

# AWM Financial Planning

What is your most valuable financial asset?



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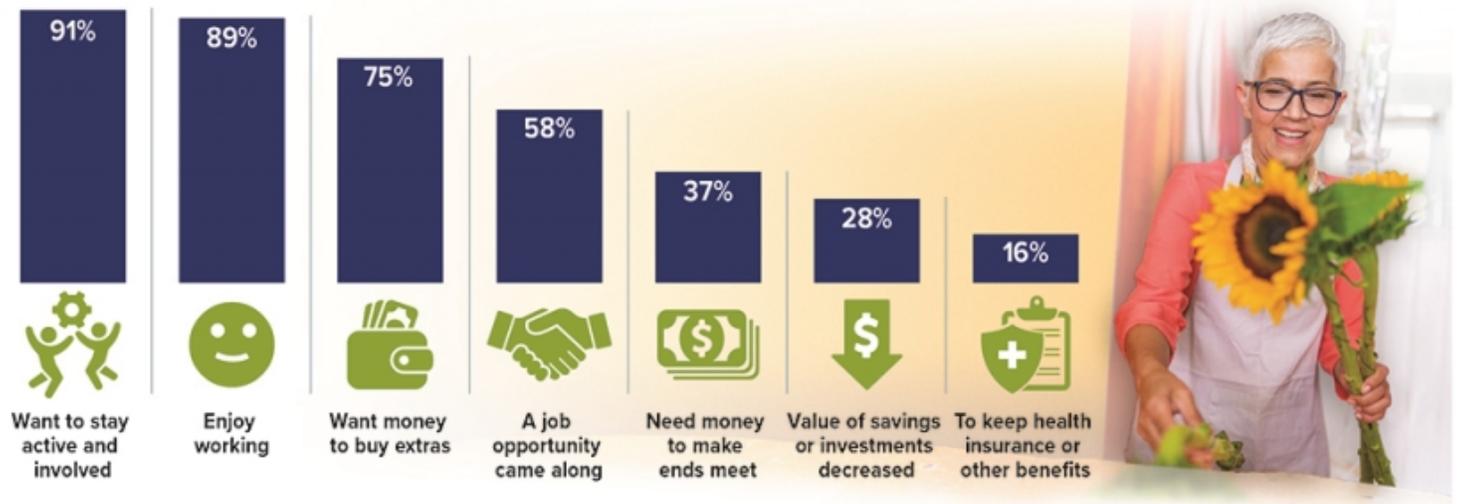


What is your most valuable financial asset? Many of you may answer your home, your 401(K), etc. For working adults, we believe your greatest asset is your ability to earn an income. Though some of us feel invincible, the reality is that 1 in 4 of today's 20-year-olds will suffer a disability before they retire. To protect that income, disability insurance provides income replacement in the event you not able to work due to illness or injury. Through our partnership with DPL Financial Partners, we can now offer commission-free disability coverage provided by Principal Financial. This is especially important for those business owners and professionals that do not have employer-provided coverage but also very important for high-income earners that may need additional coverage over what their company provides. A standard group policy which replaces 60% of your income (benefit is taxable) capped at \$5,000 a month may be insufficient. Give us a call to discuss your situation.

## Working in Retirement

In 2020, 74% of workers said they expected to work for pay after retiring from their regular jobs, but only 27% of retirees said they had actually done so. This large gap between expectation and reality has been fairly consistent in surveys over the past 20 years, and there is no reason to expect it will change. So it may be unwise to place too much emphasis on income from work in your retirement strategy.

Most retirees who worked for pay reported positive reasons for doing so; however, there were negative reasons as well.



Source: Employee Benefit Research Institute, 2020 (2019 data used for chart, multiple responses allowed)

# Seeking Sun or Savings? Explore a Retirement Move

Many people intend to retire in the place they call home, where they have established families and friendships. But for others, the end of a career brings the freedom to choose a new lifestyle in a different part of the country — or the opportunity to preserve more wealth and protect it from taxes.

