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Effective Financial Strategies

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High Earner? Make Nondeductible IRA Contributions

By Stephen Kepler, CFP®, Financial Planner

Beyond contributing as much as the government allows to an employer-sponsored 401(k), what are the options for high earners who aren't self-employed to maximize the amount of money put aside for their future?

Nondeductible IRA contributions can be a means to save tax-efficient funds for retirement, and, when part of a "backdoor Roth" strategy, can be a very valuable estate planning tool to pass assets to heirs.

> If you choose to make a nondeductible IRA contribution for 2017, make the contribution before you file your taxes; the deadline to do so is just over the horizon on April 17, 2018 (or it's as late as October 15th, 2018 if you filed an extension for your tax return).

The Savings Conundrum for High Earners

Employer-sponsored 401(k)s and deductible IRAs allow you to contribute pre-tax dollars and defer taxation on portfolio growth until you make withdrawals. These are certainly tax-efficient vehicles in which to save, as they lower your tax burden, but you may need to save more than just these deductible contributions.

Given your high income, there are limits on how much you can contribute to these programs, and in some cases, you may not be eligible at all.

- **401(k)—**In most cases for 2017, the most you can contribute is $24,000 if you are age 50 or older, or $18,000 for those younger.
- **Traditional IRA—**The contribution limits in 2017 are $6,500 for those 50 and older, and $5,500 otherwise; if your income exceeds certain limits (in 2017, $119,000 for those married, $72,000 for singles), you'll only be able to make nondeductible contributions.
- **Roth IRA—**High earners (more than $133,000 for a single tax filer or $196,000 for married couples filing jointly in 2017) can't make direct

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The 411 on 529s for 2018

By George Galat V, CFP®, Financial Planner

A 529 plan can be a powerful tool to help fund a family's education goals for their children. These plans have excellent value, and with the new changes made to them under the 2017 Tax Cuts and Jobs Act (TCJA), families have greater flexibility in funding their educational savings need.

What is a 529 Plan?

A 529 plan is a tax-advantaged savings plan specifically designed to fund qualified educational expenses. These plans are usually sponsored by the states themselves, but they can also be operated by individual educational institutions.

With a 529 plan, anybody can contribute funds, and those funds can later be used to pay for the education-related expenses of the named beneficiary. These expenses can be extended beyond tuition to include items such as books and class supplies, room and board, off-campus housing up to room and board limits set by the education institution, technology expenses such as computers, tablets, printers and software, to name a few. You may also change the beneficiary, but more on that later.

For illustrative purposes, let's take for example you and your spouse have two children, Sophia and Noah. Under current law, in 2018, you are allowed to contribute $15,000 a child per year. That means you can gift $15,000 to Sophia's account and $15,000 to Noah's account. Your spouse can also do the same. In total, that's $30,000 per year to each child's account.

Let's also assume your parents would like to contribute to Sophia and Noah's college education as well. They, too, are allowed to contribute $15,000 each,

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What's Inside

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contributions to a Roth IRA.

The Advantages of Nondeductible Contributions to an IRA

You can defer paying taxes on the growth of your nondeductible IRA contributions until you begin withdrawing funds. This can be a tax-efficient method to save additional funds for your retirement ifyou expect your tax rates to be lower when you are withdrawing funds than when you make the contributions.

For example, if you just invested after-tax dollars in a standard taxable account, the interest, dividends or capital gains would be taxed in the year they occurred.

Unfortunately, the maximum IRA contribution is $5,500 for anyone younger than 50, and $6,500 for those age 50 and older. The growth on that amount may not be significant enough to justify the added complexity of tax filing and general record-keeping associated with combining nondeductible and deductible contributions to an IRA.

The "Backdoor Roth" Conversion Option

If you choose to make nondeductible contributions to a traditional IRA, you may have the opportunity to convert the account to a Roth IRA down the road.

A "backdoor Roth IRA" allows you to contribute to a nondeductible IRA and then convert those IRA funds to a Roth IRA at a later date.

Keep in mind that the IRA aggregation rule could limit how effective this strategy may be for you. According to the rule, the tax consequences of any IRA distribution (including the one you would take to roll a traditional IRA into a backdoor Roth IRA) is calculated based on the total value of all IRA accounts you own.

