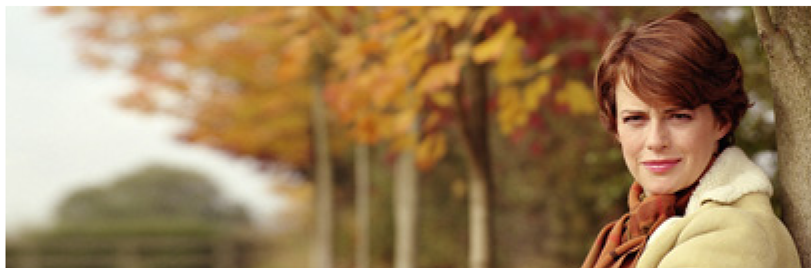
MF Advisers

$\$ = mf^2$



THE FINANCIAL FORMULA

Giving You The Financial Information You Need

October 2017

Hello FF readers! Fall is upon us. Please enjoy this month's edition of The Financial Formula, and let us know if you have any questions - thanks!

Martin A. Federici, Jr.
MF Advisers, Inc.
CEO
marty@mfadvisers.com
570-760-6524
Fax: 570-675-7105
91 Franklin Street
Dallas, PA 18612
http://mfadvisers.com

In This Issue

How Does Your Retirement Plan Stack Up?

Employer-sponsored defined contribution plans, like 401(k)s, are the savings vehicle of choice for millions of American workers. If you are a participant in such a plan, learn how your employers offering compares to other similar plans.

Catching Up With Catch-Up Contributions

Catch-up contributions offer older retirement plan participants a chance to make up for lost time by allowing them to boost their savings over the maximum allowable amount each year.

Talking Finances With Aging Parents

Talking about money matters with family is never easy -- especially when an adult child needs to ask aging parents some sensitive, but necessary, questions.

Don't Forget These Parent-Friendly Tax Breaks

Theres no escaping the IRS come tax day each year. For parents, these child-related tax rules could make the annual chore a little less stressful.

How Does Your Retirement Plan Stack Up?

Nearly three-quarters of plan participants currently own target-date funds and of those, two-thirds are 100% invested in a single fund.

Employer-sponsored defined contribution (DC) plans hold the lion's share of retirement assets for a sizable percentage of the U.S. population. According to current data, more than 94 million Americans are now covered by DC plan accounts, with total assets in such accounts exceeding $7 trillion.[1]

With so much at stake, you owe it to yourself to get to know your employer's plan, its key features, and how it stacks up to other similar plans along standard and/or trending industry metrics.

Anatomy of a Plan

Following are some notable takeaways from "How America Saves, 2017," the 16th annual study gleaned from Vanguard DC plan data. Compare these findings to your own plan experience to see how your plan stacks up.

Automatic investment programs -- Not to be confused with the auto-enrollment feature (see below), an automatic investment program as defined by the study is one in which participants have their accounts invested in "professionally managed allocations" -- e.g., target-date funds, balanced funds, or a managed account advisory service. As of December 31, 2016, more than half of all plan participants surveyed were solely invested in an automatic investment program -- that's up from 17% in 2007. Among first-time participants in 2016, 85% were invested entirely in a professionally managed allocation.

Target-date funds -- A subset of the automatic investment program, target-date funds are being used in DC plans at a rapidly growing rate. Fully 90% of employers surveyed offered target-date fund options as of year-end 2016 -- up from 50% in 2007. Nearly three-quarters of plan participants currently own target-date funds and of those, two-thirds are 100% invested in a single fund.

Contribution rates -- The average participant deferral rate was 6.2% in 2016, down from 6.9% in 2015. When employee and employer contribution rates were combined, the total average contribution rate for 2016 was 10.9%, which has remained relatively steady for the past few years.

Auto-enrollment and auto-escalation features -- The auto enrollment feature has grown by 300% over the past decade. By December 2016, almost half of employers (45%) had adopted auto enrollment. Among employers who have adopted auto-enrollment, two-thirds have also opted for automatic annual deferral increases. This trend has helped to close the deferral gap between those plan participants who voluntarily increase deferrals and those in plans that use the auto deferral feature.

