Trust UPDATE

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Advanced considerations for Social Security benefits

In 2014 some 59 million Americans will receive almost $863 billion in Social Security benefits. For some, Social Security provides most of their retirement income, and for most retirees the monthly check is a key element of their financial security. Although this critical program faces long-term deficit issues, it remains healthy in the foreseeable future.

- Benefit payments began to exceed Social Security taxes collected in 2010. Income earned from the system's substantial reserves have made up the difference since then. In 2013, for example, Social Security taxes brought in $726 billion toward expenditures of $812 billion. The interest income from the Social Security Trust Fund came to $105 billion, while income taxes imposed on the benefits of higher-income retirees raised $21 billion.
- The trust funds grew by $32 billion in 2014, to $2.76 trillion. The trust funds are projected to last until 2033.
- The Social Security Administration in June published guidance for same-sex couples to claim spousal benefits and survivor benefits. Benefits may be available whether or not a state has recognized same-sex marriages.
- The average monthly benefit in 2013 was $1,294. The maximum benefit in 2014 at full retirement age is $2,642. The maximum for an early retirement this year is $1,992, and the maximum for one who delays benefits to age 70 this year is $3,425.

When should one begin taking benefits? This is a complicated decision, driven by employment and family circumstances as well as financial considerations. The earlier benefits begin, the lower the monthly payment. The Social Security Administration points out that about one of every three persons now age 65 will live to age 90, and one of seven will live to be 95. Retirement is lasting much longer than it did when Social Security began. On the other hand, a death that comes early in retirement could mean that benefits go uncollected. See *Longevity and Your Benefits* below for a comparison of lifetime benefits.

Spousal and survivor benefits

Spousal Social Security benefits are based upon the work record of a living spouse or ex-spouse. At normal retirement age, they are generally 50% of the worker's benefit. Survivor benefits, based upon the work record of a deceased spouse or ex-spouse, are 100% of the deceased worker's last benefit. There are a number of other differences to keep in mind:

- The earliest age for spousal benefits is 62, and the earliest age for survivor's benefits is 60. The spousal benefit at 62 is 35% of the worker's benefit, and the survivor's benefit taken at age 60 is 71.5% of the worker's benefit.
- Persons born in 1944 or 1955 will have a different full retirement age for their spousal and survivor benefits. Full retirement age is 66 for spousal benefits for those born between 1943 and 1954, but for survivor benefits the window is 1945 to 1956.
- Spousal benefits do not get the benefit of delayed retirement credits, but survivor benefits do.
- Survivor benefits become available after nine months of marriage, but 12 months are required for spousal benefits.

File and suspend

When a husband and wife each have work records, each has the choice between taking a spousal benefit or the regular benefit. The choice does not have to be permanent. Some affluent couples have explored a strategy called "file and suspend" to maximize their joint Social Security benefits.

Example: Harold and Ann would like to maximize their benefits by waiting to age 70 to begin collecting. Harold, who had the higher income, files for his benefit upon reaching normal retirement age, and then suspends the benefit to gain the additional delayed retirement credits. Ann can go ahead and claim her spousal benefit, collecting it until she reaches age 70, when she'll switch to her own benefit, including the full credit for delay.

This approach is allowed only once per couple, however. The Social Security Administration provides details on the strategy at http://www.socialsecurity.gov/retire2/suspend.htm.

How we can help you

We've worked with a broad spectrum of business owners, executives and professionals to solve the problems—and maximize the opportunities—associated with stepping onto the retirement road. Our experience is yours to draw on. Whether you're retiring early, retiring late or regrouping to start a new career, we stand ready to propose realistic strategies, geared to your personal requirements.

To learn more, make an appointment with one of our asset-management specialists. ☐

