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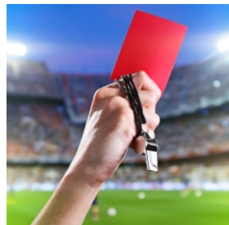
401(k) Withdrawals: Beware the Penalty Tax



You've probably heard that if you withdraw taxable amounts from your 401(k) or 403(b) plan before age 59½, you may be socked with a 10% early distribution penalty tax on top of the federal income taxes you'll be required to pay. But did you know that the Internal Revenue Code contains quite a few exceptions that allow you to take penalty-free withdrawals before age 59½?

Sometimes age 59½ is really age 55...or age 50

If you've reached age 55, you can take penalty-free withdrawals from your 401(k) plan after leaving your job if your employment ends during or after the year you reach age 55. This is one of the most important exceptions to the penalty tax.

And if you're a qualified public safety employee, this exception applies after you've reached age 50. You're a qualified public safety employee if you provided police protection, firefighting services, or emergency medical services for a state or municipality, and you separated from service in or after the year you attained age 50.

Be careful though. This exception applies only after you leave employment with the employer that sponsored the plan making the distribution. For example, if you worked for Employer A and quit at age 45, then took a job with Employer B and quit at age 55, only distributions from Employer B's plan would be eligible for this exception. You'll have to wait until age 59½ to take penalty-free withdrawals from Employer A's plan, unless another exception applies.

Think periodic, not lump sums

Another important exception to the penalty tax applies to "substantially equal periodic payments," or SEPPs. This exception also applies only after you've stopped working for the employer that sponsored the plan. To take advantage of this exception, you must withdraw funds from your plan at least annually based on one of three rather complicated IRS-approved distribution methods.

Regardless of which method you choose, you generally can't change or alter the payments for five years or until you reach age 59½, whichever occurs later. If you do modify the payments (for example, by taking amounts smaller or larger than required distributions or none at all), you'll again wind up having to pay the 10% penalty tax on the taxable portion of all your pre-age 59½ SEPP distributions (unless another exception applies).

And more exceptions...

Distributions described below generally won't be subject to the penalty tax even if you're under age 59½ at the time of the payment.

- Distributions from your plan up to the amount of your unreimbursed medical expenses for the year that exceed 10% of your adjusted gross income for that year (You don't have to itemize deductions to use this exception, and the distributions don't have to actually be used to pay those medical expenses.)
- Distributions made as a result of your qualifying disability (This means you must be unable to engage in any "substantial gainful activity" by reason of a "medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration.")
- Certain distributions to qualified military reservists called to active duty
- Distributions made pursuant to a qualified domestic relations order (QDRO)
- Distributions made to your beneficiary after your death, regardless of your beneficiary's age

Keep in mind that the penalty tax applies only to taxable distributions, so tax-free rollovers of retirement assets are not subject to the penalty. Also note that the exceptions applicable to IRAs are similar to, but not identical to, the rules that apply to employer plans.

See disclaimer on final page

Over the past 10 years, the amount of borrowing increased 78% under the unsubsidized Stafford Loan program, 26% under the Parent PLUS Loan program, and a whopping 262% under the Grad PLUS Loan program.

Source: College Board, Trends in Student Aid 2016, Table 1

Table: Federal Student Loans for College

Many families rely on federal student loans to help pay for college. This table describes features of the most common federal loans.