The Roth option -- By December 2016, 65% of DC plans surveyed had incorporated a Roth feature into their retirement plan program; 13% of plan participants in these plans had adopted the Roth option.

Account balances -- The average account balance among participants as of December 2016 was $96,495, largely unchanged from a year earlier. The median balance for the same time period was $24,713 -- down 6% from a year earlier. The researchers assert that one factor driving trends in account balances is the auto enrollment feature, which stimulates individual savings, but also results in more, smaller balances.

Passively-managed investment options -- With the growing awareness of retirement plan fees comes a growing interest in lower-cost, passively-managed index funds. Including passive target-date funds, 80% of participants surveyed currently hold index equity funds.

Preserving retirement assets -- The good news is that the majority of employees are holding on to their retirement assets instead of cashing out when they leave their jobs. For instance, among the 30% of employees who separated from service in 2016 or prior years, 82% held on to their DC plan assets by either leaving the money in their employer's plan or rolling over their account balance into an IRA.

[1] *Vanguard, "How America Saves, 2017," June 2017.*

© 2017 DST Systems Inc. All rights reserved.

Catching Up With Catch-Up Contributions

To be eligible to make catch-up contributions, an employee must be age 50 or older by the end of the year and must first contribute the maximum allowed deferral to the plan.

Catch-up contributions give older employees who may not have contributed enough to their employer's 401(k) or other retirement savings plan in earlier years an opportunity to catch up by making higher contributions now.

Catch-Up Basics

To be eligible to make catch-up contributions, an employee must be age 50 or older by the end of the year *and* must first contribute the maximum allowed deferral to the plan. The maximum is determined by the plan document limits or by certain tax law restrictions. For 2017, an eligible employee can make catch-up contributions of up to $6,000 to a 401(k), 403(b), or 457 plan and up to $3,000 to a SIMPLE IRA plans.

How Contributions Are Treated

Catch-up contributions are not subject to the dollar limit on annual additions to an employee's plan account. Nor do these contributions have to be counted in your actual deferral percentage (ADP) nondiscrimination testing. In addition, catch-up contributions by key employees are not included as part of the threshold amount that triggers required minimum contributions in a top-heavy plan.

To gain these advantages, you must take care not to misclassify an elective deferral as a catch-up contribution. For example, an employee who simply contributes $6,000 more than in past years cannot choose to have that amount classified as a catch-up contribution.

Determining Catch-up Contributions

A plan determines whether elective deferrals are catch-up contributions by comparing the total amount deferred by an employee during the year to the applicable tax law and plan limits. Here are some examples. All of the employees are age 50 or older in 2017.

- Employee #1 defers $21,000 to the plan. The $3,000 contribution in excess of the $18,000 (in 2017) dollar limit on elective deferrals is treated as a catch-up contribution. If the plan had a lower elective deferral limit, a deferral in excess of that limit would be considered a catch-up contribution.
- Employee #2 defers $23,000 to his employer's safe harbor 401(k) plan, and his employer makes a 3% nonelective contribution of $2,000 to his account, for a total contribution of $25,000. $5,000 is considered a catch-up contribution because the employee exceeded the tax law's elective deferral limit by that amount. The nonelective employer contribution doesn't factor into the determination.
- Employee #3, a key employee, receives a $54,000 profit sharing contribution from her employer in 2017. She also defers $6,000 to the plan. Her deferral is a catch-up contribution because the profit sharing and elective deferral contributions, when combined, exceed the 2017 dollar limit on annual additions ($54,000).

© 2017 DST Systems Inc. All rights reserved.

Talking Finances With Aging Parents

A durable power of attorney is a legal document that designates an individual to make financial or legal decisions on behalf of another individual. This document can become very important should an aging senior become ill or incapacitated.

Regardless of whether you and your parents have always talked freely about money or have never discussed the subject, there are several considerations you may want to address with them as they grow older. These six questions may help you think about -- and plan for -- that conversation.

