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Your Chance For An Audit And Other IRS Trivia

Don't play chicken with the IRS. The odds may seem to be in your favor, but every deviation from the rules makes you more likely to become a statistic. *The Internal Revenue Data Book*, an annual report, shows exactly how many people are invited to interact with the agency, as well as the consequences of trying to sneak past the regulations.

According to the 2006 Data Book, the IRS collected $2.2 trillion in taxes for the 2005 tax year, and paid $243 billion in refunds to 108 million filers. The IRS received an average of $16,629 per tax return filed and paid an average refund of $2,250.

The IRS got 132.3 million tax returns, of which only 1,283,950 were audited. That translates to slightly less than one in every 100 individual returns leading to an audit. Most audits (76%) were handled by correspondence; in the others, the taxpayer had to sit face to face with an IRS employee to answer questions about a return. But almost every time an audit occurred, mistakes were found. Only 17% of correspondence audits and 14% of face-to-face audits resulted in no change to the return.

What happened when there were changes? The IRS assessed $25.9 million in civil tax penalties, of which $15.4 million (59.5%) were for failure to pay. Another 25.4% (or, $6.57 million) of total penalties involved under-payment of estimated taxes, while only 1% resulted from returns that had "accuracy" problems (for example, a substantial understatement of income tax). But those are just the penalties. When returns are corrected, there are usually additional taxes to pay as well.

When the IRS finishes an audit and presents your new bill, you can attempt to negotiate, and in 2005 taxpayers made 59,000 compromise offers. But the IRS accepted just 15,000, or about one in four. Too often, taxpayers try to low-ball the tax agency. To have a chance of success, a proposal must be reasonable and in the best interests of the IRS.

While a large majority of audits lead to a change (and usually, a higher bill for taxpayers), very few audits send taxpayers to prison. A mere 0.000289% of returns filed (3,907 of 132.3 million) resulted in criminal cases, though most of those (70%) were referred for prosecution. And most of the cases that were prosecuted ended badly for taxpayers, with 2,720 referred cases leading to 2,019 guilty pleas or convictions. Moreover, almost all of those who lost criminal cases, 82% of the total, ended up behind bars. Still, the chance that the average taxpayer will do jail time is miniscule, with prison sentences for just 1,650, or 0.00125% of all tax returns filed. That's about one prison term for every 80,000 returns.

(Continued on page 4)

A Very Few Get Prison Time

Likelihood that a tax return will lead to a jail sentence.

Individual tax returns filed	132.3 million	100%
Criminal cases	3,907	0.00289%
Cases referred for prosecution	2,720	0.00206%
Convictions	2,019	0.00153%
Jail sentences	1,650	0.00125%

Retiring Abroad? Be Ready To Take The Bad With The Good

For some Americans, retiring to a tropical island is a dream that has turned into reality. However, it's not always what it is cracked up to be, according to a new survey by the Best Places in the World to Retire website.

The reasons for moving most often cited by respondents from three Central American retirement havens were hopes for a lower cost of living (87%), a less stressful lifestyle (82%), and an improved climate (74%). Two out of three isn't bad, because 84% say they indeed are able to live on less and 74% are enjoying the weather. But the 71% who say they have reduced their stress, though significant, falls short of the number of respondents who hoped that would result. The survey authors attribute this mainly to a slower pace of life and the need to temper expectations. For example, if you make a 4 p.m. appointment for someone to fix a leak, the worker might not show up until the next day. Americans typically aren't used to this.

Also, high on the list of things that the retirees miss are top-of-the-line goods and shopping (20%) and access to high-quality health care (16%).

Yet, overall, 85% of the survey respondents said they were happier living abroad than they were prior to the move.

Finally, 42% plan to never return to the U.S.; 37% aren't sure what they'll do; and 16% expect to come back due to aging or illness. Only 4% said they're coming back immediately while 3% anticipate moving back within five years.

Kim Scott, CFP®
Financial Advisor

Why Would You Take Your RMDs Sooner?

