



**Michael Tarantino, CFP®**  
**CERTIFIED FINANCIAL PLANNER™**  
 303 East Mountain Ave  
 Fort Collins, CO 80524  
 970-292-0105  
 fax: (970) 224-4180  
 michael.tarantino@investmentcenters.com  
 www.michaeltarantino.net

Greetings!

Given the current market conditions, I welcome the opportunity to discuss my outlook on the market with you. Please feel free to contact me anytime.

Mike

**Issue 15**

Six Common 401(k) Plan Misconceptions  
 Five Steps to Tame Financial Stress  
 Taxes, Retirement, and Timing Social Security  
 How do I compare my health insurance options during open enrollment?



## Six Common 401(k) Plan Misconceptions

Do you really know as much as you think you do about your 401(k) plan? Let's find out.

**1. If I leave my job, my entire 401(k) account is mine to keep.**

This may or may not be true, depending on your plan's "vesting schedule." Your own contributions to the plan--that is, your pretax or Roth contributions--are always yours to keep. While some plans provide that employer contributions are also fully vested (i.e., owned by you) immediately, other plans may require that you have up to six years of service before you're entitled to all of your employer contributions (or you've reached your plan's normal retirement age). Your 401(k)'s summary plan description will have details about your plan's vesting schedule.

**2. Borrowing from my 401(k) plan is a bad idea because I pay income tax twice on the amount I borrow.**

The argument is that you repay a 401(k) plan loan with dollars that have already been taxed, and you pay taxes on those dollars again when you receive a distribution from the plan. Though you might be repaying the loan with after-tax dollars, this would be true with any type of loan.

And while it's also true that the amount you borrow will be taxed when distributed from the plan (special rules apply to loans from Roth accounts), those amounts would be taxed regardless of whether you borrowed money from the plan or not. So the bottom line is that, economically, you're no worse off borrowing from your plan than you are borrowing from another source (plus, the interest you pay on a plan loan generally goes back into your account). But keep in mind that borrowing from your plan reduces your account balance, which may slow the growth of your retirement nest egg.

**3. Because I make only Roth contributions to my 401(k) plan, my employer's matching contributions are also Roth contributions.**

Employer 401(k) matching contributions are always pretax--whether they match your pretax

or Roth contributions. That is, those matching contributions, and any associated earnings, will always be subject to income tax when you receive them from the plan. You can, however, convert your employer's matching contributions to Roth contributions if your plan allows. If you do, they'll be subject to income tax in the year of the conversion, but future qualified distributions of those amounts (and any earnings) will be tax free.

**4. I contribute to my 401(k) plan at work, so I can't contribute to an IRA.**

Your contributions to a 401(k) plan have no effect on your ability to *contribute* to a traditional or Roth IRA. However, your (or your spouse's) participation in a 401(k) plan may adversely impact your ability to *deduct* contributions to a traditional IRA, depending on your joint income.

**5. I have two jobs, both with 401(k)s. I can defer up to \$18,000 to each plan.**

Unfortunately, this is not the case. You can defer a maximum of \$18,000 in 2015, plus catch-up contributions if you're eligible, to all your employer plans (this includes 401(k)s, 403(b)s, SARSEPs, and SIMPLE plans). If you contribute to more than one plan, you're generally responsible for making sure you don't exceed these limits. Note that 457(b) plans are not included in this list. If you're lucky enough to participate in a 401(k) plan and a 457(b) plan you may be able to defer up to \$36,000 (a maximum of \$18,000 to each plan) in 2015, plus catch-up contributions.

**6. I'm moving to a state with no income tax. I've heard my former state can still tax my 401(k) benefits when I retire.**

While this was true many years ago, it's no longer the case. States are now prohibited from taxing 401(k) (and most other) retirement benefits paid to nonresidents. As a result, only the state in which you reside (or are domiciled) can tax those benefits. In general, your residence is the place where you actually live. Your domicile is your permanent legal residence; even if you don't currently live there, you have an intent to return and remain there.



## Five Steps to Tame Financial Stress



*Seventy-two percent of adults report feeling stressed about money at least some of the time, and 22% say that the amount of stress they experience is extreme.*

*Source: American Psychological Association*

Do you sometimes lie awake at night thinking about bills that need to be paid? Does it feel as though you're drowning in debt? If this describes you, you might take solace in the fact that you're not alone. A recent report released by the American Psychological Association (APA) showed that 72% of adults feel stressed about money at least some of the time, and 22% said the amount of stress they experienced was extreme.<sup>1</sup>

The bad news is that stress can be responsible for multiple health problems, including fatigue, headaches, and depression. And, over time, stress can contribute to more significant health issues, including high blood pressure and heart disease.<sup>2</sup> The good news is that there are some simple steps you can take to reduce or eliminate some of the financial stress in your life.

### 1. Stop and assess

The first step in reducing financial stress is to look at your situation objectively, creating a snapshot of your current financial condition. Sit down and list all of your financial obligations. Start with the items that are causing you the most stress. For debts, include the principal due, the applicable interest rate, and the minimum payment amount. If you're not already doing so, review your bank account and credit-card statements to track where your money is going. The goal here is not to solve the problem; it's to determine and document the scope of the problem. You might find that this step alone significantly helps alleviate your stress level (think of it as facing your fears).

