

A New Risk To Converting To A Roth IRA

Converting to a Roth IRA is appealing if you think Federal taxes will go up, but now carries a new risk. Roth conversion is still a good idea but it's important to understand how the rules changed and could come into play.

Phantom Income. The new risk to converting stems from a change in tax rules; it may not make you decide against converting a traditional IRA to a Roth, but it is a material new factor in the equation, a risk of being taxed on "phantom income."

Roth v. Traditional IRA. Roth conversions are likely to grow more popular because a Roth is taxed

differently from a traditional IRA. You contribute pre-tax dollars to a traditional IRA, which lowers your taxable income each year you contribute. In retirement, you pay taxes on any withdrawals you make. In contrast, a Roth IRA allows you to contribute after-tax dollars and grows tax-free. Withdrawals in retirement are also tax-free. That's why converting to a Roth now looks smart if you think tax rates will be higher in your retirement years.

Tax Rates. The national debt and associated interest expenses are expected by the government to rise sharply due to years of Federal deficit spending, along with rising costs of

funding Social Security and Medicare benefits. As a result, tax rates could rise in the decade ahead, which would make withdrawing money from your traditional IRA cost you more in taxes annually in your retirement years.

New v. Old Rules. Until now you could convert to a Roth IRA and then push the "undo" button and reverse the



conversion in case of a sharp decline in your account value. The undo tactic has been around for years and it is important to understand what elimination of this technique means. Before 2018, you could reverse the Roth conversion that same year and suffer no ill effects, by using a tactic called a "re-characterization." The Tax Cuts and Jobs Act (TCJA) eliminated using this maneuver.

Re-characterizing Example. Before tax reform, say you converted \$300,000 from a traditional IRA to a Roth in June. If you were in the 24% Federal tax bracket, you would have owed \$72,000 in April of the next year. In November, if the stock market

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Keeping Your Course Steady

There seems to be no shortage of troubling news confronting investors these days. Last year's marked increase in stock market volatility was caused by concerns over: Trade wars, interest rate hikes, Brexit, oil prices, inflation, climate change, the economy, a divided congress, special investigations, inverted yield curves, and corporate profitability. Investors are naturally concerned about the prospects for the U.S. economy, and how it will influence their investment portfolio and their future financial security.

There is a natural tendency in times like these to look for active solutions: Cashing out of the market, changing asset allocations, or chasing recently-hot sectors. But instead of "tilting at windmills" in unsteady financial times, we feel that the most important advice that we can offer is to provide long-term perspective. Over time, investors benefit from strategically selling gains from their outperforming asset classes, and re-investing the proceeds into their underperforming asset classes. At Financial Decisions, our diversified portfolios have been benefitting from just that process for more than 25 years.

The markets will always be subject to fluctuations, so our portfolios are modeled conservatively to lessen the effects of market pullbacks. And by consistently taking gains when assets appreciate, we safeguard profits while constantly generating income. That will always be true no matter how rocky the road ahead may seem.

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 and Linda Schoenthaler

Key Facts On Deducting Medical Expenses

Medical expenses can increase your cash flow a lot. For that reason, the new tax law gives people a break by sweetening the long-time tax deduction for health care, at least for a couple of years.

Before the Tax Cuts and Jobs Act (TCJA), you could deduct medical expenses that exceeded 10% of your adjusted gross income (AGI). For the tax years of 2017 and 2018, the TCJA lowered the threshold to 7.5%. AGI is taxable income minus all deductions, IRA contributions and student loan interest. Of course, the medical tax break is available only to people who itemize.

The trouble is the more generous deduction expires after 2018, when the threshold rises back to 10%. Groups like AARP are lobbying in Washington to get the 7.5% level extended or made permanent, and that could factor into your timing and decisions about medical expenses in the months ahead.

Say your AGI is \$45,000 and you rack up \$5,475 in medical costs. You multiply \$45,000 by 0.075 (7.5

percent) to get your deduction threshold of \$3,375. Only medical expenses above \$3,375 would be deductible. Result: your medical expense deduction is \$2,100 (\$5,475 minus \$3,375).

pay for with before-tax dollars, which is often the case with employer-sponsored medical plans.

Another big deductible item is co-payments for prescription drugs — and also out-of-pocket fees for doctors,

dentists, physical therapists and other health-care professionals not covered by Medicare or any other health insurance. Add in prescription eyeglasses, hearing aids and wheelchairs, and transportation costs to and from medical appointments, as well as alcohol and drug treatment programs.