Is it time for you to begin taking required minimum distributions (RMDs) from your retirement plans? The rules for 401(k)s, other employer-sponsored plans, and traditional IRAs generally call for these payments to start after you reach age 70½ and to continue each year. But you don't actually have to begin RMDs until the "required beginning date" (RBD) of April 1 of the year *after* you turn 70½.

Nevertheless, you might bypass this respite. Why would you do that? Because you still must take another RMD later that year. Thus, you would be doubling up on payouts and have to pay more tax.

Although your savings in 401(k)s and traditional IRAs grow without being taxed along the way, you eventually must start receiving RMDs, taking one each year by December 31. These RMDs generally are taxed at ordinary income tax rates.

If you're still working and don't own the company you work for, you may be able to postpone withdrawals from an employer-sponsored plan with that company until you retire. But this exception doesn't apply to traditional IRAs.

The amount of the RMD is based on IRS life expectancy tables and the value of your accounts on the final day of the previous tax year. Your financial advisers or the financial company holding your account can provide assistance in computing the amount.

The penalty for failing to take an RMD is equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and any smaller amount you did withdraw). For example, if you're required to take $20,000 and you're in the 28% tax bracket, the penalty for failing to withdraw is $10,000, plus you'll owe $5,600 in federal income tax on the distribution.

If you postpone your first RMD until the following year, you'll have to take two RMDs in that year. If you remain in the same tax bracket, that will double the tax you owe, or the extra payment may push you into a higher tax bracket. Going back to our example of an annual $20,000 RMD, you'll have to take two RMDs for a total of $40,000 in the following year. Suppose that $10,000 of the extra amount is taxed at the 33% rate. Your total tax bill on RMDs for that year comes to a whopping $11,700 (28% x $30,000 + $10,000 x 33%).

Furthermore, doubling up on RMDs increases the possibility you'll have to pay the federal surtax on "net investment income," and it could hike your state income tax liability as well.

As you approach your RBD, consider your options. Let us know if you need help deciding the best time to take your first RMD. ●

Add To Your 401(k) With No Pain

We don't have to tell you how important it is to save as much as you can for retirement through a 401(k) or other plan offered by your company. But that's often easier said than done. When you're paying off a big mortgage on your home and putting your kids through college, you may be left without much you can direct into your retirement plan. But there may be a way to add to your 401(k) without feeling any pain.

It has to do with timing. If you earn more than the maximum Social Security wage base—$127,200 in 2017—you could allocate all or some of your year-end payroll tax savings to add to your 401(k) salary deferral. If you do that every year, you could boost your 401(k) account balance by tens of thousands of dollars or more. And you may not even notice those extra contributions.

With a 401(k) plan, you can defer part of your salary before taxes to an account established on your behalf, within generous limits adjusted for inflation. For 2017, the maximum you can put in is $18,000—or $24,000, if you're age 50 or older. Your company may sweeten the pot with matching contributions based on a stated percentage of your compensation.

Both employee and employer contributions to your account will grow and compound on a tax-deferred basis until you take money out, usually during retirement. If you start early enough and save diligently, you can accumulate a sizable nest egg during your working career.

Suppose that you contribute $12,000 a year and your employer provides a 3% match of your contributions. If you are 20 years away from retirement and earn an 8% return annually, you will accumulate $858,990 before calling it quits. But adding to your contributions at the end of each year can help you do even

Ten Frequent Retirement Mistakes To Avoid

When your retirement finally arrives, you can take a deep breath and exhale. You made it! But that doesn't mean you may relax completely.

In fact, mistakes made in retirement can cause significant financial distress. Here are 10 common pitfalls to avoid:

Mistake 1. Going on a spending spree. It may be tempting to start spending freely, especially because you now have more time on your hands. But you don't want to burn through your savings in just a few years. It's still important to rely on a budget that helps you balance monthly income and expenses.

Mistake 2. Applying for Social Security right away. Most people are eligible to begin receiving Social Security benefits as early as age 62. Although that may be the best approach for some retirees, it's not recommended for everyone. You can ensure greater monthly benefits by waiting until full retirement age (FRA) to apply—age 66 for most Baby Boomers—or even longer. Starting your benefits at age 70 will give you the largest possible monthly benefit.