When you have both deductible and nondeductible contributions, the aggregation rule limits your ability to convert just the new nondeductible IRA.

It may be possible to avoid the consequences of the aggregation rule by moving pre-tax funds into a 401(k) that permits funds to be rolled in, and then converting the remaining nondeductible funds into a Roth. However, doing so means you run the risk that a tax court will view these separate actions as an attempt to make an impermissible Roth contribution, so it's important to allow an adequate amount of time to lapse between the contribution and subsequent Roth conversion. The amount of time needed isn't defined anywhere, but many experts feel a year is sufficient.

Before taking this action, be sure to discuss the tactic with your CPA.

What to Know Post Roth Conversion

After a Roth conversion:

- Funds grow tax free until withdrawn.
- You aren't required to take minimum distributions at age 70 1/2.
- In some cases, you can make penalty-free withdrawals.
- You can contribute at any time, including after age 70 ½, if you qualify.

A Roth IRA can be an excellent estate-planning tool; assets continue to grow tax free. A non-spouse beneficiary must begin taking required minimum distributions by December 31st of the year following the year during which the owner died, the withdrawals to the beneficiaries remain tax free.

If you do decide to make nondeductible IRA contributions, note that you will be responsible for filing Form 8606 with your tax return every year in which you make a contribution.

Managing nondeductible IRA contributions requires some time and effort to navigate tax considerations. Ask your advisor to analyze the pros and cons as they apply to the circumstances of your individual retirement plan.

After weighing your options, decide for yourself if the time and resources spent are worth the added yearly contributions.

Thoughts to Live By

There is only one corner of the universe you can be certain of improving, and that's yourself.

—Aldous Huxley

Tell me and I'll forget; show me and I may remember; involve me, and I'll understand.

—Confucius

It is a funny thing about life; if you refuse to accept anything but the best, you very often get it.

—W. Somerset Maugham

The bad news is time flies. The good news is you're the pilot.

—Michael Altshuler

Ask an Advisor: What Are My Options for an Emergency Fund?

By Kevin Gahagan, CFP®, Advisor, Principal, CIO

Regardless of your personal circumstances, having some assets in a reserve is prudent planning.

For clients who are actively employed and earning income, we recommend holding an emergency fund that can cover 6 to 12 months of living expenses. Those who are retired or preparing to retire have different considerations, but the idea of having a reserve remains important. So what are your options? Let's break it down according to your lifestyle stage.

Employed and Saving to Your Portfolio

When you are still in the workforce and earning an income, the purpose of an emergency fund is to provide a ready source of cash that can be drawn upon when the unexpected occurs. This may be a temporary disability, job loss, or even the need to provide financial help to a family member.

The first objective for your emergency fund is that the funds are readily available when they needed (funds are "liquid," easily converted to cash). For this reason, unless your reserve is substantial, limit any restrictions that might be imposed on the access to these funds. Bank savings or money market accounts are often the most commonly used vehicles for emergency funds. CDs can serve in an emergency fund but should be of very short duration (1 to 3 months) so as not to impair liquidity when funds are needed.

Drawing on Your Portfolio

For those clients drawing on their portfolio to help fund their living expenses, a key consideration becomes cash flow. An important component should be considering how you will draw out your needed cash flow when markets are declining—including contingency planning for possible extended declines; for example, the market downturn occurring between 2007 and 2009. We advocate establishing a liquid reserve.

Like an emergency fund, a liquid reserve is a pool of money that can be drawn upon during a market decline (not a personal emergency).

When market declines persist and the level of decline crosses a predetermined threshold, this triggers the decision to discontinue "regular" portfolio withdrawals, and to begin drawing on the liquid reserve. The objective is to limit the demands on your portfolio investments when the portfolio is under greatest stress (such as the stress arising from falling equity markets).

