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Diversified Asset Management, Inc.

1113 Spruce Street, Boulder, CO 80302

phone: 303-440-2906

14 Sure-Fire Midyear Tax Planning Moves In '14

Even as we approach the midpoint of this year, it's still not clear whether some favorable tax provisions that officially expired last year will be extended retroactively into 2014. Yet while that uncertainty could affect your tax planning for this year, there's plenty we do know that you could act upon. Consider these 14 midyear tax strategies for '14:

1. Sell securities at a gain. Despite recent tax law changes, you still can benefit from rules that give you a tax break on investment sales. The maximum tax rate for long-term capital gains is only 15% (or 20% for those in the top two ordinary income tax brackets). However, some upper-income investors also may have to pay a surtax of 3.8% on capital gains.

2. Harvest capital losses. If you've already realized gains—particularly short-term gains taxed at ordinary income rates reaching as high as 39.6%—you might be able to sell losing positions to offset those profits. If your losses exceed your gains, you also can use them to erase up to $3,000 of ordinary income in 2014.

3. Max out on 0% rate. If you expect your income to be low this year—for example, if you incur a substantial business loss—a portion of your long-term capital gains may qualify for the 0% tax rate that applies to investors in the two lowest ordinary income tax brackets.

4. Avoid the wash sale rule. If you acquire "substantially identical" securities within 30 days of selling an investment at a loss, you won't be able to deduct the loss on your tax return. This "wash sale" rule can be avoided by waiting at least 31 days to buy back the same securities. Or you could buy the additional shares first and wait at least 31 days to sell your original holdings.

5. Invest in dividend-paying stocks. Most dividends are taxed at the same preferential tax rates as long-term capital gains. To qualify for this tax break, however, you have to hold the dividend-paying shares at least 61 days.

6. Arrange an installment sale. You usually can defer tax on the sale of real estate or other property if you receive payments over two years or longer. Not only do you stretch out your tax payments, but you also might reduce the effective tax rate if you stay below the thresholds for the higher capital gains rate and the 3.8% surtax.

7. Contribute to a 401(k). Another way to reduce your tax liability is to increase contributions to a 401(k) plan where you work. For 2014, you can elect to defer as much as $17,500 to your account ($23,000 if you're age 50 or over). You won't be taxed on those contributions, which can compound tax-free until you make withdrawals from the account during retirement.

8. Convert to a Roth IRA. If you have money in a traditional IRA, you can convert some or all of those funds

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Don't Expect Social Security To Be Enough To Retire On

If you're in your 20s, 30s, or even 40s, here's a warning: Don't count on Social Security benefits to sustain you comfortably through retirement. In fact, you may be better off not relying on Social Security at all.

Consider the aging population. According to the latest data, the average age of Americans is currently 36.7, and that average is edging up 0.2 years each year. With the population growing older, and birth rates falling, the number of people receiving Social Security retirement benefits will continue to increase at a time that fewer young workers will be available to fund the system with payroll deductions.

Whatever steps are taken to address that imbalance, the reality is that future benefits could decrease—and Social Security never was intended to be anyone's only source of retirement income. With increasing pressure on that system, saving on your own will be more important than ever. And the earlier you begin, the better off you're likely to be.

If you have a 401(k) plan or another kind of retirement plan at work, that's usually a good place to start, especially if your employer offers matching contributions. Contact your benefits department to get the ball rolling. You also might consider setting up a Roth IRA on your own. It's relatively easy to establish such an account, and we can provide whatever assistance you might need.

Robert Pyle & Sarah Heller

Is It Too Late For Roth Conversion?

When you're creating a retirement paycheck from a blend of Social Security, pensions, and personal retirement accounts, it only makes sense to do what you can to minimize income and investment taxes. For example, consider the distributions from your traditional IRAs or 401(k)s. Most or all of that income will be taxed at full income rates that now go as high as 39.6%. In contrast, under most circumstances, withdrawals from Roth IRAs aren't taxed at all. So should you switch from traditional IRAs to a Roth? Or is it too late to benefit from such a conversion?