Mistake 3. Not taking income taxes into account. Even though you're retiring, taxes will continue to have an impact on your financial life in general and your investments in particular. You still can take advantage of investment losses to offset capital gains that otherwise would be taxed, while distributions from your employer-sponsored retirement plans and IRAs may add to your tax bill. If you have a Roth IRA, you may be able to take tax-free payouts—or pass them along to your heirs.

Mistake 4. Becoming too conservative in your investments. The traditional advice is to shift your portfolio to lower-risk investments during retirement. That makes sense as a general principle, but don't go too far. Consider your life expectancy and how long you will have to stretch the income from your savings. By avoiding investment risk you could increase another kind of risk—the risk of outliving your savings.

Mistake 5. Being handicapped by your biggest asset. It's often hard to give up the home in which you raised your children. However, at some point during retirement, it may become too expensive to live there. Even if you've paid off your mortgage, you'll still be responsible for real estate taxes, repairs, and utilities, which could add up to thousands of dollars a month. Selling the old homestead and then buying a smaller place could free up your equity while reducing your costs.

Mistake 6. Being victimized by a scam. Con artists frequently prey on the elderly, and today's schemes are increasingly sophisticated, putting almost everyone at risk. Imposters may create phony websites that mirror ones from reputable financial institutions and pretend that the information they're seeking is crucial. Be very careful about working with anyone you don't know personally.

Mistake 7. Continuing to support your adult children. No matter how old you are, you never stop being a parent. Nevertheless, there comes a point when you must realize that you're living on a fixed income and can't support your children in the same manner as you could during your peak earning years. Worry about paying your own expenses first. Then, if there are assets left over, you can follow your parental inclinations.

Mistake 8. Underestimating health-care costs. Just because you're eligible to receive Medicare at age 65 doesn't mean all of your expenses will be paid. You'll probably need other coverage to supplement Medicare, and if you or your spouse encounter serious health issues, you could run up extremely high costs for care in a nursing home or care in your home. Long-term care insurance, when purchased early enough, can provide affordable protection. Alternatively, you might need to set aside funds to pay for potential care expenses.

Mistake 9. Leaving work too soon. Sure, some people would like to call it quits as early as possible, but it's important to be realistic. Go back to your budget and consider it in terms of how long you're likely to live. Although it may not be your first choice, the option of working for a year or two longer could help in two ways, adding to your nest egg and shortening the length of time you'll need it to fund retirement expenses. Coordinate this decision with your choices for Social Security benefits.

Mistake 10. Not seeking professional guidance. Instead of trying to do it all on your own, or relying on the advice of friends or family, sit down with your financial adviser to map out a plan. This last step may help you avoid many of the other mistakes and improve your chances of a comfortable retirement. ●

better. Note: This example is hypothetical. Actual results will vary and are not guaranteed.

During the year, Social Security tax is deducted from your paychecks. For 2017, you'll pay 6.2% on that first $127,200 of wages. Once you clear this Social Security wage base for the year, you can increase your 401(k) deferrals instead of pocketing the extra money. Because your take-home pay isn't reduced, you won't feel any pain.

How much will it help? Suppose, in the previous example, that you're able to increase your annual deferrals by $3,000 a year. With the same 8% annual return over 20 years, your nest egg will grow to $1,073,738—or $214,748 more than if you had spent your year-end payroll tax savings!

Even if your wages don't exceed the Social Security age base this year, there could still be ways to earmark more of your salary for retirement savings. Don't hesitate to give us a call to put together a game plan to save more for retirement. ●

Now Is A Perfect Time To Open A New Business

Are you thinking about going into business for yourself? Or perhaps you already operate a business and are considering starting a second venture, maybe even in a new business sector. For instance, you may run a service business and are thinking about buying or opening a retail outlet.

