Financial Services Advisory Incorporated

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# Where Will You Live After You Retire?

Do you know where you will live after you retire? You might decide to stay in your current home, move to a smaller place, or relocate to be closer to your children. You could opt for a warmer climate—or for someplace colder. You may settle in another state, or even another country. There are so many possibilities it can seem confusing to sort through them all.

Your first consideration, of course, is what will be best for you. What you can afford, whether you're in good health, what your spouse wants—all of those have to be factored into your decision. If your mortgage is paid off, staying put could be the most economical option. Of course, downsizing could put spending money in your pocket or pad your retirement account. Maybe you need to provide financial help to your children, grandchildren, or even your parents. Other considerations include state income taxes and proximity to family members.

Whatever your situation, retirement is a momentous occasion, and the more you think about how you want it to play out—and the earlier you start planning—the more likely you'll have a satisfying life after work.

Not many years ago, retirement didn't last very long, and most people just lived out their days quietly. But times have changed. According to the U.S. Centers for Disease Control and Prevention, the average 65-year-old in 2009 could expect to live another 19 years—and that's more than one and a half years longer than in 2000. Active retirements have become the rule, not the exception, and many people continue to work at least part time.

Spurred by these trends, retirement communities have sprung up all across the country, even in cold-weather states. You can find retirement communities in the mountains, on the prairie, on lakes—just about anywhere, from sea to shining sea. They may be built for a few dozen residents, or many thousand. At The Villages near Ocala, Florida, more than 51,000 retirees live and scoot around in golf carts.

A retirement community can consist of just one kind of housing—condominiums or single-family homes, for instance—or you may be able to choose from among many different options. And these days, such places frequently call themselves active adult communities, dropping the word retirement to emphasize the physically active nature of today's senior lifestyles.

And life at a retirement community—by any name—can be very active indeed, with recreational choices that may include golf courses, tennis courts, bocce courts, Olympic-size swimming pools, spas, and boats and canoes. There could be walking trails, bike trails, community newspapers, stage shows (with seniors doing the acting), seminars on health and other topics, billiard tables, ceramics classes, photography clubs, computer clubs, and state clubs. You

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## *Look Out America, Here Come Millions Of Baby Boomers!*

The first wave of the massive baby boom generation has reached retirement age at a time of great financial uncertainty. There were an estimated 79 million people born in the United States from 1946 through 1964, and in 2008, the oldest in that group turned 62, the earliest age of eligibility for Social Security retirement benefits. But 2008 also marked the height of the global economic crisis, and though conditions have improved since then, the economy has been growing fitfully, unemployment remains high, and home prices, which plunged during the crisis, have just begun to recover.

Against that backdrop, the question of when to begin receiving Social Security income has become more complicated—and more crucial. As recently as a decade ago, half of those who were eligible started at 62. But these days, more people are opting to delay their benefits. Waiting until full retirement age—66 for those born from 1943 through '54—means higher monthly payments, which can be increased further by waiting until as late as age 70 to claim benefits. Getting a bigger check can be particularly helpful for today's retirees, whose longer life expectancies increase the odds that they will outlive their assets.

Making the right decisions about Social Security and other retirement issues has never been more important. We can help you take stock of your situation.

Jim Joseph, CFP®
Vice President

# Avoid Five Pitfalls In Refinancing

Mortgage interest rates are at historic lows, but does that mean you should refinance an existing mortgage? A "refi" may pay off, but you should consider all of the relevant factors, including these five potential problems:

**1. You're back to square one.** Starting over is hard to do if you're close to paying off a mortgage. For instance, if you take out a 30-year loan, the monthly payments in the first seven years will reduce your principal by only 5% or so, with the rest going to interest. Instead of beginning to make a dent in their principal debt, homeowners who refinance after seven years are effectively starting from scratch. Figure out how much you're really saving if you shave only a percentage point or less off your current rate.

**2. Closing costs can pile up.** Depending on how long you stay in a home, the expenses of a new loan can outpace the savings. Figure on closing costs equal to about 1.5% of the mortgage amount. Then calculate your monthly savings to see how long it will take you to break even on the cost of the mortgage. For example, if you refinance a $300,000 mortgage, closing costs will run about $4,500. If the new mortgage interest rate is 1 percentage point lower than your current rate, you will save $178 a month and will need just over 25 months to recoup your closing costs. So if you're not planning to stay in the house for more than two years, you could end up losing money. Reduce these costs by paying the prepaid items out of pocket. You'll get that money back when the escrow



accounts on your old loan are paid back to you.

**3. Terms can be confusing.** With refis so popular now, they can take a long time to process, and it may not be clear when you should stop paying your current mortgage. If you inadvertently fall behind, it could throw a monkey wrench into the works. Generally, lenders offer a two-week grace period after a mortgage payment is due and then charge a 5% penalty. Even worse, your credit score might plummet by 100 points or more if you're 30 days past due—and that change could affect your refi.

