JOHNSTON INVESTMENT COUNSEL
TRUSTED FIDUCIARIES & FEE-ONLY ADVISORS

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What Is a Private Insurance Exchange?

The Patient Protection and Affordable Care Act (ACA) provides for the creation of government-sponsored health insurance Exchange Marketplaces through which consumers and small businesses (fewer than 50 full-time equivalent employees) can comparison shop for health insurance that meets the minimum requirements of the ACA. Consumers and small businesses also may use Exchange Marketplaces to apply for tax credits that help offset the cost of health insurance. Government Exchange Marketplaces also provide the venue through which consumers may apply for an exemption to the ACA's health insurance mandate that requires most people to have health insurance coverage.

But government Exchange Marketplaces are not the only health insurance forums through which consumers and businesses may shop for insurance. Private exchanges are growing in number and popularity for both individual consumers and businesses.

What is a private exchange?

A private exchange is typically an online resource set up by insurance brokers, insurance companies, or benefit consultants, through which consumers and businesses can shop for health insurance, enroll in a plan, and receive customer support. Private exchanges are not part of the ACA, so unlike government Exchange Marketplaces, private exchanges don't offer tax credits, nor do they provide exemptions to consumers from the health insurance mandate. However, some private exchanges may offer help to consumers enrolling for coverage through government Exchange Marketplaces, especially if the consumer may be eligible for tax credits.

What do private exchanges offer?

Private exchanges typically offer two or more health insurance options, which may be from a single carrier or multiple insurers. Private exchanges may also provide:

- Information on available insurance options
- Assistance and recommendations about what insurance best fits the needs of the consumer
- Automated billing and processing
- Insurance products that can't be purchased through a government Exchange Marketplace such as vision, dental, hospitalization, disability, long-term care, life, and property insurance

Types of private exchanges

Generally, there are three types of private insurance exchanges, although some private exchanges may offer a combination of services and products. Private exchanges may be described as follows:

Individual private exchange

These exchanges offer insurance products and services to individual consumers and their families. Health insurance policies must meet the requirements of the ACA as to underwriting, benefits, and cost. However, consumers are not able to receive premium tax credits or cost-sharing reductions directly through an individual private exchange.

Group private exchange

Group private exchanges service employers that provide fully insured health coverage to their employees. Employers may have several major medical insurance options available through the private exchange that can be offered to employees. In addition, employers may offer supplemental insurance products (e.g., life, accident, long-term care) to employees through the private exchange.

Employer-sponsored individual private exchange

Also referred to as defined contribution health care, employers commit a stated dollar amount to the employee for individual or family coverage. Employees then select from a variety of plans offered by the private exchange that best meet their respective needs and add their own salary-deferred contributions to cover the premium exceeding the employer's contribution.

Some Things to Consider about Gifts to Children

If you have property that would produce a loss if sold, you should consider selling the property, claiming the loss, and transferring the proceeds to the child, rather than transferring the property to the child who would not be able to claim the loss.

If you make significant gifts to your children or someone else's children, or if someone else makes gifts to your children, there are a number of things for you to consider.

Transfers that are not taxable gifts

There are a variety of ways for you to make transfers to children that are not treated as taxable gifts for gift tax purposes. Filing a gift tax return is generally required if you make gifts (other than qualified transfers) totaling more than $14,000 to an individual during the year.

- **Providing support.** When you provide support to a child, it should not be treated as a taxable gift if you have an obligation to provide support under state law. This may provide a large umbrella for parents of minor children, college-age children, boomerang children, and special needs children.
- **Annual exclusion gifts.** You can generally make gifts of up to $14,000 per child gift tax free each year. If you split gifts with your spouse, the amount is effectively increased to $28,000. In the case of a gift to a qualified tuition program (529 plan) for a child, the annual exclusion can be effectively increased to five times the above amounts (i.e., to $70,000, or $140,000 if you split gifts with your spouse).
- **Qualified transfers for medical expenses.** You can make unlimited gifts for medical care gift tax free, provided the gift is made directly to the medical care provider.
- **Qualified transfers for educational expenses.** You can make unlimited gifts for tuition gift tax free, provided the gift is made directly to the educational provider.

