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Comprehensive Financial Planning: What It Is, Why It Matters

Your approach to building wealth should be built around your goals & values.

Just what is comprehensive financial planning? As you invest and save for retirement, you may hear or read about it – but what does that phrase really mean? Just what does comprehensive financial planning entail, and why do some investors request this kind of approach?

While the phrase may seem ambiguous to some, it can be simply defined.

Comprehensive financial planning is about building wealth through a process, not a product.
Financial products are everywhere, and simply putting money into an investment is not a gateway to getting rich, nor a solution to your financial issues.

Comprehensive financial planning is holistic. It is about more than “money.” A comprehensive financial plan is not only built around your goals, but also around your core values. What matters most to you in life? How does your wealth relate to that? What should your wealth help you accomplish? What could it accomplish for others?

Comprehensive financial planning considers the entirety of your financial life. Your assets, your liabilities, your taxes, your income, your business – these aspects of your financial life are never isolated from each other. Occasionally or frequently, they interrelate. Comprehensive financial planning recognizes this interrelation and takes a systematic, integrated approach toward improving your financial situation.

Comprehensive financial planning is long range. It presents a strategy for the accumulation, maintenance, and eventual distribution of your wealth, in a written plan to be implemented and fine-tuned over time.

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What makes this kind of planning so worthwhile? If you aim to build and preserve wealth, you must play "defense" as well as "offense." Too many people see building wealth only in terms of investing – you invest, you "make money," and that is how you become rich.

That is only a small part of the story. Careful planning can involve minimizing taxes and debts as well as adjusting wealth accumulation and wealth preservation tactics in accordance with your personal risk tolerance and changing market climates.

Basing decisions on a plan may help prevent destructive behaviors when markets turn unstable. Quick decision-making may lead investors to buy high and sell low – and overall, investors may lose ground by buying and selling too actively. Openfolio, a website which lets tens of thousands of investors compare the performance of their portfolios against portfolios of other investors, found that its average investor earned 5% in 2016. In contrast, the total return of the S&P 500 was nearly 12%. Why the difference? As CNBC noted, most of it could be chalked up to poor market timing and faulty stock picking. A comprehensive financial plan – and its long-range vision – helps to discourage this sort of behavior. At the same time, the plan – and the financial professional(s) who helped create it – can encourage the investor to stay the course.[1]

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A comprehensive financial plan is a collaboration & can result in an ongoing relationship. Since the plan is goal-based and values-rooted, both the investor and the financial professional involved have spent considerable time on its articulation. There are shared responsibilities between them. Trust may strengthens as they live up to and follow through on those responsibilities. That continuing engagement can promote commitment and a view of success.

Think of a comprehensive financial plan as your compass. Accordingly, the financial professional who works with you to craft and refine the plan can serve as your navigator on the journey toward your goals.

The plan provides not only direction, but also an integrated strategy to try and better your overall financial life over time. As the years go by, this approach may do more than "make money" for you – it may help you to build and retain lifelong wealth.

To learn more about strategies to avoid probate, consult an attorney or a financial professional with solid knowledge of estate planning.

Tax Efficiency in Retirement

How much attention do you pay to this factor?

Will you pay higher taxes in retirement? Do you have a lot of money in a 401(k) or a traditional IRA? If so, you may receive significant retirement income. Those income distributions, however, will be taxed at the usual rate. If you have saved and invested well, you may end up retiring at your current marginal tax rate or even a higher one. The jump in income alone resulting from a Required Minimum Distribution could push you into a higher tax bracket.

While retirees with lower incomes may rely on Social Security as their prime income source, they may pay comparatively less income tax than you will in retirement – because up to half of their Social Security benefits won't be counted as taxable income.[1]

Given these possibilities, affluent investors might do well to study the tax efficiency of their portfolios; not all investments will prove to be tax-efficient. Both pre-tax and after-tax investments have potential advantages.

What's a pre-tax investment? Traditional IRAs and 401(k)s are classic examples of pre-tax investments. You can put off paying taxes on the contributions you make to these accounts and the earnings these accounts generate. When you take money out of these accounts, you are looking at taxes on the withdrawal. Pre-tax investments are also called tax-deferred investments, as the invested assets can benefit from tax-deferred growth.[2]

What's an after-tax investment? A Roth IRA is a classic example. When you put money into a Roth IRA, the contribution is not tax-deductible. As a trade-off, you don't pay taxes on the withdrawals from that Roth IRA (so long as you have had your Roth IRA at least five years and you are at least 59½ years old). Thanks to these tax-free withdrawals, your total taxable retirement income is not as high as it would be otherwise.[2]

Should you have both a traditional IRA and a Roth IRA? It may seem redundant, but it could help you manage your marginal tax rate. It gives you an option to vary the amount and source of your IRA distributions considering whether tax rates have increased or decreased.

