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Happ New Year to All!

2013 was a pretty good year for the markets and we enter 2014 with cautious optimism. We survived the short-lived Artic blast, and we can begin to think about warmer Spring days to come.

It's a great time look at your goals and your plans to reach them. Please let me know if I can be of help to you or anyone you care about. Thank you!

Steve

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Information to chew on...

Should You Pay Off Your Mortgage During Retirement?

For many homeowners, paying off a mortgage is a financial milestone. This is especially true when you are retired. Not having the burden of a monthly mortgage payment during retirement can free up money to help you live the retirement lifestyle you've always wanted.

To pay off, or not to pay off: that is the question

Some retirees are lucky enough to have paid off their mortgage before they reach retirement. For others, however, that monthly obligation continues. If you are retired, you may be wondering whether you should pay off your mortgage. Unfortunately, there's no one answer that's right for everyone. Instead, the answer will depend upon a variety of factors and how they relate to your individual situation.

Return on retirement investments vs. mortgage interest rate

One way many retirees pay off their mortgage is by using funds from their retirement investments. To determine whether this is a good option for you, you'll need to consider the current and anticipated rate of return on your retirement investments versus your current mortgage interest rate. In other words, do you expect to earn a higher after-tax rate of return on your current retirement investments than the after-tax interest rate you currently pay on your mortgage (i.e., the interest rate that you're paying, factoring in any mortgage interest deduction you're entitled to)?

For example, assume you pay an after-tax mortgage interest rate of 4%. You are considering withdrawing funds from your retirement investments to pay off your mortgage balance. In general, you would need to earn an after-tax return of greater than 4% on your retirement investments to make keeping your money invested for retirement the smarter choice.

On the other hand, if your retirement funds are primarily held in investments that typically offer a lower rate of return than the interest rate you pay on your mortgage, you may be better off withdrawing your retirement funds to pay off your mortgage.

Additional considerations

As you weigh your options, you'll also want to consider these additional points:

- **Effect on retirement nest egg--** If you rely on your retirement savings for most of your income during retirement, you should generally avoid paying off your mortgage if it will end up depleting a significant portion of your retirement savings. Ideally, you should pay off your mortgage only if you have a small mortgage balance in comparison to your overall retirement nest egg.
- **Tax consequences--** Keep in mind that if you are going to withdraw funds from a retirement account to pay off your mortgage, there are some potential tax consequences you should be aware of. First, if you withdraw pretax funds from a retirement account, the amount you withdraw is generally taxable. As a result, you'll want to be sure to account for the taxes you'll have to pay on the amount you withdraw from pretax funds. Depending on your tax bracket, that could be a significant amount. In addition, if you take a large enough distribution from your retirement account, you could end up pushing yourself into a higher income tax bracket. Finally, unless you are 59½ or older, you may pay a penalty for early withdrawal.
- **Comfort with mortgage debt--** For many retirees, a monthly mortgage obligation can be a heavy burden. If no longer having a mortgage would give you greater peace of mind, give the emotional benefits of paying off your mortgage some extra consideration.

Should You Roll Your 401(k) to an IRA?

**Certain investments may not be right for everyone, and some may have adverse tax consequences, so be sure to consult your financial professional.*

If you're entitled to a distribution from your 401(k) plan (for example, because you've left your job, or you've reached age 59½), and it's rollover-eligible, you may be faced with a choice. Should you take the distribution and roll the funds over to an IRA, or should you leave your money where it is?

Across the universe

In contrast to a 401(k) plan, where your investment options are limited to those selected by your employer (typically mutual funds or employer stock), the universe of IRA investments is virtually unlimited. For example, in addition to the usual IRA mainstays (stocks, bonds, mutual funds, and CDs), an IRA can invest in real estate, options, limited partnership interests, or anything else the law (and your IRA trustee/custodian) allows.*

You can move your money among the various investments offered by your IRA trustee, and divide up your balance among as many of those investments as you want. You can also freely move your IRA dollars among different IRA trustees/custodians--there's no limit on how many direct, trustee-to-trustee IRA transfers you can do in a year. This gives you the flexibility to change trustees as often as you like if you're dissatisfied with investment performance or customer service. It also allows you to have IRA accounts with more than one institution for added diversification.

