for a Roth IRA. ●