	Direct Unsubsidized Stafford Loan	**Direct Subsidized Stafford Loan**	**Perkins Loan**	**Direct PLUS Loan (Parent/Grad)**
Description	A federal student loan available to students regardless of financial need	A federal student loan available only to students with demonstrated financial need	A federal student loan available only to students with the greatest financial need	A federal loan available to parents and graduate students with good credit histories regardless of financial need
Eligibility	Undergraduate and graduate students enrolled at least half-time	Undergraduate students enrolled at least half-time	Undergraduate and graduate students (can be enrolled less than half-time)	Parents of undergraduate students enrolled at least half-time, and graduate and professional students
Funds dispersed by	Federal government	Federal government	College	Federal government
Borrower	Student	Student	Student	Parent or graduate/ professional student
Based on financial need?	No	Yes	Yes	No
Interest rate for loans disbursed in academic year 2016/2017	3.76% fixed for undergraduates; 5.31% fixed for graduate students	3.76% fixed	5% fixed	6.31% fixed
Interest subsidized?	No	Yes[1]	Yes[1]	No
Grace period	6 months	6 months	Generally 9 months	6 months
Loan limits for academic year 2016/2017	Dependent undergraduates: 1st year $5,500 ($3,500 subsidized), 2nd year $6,500 ($4,500 subsidized), 3rd to 5th year $7,500/year ($5,500 subsidized), $31,000 maximum Independent undergraduates and dependent undergraduates whose parents don't qualify for a PLUS Loan: 1st year $9,500 ($3,500 subsidized), 2nd year $10,500 ($4,500 subsidized), 3rd to 5th year $12,500/year ($5,500/year subsidized), $57,500 maximum Graduate students: $20,500 per year, $138,500 maximum including undergraduate loans		Undergraduates: $5,500/year $27,500 limit Graduate students: $8,000/year $60,000 limit (including undergraduate loans)	Total cost of education, minus any other financial aid received

[1] The federal government pays the interest on the loan while the student is in school at least half-time, in a grace period, or in a deferment period.

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Why a Life Insurance Claim May Be Denied

As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications.

Any guarantees associated with payment of death benefits are based on the claims-paying ability and financial strength of the insurer.

Life insurance can be an important financial tool for you and your family. For example, life insurance can help replace earnings that would cease upon your death. It can provide a legacy for your children or grandchildren, and can even be used to make a charitable gift after your death.

However, the fact that you've purchased life insurance doesn't guarantee that the death benefit will be paid when it's needed most — after you've died. There are several reasons insurance companies may attempt to deny, or at least delay, paying a claim for the death benefit. Here are some possible circumstances when a death-benefit claim may be contested by the insurer.

Misstatements on the application

A clause that's commonly found in life insurance contracts is the incontestability clause. A life insurance claim may be denied if the insurer finds that the applicant made misstatements on the policy application and death occurs within two years of the policy's start date. If the applicant makes statements intended to defraud the insurer, there is essentially no time limit, and the claim can be denied no matter how long the policy has been in force. That's why it is very important to provide accurate information on the policy application and not withhold information or facts that are requested by the insurer.

A good example of a policy being contested involved actor Heath Ledger, who died within seven months of purchasing a $10 million life insurance policy for the benefit of his daughter. The medical examiner ruled that the cause of death was due to an accidental drug overdose. Subsequently, the insurer denied the claim on two grounds: The death was the result of an intentional drug overdose and amounted to suicide, and the insured did not disclose on the insurance application (as requested) that he was a user of illegal drugs, which is a material misrepresentation. The policy beneficiary sued the insurer, and the case was eventually settled for an undisclosed amount believed to be much less than the policy death benefit.

Suicide clause

Most life insurance policies contain a suicide clause, which generally states that no death benefit will be paid if the insured's death results from suicide within two years from the inception of the policy. Often, policy owners inadvertently restart the two-year suicide clause when they replace existing life insurance with a new policy.

Even in the unfortunate circumstance that death by suicide occurs within two years from the policy's inception, the beneficiaries may still be able to receive at least a portion of the death benefit, depending on the circumstances. For example, whether death is intentional (suicide) or by accident is not always easily determined.

Policy lapse

A life insurance policy may not be in force because the coverage has lapsed. Policies may lapse for several reasons, including nonpayment of the premium and expiration of a stated term. Insurers generally send written notifications when a premium payment is past due, when the policy is about to lapse, and when a policy has actually expired. Sometimes the policy owner may inadvertently or intentionally neglect to make premium payments. In any case, the insurance beneficiary may not realize that the policy has lapsed until after the death of the insured.

An insurer may deny payment of the death benefit when death occurs outside the policy coverage term. Term life insurance provides death benefit coverage for a stated number of years, usually from one to 25 years, depending on the policy purchased. This type of insurance is also common through employer-provided plans. In any case, if the insured's death occurs after the policy term has expired, the claim for insurance proceeds will be denied.

What can you do?

Nothing can be more emotionally trying than having a life insurance claim denied while dealing with the loss of a loved one. Here are some tips that may help get the death benefit paid.

