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MOLDENHAUER & ASSOCIATES

FEBRUARYNEWSLETTER

Editor: Richard C. Moldenhauer, CLU, CEP, RFC *Chartered Financial Consultant*

Winter in Western New York finally made an appearance. In early January I returned to WNY for a couple of days. It was great to see Brett and his brother Mark and visit with other folks I normally see in the summer. I was only there for a short time and the terrible weather put a damper on the visit.

About the time I left WNY, the weather even got worse. With the Bills having the good fortune to make the playoffs, the snow became a big issue at the stadium. It was great to see the community come together for as long as the Bills lasted in the playoffs.

Last year ended on a positive note for investors and, despite serious inflation, people started feeling better about the economy. Regardless of political speak, inflation is one of the greatest detriments to our economy. It particularly effects the working middle class and senior population. Younger people may be suffering the worst. This is the number one reason people should pay attention to their financial planning.

I often talk about older people because they encompass a substantial portion of our active clients. I would recommend that those same people suggest to younger friends and family that they start with their financial planning sooner rather than later.

If the younger people start to get off the consumption, spend it all bandwagon, the better chance they will have to reach retirement with adequate assets to enjoy their senior years. If they have the money and opportunity presents itself, they can then take advantage of those opportunities to further grow their net worth.

One of the most important things I have learned over my 50 plus year career is that time flies by and it is never too soon to plan.

For most of my career my clients never got disabled, and no one ever passed away. Today, like most older people (I am an older person), no month goes by when someone I know does not pass on. My old friend, Peter Keenan, always reminded me that "getting old is not for sissies." Now I know what he meant all those years ago.

The best solution I have found to deal with aging is staying busy. Taking on new and scary challenges has helped me overcome physical problems and remain excited about the future. The more active you can stay physically and mentally; the better life remains.

I recommend that people stop procrastinating about their "final planning". The government keeps changing rules and soon the estate tax is scheduled to increase. When that occurs, people will have a tax liability at a lower level of net worth. Most people are under a false impression that taxes will not increase. Like many conscious advisors, I believe that soon the government will be forced to look for more sources of revenue to fund an ever-increasing federal deficit.

I find myself making changes in my planning on a regular basis. It seems to me that if I periodically update the small things, the big steps stay organized. If a financial planner says you have done everything, find a new planner.

Remember, the government keeps spending and looking for new ways to take your assets. It is up to you to protect yourself and protect your family.

As I look for a way to end this article, I am reflecting on a book I recently completed reading. It was about a young person who could not find happiness. The person consulted a wise older sage who encouraged the person to learn to accept and love herself so she would find emotional peace. After debating the wise older person, she found a meeting of the minds and realized that when she accepted herself, life would get better. In time, the young student learned not to judge herself by the unreasonable imagined standards she had assumed were true. As she learned to appreciate her own worth, life got better, and she went on to accomplish more than she could have imagined.

Each of us controls how we deal with life and a positive attitude can improve whatever circumstance we may find ourselves saddled with.

Richard Moldenhauer

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WHAT YOU NEED TO KNOW ABOUT TOD ACCOUNTS

A relatively new option for clients, transfer on death (TOD) accounts offer a unique beneficiary feature. Unlike similar non-retirement accounts, TOD accounts allow investors' assets to transfer directly to their designated beneficiaries when they pass away, circumventing the probate court process. The TOD registration, which is available for both individual and joint accounts, streamlines the account disbursement process for the account holder's beneficiary or beneficiaries.

Beneficiary features of a TOD account include

- **Streamlined administration.** A traditional brokerage account owned in the account holder's name would be a part of the owner's estate upon his or her death, with distribution delayed until the probate process has been completed. By contrast, funds held in TOD accounts are considered nonprobate assets and pass straight to the designated beneficiaries. Once a TOD account has been established, neither a court appointment nor the terms of a will can override the Supplemental Transfer on Death Registration and Beneficiary Designation Form, which designates the account's beneficiaries. If necessary, agents holding powers of attorney can manage the TOD accounts, but they generally cannot establish a new TOD account or update the beneficiary designation of an existing one unless granted specific authority to do so in the power of attorney document.

  TOD accounts have no contribution limits and can hold all types of investments. When the owner dies, all trading in the account must cease until the TOD account assets can be transferred to the beneficiaries' accounts. The beneficiaries may then sell the positions, if desired. In order for a beneficiary to receive assets from a TOD account, he or she must have a brokerage account open at Commonwealth.

- **Unlimited number of beneficiaries.** TOD account holders can designate an unlimited number of beneficiaries, each of whom will be considered a primary beneficiary. Contingent beneficiaries may be added as well. The TOD account owner can choose, among other entities, his or her estate, individuals (including minors), trusts, and charities or churches as beneficiaries. Tip: Before opening a TOD account, consider the location of your beneficiaries. For example, if a beneficiary lives out of the country, Commonwealth will need to plan accordingly.

- **You retain control.** As the account owner, you continue to manage the account assets as you wish. Your beneficiaries have no rights to the account while you are living. If necessary, you can revise your beneficiary designations.

Keep in Mind

TOD accounts are not for everyone. It's important to consider how establishing this type of account will affect your overall estate plan and the provisions of your revocable trust or will.

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IRA RECHARACTERIZATION BASICS

Traditional and Roth IRAs offer great benefits, but knowing which of these retirement savings vehicles to use (and when) can be confusing. Did you make an annual contribution to your traditional IRA and then realize you should have made a Roth IRA contribution instead?