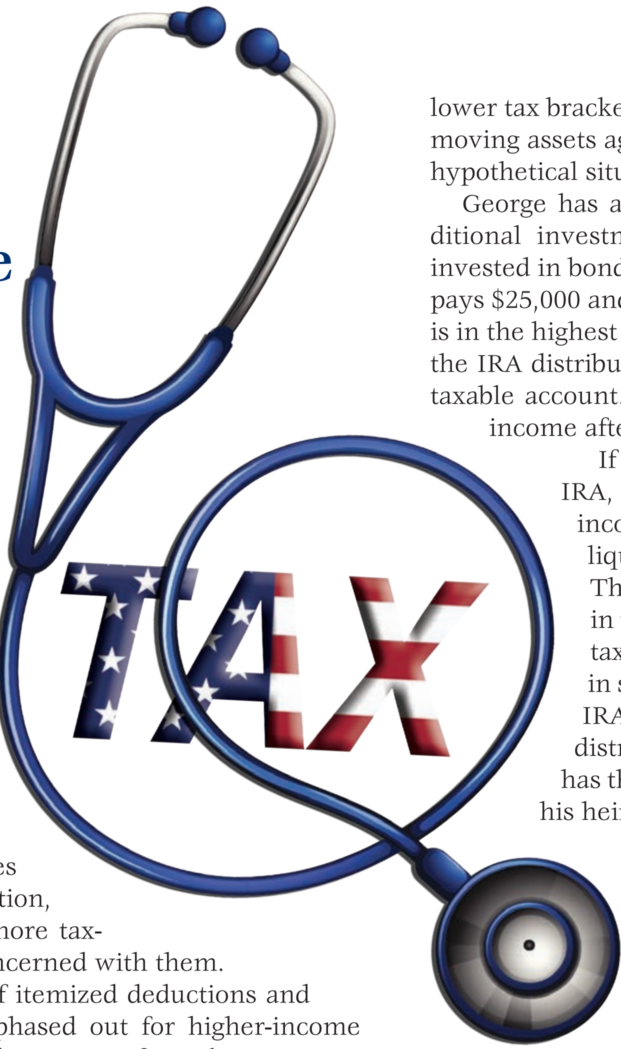
Longevity and your benefits

If you knew the date of your death, choosing the best date to begin Social Security benefits would be easy. Here are sample calculations for an individual who turns 62 in 2014 and whose projected monthly benefit at full retirement age is $1,800, above average but below the maximum possible benefit.

Start Social Security at	62	66 (normal retirement age)	70 (maximum benefits)
Initial annual income	$16,200	$21,600	$29,387
Total benefits by age 70	$129,600	$86,400	$0
Total benefits by age 80	$291,600	$302,400	$293,870
Total benefits by age 90	$453,600	$518,400	$587,740
	Best strategy if you die at 70	Best strategy if you die at 80	Best strategy if you die at 90

Additional earning credits and inflation not taken into account.
Source: M.A. Co.

Planning for the health care surtaxes



We are now in the second year of the surtaxes that were enacted with health care legislation in 2010. There is a surtax of 0.9% on compensation income in excess of $200,000 ($250,000 for married couples filing jointly). For investors, there's a 3.8% tax on net investment income, using those same thresholds. Note that these boundaries are not indexed to inflation, so over time more and more taxpayers will have to be concerned with them. In addition, the benefit of itemized deductions and personal exemptions is phased out for higher-income taxpayers. Interestingly, the revenue from the tax on net investment income is not transferred to the Medicare Trust Fund or any other Trust Fund, according to the relevant IRS regulations.

Employers are required to withhold the 0.9% tax for any employee whose compensation exceeds $200,000 in a calendar year. This is true even if the employee is married and will fall under the $250,000 threshold for joint filers. According to the IRS, the employer must withhold the tax, and the employee may claim a refund when filing his or her tax return. The tax also may apply to the value of noncash fringe benefits.

Roth IRAs dodge the tax bullet

"Net investment income" includes interest and dividend payments, capital gains, rents and royalties, among others. It does *not* include tax-exempt municipal bond income, nor does it include distributions from qualified pension plans, IRAs or Roth IRAs. These are the factors that may be taken into account in controlling one's exposure to the tax.

For those who are well below the taxable boundary, care should be taken to avoid one-year income spikes that may lift them into taxable territory, such as sales of large blocks of stock or a large conversion to a Roth IRA in a single year. Those who hover near the boundary may want to increase their exposure to securities that provide tax-free income.

The highest-income families may consider gifting assets that produce net investment to family members in lower tax brackets, or to charity. They also may consider moving assets aggressively into Roth IRAs. Consider this hypothetical situation.

George has a regular IRA worth $500,000 and a traditional investment account worth $200,000. Each is invested in bonds with an annual yield of 5%, so the IRA pays $25,000 and the traditional account $10,000. George is in the highest tax bracket, 39.6%, so he owes $9,900 on the IRA distribution and $4,340 on the income from the taxable account. (The 43.4% rate applies.) George's net income after taxes is $20,760.

If George converts his regular IRA to a Roth IRA, he will owe about $200,000 in federal income taxes. He can cover that expense by liquidating the taxable investment account. That would allow the entire $500,000 to be in the Roth IRA, generating $25,000 of after-tax income each year. That's a 20% increase in spendable income. What's more, the Roth IRA won't be subject to minimum required distributions during George's lifetime, and it has the potential to provide tax-free income to his heirs.