1. Have you thought about how you will approach the subject? When you do decide to touch base, tactfully make clear what you'd like to discuss, but also let your parents know you respect their privacy.
2. Are you confident that they are staying on top of things? Are bills getting paid on time? Are investments being monitored? Maybe you have already raised these topics with your parents, but it has been a while since you've checked in. If you think they might appreciate a follow-up, then it may be a good idea to talk to them again.
3. Are they taking advantage of banking conveniences, such as direct deposit and online bill payment, to simplify their financial life? If your parents aren't comfortable with the computer, offer to assist.
4. Do your parents have an estate plan, and is it up to date? At a minimum, they should have a will. An effective will should do a few basic things. It should name an executor (or personal representative) -- the individual who will administer your estate after death. It should also spell out how you want your property distributed as specifically as possible. If you die without a will, your estate will be divided according to the laws of your state -- not your wishes. Besides a will, there are other planning mechanisms that may be appropriate for their needs. Be sure they consult with a qualified legal professional to discuss the specifics of their situation.
5. Do you and your parents understand the potential benefits of a durable power of attorney document? A durable power of attorney is a legal document that designates an individual to make financial or legal decisions on behalf of another individual. This document can become very important should an aging senior become ill or incapacitated.
6. Should they consider a long-term care insurance policy? With the average cost of a private room in a nursing home now exceeding $92,300 per year depending on where you live, you can see how such expenses could put a tremendous financial strain on a family.[1] That is why many people consider long-term care insurance to be a sensible addition to a financial plan. For the most part, nursing home and assisted-living costs have limited coverage under Medicare. And, for most people, qualifying for Medicaid requires individuals to first exhaust their own assets. For more information about long-term care insurance, speak with your financial advisor.

[1]*Genworth 2016 Cost of Care Survey, April 2016.*

© 2017 DST Systems Inc. All rights reserved.

There are several attractive tax breaks and incentives available to help lessen the financial burden of paying for a childs education.

Don't Forget These Parent-Friendly Tax Breaks

President Trump has pledged to make child care expenses a key element of his tax reform plan. Until such new legislation is passed into law, be sure to take advantage of the child-related tax benefits that are currently available to parents. Here is a brief rundown from the IRS.

Child tax credit -- Generally, taxpayers can claim the Child Tax Credit for each qualifying child under the age of 17 on their federal tax return. The maximum credit per child is currently $1,000. See IRS Publication 972 for more on this credit.

Child and dependent care credit -- If you paid someone to care for your child or another dependent last year you may be able to claim this credit. To qualify, a child must be under age 13. Additionally, a spouse or certain other dependent individual who is physically or mentally incapable of self-care may also qualify. Note that the care must have been provided so that you -- or you and your spouse if you file a joint tax return -- could work or look for employment. See IRS Publication 503 for more on this credit.

Adoption credit -- It is possible to claim a tax credit for certain costs paid to adopt a child. For details, see Form 8839, Qualified Adoption Expenses.

Education tax breaks -- There are several attractive tax breaks and incentives available to help lessen the financial burden of paying for a child's education. Make sure to determine which ones will apply to you when it's time to file your tax return. In each case below, income restrictions apply.

- The Coverdell Education Savings Accounts, which used to be known as "education IRAs," offer tax-deferred earnings growth and tax-free qualified withdrawals. Contributions are nondeductible and limited to $2,000 annually per beneficiary. In addition to college expenses, certain K-12 expenses are considered "qualified" when using a Coverdell ESA.
- The American Opportunity Tax Credit (formerly the HOPE Scholarship Credit) has now been made permanent. It covers up to $2,500 of qualified expenses per year, per eligible child during the first four years of postsecondary education.
- The Lifetime Learning Credit covers up to $2,000 of undergraduate, graduate, and job-related studies. The American Opportunity Tax Credit and a Lifetime Learning Credit can't be claimed in the same tax year for any one student, but you can use either of them with a Coverdell account -- just not for the same expenses.
- Student loan interest. Depending on your income, you may be able to deduct up to $2,500 of the interest you paid on student loans last year.

To learn more about tax benefits for parents, visit the IRS website.

© 2017 DST Systems Inc. All rights reserved.