Taxable vs. tax-advantaged investing: How to choose

Financial professionals often advise taking full advantage of tax-sheltered accounts, such as 401(k)s, individual retirement accounts (IRAs) and 529 plans. Investing in those kinds of accounts can boost growth potential through tax-deferred compounding (or potentially tax-free compounding for Roth and 529 accounts). In most situations, investing in tax-advantaged accounts makes the most sense. But there are occasions when a taxable account may be a better choice. Consider these circumstances:

You’ll need the money soon. If you’re saving for a near-term goal — say, buying a house or going on vacation — or building an emergency fund, having your money easily accessible is a high priority. With tax-advantaged accounts, you’d have to pay a penalty to withdraw money prematurely.* (Roth accounts are an exception. You can withdraw contributions but not earnings at any time, tax- and penalty-free.)

You’ve maxed out contributions to tax-advantaged accounts. IRAs have an annual contribution limit of $5,500 ($6,500 for those 50 and older).** 401(k)s and similar employer-sponsored retirement plans have an annual contribution limit of $17,500 ($23,000 for those 50 and older).** If you’ve contributed the maximum allowed, you may want to continue your savings in a taxable account. Note that if paying college costs is the goal of your investments and you are using a 529 plan, you are not likely to max out contributions. The limits vary by state but are generally extremely generous ($200,000 or more). The only limit the IRS imposes on 529 plan contributions is that they cannot be more than the amount necessary to provide for the qualified education expenses of the beneficiary.

Your priorities are uncertain. Perhaps your big goals are retirement and your children’s college education. But you’re not sure what scholarships your students may qualify for … or whether your parent may need to move in with you, necessitating a home remodel. A taxable account allows you flexibility that a retirement- or college-specific account does not.

You want control of your tax liability in retirement. You’ll owe ordinary income tax on withdrawals you make in retirement from traditional IRAs, 401(k)s and other employer plans.* (Withdrawals from Roth accounts may be tax-free if certain conditions are met.) If you have both taxable and tax-deferred accounts, you can pick and choose where to withdraw funds to cover expenses, manage taxes and rebalance your portfolio. Plus you create the potential for paying some taxes at the more favorable capital gains tax rates instead of ordinary income tax rates.

To learn more about the potential benefits of investing in a taxable account, contact a CFS† investment professional at WPCCU. We can help you tailor solutions to your unique situation. Call 800-300-9728, ext. 1623 or visit wpcu.org.

* Premature withdrawals from retirement accounts (generally, those made before age 59½) may be subject to a 10 percent tax penalty in addition to ordinary income tax (does not apply to 457 plans). Nonqualified distributions from a 529 plan are subject to tax and a 10 percent penalty on the earnings portion of the distribution.

** These amounts are for 2014. They will be indexed to inflation for future years.

Please note that neither this financial institution nor any of its affiliates give tax or legal advice. Consult your tax advisor regarding your individual circumstances.

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How to decide when you’re ready to retire

Some people know exactly when they want to retire. They may have dreamed of it for years and set up a triggering mechanism, like when they accumulate X amount of dollars, reach age Y or pay off Z. For others, the decision of when to retire is not so obvious. In fact, it can be a complex calculation with financial, emotional, social and family considerations.

If you’re trying to decide when you’ll be ready to retire, these tips may help.

Visualize your life in retirement. Think about the activities that will fill your hours. Do you plan to do volunteer work, enjoy hobbies, take care of grandchildren or travel? Not having a job to go to every day can leave a big hole that needs to be filled with something you find fulfilling. Planning how you’ll spend your time can also provide important clues to how much money you’ll need to support your desired lifestyle.

Create a retirement budget. Do your best to estimate what your expenses will be, then consider adding a cushion for the unexpected. Be sure to make allowances for health care costs, which have been rising faster than inflation. To have a 75 percent chance of covering health care expenses (excluding long-term care) in retirement, the Employee Benefit Research Institute estimates that a 65-year-old married couple would need $227,000.*

Don’t count on “magic numbers.” Particular ages entitle you to certain financial benefits. For example:

- At age 55 you can make penalty-free withdrawals from a 401(k) or other employer-sponsored retirement plan if you leave your job.
- At age 59½ you can make penalty-free withdrawals from employer-sponsored retirement plans and individual retirement accounts (IRAs). Note, you must also have held the account for at least five years to make penalty-free withdrawals of earnings from a Roth IRA.
- At 62, you can begin collecting early Social Security benefits.

