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The Specialist

ANSWERS TO TOUGH QUESTIONS ABOUT TAXES AND INVESTING

Benjamin C. Bruton

BRUTON FINANCIAL ADVISORS
supporting individuals and businesses with financial solutions

521 East Lancaster Avenue
Downingtown, PA 19335
Toll Free: (866) 518-3900
Fax: (610) 518-3880
Email: bruton@brutonfinancial.com
www.brutonfinancial.com

Roth IRAs for College Savings? Why It Could Make Sense

By Ed Slott, CPA

Roth IRAs are popular retirement savings vehicles, but did you know they can also be used to save for college? When it comes to covering escalating college costs, a Roth IRA may even have some advantages over dedicated college savings plans.

Keep in mind that tapping retirement funds to pay for college can set back your retirement strategy, so this approach is intended to save funds that are targeted specifically for college. If you use a Roth IRA for college savings, you should consider saving for retirement in other accounts, such as a 401(k).

For financial aid purposes, most assets count toward the "expected family contribution," but retirement accounts, including a Roth IRA, do not.

Financial Aid Factors

Colleges determine need-based financial aid based on the "expected family contribution" (EFC) calculated in the Free Application for Federal Student Aid (FAFSA). Some colleges also use an EFC from an additional application called the CSS Profile, as well as a combined EFC.

Most assets count toward these EFCs, but retirement accounts, including a Roth IRA, do not. Thus, *savings* in a Roth IRA should not affect the amount of aid your student receives. (Tax-deductible retirement plan contributions are added back to income for the year in which they are made, but this would not apply to Roth IRAs because contributions are not tax deductible.)

By contrast, *withdrawals* from a Roth IRA and other retirement plans do count toward income for financial aid purposes. Starting with the 2017–18 school year, the FAFSA will be based on your federal tax return from two years prior to the beginning of the school year; for example, the 2015 return will be used for the 2017–18 year. Thus, you may want to wait until after January 1 of the student's second year of college to withdraw funds.

A child who has earned income, perhaps from a summer job, can contribute to a Roth IRA instead of a savings account. Because student savings may result in a larger reduction in need-based financial aid than parent

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If you have any questions about the topics in this newsletter or about your financial future, call us. We are available to help.

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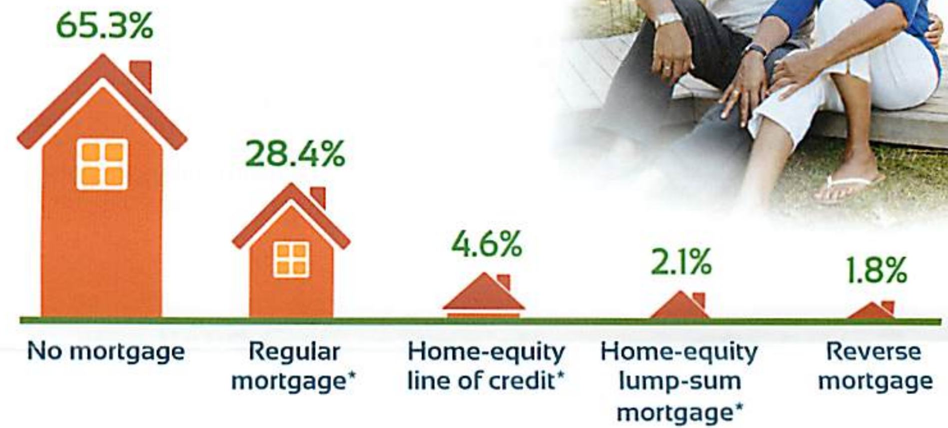
Home-Sweet-Home Equity

Buying a home is a long-term commitment, so it's not surprising that older Americans are much more likely than younger Americans to own their homes "free and clear." On average, only about 36% of owner-occupied housing units in the United States do not have a mortgage. For units occupied by homeowners who are 65 and older, the rate is more than 65%.[1]

If you have paid off your mortgage or anticipate doing so by the time you retire, congratulations! Owning your home outright can help provide financial flexibility and stability during your retirement years. Even if you still have mortgage payments, the equity in your home is a valuable asset. Here are some considerations.