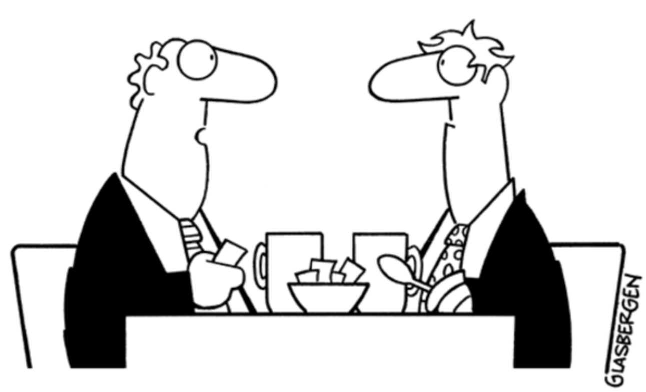
We typically recommend that a liquid reserve fund 18 to 24 months of needed income. Client circumstances may allow for a greater or lesser target. In all cases, as with clients funding an emergency reserve, the first objective of this reserve is that these funds will be available (liquid) when needed.

Where to Keep It

Subject to the size of your reserve and the time horizon over which these funds may be withdrawn, options for your reserve funds can range from CDs or short-term Treasury Bills to "ultra-short term" bond funds. Each of these can have advantages and some combination may be the best solution.

Where an ultra-short term bond fund is considered, it is important to understand that unlike a savings account that cannot lose principal, a bond fund, even an ultra-short fund, can decline in value in a volatile rising interest rate environment. Our past experience suggests that these funds can recover fairly quickly, but a short term decline can certainly be experienced. While ultra-short funds have historically offered better yields than bank instruments, today, these funds are not necessarily offering notably better yields than may be available through some FDIC-insured vehicles.

Despite the current low yield environment, for some folks, a bank savings or money market account may be best. For those willing to shop around, particularly if you're willing to work with an online bank, you can find savings account return rates above 1% (significantly better than the average bank savings account).



"So far I've got $900 saved for my retirement plus 250,000 little packets of sugar, ketchup and crackers."

(Continued from page 1—The 411 on 529s)

for a total of $30,000 to each child's account per year. This is done without needing to open multiple 529 plans. In fact, anybody can contribute to Sophia and Noah's 529 plans; there is no mandatory relationship requirement for contributors.

The law also allows for what is known as "superfunding." Under this method, you can contribute 5 years' worth of gifts in the first year. In 2018, that's $75,000 per child or $150,000 per couple. This allows the funds to grow in year one, using the power of compounding to your advantage. By employing this approach, using a 5% return, superfunding $75,000 at the beneficiary's birth is worth $8,279 more over 5 years than contributing the annual limit of $15,000 each year. In both scenarios, you've funded $75,000 into the account, but the timing of those funds is drastically different. As you'll notice on the graph below, over 18 years, you can see how this approach adds up. But if you can't afford to superfund $75,000 right now, don't fret. This isn't an all-or-nothing approach. You can gift anywhere between the individual limit of $15,000 and superfund limit of $75,000. If you elect this method, have a conversation with your tax professional as this should be reported on your tax return at the end of the year.

Plan for the Higher Cost

When it comes to college funding, we recommend you plan conservatively. Understand the entire cost, even if you only fund part of the need. There is often no shortage of college expenses when the time arrives.

For example, when faced with two options, a UC school or private school, base your calculation on the higher cost and be sure you know the all-in cost. Don't be surprised to find that the all-in cost of a school rises 30% or more above the tuition cost alone when factoring in room and board.

Eligible Schools

How can you tell whether a school is an "eligible" educational institution for 529 distributions? Within the US, a good litmus test for a school's eligibility is whether or not students can receive federal financial aid while attending that institution. By piggybacking on the Department of Education's standard, the IRS can clearly draw a line in the sand. Most schools qualify, but it doesn't hurt to check. For more information, go to fafsa.ed.gov, and navigate to the "Federal School Code Search." For those attending abroad, select "Foreign Country" in the state field.

Changing the Beneficiary

It's tough to forecast where little Noah will go to college, or what he'll study. If Noah doesn't end up using all of the funds, the plan can be rolled over to Sophia for her ultimate use and benefit. Each plan has a single, established beneficiary. To avoid running afoul of the tax law and incurring unwanted penalty, the IRS provides a detailed list of who's "eligible" to be named as the beneficiary. Rest assured that intermediate family members are considered eligible.

