



# FINANCIAL TID-BITTS

*Information to chew on...*



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Hi Everyone,

Summer is in full swing, but going way too fast. Hopefully you are getting time to spend enjoying the outdoors with friends and family between the rainstorms.

Progress is being made on the office addition and remodel, but I will still be in the temporary office for a while. It will be business as usual throughout the summer project, so please don't hesitate to call if I can help with any questions or concerns. Thank you!

Steve

## August 2015

Financial Mistakes People Make at Different Ages

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What is the Roth IRA five-year rule?

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## Financial Mistakes People Make at Different Ages



There's a saying that with age comes wisdom, but this may not always be true in the financial world. As people move through different life stages, there are new opportunities--and potential pitfalls--around every corner.

### In your 20s

*Living beyond your means.* It's tempting to want all the latest and greatest in gadgets, entertainment, and travel, but if you can't pay for most of your wants up front, then you need to rein in your lifestyle. If you take on too much debt--or don't work diligently to start paying off the debt you have--it can hold you back financially for a long, long time.

*Not saving for retirement.* You've got plenty of time, so what's the rush? Well why not harness that time to work for you. Start saving a portion of your annual pay now and your 67-year-old self will thank you.

*Not being financially literate.* Many students graduate from high school or college without knowing the basics of money management. Learn as much as you can about saving, budgeting, and investing now so you can benefit from it for the rest of your life.

### In your 30s

*Being house poor.* Whether you're buying your first home or trading up, don't buy a house that you can't afford, even if the *bank* says you can. Build in some wiggle room for a possible dip in household income that could result from switching jobs, going back to school, or leaving the workforce to raise a family.

*Not protecting yourself with life and disability insurance.* Life is unpredictable. What would happen if one day you were unable to work and earn a paycheck? Let go of the "it-won't-happen-to-me" attitude. Though the cost and availability of life insurance depend on several factors including your health, the younger you are when you buy insurance, the lower your premiums will likely be.

*Not saving for retirement.* Okay, maybe your

20s passed you by in a bit of a blur and retirement wasn't even on your radar screen. But now that you're in your 30s, it's critical to start saving for retirement. Wait much longer, and it can be hard to catch up. Start now, and you still have 30 years or more to save.

### In your 40s

*Trying to keep up with the Joneses.* Appearances can be deceptive. The nice homes, cars, vacations, and "stuff" that others have might make you wonder whether you should be buying these things, too. But behind the scenes, your neighbors could be taking on a lot of debt. Take pride in your savings account instead.

*Funding college over retirement.* In your 40s, saving for your children's college costs over your own retirement is a mistake. If you have limited funds, set aside a portion for college but earmark the majority for retirement. Then sit down with your teenager and have a frank discussion about academic options that won't break the bank--for either of you.

*Not having a will or an advance medical directive.* No one likes to think about death or catastrophic injury, but these documents can help your loved ones immensely if something unexpected should happen to you.

### In your 50s and 60s

*Co-signing loans for adult children.* Co-signing means you're on the hook--completely--if your child can't pay, a situation you don't want to find yourself in as you're getting ready to retire.

*Raiding your home equity or retirement funds.* It goes without saying that doing so will prolong your debt and/or reduce your nest egg.

*Not quantifying your retirement income.* As you approach retirement, you should know how much you can expect from Social Security (at age 62, at your full retirement age, and at age 70), pension income, and your personal retirement savings.

*Not understanding health-care costs in retirement.* Before you turn age 65, review what Medicare does and doesn't cover, and how gap insurance policies fit into the picture.

## Five Steps to Tame Financial Stress



*Seventy-two percent of adults report feeling stressed about money at least some of the time, and 22% say that the amount of stress they experience is extreme.*

*Source: American Psychological Association*

Do you sometimes lie awake at night thinking about bills that need to be paid? Does it feel as though you're drowning in debt? If this describes you, you might take solace in the fact that you're not alone. A recent report released by the American Psychological Association (APA) showed that 72% of adults feel stressed about money at least some of the time, and 22% said the amount of stress they experienced was extreme.<sup>1</sup>

The bad news is that stress can be responsible for multiple health problems, including fatigue, headaches, and depression. And, over time, stress can contribute to more significant health issues, including high blood pressure and heart disease.<sup>2</sup> The good news is that there are some simple steps you can take to reduce or eliminate some of the financial stress in your life.