Mortgaged or Not?

Type of mortgage on owner-occupied housing units among households 65+



***Total is higher than 100% because more than one starred category may apply to a unit.**

Source: U.S. Census Bureau, 2015 (2013 data)

Enjoy Lower Expenses

If you are happy with your home and don't need to tap the equity, living free of a monthly mortgage could make a big difference in stretching your retirement dollars. It's almost as if you had saved enough extra to provide a monthly income equal to your mortgage. You will still have to pay property taxes and homeowners insurance, but these expenses are typically smaller than the principal and interest on a mortgage.

Consider Downsizing

If you sell your home and purchase another one outright with cash to spare, the additional funds could boost your savings and provide additional income. On the other hand, if you take out a new mortgage, you may set yourself back financially. Keep in mind that condominiums, retirement communities, and other planned communities typically have monthly homeowners association dues. On the plus side, these dues generally pay for maintenance services and facilities that could make your retirement more enjoyable.

Borrow from Home Equity

If you stay in your home and want money for a specific purpose, such as remodeling the kitchen or fixing the roof, you might take out a home-equity loan. If instead you'll need funds over several years, such as to pay for college or medical expenses, you might prefer a home-equity line of credit (HELOC). Home-equity financing may offer tax-deductible home mortgage interest and favorable interest rates because your home secures the loan. However, you are taking on another monthly payment, and the lender can foreclose on your home if you fail to repay the loan. In addition, you may have to pay closing costs and other fees to obtain the loan.

Shift into Reverse

If you are 62 or older and want to borrow money from the value of your home equity without making monthly payments, you might consider a Home Equity Conversion Mortgage (HECM), commonly called a reverse mortgage. For this type of FHA loan, you must own the property outright or have a small mortgage balance. The loan can be structured as a fixed-rate lump-sum payment, similar to a home-equity loan, or as an adjustable-rate line of credit, similar to a HELOC. A reverse mortgage also may be used to finance approximately half the purchase price of a new home, but you must pay the rest of the cost using other funds, such as savings.

A home-equity loan and a HELOC must be paid off after a set period, but you don't have to pay back a reverse mortgage as long as you continue living in the home and pay property taxes and insurance premiums in a timely manner. However, interest accumulates and the loan must be repaid after you stop living in the home for one year or more, so you or your heirs could eventually be forced to sell the home, risking exposure to the uncertainties of the housing market. Reverse mortgages typically involve higher fees than home-equity loans or HELOCs.

1) U.S. Census Bureau, 2015

Happy Birthday Benefits

Remember when you turned 16 and rushed to get your driver's license? Or earned the right to vote at 18 and enjoyed the privileges and responsibilities of adulthood at 21? There aren't many legal changes associated with birthdays after that until you turn 50, and then there are plenty. Here's a brief overview.

50. Additional "catch-up" contributions can be made to most retirement plans. In 2016, the IRA catch-up amount is $1,000, for an annual total of $6,500 to all IRAs combined. A $6,000 catch-up contribution can be made to a 401(k), 403(b), or 457 plan, for an annual total of $24,000.

55. You (and your spouse if he or she is 55 or older) can make additional contributions to a health savings account (HSA) as long as you are not enrolled in Medicare. In 2016, the additional amount is $1,000, for a total of $4,350 for an individual plan or $7,750 for a family plan ($8,750 with spouse).

59½. Penalty-free withdrawals can be taken from IRAs, annuities, and employer-sponsored retirement plans as long as certain conditions are met. Distributions from tax-deferred plans are generally taxed as ordinary income.
Warning: *Just because you can dip into the account doesn't mean you should. The longer the funds remain untouched, the more time they have to pursue potential growth.*

62. You become eligible to collect early Social Security benefits (if you have contributed enough to qualify). However, your benefit will be permanently reduced by 25% to 30%, depending on your year of birth.