The same exceptions for transfers that are not taxable gifts generally apply for purposes of the generation-skipping transfer (GST) tax. The GST tax is a separate tax that generally applies when you transfer property to someone who is two or more generations younger than you, such as a grandchild.

Income tax issues

A gift is not taxable income to the person receiving the gift. However, when you make a gift to a child, there may be several income tax issues regarding income produced by the property or from sale of the property.

- **Income for support.** Income from property owned by your children will be taxed to you if used to fulfill your obligation to provide support.
- **Kiddie tax.** Children subject to the kiddie tax are generally taxed at their parents' tax rate on any unearned income over a certain amount. For 2014, this amount is $2,000 (the first $1,000 is tax free and the next $1,000 is taxed at the child's rate). The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support. If the child's income would be taxed at the parents' high tax rates, it may make sense to invest in ways that can produce nontaxable income (e.g., tax-exempt bonds) or defer taxation (e.g., Series EE bonds) until after the kiddie tax period.
- **Basis.** When you make a gift, the person receiving the gift generally takes an income tax basis equal to your basis in the gift. (This is often referred to as a "carryover" or "transferred" basis.) The carried-over basis is increased--but not above fair market value (FMV)--by any gift tax paid that is attributable to appreciation in value of the gift (appreciation is equal to the excess of FMV over your basis in the gift immediately before the gift). The income tax basis is generally used to determine the amount of taxable gain if the child then sells the property. However, for purpose of determining loss on a subsequent sale, the carried-over basis cannot exceed the FMV of the property at the time of the gift.

Gifts to minors

Outright gifts should generally be avoided for any significant gifts to minors. In that case, you may wish to consider a custodial gift or a trust for a minor.

- **Custodial gifts.** Gifts can be made to a custodial account for the minor under your state's version of the Uniform Gifts/Transfers to Minors Acts. The custodian holds the property for the benefit of the minor, generally until an age (often 21) specified by state statute. Generally, any adult or trust company can be the custodian, but check state law.
- **Trust for minor.** A Section 2503(c) trust is a trust specifically designed to obtain the gift tax annual exclusion for gifts to a minor. Principal and income can be distributed to the minor before age 21, but there is no requirement of any distribution to the minor before age 21. The minor does generally gain access to undistributed income and principal at age 21.

Consult a tax professional for more information about your specific situation.

Why Not Make Your Next Trip a Volunteer Vacation?

One option for finding volunteer vacation opportunities in the United States or overseas is the nonprofit organization Just Give. To view a list of resources for potential volunteers, visit the organization's website, www.justgive.org.

Is your idea of a perfect vacation spending time alone on a beach with a good book? Or would you prefer a more active vacation where you are part of a group, constantly challenging yourself, and using your talents and skills to help others? If the latter sounds more appealing, then a volunteer vacation might be right for you.

Why take a volunteer vacation?

Having the chance to give back, meet new people, form friendships, and immerse yourself in a different culture are some of the top reasons to take a volunteer vacation. And no matter why and where you choose to travel, you'll have experiences that are not available to the average tourist.

A volunteer vacation also allows you to work with others who share your interests. For example, if you love the outdoors, you can work with park rangers on a national parks project in the United States or travel with a conservation group to Peru. Or if you've always wanted to work with children, you can find a service project at an orphanage in Haiti, or volunteer at a camp for children with special needs in Hawaii.

Who can serve as a volunteer?

Whether you're a solo traveler, a retiree, a student, a family with younger children, or a grandparent with teenage grandchildren, you can find a suitable volunteer opportunity. Many vacations don't require any experience--just a willingness to help and enjoy the camaraderie of working with individuals from your host community and members of your volunteer group. However, you'll get more out of your trip if you find one that matches your interests, skill set, and stamina level. Though you can choose to travel to a remote location or an underdeveloped country, you can also make a difference in a less adventurous setting. For example, you can help teach English at a school in a major city, work on an art conservation project in a museum, or care for injured animals at a zoo. The choice is yours.

What can you expect from your trip?

Trip length varies, but many last from one to four weeks. During that time, you'll be expected to devote a substantial number of hours to project work.