### 1. Stop and assess

The first step in reducing financial stress is to look at your situation objectively, creating a snapshot of your current financial condition. Sit down and list all of your financial obligations. Start with the items that are causing you the most stress. For debts, include the principal due, the applicable interest rate, and the minimum payment amount. If you're not already doing so, review your bank account and credit-card statements to track where your money is going. The goal here is not to solve the problem; it's to determine and document the scope of the problem. You might find that this step alone significantly helps alleviate your stress level (think of it as facing your fears).

### 2. Talk to your spouse

If you're married, talk to your spouse. It's important to communicate with your spouse for several reasons. First, you and your spouse need to be on the same financial page; any steps you take to improve your situation are going to be most effective if pursued jointly. Second, not being on the same page as your spouse is only going to lead to additional stress. In fact, the APA report showed that 31% of spouses and partners say that money is a major source of conflict or tension in their relationship.<sup>3</sup> Additionally, your spouse or partner can be a valuable source of emotional support, and this emotional support alone can lower stress levels.<sup>4</sup> If you're not married, family or friends might fill this role.

### 3. Take control

First, go back and take a look at where your money is going. Are there changes you can make that will free up funds you can save or apply elsewhere? Even small changes can make a difference. And exerting control over your situation to any degree can help reduce your overall stress level. Start building a cash reserve, or emergency fund, by saving a little bit each paycheck. Think of the emergency fund as a safety net; just knowing it's there will help reduce your ongoing level of stress. Work up to a full spending plan (yes, that's another way of saying a budget) where you prioritize your expenses, set spending goals, and then stick to them going forward.

### 4. Think longer term

Look for ways to reduce debt long term. You might pay more toward balances that have the highest interest rates. Or you might consider refinancing or consolidation options as well. Beyond that, though, you really want to start thinking about your long-term financial goals, identifying and prioritizing your goals, calculating how much you might need to fund those goals, and implementing a plan that accounts for those goals. Having a plan in place can help you with your stress levels, both now and in the future.

### 5. Get help

Always remember that you don't need to handle this alone. If the emotional support of a spouse, friends, or family isn't enough, or the level of stress that you're feeling is just too much, know that there is help available. Consider talking to your primary-care physician, a mental health professional, or an employee assistance resource, for example.

A financial professional can also be a valuable resource in helping you work through some of the steps discussed here, and can help direct you to other sources of assistance, like credit or debt counseling services, depending on your needs.

The most important thing to keep in mind is that you have the ability to control the amount of financial stress in your life.

<sup>1,3,4</sup> American Psychological Association, "Stress in America™: Paying with Our Health," [www.stressinamerica.org](http://www.stressinamerica.org), February 4, 2015

<sup>2</sup> Mayo Clinic Staff, "Stress Symptoms: Effects on Your Body and Behavior," [www.mayoclinic.org](http://www.mayoclinic.org), July 19, 2013



### 529 plan fast facts

Total assets in 529 plans reached a record \$247.9 billion at the end of 2014 (up from \$227.1 billion in 2013). The total number of accounts was 12.1 million (up from 11.6 million in 2013), and the average account balance was \$20,474 (up from \$19,584 in 2013). Source: College Savings Plans Network, 529 Report: An Exclusive Year-End Review of 529 Plan Activity, March 2015

## Three College Savings Strategies with Tax Advantages

To limit borrowing at college time, it's smart to start saving as soon as possible. But where should you put your money? In the college savings game, you should generally opt for tax-advantaged strategies whenever possible because any money you save on taxes is more money available for your savings fund.

### 529 plans

A 529 plan is a savings vehicle designed specifically for college that offers federal and state tax benefits if certain conditions are met. Anyone can contribute to a 529 plan, and lifetime contribution limits, which vary by state, are high--typically \$300,000 and up.

Contributions to a 529 plan accumulate tax deferred at the federal level, and earnings are tax free if they're used to pay the beneficiary's qualified education expenses. (In his State of the Union speech in January, President Obama proposed eliminating this tax-free benefit but subsequently dropped the proposal after a public backlash.) Many states also offer their own 529 plan tax benefits, such as an income tax deduction for contributions and tax-free earnings. However, if a withdrawal is used for a non-educational expense, the earnings portion is subject to federal income tax and a 10% federal penalty (and possibly state tax).