**4. The appraisal may be too low.** Before the refi is approved, the lender will require an independent appraisal to confirm the home's value. The numbers now are trending lower than expected for many homeowners, especially those who reside in areas hit by numerous foreclosures. If the appraised value is too low and you don't have enough equity in the home, the lender could raise the rate or deny the loan altogether.

**5. You could pay hidden fees.** Under federal law, lenders must provide a good-faith estimate of the fees needed to complete the refi, and that statement could reveal costs you hadn't expected. Also, some low-interest mortgages require you to pay "points," and each point is equal to 1% of the mortgage amount. That could delay your break-even point even longer. ●

# Don't Forget The 'Other' Surtax

In the wake of the Supreme Court ruling upholding the constitutionality of the 2010 health-care law, much of the focus has shifted to the 3.8% Medicare surtax that will apply to some high-income investors beginning in 2013. And this is with good reason. Those who are in the top 39.6% tax bracket then may pay an effective federal rate of as much as 43.4% on a portion of their investment income. Add in state taxes, and the new levy could be truly painful.

Yet there's another new Medicare surtax that hasn't received much attention. Beginning in 2013, you will have to pay an extra 0.9% tax on "earned income" which exceeds an annual threshold—$200,000 for single filers and $250,000 for joint filers. It's a relatively straightforward calculation—unlike the larger new surtax, which depends on how much income you receive from your investments as well as your overall earnings.

And while this additional new tax may seem small, it comes on top of the 3.8% Medicare surtax, plus your regular federal and state income tax liability. What's more, if your income is high enough, you might owe this tax year in and year out. It really can add up.

Take the example of a single filer who earns $500,000 a year. Starting in 2013, this person will have to pay an extra 0.9% surtax on the $300,000 that exceeds the $200,000 threshold, or $2,700 (0.9% of $300,000). Now assume that the figures stay the same for the next 10 years. As a result, this taxpayer will have to fork over a total of $27,000 (10 years x $2,700).

For the purpose of calculating the surtax, you can rely on the usual IRS definition of "earned income," which includes the following:

- Wages, salaries, tips, and other taxable employee earnings,

# IRS Issues New "Dirty Dozen Tax Scam"

Each year, the IRS publishes a cautionary list of the "dirty dozen tax scams" criminals have dreamed up to separate you from your money. Here's the skinny on the top 12 for 2012:

**1. Identity Theft.** The IRS is committed to preventing, detecting and resolving cases in which someone uses stolen personal information to file a fake tax return and receive an illegal tax refund. The agency has stepped up internal reviews to spot trouble before fraudulent tax refunds are issued and to help those who fall victim to ID-theft refund schemes.

**2. Phishing.** Typically, phishing involves an unsolicited email or a fake website posing as a legitimate site to prompt victims to provide valuable data that can aid a theft. Often, the bogus sites and emails may look very similar to the real thing. If you receive a suspicious email, report it to phishing@irs.gov.

**3. Return Preparer Fraud.** Though most tax preparers provide honest service, others have been known to skim clients' refunds, charge inflated fees, and attract new clients by promising guaranteed or outsized refunds. Choose a preparer carefully and watch for anything that seems irregular.

**4. Hiding Income Offshore.** Numerous people have been discovered evading U.S. taxes by hiding income in offshore banks, brokerage accounts, or nominee entities. Others have employed foreign trusts, employee-leasing schemes, private annuities, or insurance plans for the same purpose.

**5. "Free Money" from the IRS.** Flyers advertising free money from the IRS and suggesting that you can file a tax return with little or no documentation have appeared in community churches. This scheme, often spread by well-intentioned people, preys on low-income individuals and the elderly. By the time victims discover that their claims have been rejected, the promoters have disappeared.

**6. False/Inflated Income and Expenses.** Including income that never was earned, either as wages or as self-employment income, in order to maximize refundable credits, is another popular scam. Getting caught could result in having to repay a fraudulent refund, along with interest and penalties. You also could be subject to criminal prosecution.

**7. False Form 1099 Refund Claims.** In this ongoing scam, the perpetrator files a fake information return, such as a Form 1099 Original Issue Discount (OID), to justify a false refund claim on a tax return. Falling into this web of lies could leave you liable for financial penalties and criminal prosecution.

**8. Frivolous Arguments.** Promoters of frivolous schemes encourage taxpayers to make outlandish claims to avoid paying the taxes they owe. The IRS publishes a list of frivolous tax arguments to avoid. While you have the right to contest your tax liabilities in court, no one has the right to disobey the law.

**9. Falsely Claiming Zero Wages.** Filing a phony information return is an illegal way to reduce tax liability. Typically, a Form 4852 (Substitute Form W-2), or a "corrected" Form 1099, is used for this purpose. Filing this type of return may result in a $5,000 penalty.

**10. Abuse of Charitable Organizations and Deductions.** IRS examiners continue to uncover the intentional abuse of charitable 501(c)(3) organizations, including arrangements that improperly shield income or assets from taxation, as well as attempts by donors to maintain control over donated assets, or the income from donated property. Frequently in such scams, a charity will overvalue a donation or promise to let donors repurchase a donated item later at a low price.