However, while IRAs typically provide more investment choices than a 401(k) plan, there may be certain investment opportunities in your employer's plan that you cannot replicate with an IRA. And also be sure to compare any fees and expenses.

Take it easy

The distribution options available to you and your beneficiaries in a 401(k) plan are typically limited. And some plans require that distributions start if you've reached the plan's normal retirement age (often age 65), even if you don't yet need the funds.

With an IRA, the timing and amount of distributions is generally at your discretion. While you'll need to start taking required minimum distributions (RMDs) from your IRA after you reach age 70½ (and your beneficiary will need to take RMDs after you die), those payments can generally be spread over your (and your beneficiary's) lifetime. (You aren't required to take any distributions from a Roth IRA during your lifetime, but your beneficiary must take RMDs after your death.) A rollover to an IRA may let you and your beneficiary stretch distributions out over the maximum period the law permits, letting your nest egg enjoy the benefits of tax deferral as long as possible.

The RMD rules also apply to 401(k) plans--but a special rule allows you to postpone taking distributions until you retire if you work beyond age 70½. (You also must own no more than 5% of the company.) This deferral opportunity is not available for IRAs.

Note: *Distributions from 401(k)s and IRAs may be subject to federal income tax, and a 10% early distribution penalty (unless an exception applies). (Special rules apply to Roth 401(k)s and Roth IRAs.)*

Gimme shelter

Your 401(k) plan may offer better creditor protection than an IRA. Assets in most 401(k) plans receive virtually unlimited protection from creditors under a federal law known as ERISA. Your creditors cannot attach your plan funds to satisfy any of your debts and obligations, regardless of whether you've declared bankruptcy. (Note: individual (solo) 401(k) plans and certain church plans are not covered by ERISA.)

In contrast, traditional and Roth IRAs are generally protected under federal law only if you declare bankruptcy. Federal law currently protects your total IRA assets up to $1,245,475 (as of April 1, 2013)--plus any amount you roll over from your 401(k) plan. Any creditor protection your IRA may receive in cases outside of bankruptcy will generally depend on the laws of your particular state. If you're concerned about asset protection, be sure to seek the assistance of a qualified professional.

Let's stay together

Another reason to roll your 401(k) funds over to an IRA is to consolidate your retirement assets. This may make it easier for you to monitor your investments and your beneficiary designations, and to make desired changes. However, make sure you understand how Federal Deposit Insurance Corporation (FDIC) and Securities Investor Protection Corporation (SIPC) limits apply if you keep all your IRA funds in one financial institution.

Fools rush in

- While some 401(k) plans provide an annuity option, most still don't. By rolling your 401(k) assets over to an IRA annuity, you can annuitize all or part of your 401(k) dollars.
- Many 401(k) plans have loan provisions, but you can't borrow from an IRA. You can only access the money in an IRA by taking a distribution, which may be subject to income tax and penalties.

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Think Outside the Shoe Box When Organizing Financial Records

If you have questions about how long to keep copies of your federal tax returns and related records, see IRS Publication 17, Your Federal Income Tax. And because states may have different rules, check with your state's tax authority to find out how long to keep state tax returns and records.

If you've ever had trouble finding an important financial document, you know why it's necessary to keep your financial records organized. Less clutter means less stress, and though you'll need to commit a bit of time up front to organize your files, you can save time and money over the long term when you can find what you need when you need it.

What records do you need to keep?

If you keep paperwork because you "might need it someday," your files are likely overflowing with nonessential documents. One key to organizing your financial records is to ask yourself "Why do I need to keep this?" Documents that you should retain are likely to be those that are related to tax returns, legal contracts, insurance claims, and proof of identity. On the other hand, documents that you can easily duplicate elsewhere are good candidates for the shredder. For example, if you bank online and can view or print copies of your monthly statements and cleared checks, you may not need paper copies of the same information.

How long should you keep them?