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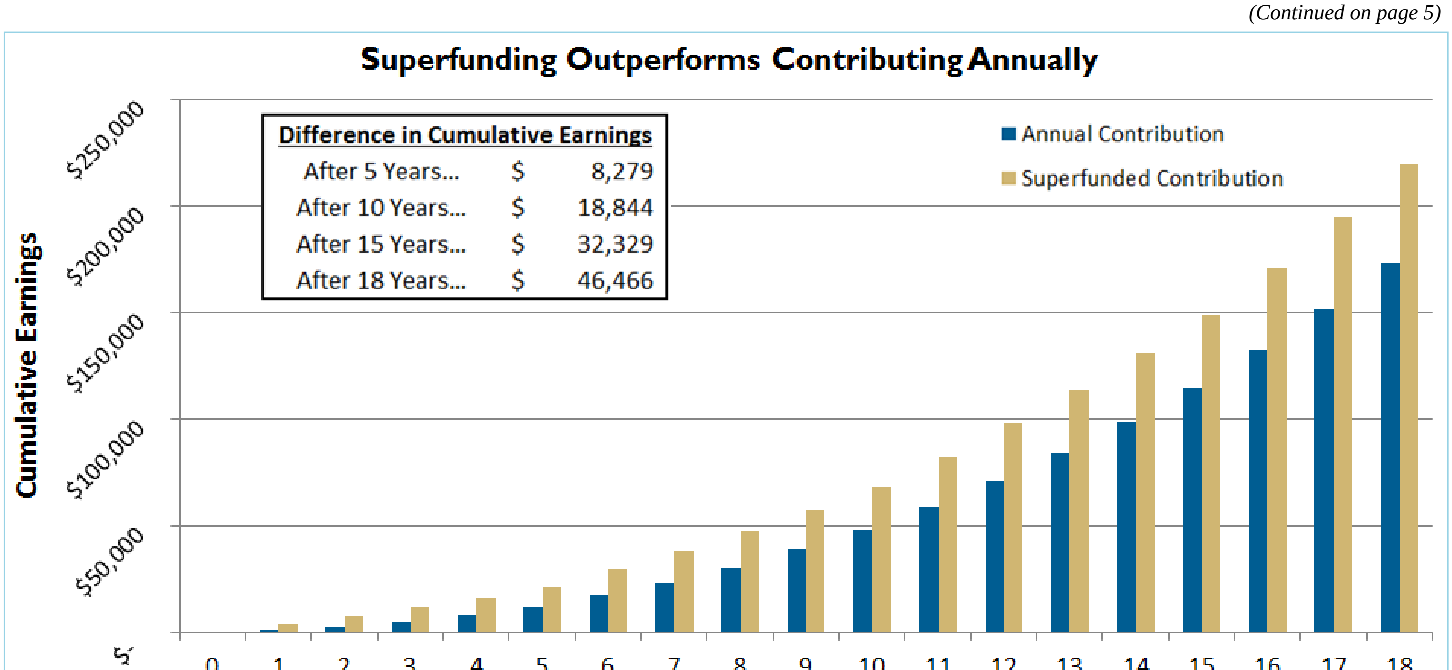


Note: Assumes 5% growth annually, maximum contributions, and no change to annual limits.

There isn't an age cap or limit on who can use the money. You're within your right if both Noah and Sophia have graduated college and have no further use for the funds to transfer the remaining balance for your own benefit. The same standard—qualified education expenses—applies. In these instances, be sure to grab your passport and sign up for culinary classes in France.

In the absolute worst case scenario where you have to make non-qualified withdrawals, you'll incur a 10% penalty plus pay ordinary income tax on any earnings. In other words, you won't be taxed and penalized on the money you put in, but rather the earnings that grew tax-deferred. While never ideal, it is an option.

Paying Directly to the Institution

Interestingly (at least to us), the tax law also allows for individuals to pay tuition directly to the educational institution gift-tax free (separate from income tax).