The answer depends on your situation. Because you'll have to pay income tax on the money you convert to a Roth IRA, one crucial calculation involves whether your federal income tax bracket will be higher or lower during retirement. It usually makes sense to convert before retirement if you expect to be in a higher tax bracket later, while if you anticipate being in a lower bracket in retirement, you probably should wait until then to convert. If you are retired and expect to remain in a relatively low tax bracket, you might decide not to convert at all.

The main attraction of a Roth IRA for retirees is the lure of tax-free payouts while living on a fixed income. Distributions you take after age 59½ from a Roth you've had for at least five years normally will be exempt from federal income tax. And, from an estate planning view, with a Roth you won't be subject to the mandatory lifetime distributions that traditional IRAs require. But because a Roth conversion is taxable, it's like taking money out of an IRA for almost any other reason—and it may or may not pay off.

Example 1: You're in the 39.6% tax bracket now, you expect to be in the 28% bracket in retirement, and you have $500,000 in an IRA. If you convert to a Roth this year, you'll have to pay a tax of $198,000. That's probably not worth the future benefit of receiving tax-free payouts—money that would have been taxed at the 28% rate without the conversion. However, if you wait until you drop into the 28% bracket the conversion will cost less and may be worthwhile.

Example 2: You're in the 28% bracket now, you expect to be in the 39.6% bracket during retirement, and you have $100,000 in an IRA. If you convert to a Roth this year, you'll pay a tax of at least $28,000. (It may be higher because part of the conversion could be taxed at a 33% rate.) But that may be preferable to being taxed on that money at the top 39.6% rate during retirement.

You'll also need to weigh other factors, including the size of your account and whether a series of smaller conversions might reduce your overall tax liability. Also, a Roth conversion effectively could increase the 3.8% surtax on your net investment income. We can help you figure out the best strategy for your situation. ●

Auto Enrollment: Boom Or Bust?

The trend toward using an "automatic enrollment" feature in 401(k) plans is having one desired effect, leading to more employees participating in such plans. With automatic enrollment, you are considered to have signed up for an employer-sponsored retirement plan as long as you don't actively opt out. Yet while participating in your company's 401(k) is almost always a good idea, other aspects of automatic enrollment may be less beneficial.

With a 401(k) plan, you can defer salary to your retirement account on a pre-tax basis, up to generous limits in the law. You can choose to defer as much as $17,500 in 2014, or $23,000 if you're age 50 or older. Often, too, participants will be eligible for "matching contributions" from their employers, based on a percentage of compensation.

However, if you're classified as a highly compensated employee (HCE), strict nondiscrimination rules could limit your participation in the plan. For example, plans must pass an actual deferral percentage test for employee contributions and an actual contribution percentage test for employer contributions. If a plan fails those tests, the amount you're allowed to contribute will be restricted.

Frequently, the figures are skewed by new hires who don't elect to participate in a plan. In addition, other employees may still be gun-shy about participating after the last economic downturn. The end result is bad news for HCEs.

That's where the automatic enrollment feature can come to the rescue. Because employees must actively choose to opt out of the plan if they don't want to participate, more tend to stay in the plan, and it's likely that a higher percentage of non-HCEs will participate than would join a plan without automatic enrollment. That could reduce the chance that

How Best To Leave IRAs To Your Grandchildren

Would you like to set aside money for your young grandchildren? One way to do that without giving up control over the assets is to leave one or more of your IRAs to the grandkids. If you handle things correctly, the youngsters have to take only minimal distributions during their lifetimes, enabling the funds to grow and compound for decades.

But you still have obstacles to overcome. Significantly, a minor child can't inherit an IRA outright. As an alternative, you generally can designate either a grandchild as the beneficiary of your IRA and appoint a custodian to oversee the account, or you can leave the IRA to a trust. With the latter, you still can dictate how the money will be used after you pass away.

Let's take a closer look at these two main options.

