



FINANCIAL TID-BITTS

Information to chew on...



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Hi Everyone,

Summer is here and I hope everyone is getting to spend time with family and friends doing all the things we dreamed of this past winter.

Please read through the articles and pass them along to anyone you know that they may apply to. If you have questions or I can help in any way, please don't hesitate to call. Thank you.

Steve

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Don't Let Rising Interest Rates Catch You by Surprise



You've probably heard the news that the Federal Reserve has been raising its benchmark federal funds rate. The Fed doesn't directly control consumer interest rates, but changes to the federal funds rate (which is the

rate banks use to lend funds to each other overnight within the Federal Reserve system) often affect consumer borrowing costs.

Forms of consumer credit that charge variable interest rates are especially vulnerable, including adjustable rate mortgages (ARMs), most credit cards, and certain private student loans. Variable interest rates are often tied to a benchmark (an index) such as the U.S. prime rate or the London Interbank Offered Rate (LIBOR), which typically goes up when the federal funds rate increases.

Although nothing is certain, the Fed expects to raise the federal funds rate by small increments over the next several years. However, you still have time to act before any interest rate hikes significantly affect your finances.

Adjustable rate mortgages (ARMs)

If you have an ARM, your interest rate and monthly payment may adjust at certain intervals. For example, if you have a 5/1 ARM, your initial interest rate is fixed for five years, but then can change every year if the underlying index goes up or down. Your loan documents will spell out which index your ARM tracks, the date your interest rate and payment may adjust, and by how much. ARM rates and payments have caps that limit the amount by which interest rates and payments can change over time. Refinancing into a fixed rate mortgage could be an option if you're concerned about steadily climbing interest rates, but this may not be cost-effective if you plan to sell your home before the interest rate adjusts.

Credit cards

It's always a good idea to keep credit card debt in check, but it's especially important when interest rates are trending upward. Many credit

cards have variable annual percentage rates (APRs) that are tied to an index (typically the prime rate). When the prime rate goes up, the card's APR will also increase.

Check your credit card statement to see what APR you're currently paying. If you're carrying a balance, how much is your monthly finance charge?

Your credit card issuer must give you written notice at least 45 days in advance of any rate change, so you have a little time to reduce or pay off your balance. If it's not possible to pay off your credit card debt quickly, you may want to look for alternatives. One option is to transfer your balance to a card that offers a 0% promotional rate for a set period of time (such as 18 months). But watch out for transaction fees, and find out what APR applies after the promotional rate term expires, in case a balance remains.

Variable rate student loans

Interest rates on federal student loans are always fixed (and so is the monthly payment). But if you have a variable rate student loan from a private lender, the size of your monthly payment may increase as the federal funds rate rises, potentially putting a dent in your budget. Variable student loan interest rates are generally pegged to the prime rate or the LIBOR. Because repayment occurs over a number of years, multiple rate hikes for variable rate loans could significantly affect the amount you'll need to repay. Review your loan documents to find out how the interest rate is calculated, how often your payment might adjust, and whether the interest rate is capped.

Because interest rates are generally lower for variable rate loans, your monthly payment may be manageable, and you may be able to handle fluctuations. However, if your repayment term is long and you want to lock in your payment, you may consider refinancing into a fixed rate loan. Make sure to carefully compare the costs and benefits of each option before refinancing.



All investing involves risk, including the possible loss of principal, and there can be no assurance that any investment strategy will be successful. Generally, the more potential for growth offered by an investment, the more risk it carries.

The performance of an unmanaged index is not indicative of the performance of any specific security. Individuals cannot invest directly in such an index.

Because zero-coupon bonds do not pay interest until maturity, their prices tend to be more volatile than bonds that pay interest regularly. Interest income is subject to ordinary income tax each year, even though the investor does not receive any income payments.

The return and principal value of stocks, bonds, and mutual funds may fluctuate with market conditions. Shares, when sold, and bonds redeemed prior to maturity may be worth more or less than their original cost.

Test Your Investing IQ

How much do you know about market basics? Put your investing IQ to the test with this quiz on stocks, bonds, and mutual funds.