But when would it make sense to simply pay directly to the educational institution? Generally speaking, if Noah were a junior in high school with no plans of graduate school, it might not make sense to open and fund a 529 but rather pay his tuition directly to the educational institution. You wouldn't be wrong for opening a 529 plan, but the tax-deferral benefit may be minimal. Remember: the power of the 529 plan lies in its ability to grow tax-deferred over a period of time. The key is giving the funds enough time to grow in the first place. If Noah and Sophia are younger, in grade school, or planning on a doctorate while currently in high school, funding a 529 plan makes more sense, as the longer timeline allows compounding dollars to accumulate tax-deferred.

Tax Benefits and Plans Range in Different States

Placing money in a 529 plan provides for considerable federal tax benefits, but additional state tax benefits may also be available depending on where you live. Be sure to check with your state's plan to see if they offer you a state income deduction for your 529 plan contributions.

Unfortunately for California residents, the golden state does not offer a state tax incentive for 529 contributions. But you have options as to where you open your 529 account. Even though you may not have a state tax incentive when funding 529 contributions, it may make sense to open a 529 account in another state. Why? Investment options and fees range significantly between providers.

For those looking for a one-time, "automated" fund choice, most plans offer an age-based investment option which automatically adjusts depending on the beneficiary's age. When the child ages and gets closer to college-age, the risk ratchets down significantly. For example, if Sophia were 5, her investment allocation would likely be invested in more equities than fixed income. At 17, that ratio is likely reversed, with much less exposure to equities, if at all. Generally speaking, these low-maintenance funds are the desired choice for many, as they are typically less expensive than the static or customized investment alternatives found in most other plans.

If you opt for a more customized investment approach, there is a limit on how many changes you can make to the investment allocation each year. (Congress likely didn't want day-traders to play around in portfolios whose sole purpose is funding a child's education.) As the law is currently written, you are allowed two allocation changes per year.

Changes to 529s for 2018 and Beyond

The 529 plan was first established in 1996, but the 2018 version represents one of the most fundamental shifts in the plan's history. A last-minute amendment to the 2017 TCJA now allows for 529 dollars to be used to fund private or religious education at the K-12 level, in addition to their traditional higher education utility. There are some limitations to be aware of; you are allowed to distribute a maximum of $10,000 in any one tax year per beneficiary under this newly-expanded definition. In other words, even if Sophia has two 529 plans in her name and $20,000 in private school expenses for the year, only $10,000 amongst all plans may be distributed tax and penalty-free. Depending on where you live, that $10,000 can be more than enough or simply a portion of Sophia's annual tuition for private or religious education at the K-12 level. Regardless, having the option is better than not.

It's worth mentioning, at the time of publishing this article, not all states have amended their laws to mirror the newly-revised federal code on K-12 529 plan distributions. California has yet to amend their state law. Thus, in our example, if you were to distribute funds to Sophia for her private high school tuition as a California resident, you would be allowed to do so free of federal income taxes, up to the $10,000 annual limit, but may be subject to state taxes on those dollars, at least until the state legislation is revised. For the time being, this is something to keep an eye on.

For more on how 529 plans might help your specific college planning, talk to your advisor.

4 Tips for Established Couples to Navigate Money Conflicts

By Sabrina Lowell, CFP®, CPCC, Advisor, COO

Married life can be quite complex, and couples in the "middle years" of marriage can have no lack of money concerns: a career that requires an investment of time and money to continue developing; if they have children, add in all the financial demands associated with parenthood, including teaching their kids financial literacy and saving for college; taking care of aging parents; the daily challenge of running and funding a household; the long-term goal of saving for retirement, and more.

What keeps such a financial partnership strong?

1. Reassess and realign.

No financial plan should ever be a static thing. Life happens. That's just what it does. Situations, needs, and objectives change, and your financial plan needs to adapt as well. There are transitions on the horizon—near and far—which have financial tethers. Couples who find themselves mired in conflict can often break out of their rut by sitting down and reassessing where they are financially. List your earnings and assets, expenditures and obligations, and compare how they measure up to your long-term goals. While you're at it, take a look at your goals to ensure they're still the same, or to decide if they need to change.

On Listening Deeply

* Get in the right frame of mind.
* Get rid of distractions.
* Let go of judgement.
* Know why you're listening.
* Know the value of what you're hearing.
* Know when to speak.
* Ask for clarification.