1. Name the grandchild as the IRA beneficiary. Typically, you might appoint one of your grandchild's parents—your son or daughter—as custodian for the account. Also, remember to name a backup in the event your first choice is unable to serve. Fail to make contingency plans and the entire matter may end up in court, with whoever is seeking guardianship for the IRA having to ask to be appointed as custodian.

If you're going this route, check with the financial institution or brokerage firm holding the IRA to make sure it permits minors to be named as IRA beneficiaries. Not all companies do, but it's relatively easy to move the funds to an institution that does allow it.

This arrangement can be simple and effective, but there's one potential downside. Once grandchildren reach the age of majority (usually 18 or 21) in the state where they live, the money is legally theirs. Instead of investing the funds over the long term as you envisioned, the grandchild might rush out and buy a Range Rover or splurge on an exotic vacation.

2. Name a trust as the IRA beneficiary. This may the optimal approach if you're concerned that a young beneficiary will squander the money. All you have to do is set up a trust (the fees generally are reasonable), designate it as the IRA beneficiary, and choose a grandchild as the beneficiary of the trust.

This will give you greater control. For instance, with a trust you can dictate when the money can be spent or what it can be spent on. In addition, the trust terms could require the grandchild to take distributions over his or her life expectancy, or the trust could dole out specified amounts on a predetermined schedule.

Note, however, that a trust likely won't provide any tax benefits. Investment earnings will be taxed to the trust while the funds accumulate, and the annual tax rate for the trust frequently will be higher than the rate a youngster would have paid. For 2014, a trust with an income of $15,000 a year is in the top 39.6% tax bracket, while the grandchild would pay a maximum rate of only 15%.

To avoid that problem, you could convert some or all of your traditional IRA funds into a Roth IRA. The conversion is subject to current tax, but this may ensure future tax-free payouts.

Time Is On Your Side

No matter which method you use, time is a valuable ally. Heirs of both traditional and Roth IRAs can stretch the tax advantages by taking "required minimum distributions" (RMDs) over their life expectancies. While distributions from a traditional IRA are taxable, payouts from a Roth IRA are tax-free.

Because of differences in life expectancy, a younger heir will have to withdraw less money than an older one. For example, the first RMD for a 10-year-old inheriting a $200,000 IRA that grows 6% a year would be around $2,950. In comparison, a 20-year-old inheriting that IRA would get an initial RMD of about $3,400. The amount that must be withdrawn increases each year, but it will be small enough that much of the account can continue to grow.

Like your own RMDs, these are based on both age and account balance. Going back to the previous example of the 10-year-old, the second distribution would increase to about $3,130. By the time that heir turns 68, assuming the same 6% annual growth, the account would be valued at roughly $1.3 million, with an RMD of about $89,560. Of course, these figures are hypothetical and not indicative of any particular investment.

Finally, if you've made nondeductible contributions to an IRA, keep detailed records of those contributions. When the contributions are withdrawn, they aren't taxable, but the paperwork may be needed to prove it. Otherwise, your heirs could end up paying tax they don't actually owe.

It may be wise to divide up IRAs based on the respective ages of grandchildren. Consider all your options carefully. We're available to provide guidance. ●

there will be extra limits on contributions by HCEs.

But what if you're at the lower end of the salary scale? Automatic enrollment may get you into your company's 401(k), but employers sometimes try to encourage participation by limiting the "default rate" of salary deferral for employees who don't choose their own rate. Stick with the default rate, which might be as low as 3%, and you're likely not to set aside enough to fund your retirement. In addition, plans with automatic enrollment may include a default investment allocation that may not fit your needs.

In the case of both of these features, the solution could be to go beyond the default options, choosing to contribute more and to put the money in other kinds of investments. Young people who have several decades until retirement, for example, might choose to emphasis stock funds that have the potential to provide higher returns than they might earn in less aggressive investments. ●

Markets May Not Be Certain, But Experience Is

Have you ever wished you could do it all over again? Experience can be a great teacher, and it's natural to imagine that with the benefit of hindsight you would have made better decisions about everything from raising your children to managing your financial affairs. And while that may or may not be true, what is certain is that you can offer younger family members some of the insight you've acquired along the way.