A good rule of thumb is to keep financial records only as long as necessary. For example, you may want to keep ATM receipts only temporarily, until you've reconciled them with your bank statement. If a document provides legal support and/or is hard to replace, you'll want to keep it for a longer period or even indefinitely.

Records that you may want to keep for a year or less include:

- Bank or credit union statements
- Credit card statements
- Utility bills
- Annual insurance policies

Records that you may want to keep for more than a year include:

- Tax returns and supporting documentation
- Mortgage contracts and supporting documents
- Receipts for home improvements
- Property appraisals
- Annual retirement and investment statements
- Receipts for major purchases

Records that you may want to keep indefinitely include:

- Birth, death, and marriage certificates
- Adoption papers
- Citizenship papers
- Military discharge papers
- Social Security card

Of course, this list is not all-inclusive and these are just broad guidelines; you may have a good reason for keeping some records for a shorter or longer period of time.

Where should you keep them?

Where you should keep your records and documents depends on how easily you want to be able to access them, how long you plan to keep them, and how many records you have. A simple set of labeled folders in a file cabinet works fine for many people, but electronic storage is another option if space is tight.

For example, one easy way to cut down on clutter and still keep everything you need is to store some of your files on your computer. You can save copies of online documents or purchase a scanner that you can use to convert your documents to electronic form. But make sure you keep backup copies on a portable storage drive or hard drive, and make sure that your files are secure.

Another option to consider is cloud storage. Despite its lofty name, cloud storage is simply an online backup service that allows you to upload and store your files over the Internet, giving you easy access to information without the clutter. Information you upload is encrypted for security. If you're interested, look for a company with a reliable reputation that offers automatic backup and good technical support, at a reasonable subscription cost.

Staying organized

Keeping your financial records in order can be even more challenging than organizing them in the first place. One easy way to prevent paperwork from piling up is to remember the phrase "out with the old, in with the new." For example, when you get this year's auto policy, discard last year's. When you get an annual investment statement, discard the monthly or quarterly statements you've been keeping. It's a good idea to do a sweep of your files at least once a year to keep your filing system on track (doing this at the same time each year may be helpful).

But don't just throw your financial paperwork in the trash. To protect sensitive information, invest in a good quality shredder that will destroy any document that contains account numbers, Social Security numbers, or other personal information.

Whatever system you choose, keep it simple. You'll be much more likely to keep your records organized if your system is easy to follow.

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Is my child's college scholarship taxable?

It depends. If a scholarship is used to pay for tuition, fees, books, supplies, or equipment required for admission, then it's not taxable. But if it's used to cover incidental expenses like room and board, travel, or optional equipment, or if it's awarded as payment for teaching or research, then it's taxable. Generally, if a scholarship is taxable and needs to be reported on your tax return, you will include the amount on the same line as "Wages, salaries, tips, etc."

Fortunately, most scholarships let the recipient decide how to apply the money. However, there's one thing to consider here: if you use a scholarship to cover tuition, fees, books, or required equipment--making the scholarship tax free--you can't use those same expenses to qualify for the American Opportunity tax credit. That's because the credit applies only to tuition and fees paid with after-tax funds--tuition and fees paid with tax-free funds like scholarships or 529 plan funds won't count.

The American Opportunity tax credit--available for each of the first four years of a student's college education--is worth up to $2,500 per year and is calculated as 100% of the first $2,000 in tuition and fees plus 25% of the next $2,000 in tuition and fees. Your modified adjusted gross income must be below a certain level to get the full credit: $160,000 for married couples filing jointly and $80,000 for single filers.

If your child gets a scholarship and you qualify for the credit, you'll want to run some numbers to decide whether it's best to:

- Apply the scholarship to tuition and fees, making it tax free, but also disqualifying those same tuition and fees from counting toward the credit, or
- Apply the scholarship to incidental college expenses like room and board, making it taxable, but allowing the full amount of tuition and fees to count toward the credit.

In making this determination, keep in mind that a tax credit is generally more valuable than a tax deduction because a tax credit reduces any taxes owed dollar for dollar.

For more information on the tax treatment of scholarships and the American Opportunity tax credit, refer to IRS Publication 970, Tax Benefits for Education.