2. Talk about the things you haven't wanted to talk about so far.

Virtually every marriage has at least one partner with a money-related issue that they don't know how to talk about. Perhaps your partner has a different style than you do—which by the way is very common—and this impacts their approach to personal finance. Try to focus on being a focused, engaged listener.

Make time for a mid-marriage check-up. Mosaic offers a 90-minute "mid-marriage check-up" to clients who aren't already walking together down this path. Ask your advisor about it.

3. Don't relax over debt.

If you're both established in your careers and earning good money, you have more incentive than ever to be smart about the type of debt you accrue and how you use credit. Understanding your joint philosophy on debt is important. While it's critical to be able to run the numbers before taking on additional debt (calculations that factor how much interest will it cost, is it tax deductible, is it more beneficial to finance the debt or use cash reserves, and the like), many times decisions about debt are more of an art than a science, centering on emotion rather than evidence. People often bring their own biases about whether to use debt or not, and when. Together you can work on creating personal financial planning policies for each debt area (home, education, consumer, auto, and other debt).

4. Find balance over investing styles.

Most couples know saving for retirement is a priority; if you want to enjoy your golden years together, you will need plenty of money. However, multiple studies indicate men and women can have very different investment approaches. In a partnership, often one individual is risk seeking and the other conservative. If one partner dominates the investing conversation, and one style is allowed to rule over the other partner's discomfort, conflict can occur. Understanding your joint financial risk capacity (how much risk you can afford to take on, or conversely, how much risk you don't need to take on) as well as each of your emotional risk tolerances (the "sleep at night" factor) will enable you to put in place a portfolio structure that both gets you where you want to go and allows you to sleep at night along the way.

A recent poll from Money Magazine offered an encouraging insight for married couples: The older you get, the less likely you are to argue over money. The survey found that money disagreements peak between ages 35-44, when 80% of couples disagree over money. Money conflicts decline as couples get older, and by age 65-plus, less than 60% fight over money.

At any age, you can further lower the number of money arguments you have by regularly revisiting your financial plan. Doing so will help you gain confidence that you're moving together in the right direction, which can put your partnership on the path to healthy financial dialog in your later years.

For more tips, download your copy of the ebook!
www.mosaicfp.com/couples-money

Around the Office...

At the Podium

In January, **Kevin Gahagan** was a featured panelist for Asset TV's program "Master Class on Liquid Alternatives," which focused on the emergence of liquid alternative investments and their application in investor portfolios.

Also in January, **Sheila Schroeder** presented a webinar titled "Creating Your Budget Roadmap" to the Golden Gate Mothers Group.

In February, **Sheila** led the senior class of the San Francisco Waldorf High School on a two-day introduction to the tenants of personal finance, covering budgets, saving, investing, retirement, and managing (and avoiding) debt.

Later in February, **Geoff Zimmerman** presented as a panelist in a focused seminar on the main elements of estate planning for the East Bay's Regional Parks Foundation, covering wills, revocable trusts, powers of attorney, health care directives, charitable trusts, and more.

Education, a Continuing Affair

In January, **Channing Hussey** started the 2 year program known as the G2 Leadership Institute, which focuses on developing the leadership and business management skills of professionals who are preparing themselves for leadership positions within their firms.

Also in January, **Kevin Gahagan** and **Sabrina Lowell** attended a Commonwealth Club lecture by noted economist and historian, Niall Ferguson. Ferguson spoke on the theme of his recent book, The Square and the Tower, where he argues that it is "networks" of people—not government leaders or social elites—that have driven change and molded western society. Ferguson was not shy in offering his view as to which networks, currently in their infancy, may be the drivers of future change.

In February, **Kevin** attended a half-day program on new developments in environmental, social and governmental (ESG) investing. The program provided a current overview of the range of ESG-focused offerings in many of the investment asset classes Mosaic employs in multiple client portfolios.

Giving Back to the Community

In December 2017, **Channing** joined the board of directors of the Marina Community Association.

In January, **Channing** was elected to serve as the 2018-2019 Nominating Vice Chair for Junior League of San Francisco (JLSF); never one to rest on her laurels, in February **Channing** launched the spring class of "Provisionals" for the JLSF, guiding 60 women through the process of learning about all aspects of JLSF history and structure to community programs, fundraising, advocacy, and strategic planning. She also attended the Organizational Development Institute Conference, for the Association of Junior Leagues International, in Orlando, Florida, in February.

