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Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

December 2015

Investing for the Long Term

August 2015 was a brutal month for stocks. There were constant reports that the Dow Jones Industrial Average (DJIA) was down hundreds of points for the day, even down by 1000 points during one daily trading session. Ultimately, where do you think August 2015 wound up as far as historical comparisons? As bad as the crash of late 2008? Or even the subsequent bottom of early 2009?

Not exactly. August 2015 was the worst month for the DJIA since May 2010; it was the worst month for the S&P 500 index since May 2012. Thus, in the middle of a bull market that has lasted since 2009, there have been some severe ups and downs.

By the numbers

With that perspective, there are some points to keep in mind. For instance, don't panic over what seem to be huge losses. Hearing that "the Dow is down by 1,000 points today" can be scary. However, when the Dow is over 18,000, as it was as recently as July 2015, a 1,000-point drop is less than a 6% loss. Indeed, the DJIA was down by 6.6% in August, while the S&P 500 lost 6.3%.

Now, losing 6% or 7% of your investment portfolio is hard to shrug off. It could be a precursor to a time like late 2008, when stocks continued to sink into the following year, and major U.S. indexes lost nearly 50% of their value.

On the other hand, the DJIA lost almost 8% in May 2010, and the S&P 500 fell by 6.3% in May 2012. Investors who sold during those pullbacks watched while stocks rebounded and continued to rise for years afterwards, reaching a succession of new highs.

The bottom line is that stocks can be volatile, on the way up or the way down. By the time you read this article, those indexes may have regained lost ground or dropped even lower.

Staying the course

Looking at the historical record, broad U.S. market indexes have always

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Knot Again

In the latest year on record (2013), 4 out of 10 weddings included at least one person who had been married before.

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recovered from bear markets. That's been true after the 1929 crash and the subsequent Great Depression; the stagnant stock market of the 1970s, stunted by inflation and unemployment, turned into a bull market lasting through the following two decades.

There's no reason to suspect the current market weakness will be any different and probably no reason to alter your investment plan. Timing the stock market is notoriously difficult.

Basic strategies, such as building a diversified portfolio and investing regularly, are likely to prove profitable for investors with a long time horizon. However, if you are at a stage in your life where conservative investing is more appropriate—getting ready for retirement or building a college fund for your kids—you might want to talk with your investment advisor about the possibility of trimming stock market exposure now.

Opportunities abound

The worst recent stock market crashes (2000-02, 2008-09) have proven to be buying opportunities, as the market ascended to new highs both times. This might be the case again, especially if you're periodically acquiring shares of stock funds in your 401(k) or a similar employer retirement plan.

Ironically, the August 2015 stock market stumble could also turn out to be a selling opportunity. If you are holding stocks or stock funds in a taxable account, consider selling any issues that now trade significantly below the price you've paid for them. In case of multiple purchases of the same security, specifically identify for sale the shares with the highest cost, which will generate the largest loss.

Once you've made the sales, you can deduct your net capital losses for the year 2015, up to $3,000. Excess losses can be carried forward and used to offset capital gains taken in the future. Therefore, harvesting losses can deliver tax savings in 2015 and the opportunity to take tax-free gains in future years. ■

QTIP Trusts Still Offer Advantages

For many people, trusts can play a role in estate planning. Indeed, a qualified terminable interest property (QTIP) trust may offer benefits to married couples. That's especially true for people who are in a second (or even a third) marriage, because a QTIP trust can prevent a second spouse from disinheriting children from a first marriage.

Extending control

A QTIP trust allows the creator (grantor) to provide funds for a surviving spouse and also name the final beneficiaries.

Example 1: Dwight Emerson's will calls for the establishment of a QTIP trust, to be funded with most of his assets. His second wife, Flo, will be entitled to all of the income from the QTIP trust, for as long as she lives. At Flo's death, the assets remaining in the trust will go to Gregg Emerson and Helen Jenkins, Dwight's children from a prior marriage.

Thus, Flo will be assured of cash flow for the rest of her life. However, she won't be able to direct the QTIP trust assets to her own children, also from a prior marriage. Dwight can be sure that his children will receive whatever is left in the trust after Flo's death.

This process can go both ways. Flo's will also can create a QTIP trust for her assets, so that Dwight would receive lifetime income if he is the surviving spouse, yet Flo's children would ultimately get the trust assets.

Asset protection

What's more, a QTIP trust can provide asset protection.

Example 2: Kirk and Laurie Miller are married with grown children. Both Millers have wills calling for all of their assets to go into QTIP trusts. The surviving spouse will get all the trust income; in addition, the local bank named as trustee will be instructed to provide the survivor with additional funds from the trust, if necessary for ordinary living expenses, such as health care. Then, the remainder ultimately will go to their children.

With this arrangement, a remarriage after the death of the

Did You Know?

Among parents who are saving for their kids' college education, 45% are using a regular savings account to do so. Including multiple responses, 31% of parents are using a 529 account, designed to fund higher education, and 30% are using their own 401(k) accounts, which are meant to be retirement plans.

Source: T. Rowe Price

first spouse won't lead to their children being disinherited. Control of the assets by a trustee will reduce the chance of depletion through squandering or unwise investments by the surviving spouse.

Tax benefits

Historically, QTIP trusts were used to defer estate tax to the death of the second spouse. With the federal estate tax exemption now at $5.43 million per person, scheduled to rise with inflation, federal estate tax is not a concern for many people.