Smart moves can help you reduce your taxable income & taxable estate. If you're making a charitable gift, giving appreciated securities that you have held for at least a year may be better than giving cash. In addition to a potential tax deduction for the fair market value of the asset in the year of the donation, the charity can sell the stock later without triggering capital gains for it or you.[3]

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The annual gift tax exclusion gives you a way to remove assets from your taxable estate. In 2018, you may give up to $15,000 to as many individuals as you wish without paying federal gift tax, so long as your total gifts keep you within the lifetime estate and gift tax exemption. If you have 11 grandkids, you could give them $15,000 each – that's $165,000 out of your estate. The drawback is that you relinquish control over those dollars or assets.[4]

Are you striving for greater tax efficiency? In retirement, it is especially important – and worth a discussion. A few financial adjustments could help you lessen your tax liabilities.

Ways to Fund Special Needs Trusts

A look at the different options & strategies

Special
Needs
TRUSTS

If you have a child with special needs, a trust may be a financial priority. There are many crucial goods and services that Medicaid and Supplemental Security Income will not pay for, and a special needs trust may be used to address that financial challenge.

In planning a special needs trust, a pressing question must be answered. When it comes to funding the trust, what are the options?

There are four basic ways to build up a third-party special needs trust. One method is simply to pour in personal assets, perhaps from extended family as well as immediate family. Another possibility is to fund the trust with permanent life insurance. Proceeds from a settlement or lawsuit can also serve as the core of the trust assets. Lastly, an inheritance can provide the financial footing for this kind of trust.

Families choosing the personal asset route may put a few thousand dollars of cash or other assets into the trust to start, with the intention that the initial investment will be augmented by later contributions from grandparents, siblings, or other relatives. Those subsequent contributions can be willed to the trust, or the trust may be named as a beneficiary of a retirement or investment account.[1]

When life insurance is used, the trustor makes the trust the beneficiary of a life insurance policy. When the trustor dies, the policy's death benefit is left, tax free, to the trust.[2]

A lump-sum settlement or inheritance can be invested while within the trust, inviting the possibility of growth and compounding. With a worthy trustee in place, there is less likelihood of mismanagement, and funds may come out of the trust to support the beneficiary in a measured way that does not risk threatening government benefits.

> *"A lump-sum settlement or inheritance can be invested while within the trust, inviting the possibility of growth and compounding."*

The trust may also be funded with tangible, non-cash assets. Examples include real estate, securities, collections of cars or art or antiques, even a business. These assets (and others like them) can be left to the trustee of the special needs trust via a revocable living trust or will. Just remember that the goal of the trust is to provide the trust beneficiary with cash. Those tangible assets will need to be sold or liquidated to meet that objective.[1]

Currently, it costs about $2,000 to design a basic special needs trust. Given that initial expense and ongoing administrative costs, most families aim to place at least $100,000 inside these vehicles. The typical trustee is a bank – or more precisely, a bank's trust division – and annual administration fees commonly range from 0.5%-1.5%. If the trustee is a relative of the child or a close friend of the family, administration may be done for free or at minimal cost.[3]

Care must be taken not only in the setup of a special needs trust, but in the management of it as well. This should be a team effort. The family members involved should seek out legal and financial professionals well versed in this field, and the resulting trust should be a product of close collaboration.

A Look at HSAs

Health Savings Accounts may provide you with remarkable tax advantages

Why do some higher-income households inquire about Health Savings Accounts? They may have heard about what an HSA can potentially offer them: a pool of tax-exempt dollars for health care, a path to tax savings, even a possible source of retirement income after age 65. You may want to look at this option yourself.

About 26 million Americans now have HSAs. You must enroll in a high-deductible health plan (HDHP) to have one, a health insurance option that is not ideal for everybody. In 2018, this deductible must be $1,350 or higher for individuals or $2,650 or higher for a family. In exchange for accepting the high deductible, you may pay relatively low premiums for the coverage.[1,2]

You fund an HSA with tax-free contributions. This year, an individual can direct as much as $3,450 into an HSA, while a family can contribute up to $6,900. (These contribution caps are $1,000 higher if you are 55 or older in 2018.) Some employers will even provide a matching contribution on your behalf.[1,2]

HSAs offer you three potential opportunities for tax savings. Your account contributions are tax-deductible unless made through a payroll deduction, in which case they are pre-tax. Any earnings in your account grow tax free, and you can withdraw funds from your HSA, tax free, so long as they are used to pay for qualified health care expenses, such as deductibles, co-payments, and hospitalization costs. (HSA funds may not be used to pay health insurance premiums.)[1,3]

At age 65, you can even turn to your HSA for retirement income. Currently, federal tax law allows an HSA owner 65 or older to withdraw HSA funds for any purpose, tax free. Yes, any purpose. You can use the money to pad your retirement income; you can use it to pay Medicare premiums or long-term care insurance premiums. No Required Minimum Distributions (RMDs) are ever required of HSA owners. (Prior to age 65, an HSA withdrawal not used for qualified medical expenses is assessed a 20% I.R.S. penalty.)[3]

"federal tax law allows an HSA owner 65 or older to withdraw HSA funds for any purpose, tax free.