This big life decision is not all about money or the weather. Quality-of-life issues matter, too, such as proximity to family members and/or a convenient airport, access to good health care, and abundant cultural and recreational activities. In fact, choosing a retirement destination typically involves a delicate negotiation of emotional and financial issues, especially for married couples who may not share all the same goals and priorities.

If you're nearing retirement, there's a good chance you have at least thought about living somewhere warmer, less expensive, or perhaps closer to children who have built lives elsewhere. Here are some important factors to consider.

## Cost of Living

A high cost of living can become a bigger concern in retirement, when you may need to stretch a fixed income or depend solely on your savings for several decades. There's no question that your money will go further in some places than in others.

The cost of living varies among states and even within a state, and it's typically higher in large cities than in rural areas. Housing is typically the largest factor — and often varies the most from place to place — but cost of living also includes transportation, food, utilities, health care, and, of course, taxes.

Selling a home in a high-cost area might enable you to buy a nice home in a lower-cost area with cash to spare. The additional funds could boost your savings and provide additional income. Moving to a more expensive locale may require some sacrifices when it comes to your living situation, future travel plans, and other types of personal spending.

## Tax Differences

Seven states have no personal income tax — Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming (Tennessee and New Hampshire tax only interest and dividend income) — and other states

have different rules for taxing Social Security and pension income. Estate taxes are also more favorable in some states than in others. Property taxes and sales taxes also vary by state and even by county, so make sure to include them when calculating and comparing the total tax bite for prospective destinations.

The Tax Cuts and Jobs Act limited the annual deduction for state and local taxes to \$10,000. This change resulted in federal tax increases for some wealthier households in high-tax states, and it may also factor into your relocation decision.



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## Tips for Snowbirds

If you can afford the best of both worlds, you might prefer to keep your current home and head south for the winter. But if your choice of location is based largely on lower taxes, consider how much the costs of owning, maintaining, and traveling between two homes might cut into (or exceed) the potential tax savings.

To establish residency in the new state, you must generally live there for more than half of the year and possibly meet other conditions. You should also be aware that the tax agency in your old state may challenge your residency claim, especially if you still own property, earn income, or maintain other strong ties. If so, you may need to document your time and activities in each state and/or prove that your new home is your primary and permanent residence.

If you decide to live somewhere new on a full- or part-time basis, it may be worthwhile to rent for the first year, just in case the adjustment turns out to be more difficult than expected. You might also discuss the financial implications of a move with a tax professional.

# Is Now a Good Time to Consider a Roth Conversion?

This year has been challenging on many fronts, but one financial opportunity may have emerged from the economic turbulence. If you've been thinking about converting your traditional IRA to a Roth, now might be an appropriate time to do so.

## Conversion Basics

Roth IRAs offer tax-free income in retirement. Contributions to a Roth IRA are not tax-deductible, but qualified withdrawals, including any earnings, are free of federal income tax. Such withdrawals may also be free of any state income tax that would apply to retirement plan distributions.

Generally, a Roth distribution is considered "qualified" if it meets a five-year holding requirement and you are age 59½ or older, become permanently disabled, or die (other exceptions may apply).

Regardless of your filing status or how much you earn, you can convert assets in a traditional IRA to a Roth IRA. Though annual IRA contribution limits are relatively low (\$6,000 to all IRAs combined in 2020, or \$7,000 if you are age 50 or older), there is no limit to the amount you can convert or the number of conversions you can make during a calendar year. An inherited traditional IRA cannot be converted to a Roth, but a spouse beneficiary who treats an inherited IRA as his or her own can convert the assets.

Converted assets are subject to federal income tax in the year of conversion and may also be subject to state taxes. This could result in a substantial tax bill, depending on the value of your account, and could move you into a higher tax bracket. However, if all conditions are met, the Roth account will incur no further income tax liability and you won't be subject to required minimum distributions. (Designated beneficiaries are required to take withdrawals based on certain rules and time frames, depending on their age and relationship to the original account holder, but such withdrawals would be free of federal tax.)

## Why Now?

Comparatively low income tax rates combined with the impact of the economic downturn might make this an appropriate time to consider a Roth conversion.