529 plans offer a unique savings feature: accelerated gifting. Specifically, a lump-sum gift of up to five times the annual gift tax exclusion (\$14,000 in 2015) is allowed in a single year per beneficiary, which means that individuals can make a lump-sum gift of up to \$70,000 and married couples can gift up to \$140,000. No gift tax will be owed if the gift is treated as having been made in equal installments over a five-year period and no other gifts are made to that beneficiary during the five years. This can be a favorable way for grandparents to contribute to their grandchildren's education.

Also, starting in 2015, account owners can change the investment option on their existing 529 account funds twice per year (prior to 2015, the rule was once per year).

**Note:** Investors should consider the investment objectives, risks, fees, and expenses associated with 529 plans before investing. More information about specific 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits. Finally, there is the risk that investments may lose money or not perform well enough to cover college costs as anticipated.

### Coverdell education savings accounts

A Coverdell education savings account (ESA) lets you contribute up to \$2,000 per year for a child's college expenses if the child (beneficiary) is under age 18 and your modified adjusted gross income in 2015 is less than \$220,000 if married filing jointly and less than \$110,000 if a single filer.

The federal tax treatment of a Coverdell account is exactly the same as a 529 plan; contributions accumulate tax deferred and earnings are tax free when used to pay the beneficiary's qualified education expenses. And if a withdrawal is used for a non-educational expense, the earnings portion of the withdrawal is subject to income tax and a 10% penalty.

The \$2,000 annual limit makes Coverdell ESAs less suitable as a way to accumulate significant sums for college, though a Coverdell account might be useful as a supplement to another college savings strategy.

### Roth IRAs

Though traditionally used for retirement savings, Roth IRAs are an increasingly favored way for parents to save for college. Contributions can be withdrawn at any time and are always tax free (because contributions to a Roth IRA are made with after-tax dollars). For parents age 59½ and older, a withdrawal of earnings is also tax free if the account has been open for at least five years. For parents younger than 59½, a withdrawal of earnings--typically subject to income tax and a 10% premature distribution penalty tax--is spared the 10% penalty if the withdrawal is used to pay a child's college expenses.

Roth IRAs offer some flexibility over 529 plans and Coverdell ESAs. First, Roth savers won't be penalized for using the money for something other than college. Second, federal and college financial aid formulas do not consider the value of Roth IRAs, or any retirement accounts, when determining financial need. On the flip side, using Roth funds for college means you'll have less available for retirement. To be eligible to contribute up to the annual limit to a Roth IRA, your modified adjusted gross income in 2015 must be less than \$183,000 if married filing jointly and less than \$116,000 if a single filer (a reduced contribution amount is allowed at incomes slightly above these levels).

And here's another way to use a Roth IRA: If a student is working and has earned income, he or she can open a Roth IRA. Contributions will be available for college costs if needed, yet the funds won't be counted against the student for financial aid purposes.

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## What is the Roth IRA five-year rule?

Actually, there are *two* five-year rules you need to know about. The first five-year rule determines when you can begin receiving tax-free qualified distributions from your Roth IRA. Withdrawals from your Roth IRA--including both your contributions and any investment earnings--are completely tax and penalty free if you satisfy a five-year holding period *and* one of the following also applies:

- You've reached age 59½ by the time of the withdrawal
- The withdrawal is made due to a qualifying disability
- The withdrawal is made for first-time homebuyer expenses (\$10,000 lifetime limit)
- The withdrawal is made by your beneficiary or estate after your death

This five-year holding period begins on January 1 of the tax year for which you made your first contribution (regular or rollover) to any Roth IRA you own. For example, if you make your first Roth IRA contribution in March 2015 and designate it as a 2014 contribution, your

five-year holding period begins on January 1, 2014 (and ends on December 31, 2018). You have only one five-year holding period for determining whether distributions from any Roth IRA you own are tax-free qualified distributions. (Roth IRAs you *inherit* are subject to different rules.)

The second five-year rule is a little more complicated. When you convert a traditional IRA to a Roth IRA, the amount you convert (except for any after-tax contributions you've made) is subject to income tax at the time of conversion. However, your conversion isn't subject to the 10% early distribution penalty, even if you haven't yet reached age 59½.

But what the IRS giveth it can also taketh away. If you withdraw any portion of your taxable conversion within five years, you'll have to pay the 10% early distribution penalty on those funds that you previously avoided--unless you've reached age 59½ or qualify for another exemption from the penalty tax. This five-year holding period starts on January 1 of the year you convert your traditional IRA to a Roth IRA. And if you have more than one conversion, each will have its own separate five-year holding period for this purpose.