Whether you fill out the life insurance application or it is completed by a life insurance agent, be sure you review each section of the application and answer each question honestly. Do not withhold or falsify information.

Pay the premiums on time. Indicate an alternative address for mailing the premium notices and also name another individual to receive notices of premium lapses. If you move or change financial institutions and don't notify the insurer, you may forget about the premium payments and the policy could lapse without your knowledge.

If you have group life insurance, verify that it is still in force at least once each year. Also, review your policy with an insurance professional. You may not realize that your life insurance will end on a certain date.

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Will I owe income taxes when I sell my home?

In general, when you sell your home, any amount you receive over your cost basis (what you paid for the home, plus capital improvements, plus the costs of selling the home) is subject to capital gains taxes. However, if you owned and used the home as your principal residence for a total of two out of the five years before the sale (the two years do not have to be consecutive), you may be able to exclude from federal income tax up to $250,000 (up to $500,000 if you're married and file a joint return) of the capital gain when you sell your home. You can use this exclusion only once every two years, and the exclusion does not apply to vacation homes and pure investment properties.

For example, Mr. and Mrs. Jones bought a home 20 years ago for $80,000. They've used it as their principal residence ever since. This year, they sell the house for $765,000, realizing a capital gain of $613,000 ($765,000 selling price minus a $42,000 broker's fee, minus the original $80,000 purchase price, minus $30,000 worth of capital improvements they've made over the years). The Joneses, who file jointly and are in the 28% marginal tax bracket, can exclude $500,000 of capital gain realized on the sale of their home. Thus, their tax on the sale is only $16,950 ($613,000 gain minus the $500,000 exemption, multiplied by the 15% long-term capital gains tax rate).

What if you don't meet the two-out-of-five-years requirement? Or you used the capital gain exclusion within the past two years for a different principal residence? You may still qualify for a partial exemption, assuming that your home sale was due to a change in place of employment, health reasons, or certain other unforeseen circumstances.

Special rules may apply in the following cases:

- You sell vacant land adjacent to your residence
- Your residence is owned by a trust
- Your residence contained a home office or was otherwise used for business purposes
- You rented part of your residence to tenants
- You owned your residence jointly with an unmarried taxpayer
- You sell your residence within two years of your spouse's death
- You're a member of the uniformed services

What happens to my property if I die without a will?

If you die without a will, your property will generally pass according to state law (under the rules for intestate succession). When this happens, the state essentially makes a will for you. State laws specify how your property will pass, typically in certain proportions to various persons related to you. The specifics, however, vary from state to state.

Most state laws favor spouses and children first. For example, a typical state law might specify that your property pass one-half or one-third to your surviving spouse, with the remainder passing equally to all your children. If you don't have children, in many states your spouse might inherit all of your property; in other states, your spouse might have to share the property with your brothers and sisters or parents.

But not all property is transferred by will or intestate succession. Regardless of whether you have a will, some property passes automatically to a joint owner or to a designated beneficiary. For example, you can transfer property such as IRAs, retirement plan benefits, and life insurance by naming a beneficiary. Property that you own jointly with right of survivorship will pass automatically to the surviving owners at your death. Property held in trust will pass to your beneficiaries according to the terms you set out in the trust.

Only property that is not transferred by beneficiary designation, joint ownership, will, or trust passes according to intestate succession. You should generally use beneficiary designations, joint ownership, wills, and trusts to control the disposition of your property so that you, rather than the state, determine who receives the benefit of your property.

Even if it seems that all your property will be transferred by beneficiary designation, joint ownership, or trust, you should still generally have a will. You can designate in the will who will receive any property that slips through the cracks.

And, of course, you can do other things in a will as well, such as name the executor of your estate to carry out your wishes as specified in the will, or name a guardian for your minor children.

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Depression's Silver Lining

A lot of people are depressed these days: in 2015, one study showed that 6.7% of American adults suffered from a major depressive episode in the previous 12 months. Meanwhile, an estimated 12% of Americans are taking antidepressants, which suggests that the study may have underestimated the problem.

A major depressive episode, according to the National Institute of Mental Health, is defined as a period of two weeks or longer where there is either depressed mood or loss of interest or pleasure, along with at least four other symptoms that reflect a change in functioning: disorders in sleep, eating, energy, concentration and self-image. Sometimes the condition lasts for years. Sound depressing?