The lower income tax rates passed in 2017 are scheduled to expire at year-end 2025; however, some industry observers have noted that taxes may rise even sooner due to rising deficits exacerbated by the pandemic relief measures.

Moreover, if the value of your IRA remains below its pre-pandemic value, the tax obligation on your conversion will be lower than if you had converted prior to the downturn. If your income is lower in 2020 due to the economic challenges, your tax rate could be lower as well.

Any or all of these factors may make it worth considering a Roth conversion, provided you have the funds available to cover the tax obligation.

As long as your traditional and Roth IRAs are with the same provider, you can typically transfer shares from one account to the other. When share prices are lower, as they may be in the current market environment, you could theoretically convert more shares for each dollar and would have more shares in your Roth account to pursue tax-free growth. Of course, there is also a risk that the converted assets will go down in value.

## Using Conversions to Make "Annual Contributions"

Finally, if you are not eligible to contribute to a Roth IRA because your modified adjusted gross income (MAGI) is too high (see table), a Roth conversion may offer a workaround. You can make nondeductible contributions to a traditional IRA and then convert traditional IRA assets to a Roth. This is often called a "back-door" Roth IRA.

As this history-making year approaches its end, this is a good time to think about last-minute moves that might benefit your financial and tax situation. A Roth conversion could be an appropriate strategy.

*All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.*

| If your federal tax filing status is:          | Your 2020 Roth contribution is reduced if your MAGI is: | You can't contribute to a Roth IRA for 2020 if your MAGI is: |
|--|---|--|
| Single or head of household                    | More than \$124,000 but less than \$139,000             | \$139,000 or more  |
| Married filing jointly or qualifying widow(er) | More than \$196,000 but less than \$206,000             | \$206,000 or more  |
| Married filing separately                      | More than \$0 but less than \$10,000                    | \$10,000 or more   |

*Note that your contributions generally cannot exceed earned income for the year. (Special rules apply to spousal IRAs.)*

# Should You Pay Off Student Loans Early or Save More for Retirement?

For adults with student debt and extra money on hand, deciding whether to pay off student loans early or put those funds toward retirement can be tricky. It's a financial tug-of-war between digging out from debt today and saving for the future, both of which are very important goals. This decision is relevant today considering that roughly 65% of college graduates in the class of 2018 had student debt, with an average debt of \$29,200.<sup>1</sup> This amount equates to a monthly payment of \$295, based on a 4% interest rate and standard 10-year repayment term.

Let's assume you have a \$300 monthly student loan obligation. You have to pay it each month — that's non-negotiable. But if you have extra money available, what's the better course: pay more toward your student loans each month to pay them off faster or contribute extra funds to your retirement? The answer comes down to optimizing how those dollars can be put to work for you.

The first question to consider is whether you are taking full advantage of any 401(k) match offered by your employer. For example, let's say your employer matches one dollar for every dollar you save in your 401(k), up to 6% of your pay. If you make \$50,000 a year, 6% of your pay is \$3,000. So by contributing \$3,000 per year to your 401(k), or \$250 per month, you will get the full employer match of \$3,000. That's a 100% return on your investment.

If you are already contributing enough to get the full match, next compare the interest rate on your debt to the rate of return you could be earning on any extra funds you invest. When you make extra payments on a specific debt, you are essentially earning a rate of return equal to the interest rate on that debt. In the student loan example, the interest rate is 4%, so by applying extra money toward that debt you are "earning" a 4% return. If you think you can earn a higher rate of return by investing extra money in your retirement account, then those funds might best be put to work for you there.

Of course, no one can predict their expected rate of return with certainty. But generally speaking, if the interest rate on your debt is relatively low, the potential long-term returns you might earn in your retirement account could outweigh the benefits of shaving a year or two off your student loans. If you have time on your side when saving for retirement, the long-term growth potential of even small amounts can make contributing to your retirement account a smart financial move.

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1) The Institute for College Access and Success, 2019

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## IMPORTANT DISCLOSURES

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