Yet volunteer vacations aren't all work and no play. Trips generally incorporate rest days or leisure periods where you're free to explore on your own or participate in a group tour, giving you unique insight into the area and a chance to unwind.

How much will your trip cost?

Some people are surprised to learn that there's a cost associated with volunteering, but you'll generally need to pay for your own travel expenses. Your trip may cost hundreds or thousands of dollars, depending on your destination, itinerary, and accommodations.

You may be able to offset part of the cost of your trip by deducting certain trip-related expenses when you file your federal income tax return. To get any tax benefits, your trip must be sponsored by a qualified organization (check with the charity or the IRS); the personal element of your trip must be insignificant (i.e., the time spent on pleasure, recreation, or vacation); and you must itemize your income tax deductions. You can generally deduct actual unreimbursed costs related to your volunteer service (such as airfare, lodging, and meals) but you can't deduct the value of your time or services. These are just general guidelines--for more information, ask your tax advisor and review IRS publication 526, Charitable Contributions.

What questions should you ask?

Before you sign up for a volunteer vacation, it's very important to make sure that you're traveling with an organization you trust. Trips may be sponsored by churches, national or global nonprofit volunteer organizations, or for-profit companies. Here are some of the questions you should ask before signing up. Some of this information may be found in literature provided by the sponsoring organization:

- How long has the group or organization been conducting volunteer vacations?
- How large is the volunteer group?
- How experienced are the team leaders? How well do they know the culture and the area?
- Will training be necessary, and if so, when and where will it be provided?
- What does the trip fee cover? Airfare? Meals? Transportation to the work site?
- Are costs or fees refundable? Make sure you read all policies and understand what will happen if you're unable to travel.
- What about insurance? You may be asked to provide proof of health insurance, or if traveling overseas, purchase medical and emergency evacuation coverage.
- How do you prepare, and what will you need to bring? You should be given a checklist of tasks to complete before your trip, and packing guidelines.

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Have the rules for 401(k) in-plan Roth conversions changed?

Yes. Thanks to the American Taxpayer Relief Act of 2012 (ATRA), the rules for making 401(k) in-plan Roth conversions have gotten substantially easier. (These rules also apply to 403(b) and 457(b) plans.)

A 401(k) in-plan Roth conversion (also called an "in-plan Roth rollover") allows you to transfer the non-Roth portion of your 401(k) account into a designated Roth account within the same plan. The amount you convert is subject to federal income tax in the year of the conversion (except for any nontaxable basis you have in the amount transferred), but qualified distributions from the Roth account are entirely income tax free. The 10% early distribution penalty doesn't apply to amounts you convert (but that penalty tax may be reclaimed by the IRS if you take a nonqualified distribution from your Roth account within five years of the conversion).

While in-plan conversions have been around since 2010, they haven't been widely used, because they were available only if you were otherwise entitled to a distribution from your plan--for example, upon terminating employment, turning 59½, becoming disabled, or in other limited circumstances. But in that case, you already had the option of rolling your funds over (converting) into a Roth IRA.

ATRA eliminated the requirement that you be eligible for a distribution from the plan in order to make an in-plan conversion. Now, if your plan permits, you can convert any vested part of your 401(k) plan account into a designated Roth account regardless of whether you're otherwise eligible for a plan distribution. The IRS has also just recently issued regulations that provide additional clarity on how in-plan conversions work.

Caution: Whether a Roth conversion makes sense financially depends on a number of factors, including your current and anticipated future tax rates, the availability of funds with which to pay the current tax bill, and when you plan to begin receiving distributions from the plan. Also, you should consider that the additional income from a conversion may impact tax credits, deductions, and phaseouts; marginal tax rates; alternative minimum tax liability; and eligibility for college financial aid.

Is there a new one-rollover-per-year rule for IRAs?

Yes--starting in 2015.

The Internal Revenue Code says that if you receive a distribution from an IRA, you can't make a tax-free (60-day) rollover into another IRA if you've already completed a tax-free rollover within the previous 12 months. The long-standing position of the IRS, reflected in Publication 590 and proposed regulations, was that this rule applied separately to each IRA you own.

