



## Berman Capital Management & Research

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Financial Myths, Mistakes, and Misunderstandings

Helping Your Parents Manage Their Finances

Leaving Assets to Your Heirs: Income Tax Considerations

Do I have to pay an additional tax on investment income?

# Berman Capital Management News

## *Financial & Investment Insights*

### Financial Myths, Mistakes, and Misunderstandings

Throughout our financial lives, we may be influenced by myths, mistakes, and misunderstandings (MMMs). Here are just a few.

#### In the beginning . . .



**"I don't invest because I don't know much about it."** It's time to learn, because a basic understanding of investing concepts can help you make more informed financial decisions.

**"Wow, they'll give me that much credit! I must be able to handle it."** Just because the credit-card company or bank extends a large amount of credit to you, it doesn't mean you should use all of it. The more you borrow, the larger the monthly payments, and before you know it, you've bitten off more than you can chew. Figure out how much you'll owe based on the amount you borrow and determine if it will fit within your budget. Generally speaking, if you can't afford the payment, don't incur the debt.

**"I'm young. I'll worry about retirement when I'm older."** Planning for retirement involves saving enough by a desired age to enable you to support yourself without having to work. If you wait to begin saving for retirement, you'll have to sock more away or put off retirement to a later date. So the earlier you begin saving, the better.

#### Go figure

Sometimes we think we know something and rely on it as being correct, when in fact it couldn't be further from the truth.

**"I know my finances like the back of my hand. I don't need to write them down."** You'd be surprised how often we think we know how much we can afford until our bills start to exceed our income. If you write down your expenses and income (e.g., create a spending plan or budget), you'll know how much you can spend.

**"I'll dip into my retirement account and make it up later."** First, if you borrow from your 401(k), you'll likely pay fees and interest. If you take money from a traditional IRA, you'll pay income tax on the amount you take and possibly a 10% penalty. Remember, these accounts are intended for retirement. Taking money out now increases the risk you might run out of money during retirement.

**"My child will pay back the money I loaned to him or her."** Good luck. That "loan" is probably going to turn into a gift, which isn't necessarily a bad thing if it really helps your child, but be sure you can afford the loan/gift before making it.

#### And later on . . .

As we get older, we may fall prey to some MMMs that can be the source of needless angst, such as:

**"I won't need as much income in retirement."** Maybe, but it might be a mistake to count on it. In fact, in the early years of retirement, you may find that you spend just as much money, or maybe more, than when you were working, especially if you are still paying a mortgage. And don't forget to factor in increasing health-care costs.

And speaking of health care, **"the new health-care law cuts my basic Medicare benefits and services."** Just the opposite is true. The Affordable Care Act (ACA) mandates that no guaranteed Medicare benefits are cut. In fact, the ACA expands Medicare benefits to include a free annual wellness assessment.

And finally, **"If I die without a will, the state will get my assets and property."** This isn't necessarily true. Each state has intestacy laws, which determine who gets what when someone dies without a will. But those laws generally deal with assets in your name at your death that don't have a designated beneficiary or joint owner. In any case, if you want to have some say in who will inherit your assets after your death, you need to prepare an estate plan, which probably includes a will.





***Postponing a discussion about helping a parent with his or her finances increases the odds that problems could arise before that discussion takes place.***

## Helping Your Parents Manage Their Finances

As the U.S. population gets older, more people, particularly baby boomers, are confronting a dilemma. As parents age, their ability to manage their own finances may decline. That can make it more likely that they may neglect the life savings they've worked so hard to accumulate or make costly mistakes with them. Even worse, they're more likely to fall victim to one of the fraudulent schemes that frequently target seniors. "Financial Fraud and Fraud Susceptibility in the United States," a September 2013 report prepared for the FINRA Investor Education Foundation, found that seniors were 34% more likely to lose money to fraudsters than were those in their 40s.

And yet many seniors, especially those who have always been independent and/or money-savvy, may be reluctant to accept advice or help from their children, or even discuss living expenses, health care plans, investments, or general estate planning. Sadly, postponing that discussion can increase the difficulty of tackling whatever problems may eventually arise.

### What's behind parental reluctance?

Suggesting that parents might benefit from assistance, either from their children or a professional, may remind them of their own mortality. People are living longer; if they're still active and involved, they may have difficulty accepting that their current good health and financial comfort may not always continue.

Also, some seniors may be reluctant to discuss finances because it can reinforce a sense of loss; this could be especially true if they can no longer drive or participate in activities they enjoy. Admitting that they need help with financial issues may make them feel as though one more area is no longer under their control. If this is the case, they might respond to the idea that addressing important issues now--planning for ill health or an incapacity--could give them greater decision-making power over their quality of life later.