Congratulations!

Norm and **Linda Boone** welcomed their very first grandchild, a rosebud of a girl named Brooklyn Lee Boone, this past December!

Savoring SF—Restaurants We Like Lately

Zach Schlaht recommends The House in North Beach, a small Asian fusion restaurant that's great for dinner. Call at least a week in advance to make a reservation, and try the scallops. And there's Mister Jiu's in Chinatown, a modern spin on Cantonese, which was recently awarded its first Michelin Star. Make reservations 2 to 3 months in advance. Devil's Gulch pig's head or salt-baked trout are both very good.

Elka Weber recommends Zazie in Cole Valley for brunch with a French twist. Arrive when they open to bypass the waitlist. Try the miracle pancakes (a rotating recipe, currently bread pudding!) or the gingerbread pancakes with Meyer lemon curd and Bosc pears.

Multiple Designations Awarded

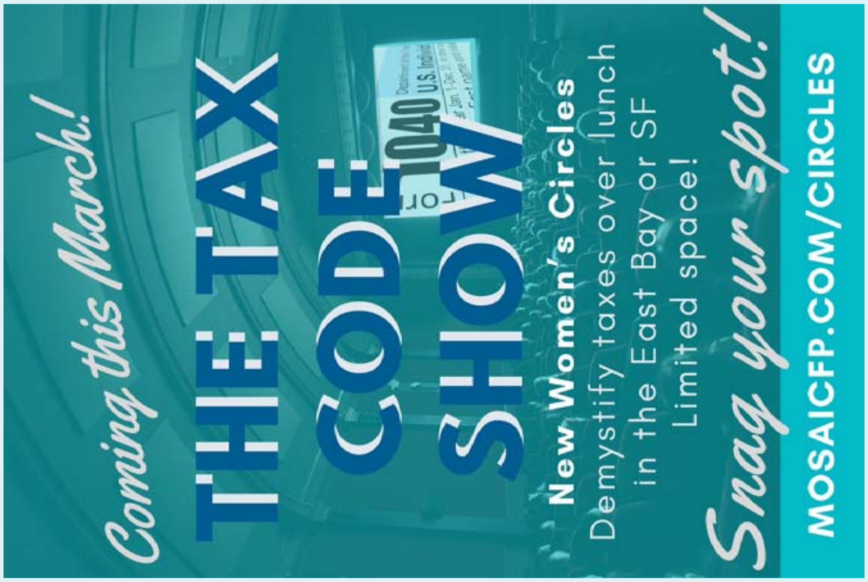
Mosaic is proud to announce multiple new designations acquired by our advisory staff. Thank you for furthering and deepening our commitment to exceptional service.

Mary Ballin has passed the 4 rigorous exams required to earn the Certified Divorce Financial Analyst® (CDFA®) designation, which strengthens Mary's specific expertise in assisting clients with managing the many financial details associated with the life-changing transition.

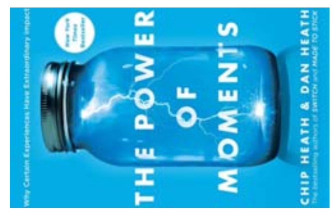
Steve Branton, **Sabrina Lowell**, and **Liz Revenko** have each earned their Certified Professional Co-Active Coach® (CPCC) credential. The year-long program required a minimum of 200 hours of training and 100 hours of direct client coaching. Coaching enables people to achieve success and fulfillment in their work and life through a powerful coach/client alliance that promotes and enhances the lifelong process of learning. We believe these skills will significantly assist our financial planning work.

MOSAIC WOMEN'S CIRCLES

Sign up for the Women's Circles mailing list and we'll keep you in the loop about future topics.



What We're Reading



Why do we remember certain experiences and forget others? In their new book, written with trademark illustrative storytelling style, the Heath brothers examine defining moments and identify the traits they have in common, and show the reader how to create defining moments by making use of those elements. Instead of passively waiting for them to happen to you, you can make more of the memories that matter most.

Even more advice, articles & events: mosaicfp.com/blog

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