65. Eligibility for Medicare begins if you or your spouse worked at least 10 years in Medicare-covered employment.
Warning: *If you miss your initial enrollment period for Medicare Part B, you may incur a penalty if you sign up at a later date. Visit* medicare.gov *to determine your enrollment date.*

66 to 67. When you reach your full retirement age, you can receive your full Social Security benefit (see table below). For each month you wait to file after full retirement age, up to age 70, you will receive a higher benefit amount.

70. This is the age when you would receive your maximum Social Security benefit (about 132% of the full retirement benefit).

70½. Required minimum distributions (RMDs) must begin from traditional IRAs and most employer-sponsored retirement plans. The required beginning date (latest date to take your first distribution) is April 1 of the year after the year in which you turn 70½; subsequent RMDs must be taken annually by December 31.
Warning: *Neglecting to take your RMD could result in a 50% penalty on the amount that should have been withdrawn.*

Eligibility for Social Security

Birth year	Full retirement age
1943–54	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Source: Social Security Administration, 2016

Expressing Your Wishes in Advance

It's not pleasant to think about the possibility of being unable to make your own medical or financial decisions. That may explain why many people don't take the time to draw up appropriate documents expressing their wishes.

Regardless of your age or health, it's better to prepare now — and hope you never need advance directives — than to force your loved ones to make difficult choices without knowing your wishes. Here are some documents to consider. Be sure to consult with an attorney who is familiar with the laws of your state.

Durable power of attorney for health care (also called a health-care proxy). This health directive enables you to appoint a representative who would make medical decisions for you in the event you are unable to make them yourself. You can appoint anyone of legal age (usually 18 or older) and specify how much power your agent will have. A health directive should be HIPAA compliant so your representative can access your private medical information.

> It's better to prepare now and hope you never need these documents.

Living will. You can use this document to outline which medical procedures you would want to be used to prolong your life. Some states do not recognize living wills, but you may still want one as a way to document your wishes.

Durable power of attorney for finances. A DPOA enables you to authorize someone to act on your behalf in financial and legal matters. The person you designate as your agent could pay everyday expenses, watch over your investments, and file taxes, among other tasks. A DPOA may become effective immediately or when a triggering event occurs, such as a doctor certifying that you are physically or mentally incapacitated.

You can select the same person to serve as the agent for your health-care and financial powers of attorney, but you aren't compelled to do so. Be sure to discuss your wishes with the person you select and let him or her know where you keep the documents. Consider giving copies to your representative, your doctor, and key family members, and review these documents regularly to make sure they continue to express your wishes.

Roth IRAs for College Savings?

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assets, even a small amount set aside in a Roth IRA could be helpful.

Withdrawal Considerations

Because contributions to a Roth IRA are made on an after-tax basis, they can be withdrawn at any time, for any purpose, without incurring a federal income tax liability.

Moreover, withdrawals of earnings that are used to pay qualified higher-education expenses avoid the 10% penalty that typically applies to early withdrawals from most retirement plans. If you are 59½ or older and meet the five-year holding requirement, you can make tax-free and penalty-free withdrawals of earnings.

Money saved in a Roth IRA by a parent, a student, or both does not have to be used for higher education, even if that was the original intention. So if your child does not end up needing the savings for college, the funds are still available for retirement or other purposes as long as you follow Roth IRA distribution guidelines.

The maximum annual contribution limit to all IRAs combined in 2016 is $5,500 per person ($6,500 if you are 50 or older). Eligibility to contribute to a Roth IRA phases out at modified adjusted gross income levels of $117,000 to $132,000 for single filers or $184,000 to $194,000 for married joint filers.

Ed Slott is a professional speaker and the creator of several public television specials, including "Ed Slott's Retirement Road Map." He is the author of *The Retirement Savings Time Bomb...And How to Defuse It* and many other books about IRA planning.

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