Nevertheless, many states have their own estate tax or inheritance tax, with lower exemption levels. A couple with combined net worth of $3 million or $4 million might wind up owing substantial amounts of state tax at death, so tax deferral through a QTIP trust could be valuable. State rules regarding QTIP trusts vary greatly, however, so the applicable state's rules must be reviewed carefully when determining whether to use a QTIP trust. In addition, couples with combined net worth well in excess of $10 million may have federal estate tax exposure, so a QTIP trust could be worthwhile for them.

Addressing concerns

Just as any well-drafted trust may offer advantages, trusts also require time and expense to create and maintain. Moreover, a QTIP trust poses specific issues in addition to the usual cautions about using a knowledgeable attorney to set it up.

With a QTIP trust, the executor will have to make a required election after the grantor's death. A separate state election also may be required to get QTIP tax treatment. Thus, if you create a QTIP trust, the trustee you name should be prepared to make a well-considered election.

You also should prepare your heirs for QTIP consequences. Your spouse, for example, should know that income will flow life-long, but access to the trust principal will be limited. If your children will be the ultimate beneficiaries, they should understand they'll have to wait for their inheritance, perhaps for many years. You might want to provide a more immediate source of funds to your children through insurance on your life or through a bequest outside of the trust.

In addition, you should discuss ongoing investment of trust assets with your chosen trustee. A QTIP trust must be invested to generate income to the surviving spouse, yet the trustee should attempt to provide a substantial amount to the ultimate beneficiaries as well. ■

Put Cadillac Health Plans on Your Road Map

As 2015 nears its end, business owners are naturally looking ahead to 2016. When it comes to your company's health plan, you might want to peer farther into the future, to 2018. That's when a steep tax on high-cost health insurance under the Affordable Care Act, dubbed the Cadillac tax, will go into effect.

Although some people have described this tax as an effort to rein in lavish health plans offered to top-bracket taxpayers, that may not paint the entire picture. Studies indicate that anywhere from 15% to 40% of employer-sponsored health plans will be affected when the tax is introduced. In the following years, over half of all health plans could generate this tax.

The Cadillac tax is a 40%, non-deductible charge on costs over specific limits. Ultimately, the tax will be borne by employers, so you should know how it works and what to do about it.

Coverage costs

As the IRS indicated in a pair of 2015 notices, the impact of the Cadillac tax may go beyond basic health plans. Flexible spending arrangements (FSAs), health savings accounts (HSAs), and health reimbursement arrangements (HRAs) also may be included. For the plans coming under this provision of the law, the cost of coverage will be the total contributions paid by both the employer and employees. However, employee-paid deductibles, coinsurance, and copays will not be considered as costs for the Cadillac tax calculation.

The thresholds for high-cost plans are currently $10,200 for individual coverage, and $27,500 for family coverage. These amounts will be updated for 2018 when the tax kicks in, and indexed for inflation after that.

Example: Assume the current thresholds are in effect in 2018. ABC Corp. calculates its costs at $11,000 for individual plans. That would be $800 over the $10,200 threshold, so the 40% tax would be $320 (40% of $800) per covered employee. Various penalties include a 100% fine for miscalculation.

In many cases, the Cadillac tax will be owed by the insurance

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company providing the plan, but that cost likely would be passed through to the employer.

Cutting Back

As might be expected, the Cadillac tax provisions are complex, with multiple definitions and exclusions. Our office can review your current health plans and determine your exposure, if any, to the Cadillac tax.

If your company is vulnerable to the Cadillac tax, what can you do? Options range from paying the tax, in order to keep providing current health care coverage to your employees, to dropping health insurance altogether, subject to Affordable Care Act requirements.

Another, perhaps more common reaction will be to cut health coverage costs and, thus, avoid the Cadillac tax. Employers might do so by changing their plans to include some combination of higher insurance deductibles, smaller provider networks, and more cost sharing by employees. Such moves effectively would shift health care costs from employers to employees; companies might boost employees' compensation to make up for some of the higher costs—or they might not.

Even with higher pay, though, employees would be losing tax-free health coverage while adding taxable compensation. Such changes could have considerable economic impact on your employees. By starting now to gauge the potential effect of the Cadillac tax in 2018, you can decide what steps you're likely to take and establish a schedule for introducing any new developments to your workers. ■

Trusted Advice

Costly Coverage

- The "Cadillac" tax is a 40% excise tax on any excess benefit provided to an employee.
- An excess benefit is the aggregate cost of coverage of the employee for the month over the dollar limit for that month.
- Each coverage provider must pay the tax on its share of the excess benefit.
- The coverage provider might be the health insurance issuer, the employer, or the person that administers the plan benefits, depending on the situation.
- Each employer must calculate for each taxable period the amount subject to the excise tax and the share of the excess benefit for each coverage provider, delivering the appropriate notifications.

TAX CALENDAR

December 2015

December 15

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in November if the monthly rule applies.

Corporations. Deposit the fourth installment of estimated income tax for 2015.

January 2016

January 15

Individuals. Make a payment of your estimated tax for 2015 if you did not pay your income tax for the year through withholding (or did not pay enough in tax that way). Use Form 1040-ES. This is the final installment date for 2015 estimated tax. However, you don't have to make this payment if you file your 2015 return and pay any tax due by February 1, 2016.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in December 2015 if the monthly rule applies.

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