Medical expenses are deductible only if they alleviate or

prevent a physical or mental defect or illness, including dental and vision. So, you cannot deduct a gym membership if it is to promote your general wellness. However, if a doctor diagnoses you with a specific medical condition, such as obesity or hypertension, then the expense of the prescribed treatment may indeed be tax-deductible, including a gym membership. ●



Some big-ticket items are deductible medical expenses, like long-term care insurance premiums, nursing home payments and Medicare costs — including Medicare Part B, Medigap policies, Medicare Advantage programs and Part D Prescription plans.

In addition, any health insurance you pay out of pocket can be deducted. But that can't include coverage you

Qualifying For Medicaid To Benefit Heirs

For almost every family, long-term care—at home or in a nursing facility—is a financial disaster waiting to happen. At an annual cost that may exceed \$100,000, an extended stay could drain your savings, hurting your spouse and decimating the wealth you hoped to leave to your heirs. One way around this problem is to impoverish yourself intentionally, transferring assets to other family members while you're healthy so you'll qualify for Medicaid, the government program that funds most long-term care. But this process, known as Medicaid planning, can be complicated and expensive, and you

may not be comfortable with compromises it requires.

Medicaid is often confused with Medicare, the federal health insurance program that covers everyone beginning at age 65 but pays for long-term care only in very limited circumstances. Medicaid, jointly run by the federal government and the states, finances care for the poor, including those who have to go into a nursing home but can't afford the high price tag.

Medicaid planning is the process of shifting wealth to other family members so you'll qualify for the program. Although requirements vary

from state to state, you generally can't hold on to more than \$2,000 in cash and investments, though you may be able to keep your principal residence.

Reaching the state-imposed threshold could mean transferring assets to irrevocable trusts benefiting younger family members. To fund a trust or to transfer assets directly to family members, you could begin making a series of gifts covered by the annual gift tax exclusion (currently \$15,000). Because you're allowed to make as many such tax-free gifts as you like, you might be able to reduce your net worth relatively quickly. If you have, say, three children and

Protect Yourself Against Spearphishing

The Russian conspiracy to meddle in the 2016 presidential campaign relied on a common scam called “spearphishing.” While the history-making scam may sound sophisticated, this form of digital fraud is running rampant. Anyone using email is likely to be attacked these days. Here are some tips to protect yourself.

In a spearphishing attack, a hacker sends you an email message to trick you into disclosing your username and password to a secure account. The message looks like it’s from a legitimate source you trust.

You click on the link and, unbeknownst to you, you install a program that records your next 100 keystrokes. The email from a trusted source was a Trojan Horse, malicious software that sends your password and user ID to the hackers.

New variants of the scam are appearing so fast that anti-virus software can’t keep up, which puts you on the front line in defending yourself from attack. Perhaps the most important way to thwart an attack is by looking at links in emails



before clicking.

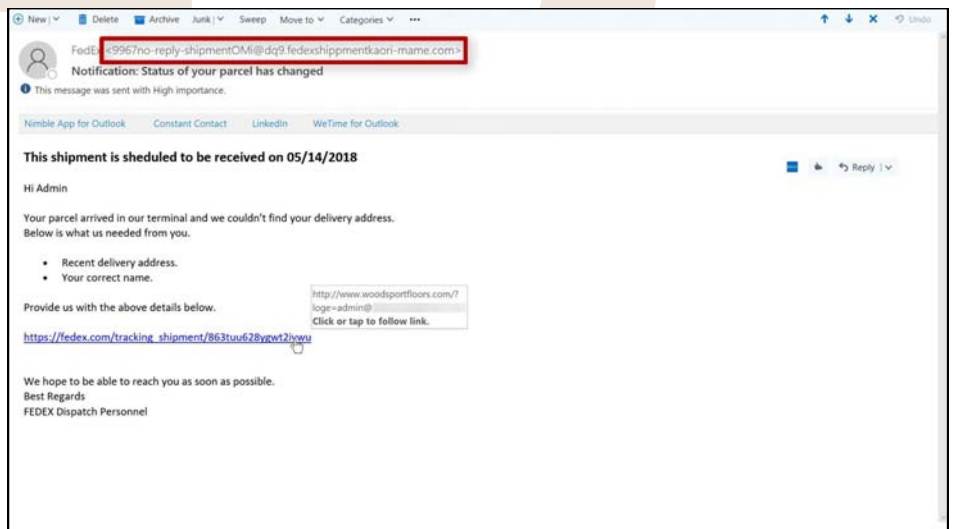
In this popular spearphishing scam, hovering over the link in the

easy to spot because they

commonly contained misspellings, grammatical errors and company

email displays a website address that is absolutely, positively not Federal Express. And the email address from which this message was sent is plainly NOT a legitimate Federal Express dot-com account. Often the “From” address will tip you off to a fraud.

Phishing emails, until recently, were



seven grandchildren, you could transfer cash or property worth \$150,000 a year without gift tax consequences. You could also use some or all of your lifetime exemption (\$11.4 million for 2019) to avoid gift taxes.