Parents also may be uncomfortable discussing finances with only one child, preferring to involve all siblings. In this case, you may need to either try to reach a consensus about which child is best equipped to help, or divide responsibilities among siblings. For example, one child might assist with billpaying and day-to-day expenses while another reviews investments or handles health insurance, Medicare, and Social Security.

In some cases, parents may respond to the idea that taking action sooner rather than later can help prevent the loss of much of their

hard-earned savings to taxes or scams. If they're uncomfortable discussing finances with you, you could suggest working with a third party who can review their situation and make recommendations that could then be discussed jointly.

### When to offer help

Here are some signs that a parent might need some assistance: confusion about whether direct-mail offers are advertising or bills; failing to pay bills or file documents properly, especially if someone has always been highly organized; complaints about being unable to make ends meet; talking about the merits of certain investments, especially unfamiliar ones and especially if a parent hadn't previously exhibited much interest in investing; unusual behavior, such as making unexpected large purchases or spending a lot of time gambling.

Be sure to rule out other physical problems, such as an infection or difficulties with vision or hearing, before assuming that mental confusion is automatically a sign of dementia.

### A start is better than nothing

If parents are reluctant to discuss specific figures, try to make sure that key information, including online account information and passwords, is on paper, and that someone else knows the location of those items and will be able to access them if necessary.

You might start providing assistance in stages. Offer to review checking account statements and/or credit card bills to ensure they're not paying for services they want to cancel or didn't request; this may give you insight into the overall state of their finances. Because seniors may be more willing to discuss issues such as health insurance and preferences regarding long-term care or end-of-life decisions before other topics, building trust in these areas could increase comfort levels on both sides with other matters.

If a trust has been set up, a trustee might be the logical person to handle finances, since he or she may eventually have to deal with trust-related issues anyway. The same is true for someone who has been granted a durable power of attorney, even if he or she doesn't yet have full responsibility for managing finances. And in a worst-case scenario, children can petition a probate court to name a conservator or guardian. Whatever approach you take, one of the key challenges of this process is to respect a parent's dignity while protecting his or her ongoing well-being.





**An inheritance is generally worth only what your heirs get to keep after taxes are paid. Here we have focused primarily on federal income taxes. Depending on your circumstances, you may wish to also consider federal estate tax and state income, estate, and inheritance taxes.**

**Note: It is generally recommended that you designate IRA and other retirement plan beneficiaries, their shares, and any backup beneficiaries on the plan beneficiary form. This will help assure that retirement plan benefits pass as you wish at your death and that a beneficiary will be able to stretch distributions over his or her remaining life expectancy.**

## Leaving Assets to Your Heirs: Income Tax Considerations

An inheritance is generally worth only what your heirs get to keep after taxes are paid. So when it comes to leaving a legacy, not all property is created equal—at least as far as federal income tax is concerned. When evaluating whom to leave property to and how much to leave to each person, you might want to consider how property will be taxed and the tax rates of your heirs.

### Favorable tax treatment for heirs

#### Roth IRAs

Assets in a Roth IRA will accumulate income tax free and qualified distributions from a Roth IRA to your heirs after your death will be received income tax free. An heir will generally be required to take distributions from the Roth IRA over his or her remaining life expectancy. (Of course, your beneficiaries can always withdraw more than the required minimum amounts.) If your spouse is your beneficiary, your spouse can treat the Roth IRA as his or her own and delay distributions until after his or her death. So your heirs will be able to continue to grow the assets in the Roth IRA income tax free until after the assets are distributed; any growth occurring after funds are distributed may be taxed in the future.

**Note: The Supreme Court has ruled that inherited IRAs are not retirement funds and do not qualify for a federal exemption under bankruptcy. Some states may provide some protection for inherited IRAs under bankruptcy. You may be able to provide some bankruptcy protection to an inherited IRA by placing the IRA in a trust for your heirs. If this is a concern of yours, you may wish to consult a legal professional.**

#### Appreciated capital assets

When you leave property to your heirs, they generally receive an initial income tax basis in the property equal to the property's fair market value (FMV) on the date of your death. This is often referred to as a "stepped-up basis," because basis is typically stepped up to FMV. However, basis can also be "stepped down" to FMV.

If your heirs sell the property with a stepped-up (or a stepped-down) basis immediately after your death for FMV, there should be no capital gain (or loss) to recognize since the sales price will equal the income tax basis. If they sell the property later for more than FMV, any appreciation after your death will generally be taxed at favorable long-term capital gain tax rates. If the appreciated assets are stocks, qualified dividends received by your heirs will also be taxed at favorable long-term capital

gain tax rates.