**11. Disguised Corporate Ownership.** In this scam, third parties request employer identification numbers and form corporations that obscure the true ownership of a business. Fraudulent entities then can be used to underreport income, claim fictitious deductions, avoid filing tax returns, participate in prohibited transactions, and facilitate money laundering and financial crimes. The IRS works with state authorities to thwart such activities.

**12. Misuse of Trusts.** For years, unscrupulous promoters have urged taxpayers to transfer assets into trusts. While there are legitimate uses for trusts in tax and estate planning, questionable transactions may promise to reduce taxable income, provide deductions for personal expenses, and minimize estate or gift taxes. Such trusts rarely deliver the benefits promised and are used primarily to evade tax and hide assets from creditors, including the IRS. ●

- Union strike benefits,
- Long-term disability benefits received prior to minimum retirement age,
- Net earnings from self-employment if you own or operate a business or if you're a minister or member of a religious order,
- Gross income received as a statutory employee.


On the other hand, the IRS says the following items are not included under its definition of earned income:

- Pay received for work while an inmate in a penal institution,
- Interest and dividends,
- Retirement income,
- Social Security benefits,
- Unemployment benefits,
- Alimony,
- Child support.

Finally, business owners don't have to fret about doubling up on the surtax. The 0.9% levy applies only to employees who exceed the income threshold, not to the business entity that provides their salaries. At least that's a small consolation if you're stuck with this extra tax liability. ●

# Which Funds To Tap In Retirement?

Unless you're independently wealthy, eventually you'll have to start using some of the money you've saved for retirement. After all, that's what it's there for, so there's nothing wrong with using those assets. But it could create problems if you spend the "wrong" funds first.

For purposes of deciding what to spend when, let's divide your retirement assets into three baskets: personal accounts, such as stock and bond holdings that are currently taxable; traditional IRAs and qualified retirement plans, such as a 401(k), income from which is typically taxed only when withdrawn during retirement; and non-taxable accounts, such as Roth IRAs.

The rule of thumb is to withdraw funds from your personal accounts first, your traditional IRAs and qualified plans second, and your Roth IRAs third. This spending order is likely to produce the lowest possible tax bill, promote more tax-deferred growth, and allow you to milk your assets for as long as possible. If you were to spend your money in the reverse order, you would pay more in taxes each year, thereby siphoning off funds that could have been reinvested and reducing your overall nest egg—and maybe even exhausting all your funds during your lifetime.

The preferred "spending order" in retirement is only reinforced by tax law changes scheduled to take effect in 2013. Barring last-ditch legislation, the tax brackets for individuals will be adjusted upward, with the current top tax rate of 35% being replaced by 39.6%. Furthermore, the maximum capital gains rate of 15% for most investors (0% for low-income investors) is increasing to 20% (10% for low-income investors). And qualified dividends, currently taxed at a rate no higher than 15%, will be taxable at ordinary income rates.

To add insult to injury for high-income investors, a new 3.8% Medicare surtax debuts in 2013. Under a special tax law provision, an investor must pay the 3.8% surtax on the lesser of "net investment income" or the amount by which modified adjusted gross income (MAGI) exceeds a threshold of $200,000 for single filers or $250,000 for joint filers. "Net investment income" includes most forms of taxable income, such as capital gains and dividends, but not distributions from qualified retirement plans and IRAs or tax-exempt income. Still, those items may increase your MAGI for this calculation.

Despite these tax-based incentives, remember that you generally have to begin taking "required minimum distributions" (RMDs) from qualified retirement plans and IRAs—but not from Roth IRAs—after age 70½. If you've reached that point, you may as well take the RMD amounts first before the regular sequence.

Last but not least: Everyone is different, so you may have valid reasons for changing the usual order. If you have any questions about your situation, please let us know. ●

## Where Will You Live?

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may get a place to store your boat or your recreational vehicle, and just about every retirement community has a clubhouse, complete with card rooms, craft rooms, bingo halls, dance halls, libraries, TV rooms, and, of course, an office staff ready to assist you. And because most communities have a minimum age requirement of 55 or so, you'll be living with people mostly from your own generation—and you won't be disturbed by a lot of noisy children running around. (You can visit your grandchildren for that!)

State clubs are amazingly popular in retirement communities. It seems that many people prefer mixing socially with others from their home states rather than with people from other parts of the country.
Another surprising thing about state clubs is that those with the most members often don't represent the most populous Northern states. In Florida, the retirement-haven state, Michigan seems to lead all other states in retirement club membership.

All retirement communities have homeowner associations—and homeowner association fees that can range in cost from low to moderate to very expensive, depending on the types and numbers of amenities and services offered. Before choosing a place, be sure to consider not just the initial cost of buying a house or a condo but also all of the fees and other recurring expenses. You might rent a place first to try it out.

Yet while you may be reluctant to pay a hefty monthly homeowner association fee, it's likely to cover a host of convenient services ranging from basic cable TV and garbage collection to lawn maintenance, pest control, exterior painting and other maintenance, and roof repair. And if you've ever cut grass on a hot, muggy, Florida summer day, you might agree that lawn maintenance alone makes retirement community living worth the price! l

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