Using an IRS example, assume you have two traditional IRAs, IRA-1 and IRA-2. You take a distribution from IRA-1 and within 60 days roll it over into your new traditional IRA-3. Under the old rule, you could not make another tax-free 60-day rollover from IRA-1 (or IRA-3) within one year from the date of your distribution. But you could still make a tax-free rollover from IRA-2 to any other traditional IRA.

Recently a taxpayer, Mr. Bobrow, did just what the example above seemed to allow, taking a distribution from IRA-1 and repaying it back to IRA-1 within 60 days, and then taking a distribution from IRA-2 and repaying it back to IRA-2 within 60 days. Unfortunately for the taxpayer, the IRS decided this was no longer the correct interpretation, and told Mr. Bobrow that his transactions violated the one-rollover-per-year rule. The case made its way to the Tax Court, which agreed with the IRS and held that regardless of how many IRAs he or she maintains, a taxpayer may make only one nontaxable 60-day rollover within each 12-month period.

Not surprisingly, the IRS has announced that it will follow the Bobrow case beginning in 2015 (more technically, the new rule will not apply to any rollover that involves a distribution occurring before January 1, 2015). For the rest of 2014 the "old" one-rollover-per-year rule in IRS Publication 590 (see above) will apply to any IRA distributions you receive. But keep in mind that you can make unlimited direct transfers (as opposed to 60-day rollovers) between IRAs--these aren't subject to the one-rollover-per-year rule. So if you don't have a need to actually use the cash for some period of time, it's generally safer to use the direct transfer approach and avoid this potential problem altogether.

(Note: The one-rollover-per-year rule also applies--separately--to your Roth IRAs.)

Food Price Crisis?

If you've visited the grocery store this year, you know that food prices have been going up alarmingly in recent months. In many cases, the price increases actually started years ago. Bacon prices (average $5.55 a pound) have risen 53% over the last four years, joining margarine ($2.11/lb, up 30%), ground beef ($4.13/lb, up 35%), oranges ($1.21/lb, up 35%), coffee ($5.00/lb; up 31%) and peanut butter ($2.71/lb, up 30%) as food commodities that have seen their prices rise by roughly a third over the past 48 months.

Some specialty items have gone up even more. If you had invested in a warehouse of fresh pine nuts four years ago, you'd be able to retire comfortably today.

The question we should be asking ourselves--especially those of us who expect to rely on fixed income in retirement, is: is this trend going to continue? Are food prices headed ever higher? And if so, should we be adjusting our budgets for double-digit annual inflation at the dinner table?

As it happens, we are living in a perfect storm, where supply shortages have been caused by forces over which farmers and ranchers have very little control. The biggest culprit is the multi-year drought in much of the western U.S. California is in the midst of its longest--and worst--drought on record. 2013 was California's driest year on record, and a freak heat wave during this year's rainy season has put 2014 on track to break that dismal mark. Farmers in the most productive agricultural land on Earth--California's central valley--have cut back on the number of acres planted as the snow pack in the Sierra Nevada mountains remains at roughly 15% of normal. This matters to food consumers everywhere. California produces a huge percentage of the nation's celery (95%), avocados (90%), cauliflower (89%), lemons (83%), spinach (83%), carrots (66%), broccoli (94%), strawberries (88%), bell peppers (50%) and tomatoes (30%).

The same drought pattern also extends deep into Texas, New Mexico, Oklahoma, Kansas and Nebraska, which have forced many of the nation's most productive beef cattle and feed growers to pare back herds and acreage. At the same time, Florida's citrus growers are facing a deadly new disease called "citrus greening" that has devastated orange groves--and for which there appears to be no cure. A relatively new hog virus called Porcine Epidemic Diarrhea Virus has significantly cut into pork production. And coffee prices have exploded ever since a fast-spreading fungus infection has begun spreading across farms from Mexico all the way to Peru. Hardest hit are the so-called "arabica" coffee plants, which produce the beans used in espressos and gourmet specialty coffee blends.

Normally, you hear commentators talk about commodity cycles, where higher prices in one year give farmers an incentive to plant more acreage, which means they produce more in hopes of taking advantage of those high prices. The excess supply drives prices back down toward normalcy. If prices are low, farmers cut back on acreage, and the lower production causes prices to rise back toward more normal levels. Some analysts are trying hard to explain why these time-honored mechanisms seem to have failed us over the past four years.