In any event, now could be the perfect time to take action, thanks to the Small Business Administration's 2016 Summer of Encore Entrepreneurship. The SBA's Southeast Regional Administrator, Cassius F. Butts, says the SBA has partnered with the American Association of Retired People throughout the nation to assure that all seasoned entrepreneurs have the tools they need to succeed. "Entrepreneurship is about following your dreams and following your passion," Butts says.

"The SBA is here as a resource to every aspiring and existing entrepreneur," he adds. "When is it the right time to go into business for yourself? The time is right when you are ready to start your entrepreneurial chapter – no matter when that time comes during your lifetime."

"It is never too early or too late to own your own small business. Resources are available to seasoned entrepreneurs who are ready to take the next step." Go to https://www.sba.gov/starting-business/how-start-business/business-types/encore-entrepreneurs.

A growing number of workers age 50-plus are turning interests, hobbies, and skills into a small business.

"Whether you are interested in starting a small business right away or are intending to wait until after retirement, now is the time to explore the possibilities," Butts stresses. "Whether your target market is global or just your neighborhood, the SBA and its resource partners can help at every stage of turning your entrepreneurial dream into a thriving business. Entrepreneurs over the age of 50 are one of the fastest growing groups of business owners."

"If you are an individual age 50+, then entrepreneurship can offer an opportunity for you to use your knowledge, passion, life and professional experience toward creating a small business."

As an example of a middle-age person making the jump into the world of entrepreneurship, Butts cites the case of Michele Muirhead, who took the plunge in 2009. Now 50, Muirhead decided she wanted to start her own business, launching HireTheHelp.com in Jamestown, New York. HireTheHelp.com offers house cleaning, elderly care, vehicle detail services (pickup and delivery), and assistance with computers, pet sitting, landscaping, painting, handyman services, snow removal and almost anything you can imagine in Chautauqua, Cattaraugus and Warren counties, Muirhead says.

The SBA offers free help in developing plans for small businesses. It also helps potential business owners to determine what options are available to finance a small business. Plus, it helps you answer questions about the best ways to market your new or existing small business.

The SBA also offers online courses designed to help you launch your new business as well as determine if you have what it takes to start your own company.

To get started, find your regional SBA office by searching on the Internet. ●

Your Chance For An Audit

(Continued from page 1)

Individuals aren't the only ones who have to worry about audits, however. The IRS also scrutinizes the tax returns of small businesses, estates, and trusts, though those entities are audited at much lower rates than individuals. Fiduciary audits (of estates and trusts) were least common for the 2005 tax year, with only 0.1% of returns catching the eye of the IRS. Partnerships and S Corporations were next, with audit rates of 0.36% and 0.38%, respectively. Individuals, with a 1% rate, were almost three times as likely as partnerships or S Corporations to be audited. One reason is that audits of individuals are much easier to conduct than those involving small businesses or estates.

Will You Hear From The IRS?

Audit rates (percentage of total returns) for individuals, fiduciaries, and small businesses in the 2005 tax year.

Individual	Fiduciary	Partnership	S Corporation
0.97%	0.10%	0.36%	0.38%

Major corporations, on the other hand, face a relatively high likelihood of extra attention from the IRS, and the bigger the company, the better the chance of an audit. While only 0.8% of businesses with assets of less than $10 million were audited, tax returns filed by companies with assets beyond that threshold were audited at a rate of 18.6%. Larger corporations often use sophisticated accounting practices that may have substantial tax implications. The IRS is on the lookout for impropriety at big corporations, especially in the wake of the Enron implosion. At the time of its failure, that company hadn't paid federal income taxes in years, despite posting significant and growing profits.

As these statistics show, most taxpayers never interact with the IRS. Of the 132.3 million returns filed in 2005, only a handful led to a second look. A few audits left nothing changed, and most resulted in a civil penalty and the payment of additional taxes. The threat of prosecution—and jail—is remote, and such situations are easy to avoid. Follow the rules, and like most people, you will be nothing more than a stack of paper to the IRS. Trying to "win" the tax game, though, can send you down the road of the few. ●

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