**Note: If your heirs receive property from you that has depreciated in value, they will receive a basis stepped down to FMV and will not be able to claim any loss with respect to the depreciation before your death. You may want to consider selling depreciated property while you are alive so that you can claim the loss.**

### Not as favorable tax treatment for heirs

#### Tax-deferred retirement accounts

Assets in a tax-deferred retirement account (including a traditional IRA or 401(k) plan) will accumulate income tax deferred within the account. However, distributions from the account will be subject to income tax at ordinary income tax rates when distributed to your heirs (if there were nondeductible contributions made to the account, the nondeductible contributions can be received income tax free). An heir will generally be required to take distributions from the tax-deferred retirement account over his or her remaining life expectancy. (Of course, your beneficiaries can always withdraw more than the required minimum amounts.) If your spouse is the beneficiary of the account, the rules may be more favorable. So your heirs will be able to defer taxation of the retirement account until distribution, but distributions will generally be fully subject to income tax at ordinary income tax rates.

**Note: Your heirs do not receive a stepped-up (or stepped-down) basis in your retirement accounts at your death.**

Even though distributions are taxable, your heirs will nevertheless generally appreciate receiving tax-deferred retirement accounts from you. After all, they do get to keep the amounts remaining after taxes are paid.

#### Toxic or underwater assets

Your heirs might not appreciate receiving property that is subject to a mortgage, lien, or other liability that exceeds the value of the property. In fact, an heir receiving such property may want to consider disclaiming the property.

### Always nice to receive

#### Life insurance and cash

Life insurance proceeds received by your heirs will generally be received income tax free. Your heirs can generally invest life insurance proceeds and cash they receive in any way that they wish. When doing so, your heirs can factor in how the property will be taxed to them in the future.

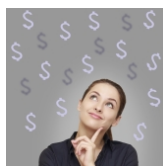




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## Do I have to pay an additional tax on investment income?

You might, depending on a few important factors.

A 3.8% net investment income tax is imposed on the

unearned income of high-income individuals. The tax is applied to an amount equal to the lesser of:

- Your net investment income
- The amount of your modified adjusted gross income (basically, your adjusted gross income increased by an amount associated with any foreign earned income exclusion) that exceeds \$200,000 (\$250,000 if married filing a joint federal income tax return, and \$125,000 if married filing a separate return)

So if you're single and have a MAGI of \$250,000, consisting of \$150,000 in earned income and \$100,000 in net investment income, the 3.8% tax will only apply to \$50,000 of your investment income.

The 3.8% tax also applies to estates and trusts. The tax is imposed on the lesser of undistributed net investment income or the excess of MAGI that exceeds the top income tax bracket threshold for estates and trusts

(\$12,150 in 2014). This relatively low tax threshold potentially could affect estates and trusts with undistributed income. Consult a tax professional.

## What is net investment income?

Net investment income generally includes all net income (income less any allowable associated deductions) from interest, dividends, capital gains, annuities, royalties, and rents. It also includes income from any business that's considered a passive activity, or any business that trades financial instruments or commodities.

Net investment income does not include interest on tax-exempt bonds, or any gain from the sale of a principal residence that is excluded from income. Distributions you take from a qualified retirement plan, IRA, 457(b) deferred compensation plan, or 403(b) retirement plan are also not included in the definition of net investment income.



## I just learned that my credit- and debit-card information was part of a data breach. What should I do?

Now, more than ever, consumers are relying on the convenience of credit and debit cards to make everyday

purchases, such as gas and groceries, and to make online purchases. With this convenience, however, comes the risk of having your account information compromised by a data breach.

In recent years, data breaches at major retailers have become commonplace across the United States. Currently, most retailers use the magnetic strips on the backs of credit and debit cards to access account information. Unfortunately, the account information that is held on these magnetic strips is also easily accessed by computer hackers.

While many U.S. banks and financial institutions are in the process of replacing the older magnetic strips with more sophisticated and secure embedded microchips, it will take time for both card issuers and retailers to get up to speed on these latest card security measures.

In the meantime, if you find that your account information is at risk due to a data breach, you should make it a priority to periodically review

your credit card and bank account activity. If you typically wait for your monthly statement to arrive in the mail, consider signing up for online access to your accounts--that way you can monitor your accounts as often as needed. If you see suspicious charges or account activity, you should contact your bank or credit-card company as soon as possible.

In most cases, your bank or credit-card company will automatically issue you a new card and card number. If not, request to have new cards and card numbers issued in your name. As an additional precaution, you should also change the PIN associated with the cards.

Whether you will be held liable for the unauthorized charges depends on whether the charges were made to your credit- or debit-card account and how quickly you report them.

For more information on your rights if you are affected by a data breach, visit the [Federal Trade Commission](#) and [Consumer Financial Protection Bureau](#) websites.