The answer is simple: the current situation is out of the control of farmers. Because of the unpredictable dynamics caused by Mother Nature, and the sudden advent of new crop diseases, food prices might stay high for at least a few more years -- and future prices may be harder to predict.

A "Guaranteed" Loser

Why would any investment "opportunity" guarantee a negative return to its investors, who happen to be some of the shrewdest minds in the banking industry?

This situation actually exists today--and the story is interesting. The European Central Bank has recently dropped its bank deposit rate to -0.1%. That means that if European-based lending institutions invest their assets in the Central Bank's money fund, they are guaranteed to receive less money when they take it back out again. The fund is a guaranteed loser.

The comparable number in the U.S. -- the return offered by the U.S. Federal Reserve to banks that want to park their excess capital in an interest-bearing account -- is 0.25%. That isn't very much, but many banks find it preferable to, for example, giving you a 30-year mortgage at around 4% (current rates, in other words) when the Fed's own economists expect the Fed Funds rate to reach 4% sometime in the next year or two. This explains why $4.34 trillion in bank reserves are sitting on the sidelines at a time when our economy sorely needs an investment boost. And it also explains why people with excellent credit scores are having trouble finding a bank willing to finance their home purchase.

So why has the ECB dropped its own rate below zero? By making it actually painful to park banking reserves, it wants to shake that sleeping money out of its accounts and back where it belongs: into the European economy. The strategy appears to be working; the graph shows that reserves have dropped--very suddenly, since the announcement--to their lowest point since 2011. This may be the only example in history where billions of dollars were invested in an investment "opportunity" that was absolutely, positively guaranteed to lose money.

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How Safe Are Our Jobs?

Researchers at Oxford University have recently released a report ("*The Future of Employment: How Susceptible Are Jobs to Computerisation*") which ranked 702 occupations based on their vulnerability to being replaced by increasingly powerful, increasingly inexpensive computer technology.

They posited that computers can be more productive than human labor whenever the job's tasks can be specified with precision--such as driving an automobile, performing routine manufacturing work or translating text from one language to another. The report says that law firms now rely on computers to scan thousands of legal briefs and precedents to assist in pre-trial research--a job once reserved for paralegals and young attorneys aspiring to partnership. Large databases of computer code make it possible for algorithms to learn to write programs and detect bugs in the software.

Somewhat alarmingly, the researchers found that 47% of total U.S. employment is at risk. The lowest-risk workers tended to have ties to the medical field, including 1) recreational therapists; 2) first-line supervisors of mechanics, installers and repairers; 3) emergency management directors; 4) mental health and substance abuse social workers; 5) audiologists; 6) occupational therapists; 7) orthotists; 8) healthcare social workers; 9) oral and maxillofacial surgeons; 10) first-line supervisors of fire fighting workers; 11) dietitians and nutritionists; 12) lodging managers; and 13) choreographers. Psychologists, dentists, human resources managers, athletic trainers, anthropologists and archeologists, and preschool teachers were also deemed unlikely to be replaced by machines in the near future.

At the other end of the spectrum, people who should probably be looking for another career include 702) telemarketers; 701) title examiners; 700) people who sew clothing by hand; 699) mathematical technicians; 698) insurance underwriters; 697) watch repairers; 696) cargo and freight agents; and 695) tax preparers. Data-entry keyers, loan officers, bank tellers, credit analysts, legal secretaries and, interestingly, models (replaced by attractive robots?) all fall deeply on the endangered end of the spectrum.