### 2. Talk to your spouse

If you're married, talk to your spouse. It's important to communicate with your spouse for several reasons. First, you and your spouse need to be on the same financial page; any steps you take to improve your situation are going to be most effective if pursued jointly. Second, not being on the same page as your spouse is only going to lead to additional stress. In fact, the APA report showed that 31% of spouses and partners say that money is a major source of conflict or tension in their relationship.<sup>3</sup> Additionally, your spouse or partner can be a valuable source of emotional support, and this emotional support alone can lower stress levels.<sup>4</sup> If you're not married, family or friends might fill this role.

### 3. Take control

First, go back and take a look at where your money is going. Are there changes you can make that will free up funds you can save or apply elsewhere? Even small changes can make a difference. And exerting control over your situation to any degree can help reduce your overall stress level. Start building a cash reserve, or emergency fund, by saving a little bit each paycheck. Think of the emergency fund as a safety net; just knowing it's there will help reduce your ongoing level of stress. Work up to a full spending plan (yes, that's another way of saying a budget) where you prioritize your expenses, set spending goals, and then stick to them going forward.

### 4. Think longer term

Look for ways to reduce debt long term. You might pay more toward balances that have the highest interest rates. Or you might consider refinancing or consolidation options as well. Beyond that, though, you really want to start thinking about your long-term financial goals, identifying and prioritizing your goals, calculating how much you might need to fund those goals, and implementing a plan that accounts for those goals. Having a plan in place can help you with your stress levels, both now and in the future.

### 5. Get help

Always remember that you don't need to handle this alone. If the emotional support of a spouse, friends, or family isn't enough, or the level of stress that you're feeling is just too much, know that there is help available. Consider talking to your primary-care physician, a mental health professional, or an employee assistance resource, for example.

A financial professional can also be a valuable resource in helping you work through some of the steps discussed here, and can help direct you to other sources of assistance, like credit or debt counseling services, depending on your needs.

The most important thing to keep in mind is that you have the ability to control the amount of financial stress in your life.

<sup>1,3,4</sup> American Psychological Association, "Stress in America™: Paying with Our Health," [www.stressinamerica.org](http://www.stressinamerica.org), February 4, 2015

<sup>2</sup> Mayo Clinic Staff, "Stress Symptoms: Effects on Your Body and Behavior," [www.mayoclinic.org](http://www.mayoclinic.org), July 19, 2013





## Taxes, Retirement, and Timing Social Security



*\*This hypothetical example is for illustrative purposes only, and its results are not representative of any specific investment or mix of investments. Actual rates of return and results will vary. The example assumes that earnings are taxed as ordinary income and does not reflect possible lower maximum tax rates on capital gains and dividends, as well as the tax treatment of investment losses, which would make the return more favorable. Investment fees and expenses have not been deducted. If they had been, the results would have been lower. You should consider your personal investment horizon and income tax brackets, both current and anticipated, when making an investment decision as these may further impact the results of the comparison. Investments offering the potential for higher rates of return also involve a higher degree of risk to principal.*

The advantages of tax deferral are often emphasized when it comes to saving for retirement. So it might seem like a good idea to hold off on taking taxable distributions from retirement plans for as long as possible. (Note: Required minimum distributions from non-Roth IRAs and qualified retirement plans must generally start at age 70½.) But sometimes it may make more sense to take taxable distributions from retirement plans in the early years of retirement while deferring the start of Social Security retirement benefits.

### Some basics

Up to 50% of your Social Security benefits are taxable if your modified adjusted gross income (MAGI) plus one-half of your Social Security benefits falls within the following ranges: \$32,000 to \$44,000 for married filing jointly; and \$25,000 to \$34,000 for single, head of household, or married filing separately (if you've lived apart all year). Up to 85% of your Social Security benefits are taxable if your MAGI plus one-half of your Social Security benefits exceeds those ranges or if you are married filing separately and lived with your spouse at any time during the year. For this purpose, MAGI means adjusted gross income increased by certain items, such as tax-exempt interest, that are otherwise excluded or deducted from your income for regular income tax purposes.

Social Security retirement benefits are reduced if started prior to your full retirement age (FRA) and increased if started after your FRA (up to age 70). FRA ranges from 66 to 67, depending on your year of birth.

Distributions from non-Roth IRAs and qualified retirement plans are generally fully taxable unless nondeductible contributions have been made.

### Accelerate income, defer Social Security

It can sometimes make sense to delay the start of Social Security benefits to a later age (up to age 70) and take taxable withdrawals from retirement accounts in the early years of retirement to make up for the delayed Social Security benefits.

If you delay the start of Social Security benefits, your monthly benefits will be higher. And because you've taken taxable distributions from your retirement plans in the early years of retirement, it's possible that your required minimum distributions will be smaller in the later years of retirement when you're also receiving more income from Social Security. And smaller

taxable withdrawals will result in a lower MAGI, which could mean the amount of Social Security benefits subject to federal income tax is reduced.