Questions

1. What does it mean to buy stock in a company?

- a. The investor loans money to the company
- b. The investor becomes a part owner of the company
- c. The investor is liable for the company's debts

2. Which of the following statements about stock indexes is correct?

- a. A stock index is an indicator of stock price movements
- b. There are many different types of stock indexes
- c. They can be used as benchmarks to compare the performance of an individual investment to a group of its peers
- d. All of the above

3. What is a bond?

- a. An equity security
- b. A nonnegotiable note
- c. A debt investment in which an investor loans money to an entity

4. What kind of bond pays no periodic interest?

- a. Zero-coupon
- b. Floating-rate
- c. Tax-exempt

5. What is a mutual fund?

- a. A portfolio of securities assembled by an investment company
- b. An investment technique of buying a fixed dollar amount of a particular investment regularly
- c. A legal document that provides details about an investment

6. What is the difference between mutual fund share classes?

- a. The investment advisers responsible for managing each class
- b. The investments each class makes
- c. The fees and expenses charged by each fund class

Answers

1. b. The investor becomes a part owner of the company. Stocks are often referred to as equities because they represent an ownership position. As part owners, shareholders assume both the potential financial risks and benefits of this position, but without the responsibility of running the company.

2. d. All of the above. A stock index measures and reports value changes in representative stock groupings. A broad-based stock index represents a diverse cross-section of stocks and reflects movements in the market as a whole. The Dow Jones Industrial Average, NASDAQ Composite Index, and S&P 500 are three of the most widely used U.S. stock indexes. There are also more narrowly focused indexes that track stocks in a particular industry or market segment.

3. c. A debt investment in which an investor loans money to an entity. Unlike shareholders, bondholders do not have ownership rights in a company. Instead, investors who buy bonds are lending their money to the issuer (such as a municipality or a corporation) and thus become the issuer's creditors.

4. a. Zero-coupon. Unlike many types of bonds, zero-coupon bonds pay no periodic interest. They are purchased at a discount, meaning the purchase price is lower than the face value. When the bond matures, the difference between the purchase price and that face value is the investment's return.

5. a. A portfolio of securities assembled by an investment company. A mutual fund is a pooled investment that may combine dozens to hundreds of stocks, bonds, and other securities into one portfolio shared by many investors.

6. c. The fees and expenses charged by each fund class. A mutual fund may offer various share classes to investors, most commonly A, B, and C. This gives an investor the opportunity to select a share class best suited to his or her investment goals.

Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

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Future of the Federal Estate Tax



The federal estate tax has been enacted or repealed a number of times over the years, while undergoing many changes. Tax reform, including possible repeal of the estate tax, is back in the spotlight once again.

¹ 2015 Field Guide to Estate Planning, Business Planning & Employee Benefits

While no one can predict the future, the possibility of tax reform is once again in the spotlight. If it occurs, it may very well include repeal of the federal estate tax and related changes to the federal gift tax, the federal generation-skipping transfer (GST) tax, and the federal income tax basis rules.

History of the federal estate tax

In general, an estate tax is a tax on property a person owns at death. In one form or another, a federal estate tax has been enacted or repealed a number of times since 1797.¹

| Estate tax enacted | Estate tax repealed |
|--------------------|---------------------|
| 1797 | 1802 |
| 1862 | 1872 |
| 1894 | 1902 |
| 1916 | 2010* |
| 2011* | |

**For 2010, the estate tax was repealed, but later retroactive legislation provided that an estate could elect to be subject to estate tax in return for a stepped-up (or stepped-down) income tax basis for most property. The estate tax was extended in 2011, with some changes.*

The estate tax has undergone many changes over the years, including the addition of a federal gift tax and a federal GST tax during modern times. A gift tax is a tax on gifts a person makes while alive. A GST tax is a tax on transfers to persons who are two or more generations younger than the transferor. In recent years, property owned at death has generally received an income tax basis stepped up (or down) to fair market value at death.