For the full report, go to:
http://www.oxfordmartin.ox.ac.uk/downloads/academic/The_Future_of_Employment.pdf

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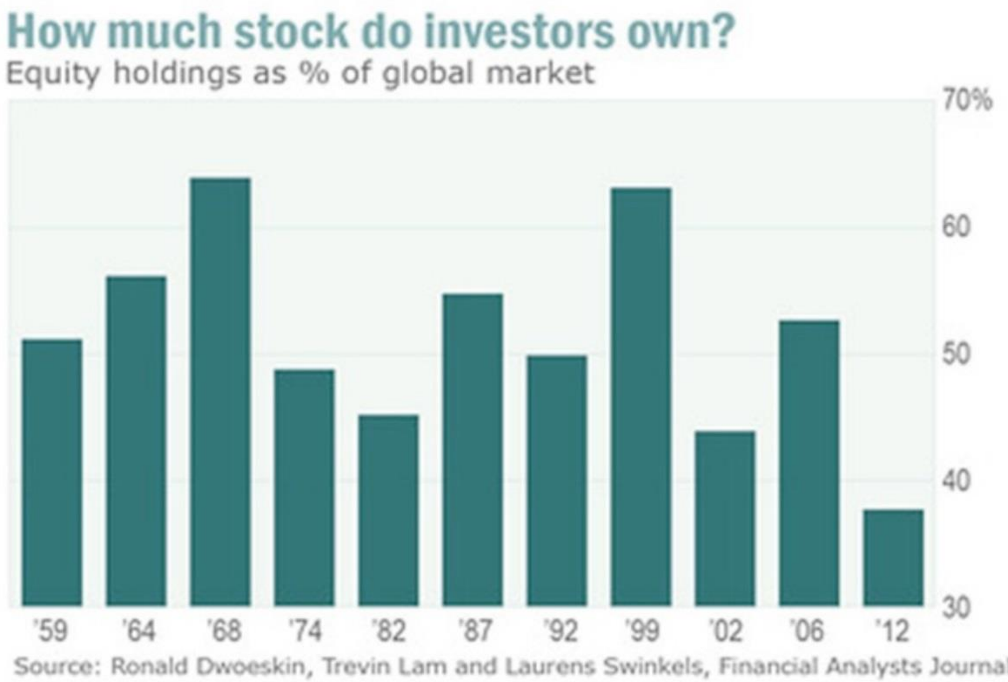
Fewer Stocks, Missed Opportunities

Investment pundits and gurus have been pouring over an interesting chart, reproduced here, that was published last year in the *Financial Analysts Journal*. The chart shows that, despite the recent high returns for stocks, investors, in aggregate, actually held only 37% of their portfolios in stocks at the end of 2012. Follow-up research has shown that even with five-year returns of 18% or more since the Great Recession of 2008, that percentage has hardly budged.



If you want to translate these statistics into real money, the research strongly suggests that many people didn't reap the full benefits of the recent stock market boom, and their portfolios today hold far few stocks than in 1959, when the data-set begins.

What's going on? You can see a few clues from the chart itself. The stock ownership percentage went down dramatically from 1999--when equities made up a near-record 62% of the average investor's portfolio--to 2002, when the Tech Wreck market decline sent investors scurrying to the sidelines and drove stock allocations below 45%. These investors moved back into the market over the next four years, taking their equity allocations above 50%, just in time for the market to crash all over again.

"Twice burned, quite shy" is one explanation for why so many investors have missed out on the strong returns we've experienced recently. Many have moved into bonds, which currently make up 57% of the aggregate investor portfolio today.

In addition, an unprecedented number of other investments are competing for space in an investor's portfolio -- certainly more today than in the 1960s or 1980s. Hedge funds and private equity firms now hold 9% of investors' aggregate portfolios. Gold and commodities have become increasingly popular investments, as have real estate investment trusts.

The markets are impossible to predict, in part because the behavior of people -- in aggregate as well as individually. But it is possible that the high fees and disappointing returns of hedge funds might cause some investors to rethink some of their more exotic allocations, and any rise in interest rates could startle the investor herd away from their record-high allocation to bonds. One possible future scenario would have the next data point on the chart show a return to stocks. Since higher levels of demand are one engine that drives stock prices higher, we could experience more years of high returns, which could, in turn, bring about one of those cycles that feeds on itself.

Until, of course, the next downturn--which, alas, is also unpredictable. The tragedy is how many people have largely missed out on the recovery returns since 2008. It is the nature of markets that they frighten people off while long-term investors enjoy their best years, and lure people back in as stock prices are just about to go over a cliff. The first part of this unhappy tale seems to have played itself out as usual.