But asset transfers must happen well in advance of your attempt to qualify for Medicaid. According to the Medicaid “look-back” rule, any gifts or transfers to individuals or trusts within the past five years still count as your property. (This look-back period was recently extended from three



years.) And even if you qualify for Medicaid—a process that usually involves hiring an experienced (and expensive) “Medicaid attorney”—you may not like the restrictions it imposes.

Some nursing homes limit the number of Medicaid recipients or don’t take Medicaid at all. Moreover, Medicaid planning is particularly difficult if you’re trying to preserve assets for a

healthy spouse, and many people feel uncomfortable accepting public assistance. We can explain the rules and help you consider alternatives for financing long-term care. ●

branding mistakes. A scan of hundreds of recent phishing messages indicates fewer of these telltale signs. The scammers are getting smarter.

While the cat versus mouse game has of late been won by the evildoers, software solutions are growing stronger. For example, Microsoft Office 365 online users now have a way of designating a message as “Phishing.” This new feature for “blacklisting” a malicious message prevents a scam from hitting you twice and gives Microsoft information about its origin. Of course, updating your anti-virus software is always a must. If you ever have any questions about emails you receive from us, please do not hesitate to call us. ●

Time Itemized Deductions To Reduce Taxes

You can't have your cake and eat it, too, but this tax planning strategy lets you have a tax break and repeat it, too.

An old tax tactic, bunching deductions, is used in an entirely new way to minimize your tax bill under the Tax Cuts and Jobs Act (TCJA). By planning to take the new enlarged standard deduction some years and concentrating deductible expenses (also known as bunching) in other years, you may save thousands of dollars in income taxes over two or three years.

The TCJA almost doubled the standard deduction to \$12,000 for singles and \$24,000 for couples filing jointly in 2018. Trouble is, if you take the standard deduction, you can't itemize other deductions. You no longer can lower your taxable income by itemizing deductions such as charitable donations, medical expenses, mortgage interest, and other miscellaneous expenses.

By bunching, you do both: This

year, you take the enlarged standard deduction. For 2019, you don't. Instead you bunch your deductions, so that their total surpasses the standard deduction, and itemize them when you file your taxes for 2019. If your itemized deductions aren't higher than the standard deduction, you take the standard deduction again in 2019, but you can aim to bunch and itemize in 2020.



This strategy also helps overcome another downside of the TCJA: It capped deductions on property and state taxes at \$10,000 annually. These breaks used to be unlimited, and in some high-tax states exceeded the standard deduction.

By planning to bunch two or three years of charitable donations and other

deductions you can control into a single year, your itemized list of deductions every other year could exceed the \$24,000 (\$12,000 for singles) standard deduction.

For example, a married couple itemizes and claims the maximum property and state income tax deduction of \$10,000. They also pay \$8,000 in mortgage interest. They'd need to make more than \$6,000 of

charitable donations to surpass the \$24,000 standard deduction threshold. The couple usually gives \$4,000 to charity yearly, so they choose to make the gift by combining two years of donations into one tax year. As a result, they can

itemize deductions one year and claim \$26,000 in deductions. Next year, they take the \$24,000 standard deduction.

Planning to benefit by bunching deductions depends on your expected income as well as the specific deductions you can control, but with a little clever planning, you can have your tax break and repeat it, too! ●

A New Risk To Converting

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plunged by 37%, as it did in 2008, your Roth IRA would now be worth \$189,000. Making matters worse, you'd still owe \$72,000 to Uncle Sam on the withdrawal of the full amount converted from your traditional IRA. You'd have to pay tax on income that was lost in the market decline. The tax reform eliminated the option of undoing the conversion to avoid paying tax on phantom income.

The New Risk In Converting. Since the new tax law eliminated this option, you now have little choice but to pay Uncle Sam the phantom income-tax and — should your account value plunge after converting — you must be prepared to stick with your

long-term strategy in the hope that the stock market will rebound. Past performance is no guarantee of your



future results, but a recovery is exactly what happened after the 2008 bear market. However, the climb back may

take years and it's possible — though unlikely — that it might never rebound. From its October 9, 2007 record high of 1565.15, the S&P 500 dropped to a low of 676.53 on March 9, 2009 in the near-collapse of the world financial system. It was not until March 28, 2013 that the S&P 500 surpassed its previous record closing high set in 2007 — a seven-year span.

Bottom line. The new risk of converting and getting hit by phantom income tax is now part of the equation in the math of retirement planning. However, if your Roth IRA has been compounded tax-free for the next decade and you can tap it for income without paying Uncle Sam a dime, then the math may indeed work better for you — especially if you believe tax rates are on the rise. ●