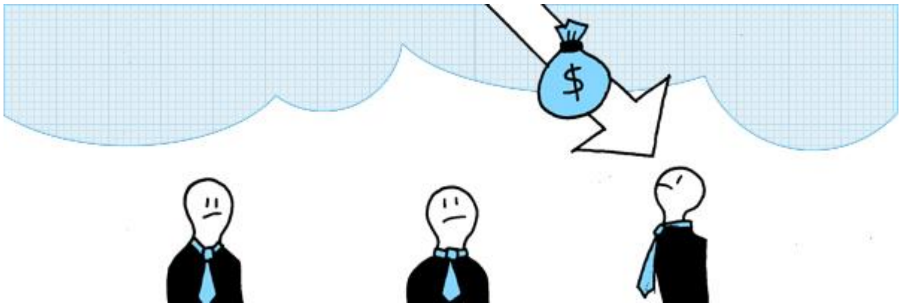
Why is an HSA less attractive for some people? Well, the first thing to mention is the related high-deductible health plan. When you enroll in one of these plans, you agree to pay all (or nearly all) of the cost of medicines, hospital stays, and doctor and dentist visits out of your pocket until that high insurance deductible is reached.[1]

The other hurdle is just saving the money. If you pay for your own health insurance, just meeting the monthly premiums can be a challenge, especially if your household contends with other significant financial pressures. There may not be enough money left over to fund an HSA. Also, if you are a senior (or a younger adult) with a chronic condition or illnesses, you may end up spending all of your annual HSA contribution and reducing your HSA balance to zero year after year. That works against one of the objectives of the HSA – the goal of accumulation, of potentially growing a tax-advantaged health care fund over time.

If you would like to explore opening an HSA, your first step is to consult an insurance professional to see if you can enroll in a qualified HDHP, unless your employer already sponsors such a plan. Finding an HSA provider is next.

Are Your Beneficiary Designations Up to Date?

A useful year-end move to counteract capital gains.



Here's a simple financial question: who is the beneficiary of your IRA? How about your 401(k) or annuity? You may be saying, "I'm not sure." It is smart to periodically review your beneficiary designations.

Your choices may need to change with the times. When did you open your first IRA? When did you buy your life insurance policy? Was it back in the Nineties? Are you still living in the same home and working at the same job as you did back then? Have your priorities changed?

While your beneficiary choices may seem obvious and rock-solid when you initially make them, time has a way of altering things. In a stretch of five or ten years, some major changes can occur in your life and may warrant changes in your beneficiary decisions.

In fact, you might want to review them annually. Here's why: companies frequently change custodians when it comes to retirement plans and insurance policies. When a new custodian comes on board, a beneficiary designation can get lost in the paper shuffle. (It has happened.) If you don't have a designated beneficiary on your retirement accounts, those assets may go to the "default" beneficiaries when you pass away, which might throw a wrench into your estate planning. An example: under ERISA, your spouse receives your 401(k) assets if you pass away. Your spouse must waive that privilege in writing for those assets to go to your children instead.[1]

"Naming a beneficiary helps to keep these assets out of probate when you pass away."

How your choices affect your loved ones. The beneficiary of your IRA, annuity, 401(k), or life insurance policy may be your spouse, your child, maybe another loved one, or maybe even an institution. Naming a beneficiary helps to keep these assets out of probate when you pass away.

Many people do not realize that beneficiary designations take priority over bequests made in a will or living trust. For example, if you long ago named a son or daughter who is now estranged from you as the beneficiary of your life insurance policy, he or she will receive the death benefit when you die, regardless of what your will states.[2]

You may have even chosen the "smartest financial mind" in your family as your beneficiary, thinking that he or she has the knowledge to carry out your financial wishes in the event of your death. But what if this person passes away before you do? What if you change your mind about the way you want your assets distributed and are unable to communicate your intentions in time? And what if he or she inherits tax problems as a result of receiving your assets?

How your choices affect your estate. If you are naming your spouse as your beneficiary, the tax consequences are less thorny. Assets you inherit from your spouse aren't subject to estate tax, as long as you are a U.S. citizen.[3]

When the beneficiary isn't your spouse, things get a little more complicated – for your estate and for your beneficiary's estate. If you name, for example, your son or your sister as the beneficiary of your retirement plan assets, the amount of those assets will be included in the value of your taxable estate. (This might mean a higher estate tax bill for your heirs.) And the problem will persist: when your non-spouse beneficiary inherits those retirement plan assets, those assets become part of their taxable estate, and their heirs might face higher estate taxes. Your non-spouse heir might also have to take required income distributions from that retirement plan someday and pay the required taxes on that income.[4]

If you properly designate a charity or other 501(c)(3) non-profit organization as a beneficiary of your retirement account assets, the assets can pass to the charity without your estate being taxed, and the gift will be deductible for estate tax purposes.[5]

If you would like to further discuss any of the topics written about in this newsletter, or inquire about any of our other services, please feel free to contact us

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