During the 2000s, the estate, gift, and GST tax rates were substantially reduced, and the gift and estate tax lifetime exclusion and the GST tax exemption were substantially increased. The estate tax and the GST tax, but not the gift tax, were scheduled for repeal in 2010 (although certain sunset provisions would bring them back unless Congress acted), but legislation extended the estate tax and the GST tax in 2011. (For 2010, the estate tax ended up being optional and the GST tax rate was 0%.) The gift and estate tax lifetime exclusion and the GST tax exemption were increased to \$5,000,000 and indexed for inflation in later years. For 2013, the top estate, gift, and GST tax rate was increased to 40%, and the extension and modifications were made "permanent."

| 2017 Estate Planning Key Numbers | |
|--|-------------|
| Annual gift tax exclusion | \$14,000 |
| Gift tax and estate tax basic exclusion amount | \$5,490,000 |
| Noncitizen spouse annual gift tax exclusion | \$149,000 |
| Generation-skipping transfer (GST) tax exemption | \$5,490,000 |
| Top gift, estate, and GST tax rate | 40% |

Federal estate tax

Repeal of the estate tax seems possible once again. If repeal occurs, it could be immediate or gradual as during the 2000s. Would it be subject to a sunset provision, so that the estate tax would return at a later time? All of this may depend on congressional rules on the legislative process, other legislative priorities, and the effect the legislation would have on the budget and the national debt.

Federal gift tax

If the estate tax is repealed, the gift tax may also be repealed. However, it is possible that the gift tax would be retained as a backstop to the income tax (as in 2010). To some extent, the gift tax reduces the ability of individuals to transfer property back and forth in order to reduce or avoid income taxes.

Federal GST tax

If the estate tax is repealed, the GST tax would probably be repealed (as in 2010). If the gift tax is not repealed, it is possible that the lifetime GST tax provisions would be retained, but the GST tax provisions at death repealed.

Federal income tax basis

If the estate tax is repealed, it is possible that the general income tax basis step-up (or step-down) to fair market value at death would be changed to a carryover basis (i.e., the decedent's basis before death carries over to the person who inherits the property). In 2010, a modified carryover basis (a limited amount of property could receive a stepped-up basis) applied unless the estate elected to be subject to estate tax. It is also possible that a Canadian-style capital gain tax at death could be adopted in return for a stepped-up basis for the property.

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Can I roll my traditional 401(k) account balance over to a Roth IRA?

Yes, you can make a direct or 60-day rollover from a 401(k) plan [or other qualified plan, 403(b) plan, or governmental 457(b) plan] to a Roth IRA, as long as you meet certain requirements.*

First, you must be entitled to a distribution from your plan. While you can always access your account when you terminate employment, in some cases you may be able to withdraw your own or your employer's contributions while you're still working (for example, at age 59½).

[Note: Your plan may also permit the "in plan" conversion of all or part of your account balance to a Roth account, regardless of whether you're eligible for a distribution from the plan. Check with your plan administrator.]

Second, your distribution must be an "eligible rollover distribution." Distributions that cannot be rolled over include hardship withdrawals, certain periodic payments, and required minimum distributions (RMDs).

Third, you must include the taxable portion of the distribution in your gross income in the year you make the rollover ("conversion"). But that's

the price you have to pay to potentially receive tax-free qualified distributions from your Roth IRA in the future.

Fourth, if your distribution includes both after-tax and pre-tax dollars, you can generally direct that only the after-tax dollars be rolled over to the Roth IRA (resulting in a tax-free conversion), while making a tax-deferred rollover of the pre-tax dollars to a traditional IRA.

When evaluating whether to initiate a rollover from an employer plan to an IRA, be sure to: (1) ask about possible surrender charges that your employer plan or IRA may impose, (2) compare investment fees and expenses charged by your IRA with those charged by your employer plan (if any), and (3) understand any accumulated rights or guarantees that you may be giving up by transferring funds out of your employer plan. Also consider all of your distribution options, including leaving the money in your employer's plan, transferring the funds to a new employer's plan, or taking a cash withdrawal.

* If you make a 60-day rollover, your plan will withhold 20% of the taxable portion of your distribution for federal income tax purposes.