Here are some thoughts you might pass along:

1. When you get a pay raise or a new higher-paying job, consider earmarking at least part of the additional money for retirement savings. You'll be amazed by what tax-deferred compounding can do to even relatively small sums over the course of several decades. And using raises to increase your contribution to a 401(k) can be relatively painless. Ratchet up your saving rate by a percentage point or two each year and you'll soon reach the maximum for annual pre-tax contributions to 401(k)s and similar employer-sponsored plans—$17,500 in 2014 if you're younger than age 50. Beginning at 50, you'll be eligible to save an extra $5,500 a year.

2. Try to resist the siren song of early retirement. Leaving your job in your 50s may be tempting, but it runs counter to several financial realities. Most people have not saved enough to retire comfortably even at the traditional age of 65, and quitting early can mortgage your future in two ways—reducing the amount you can save while extending the time that your savings must support you. By the same token, however, every year you keep working improves your situation. Moreover, as life expectancies increase, more and more people find they want to stay on the job at least part time, and not only for financial reasons. Working can help keep you engaged and healthy, particularly if you find something you really like to do.

3. Consider postponing Social Security. You can begin receiving benefits as early as age 62, but each year you delay will increase the amount of your monthly payment, and if you wait until age 70, you'll get 76% more than if you had started drawing benefits at 62. And most people will live long enough to get a larger total payout if they begin later.

4. Don't feel like you have to go it alone in making financial decisions. Working with an advisor could help you make sense of complex financial markets and chart a comfortable path toward your goals. The right advisor can assist you in deciding how much to save, how to allocate your investments, how to weigh the pros and cons of buying a home and other major financial choices, and, when the time comes, how to deploy your retirement nest egg. ●

Midyear Tax Planning Moves

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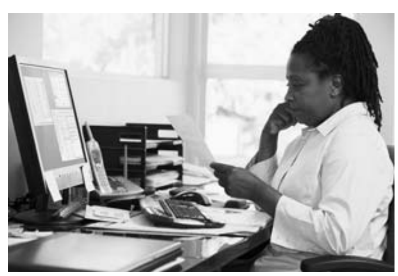
to a Roth IRA. The amount you convert will be taxed as regular income, but you could ease that pain by spreading out the conversion over several years. And you'll be able to enjoy tax-free distributions during retirement with a Roth.

9. Sell the old homestead. Tax law allows you to exclude tax on up to $250,000 (for single filers) or $500,000 (for joint filers) of profit on a home sale if you've owned and used the home as your principal residence at least two of the past five years.

10. Rent out a vacation home. You can write off certain rental activity costs, plus depreciation, but you must be careful. If your personal use exceeds 14 days or 10% of the days the home is rented out—whichever is greater—deductions are limited to the amount of rental income.

11. Help support your new college graduate. Generally, you can claim a $3,950 dependency exemption for a child graduating from college in 2014 if you provide more than half of the child's annual support. It might work out to your advantage—to say nothing of your child's—if you provide a gift that puts you over the half-support mark.



12. Dust off charitable donations. Instead of tossing out old furniture and clothing, you could give items in good condition to charity. You generally can deduct the fair market value of property donated to a qualified charitable organization, within certain limits.

13. Adjust your withholding. If you have too little income tax withheld from your paycheck you could be penalized for not making estimated payments—a penalty that's easy to avoid.

14. Give generous gifts. Finally, under the annual gift tax exclusion, you can provide up to $14,000 to any family member in 2014 without any gift tax consequences. Meanwhile, such gifts reduce the size of your taxable estate. ●

Robert J. Pyle **Diversified Asset Management, Inc.** **1113 Spruce Street, Boulder, CO 80302**
Phone: (303) 440-2906 **Fax: (303) 539-9880** **E-mail: rpyle@diversifiedassetmanagement.com** **www.DiversifiedAssetManagement.com**