Whether this strategy works to your advantage depends on a number of factors, including your income level, the size of the taxable withdrawals from your retirement savings plans, and how many years you ultimately receive Social Security retirement benefits.

### Example

Mary, a single individual, wants to retire at age 62. She can receive Social Security retirement benefits of \$18,000 per year starting at age 62 or \$31,680 per year starting at age 70 (before cost-of-living adjustments). She has traditional IRA assets of \$300,000 that will be fully taxable when distributed. She has other income that is taxable (disregarding Social Security benefits and the IRA) of \$27,000 per year. Assume she can earn a 6% annual rate of return on her investments (compounded monthly) and that Social Security benefits receive annual 2.4% cost-of-living increases. Assume tax is calculated using the 2015 tax rates and brackets, personal exemption, and standard deduction.

**Option 1.** One option is for Mary to start taking Social Security benefits of \$18,000 per year at age 62 and take monthly distributions from the IRA that total about \$21,852 annually.

**Option 2.** Alternatively, Mary could delay Social Security benefits to age 70, when her benefits would start at \$38,299 per year after cost-of-living increases. To make up for the Social Security benefits she's not receiving from ages 62 to 69, during each of those years she withdraws about \$40,769 to \$44,094 from the traditional IRA--an amount approximately equal to the lost Social Security benefits plus the amount that would have been withdrawn from the traditional IRA under the age 62 scenario (plus a little extra to make the after-tax incomes under the two scenarios closer for those years). When Social Security retirement benefits start at age 70, she reduces monthly distributions from the IRA to about \$4,348 annually.

Mary's after-tax income in each scenario is approximately the same during the first 8 years. Starting at age 70, however, Mary's after-tax income is higher in the second scenario, and the total cumulative benefit increases significantly with the total number of years Social Security benefits are received.\*



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303 East Mountain Ave  
Fort Collins, CO 80524  
970-292-0105

fax: (970) 224-4180

michael.tarantino@investmentcenters.com  
www.michaeltarantino.net

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## How do I compare my health insurance options during open enrollment?

The decisions you make during open enrollment season regarding health insurance are especially

important, since you generally must stick with the options you choose until the next open enrollment season, unless you experience a "qualifying" event such as marriage or the birth of a child. As a result, you should take the time to carefully review the types of plans offered by your employer and consider all the costs associated with each plan.

With most health insurance plans, your employer will pay a portion of the premium and require you to pay the remainder through payroll deductions. When comparing different plans, keep in mind that even though a plan with a lower premium may seem like the most attractive option, it could have higher potential out-of-pocket costs.

You'll want to review the copayments, deductibles, and coinsurance associated with each plan. This is an important step because these costs can greatly affect what you end up paying out-of-pocket. When reviewing the costs of each plan, consider the following:

- Does the plan have an individual or family deductible? If so, what is the amount that will have to be satisfied before your insurance coverage kicks in?
- Are there copayments? If so what amounts are charged for doctor visits, specialists, hospital visits, and prescription drugs?
- Will you have to pay any coinsurance once you've satisfied the deductible?

You should also assess each plan's coverage and specific features. For example, are there coverage exclusions or limitations that apply? Which expenses are fully or partially covered? Do you have the option to go to doctors who are outside your plan's provider network? Does the plan offer additional types of coverage for vision, dental, or prescription drugs?

In the end, when reviewing your options, you'll want to balance the coverage and features offered under each plan against the plan's overall cost to determine which plan offers you the best value for your money.



## How important are dividends in the S&P 500's total returns?

In a word, very. Dividend income has represented roughly one-third of the total return on the Standard & Poor's 500 index since 1926.\*

According to S&P, the portion of total return attributable to dividends has ranged from a high of 53% during the 1940s--in other words, more than half that decade's return resulted from dividends--to a low of 14% during the 1990s, when the development and rapid expansion of the Internet meant that investors tended to focus on growth.\*

And in individual years, the contribution of dividends can be even more dramatic. In 2011, the index's 2.11% average dividend component represented 100% of its total return, since the index's value actually fell by three-hundredths of a point.\*\* And according to S&P, the dividend component of the total return on the S&P 500 has been far more stable than price changes, which can be affected by speculation and fickle market sentiment.

Dividends also represent a growing percentage of Americans' personal incomes. That's been especially true in recent years as low interest

rates have made fixed-income investments less useful as a way to help pay the bills. In 2012, dividends represented 5.64% of per capita personal income; 20 years earlier, that figure was only 3.51%.\*

**Note:** *All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful. Investing in dividends is a long-term commitment. Investors should be prepared for periods when dividend payers drag down, not boost, an equity portfolio. A company's dividend can fluctuate with earnings, which are influenced by economic, market, and political events. Dividends are typically not guaranteed and could be changed or eliminated.*

\*Source: "Dividend Investing and a Look Inside the S&P Dow Jones Dividend Indices," Standard & Poor's, September 2013

\*\*Source: www.spindices.com, "S&P 500 Annual Returns" as of 3/13/2015



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