A recharacterization may be the solution. Here's an overview of what a recharacterization is and the IRS requirements for recharacterizing IRA contributions.

IRA Contribution Recharacterization

Contribution recharacterization involves changing the initial designation of a contribution from one type of IRA to another—that is, switching a traditional IRA contribution to a Roth IRA contribution or vice versa. You might make a contribution to a Roth IRA and then recharacterize it as a traditional IRA contribution in order to claim a tax deduction on the amount. Or, if you're ineligible to receive a deduction on a traditional IRA contribution, you may decide you'd be better off putting that amount into a Roth IRA, assuming your income doesn't fall outside the phaseout limits.

Roth Conversions Not Eligible for Recharacterization

In the past, you could use a recharacterization to undo or reverse a previously processed Roth conversion. That is no longer the case. The IRS no longer allows Roth conversion contributions processed on or after January 1, 2018, to be recharacterized.

Calculating Earnings

When recharacterizing, you're responsible for calculating and reporting any earnings, or negative earnings, on the recharacterized amount, according to an IRS formula:

> *Net Income = Contribution x (Adjusted Closing Balance – Adjusted Opening Balance) ÷ Adjusted Opening Balance*

This calculation isn't necessary if you're recharacterizing the full amount of the contribution and no other money has been transferred into or out of the account. For instance, if you were to recharacterize all of a $5,000 Roth IRA contribution to a

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traditional IRA contribution—assuming that no other transactions had taken place within the Roth IRA and no other contributions had been made to the account—you wouldn't need to perform the calculation. You have until your tax-filing deadline, including extensions, to recharacterize an IRA contribution. If you file your return on time, you will receive an automatic six-month extension to recharacterize the contribution.

What's the Best Move?

As you can see, there are many factors to consider, including potentially significant tax implications, when deciding whether to recharacterize IRA funds. Be sure to seek the advice of a tax professional or reach out to our office to determine the best strategy for your situation.

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YOUR 401(K) IS NOT AN ATM

6 things to consider before taking a loan from your retirement plan

If you are considering taking a loan from your retirement plan to bridge a financial gap, pause for a minute. This is a major decision that should not be made lightly, as there are consequences that could affect your ability to fund your future retirement. Here are six things you need to be aware of before you borrow from your 401(k) savings:

1. You'll incur double taxation.

You will repay the loan with after-tax dollars, and because the interest you pay is not tax deductible, you will pay tax on it again in the future when you retire and start withdrawing funds from your account.

2. Your take-home pay will be reduced.

Most plans require you to start repaying the loan (via paycheck deductions) almost immediately after you borrow the money. Your loan payment will reduce your take-home pay, potentially affecting your ability to meet your monthly expenses.

3. Your taxable income may increase.

Most likely, you will reduce or eliminate your normal 401(k) contributions until you have repaid the loan. Your loan repayments are not tax deferred, and they do not reduce your taxable income like 401(k) contributions do. As a result, you could shift into a higher tax bracket until you repay the loan and begin to contribute to your retirement savings again.

4. Your repayment schedule will accelerate if you leave your company.

If you lose your job or leave the company, it's not uncommon for plans to require full repayment of a loan within 60 days. This could create additional unforeseen financial stress on your household.

5. Failure to repay by the deadline will trigger a taxable event.

Most 401(k) plan loans must be repaid within five years. If you do not repay your loan based on the terms of the loan agreement, your employer will treat the loan balance as a distribution, triggering income taxes and the 10 percent early withdrawal penalty if you are younger than 59½.

6. You will lose the magic of compounding.

When you take a loan from your 401(k), you lose the ability to earn interest on that money, which can affect your total portfolio balance come retirement.

A Cautionary Tale

Your 401(k) plan is one of the best ways to save for retirement and help ensure your future security. Explore alternative options and consider all the implications before you take a loan or withdrawal from your employer-sponsored retirement plan. Otherwise, you may regret today's decision when you need this money most—at retirement.

Example:

John has a balance in his 401(k) account of $20,000. John defers $300 per month (or $3,600 annually) of his pretax salary. His employer matches 50 percent of his deferrals, or $150 per month.

John decides to take a loan of $10,000 from his 401(k) account. The terms of the loan are $10,000 with a 6 percent interest rate and a repayment duration of 60 months.

Because John's loan repayments will come out of his paycheck and reduce his take-home pay, he decides to stop contributing to his 401(k) plan until the loan is paid off. In other words, he stops contributing $300 per month. This also means he doesn't receive the $150 that his employer is matching.

As a result, John has removed $10,000 from his account. In addition, he is no longer contributing $5,400 each year for five years ($3,600 in deferrals and $1,800 in match). Assuming those assets, if they had remained invested in his account, earned a 7 percent rate of return, the value of John's 401(k) account in 30 years would have been $711,316.90. Because they were not, his account value is only $521,921.18 and his lost opportunity is $189,395.72.

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UPCOMING EVENTS:

Our upcoming seminars are at:

The Roycroft Inn

Tuesday, March 5, 2024 at 6 p.m.
40 S Grove Street
East Aurora, NY 14052

Orchard Park Country Club

Thursday, March 7, 2024 at 6 p.m.
4777 South Buffalo Street
Orchard Park, NY 14127

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