Seek out the advice of a tax attorney before deciding upon any course of action. But don't wait too long to get started on your year-end tax planning for 2014. ☐

How a Roth conversion increases after-tax income

An investor has the following holdings:

	Regular IRA	Traditional account	Roth IRA
Assets	$500,000	$200,000	$0
5% income	25,000	10,000	0
Tax rate	39.6%	43.4%	0%
Tax	9,900	4,340	0
After-tax income	15,100	5,660	0
Total after-tax income is $20,760			

The investor converts to a Roth IRA, at a tax cost of $200,000. The result is nearly a 20% increase in after-tax income. Here's the subsequent snapshot of the holdings:

	Regular IRA	Traditional account	Roth IRA
Assets	$0	$0	$500,000
5% income	0	0	25,000
Tax rate	39.6%	43.4%	0%
Tax	0	0	0
After-tax income	0	0	25,000
Total after-tax income is $25,000			

Note: 5% income is for illustrative purposes only and does not represent any particular investment.

Source: M.A. Co.

Who is liable for unpaid estate taxes?

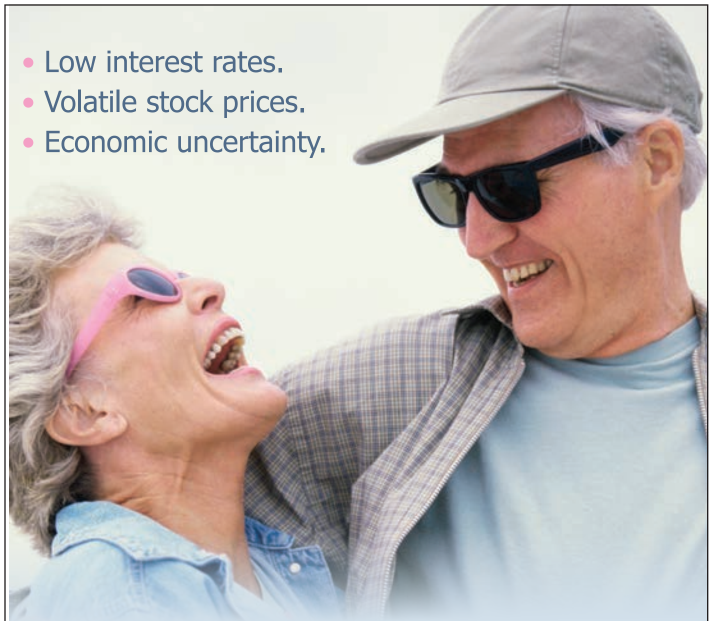
Dr. Jacob Lindy Kay died in August 2002. An extension was granted to the estate for filing an estate tax return, but the return was not filed until July 2007, very tardy. The return was accompanied by the payment of $318,516.68 in estate taxes. The IRS accepted the return as filed. However, in September 2007 the Service assessed two penalties, $85,616 for the late filing of the return and $95,129 for the late payment of the tax.

In January 2008 the IRS examined the return and sent a notice to the estate that there would be no additional estate liabilities. However, the penalties were not yet paid. In April 2008 the estate's beneficiaries executed an agreement. Some $95,000 was placed in escrow against future claims by the IRS, and the balance of the estate was distributed to the beneficiaries. The $95,000 was transferred to the IRS in 2011 in partial satisfaction of the tax penalties. The IRS proceeded to file and win an action against the estate's executor and the estate's beneficiaries in January 2012.

Another case with a similar outcome began when Andrew Cowles died in April 2000. He had owned three blocks of Procter & Gamble stock jointly with each of his three children. Daughter Cheryl was nominated in Andrew's will to be his executor, but apparently no probate proceedings were needed. Cheryl arranged for the filing of an estate tax return, which reported the total value of the stock to be just over $1.7 million, generating an estate tax liability of $347,653. Cheryl sent somewhat more than her share, $126,198, with the estate tax return. Unfortunately, her brothers never sent in their portions.

The IRS filed its notice of intent to levy in January 2004. All three children were targets, as transferees of the estate. In July 2011 the IRS filed its action in the District Court to recover estate taxes, penalties and interest, which by then had grown to $473,992.44.

The District Court granted summary judgment for the IRS, as there was no question that the P&G stock was taxable, and the tax was due. Unfortunately for Cheryl, she gets no credit from the IRS for paying her share. Her personal liability is capped only by the value of the stock that she received. It may not seem fair that she has to pay the penalties and interest caused by her brothers' failures, but that is how the law is written. The Court did not entertain claims from the beneficiaries for administrative expenses or that the lateness should be excused because it was for reasonable cause and not willful neglect. Those are arguments for the estate and its representatives to make. They are not available to the beneficiaries. ☐



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