- At 65, you qualify for Medicare.
- Between 65 and 67, depending on when you were born, you can begin collecting full Social Security benefits.

Any of these milestones may play a role in your readiness for retirement, but can’t on its own signal that the time is right to retire.

Reduce financial responsibilities. Without a steady paycheck, meeting financial obligations may mean drawing down your retirement nest egg. So before you retire, do what you can to reduce financial drains like credit card debt, a child’s college tuition, support for an adult child who lives with you, major repairs to your home or car, etc.

If you’re married, get your spouse on board. Just like the first year of marriage, the first year of retirement requires adjustments in routines, responsibilities and more. It can be difficult for both of you, so having each other’s support is important.

Get an objective view. Meeting with a financial advisor can give you an unbiased view of your financial readiness to retire.

Estate planning may not be on top of your to-do list, but taking care of some essentials now will make it much easier on your loved ones in the event of your passing. Think of it as a final kindness to your kin. Plus, you’ll have the satisfaction of knowing your wishes will be followed.

1 Organize paperwork and/or online files. Make sure your family and/or personal representative can find your insurance policies, deeds, titles, pension information and financial account records. For online accounts, keep a list of passwords in a safe place and let your personal representative/executor know where it is.

2 Retitle accounts to make it easier to pass them on without probate. One way is to use joint tenancy with right of survivorship, in which case the assets automatically pass in full to the joint owner upon your death. However, this also means your joint owner (and possibly his or her creditors) has full access to the assets while you’re alive. To avoid that, you may want to consider payable on death accounts — sometimes called Totten trusts — for savings or certificates, or transfer on death registrations for stocks, bonds and mutual funds. The beneficiary has no claim on the assets while you are alive, and you can change the beneficiary at any time.

3 Make a will. The most basic estate planning document, a will allows you to name beneficiaries, distribute personal property and, if you have minor children, name their guardians.

4 Review and update beneficiaries on insurance policies, employer-sponsored retirement plans, individual retirement accounts (IRAs) and annuities. Updating beneficiaries is especially important since these designations supersede your will instructions.

5 Create a living will and designate a health care proxy. Don’t leave your loved ones guessing about the end-of-life care you would like to receive. Having instructions in place will spare them the burden of trying to guess what you would have wanted. You may be able to obtain these forms from your health care provider or your state department on aging.

6 Consider naming financial power of attorney. This will allow a trusted individual to take care of your financial affairs should you be incapacitated.

7 Spell out final wishes. Let your family know whether you prefer cremation or burial and what kind — if any — of funeral service you would like. If you’ve done preplanning, make sure your family has access to the contract.

8 Consider a trust. A trust may give you more control, more flexibility, help you reach charitable goals and — depending on the type of trust — may help save on estate taxes.

Please note that neither this financial institution nor any of its affiliates give tax or legal advice. Consult your tax advisor or attorney for information specific to your situation.
**Investor fraud: Don’t fall victim**

Fraud schemes come in all different forms — telephone calls, emails, late night infomercials — and con artists are constantly creating new ones. Becoming a victim of investment fraud can happen to anyone, and you may not always know a scam when you come across one. To protect yourself from investment fraud take a look at these tips:

**Make sure you understand the investment.**
As with any financial decision, it’s important to completely understand where your money will be going. Fraud artists count on pressuring you into an uninformed decision in order to steal your money. Make sure you have a solid understanding of the potential risks and rewards of an investment before committing.

**Research carefully.** From creating fake websites to gathering false testimonials, fraud artists are becoming more sophisticated with their schemes. To ensure that you don’t fall for fake research, make sure you can verify any information you find. For example, ask which state or federal agencies the firm or company is regulated by and contact them.

**Take your time with financial decisions.** Fraud artists will try to push you toward a quick financial decision in whatever way they can. Take time to thoroughly investigate potential investments, the companies they’re with and the individual or company trying to advertise them.

**Protect your personal information.** Protecting your personal information is one of the easiest ways to avoid becoming a victim. Don’t give anyone your credit or debit card information or account numbers unless you are sure you are dealing with a reputable company and you are certain that you want to make a purchase with them.

Doing business with people you know and trust — such as the investment professionals at WPCCU — is also a good way to avoid investment fraud. They can share more tips to help safeguard your financial security. Call 800-300-9728, ext. 1623 or visit wpcu.org.