Recently, researchers have proposed that depression actually serves a useful function, which psychologists might consider when treating patients, and patients might consider before they start popping pills. Evolutionary psychologist Paul Andrews of McMaster University in Canada notes that depressed people often spend more time ruminating about their lives, get more REM sleep (a phase associated with memory consolidation) and pull away from the normal pursuits of life to experience deeply a problem or challenge they're facing. From an evolutionary standpoint, depressive episodes might actually be a healthy way for people to stop all the distractions of their lives and give full attention to whatever has wounded them, as a way to find a resolution of the problem.

Viewed from this perspective, depression is an altered state that allows (some would say forces) individuals to assess problems and prevent future mistakes.

This reframing of depression as a space for reflection might be empowering to people suffering from depression, and recognizes that they might be achieving positive results as a consequence of their misery. Vanderbilt psychologist Steven Hollon notes that most episodes of depression end on their own, and the depression-as-adaptation narrative may explain why. Rather than antidepressants, maybe a retreat from work and the pressures of life would bring about faster, more reliable healing.

Source:

- http://nymag.com/scienceofus/2017/02/a-new-way-to-understand-and-treat-depression.html

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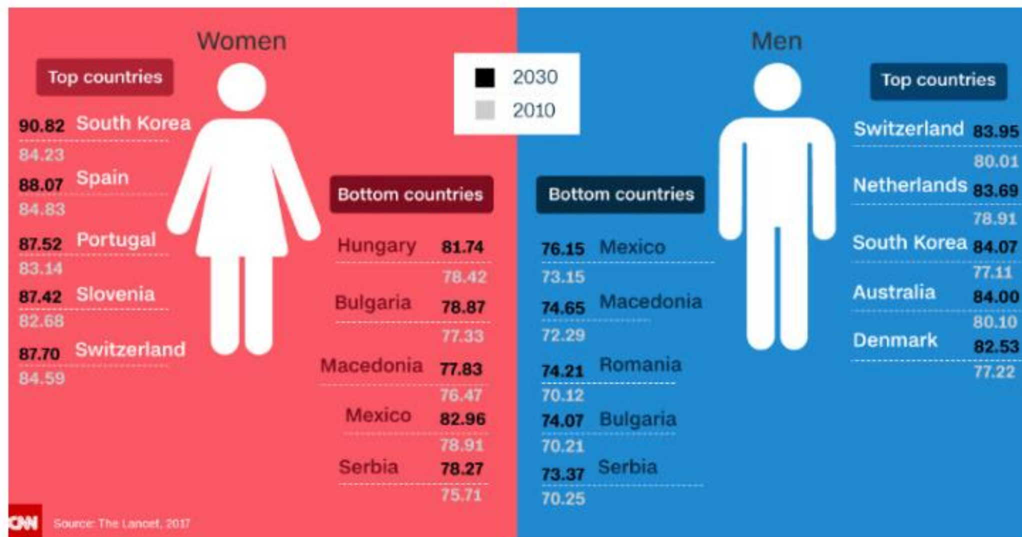
Longer Lives, Here and Abroad

For years, the U.S. life expectancy was among the longest in the world, a natural byproduct of the fact that the U.S. is wealthier, per capita, than other nations. Indeed, a research report in the medical journal The Lancet projects that between now and 2030, women in the U.S. will live an average 83.3 years (up from 81.2 today) and men an average of 79.5 years (up from 76.5 today).

The report analyzed data on mortality and longevity patterns from 35 industrialized nations, both high-income and emerging. American longevity increases are surely encouraging, but the more interesting part of the study is how the rest of the world is catching up and even surpassing American seniors. South Korean women are projected to live to an average age of 90 years in 2030, and women in Spain, Portugal, Slovenia and Switzerland will see average lifespans above 87. South Korea, the Netherlands, Australia Denmark and Switzerland will all see their male citizens survive, on average, beyond age 80. Gains in Mexico and the Czech Republic will put lifespans there, for both men and women, to levels comparable to the U.S. by 2030.



Why is the U.S. not progressing as fast as other countries? The report and some of the research around the report note that the U.S. has high obesity rates and our diets are not as healthy, per capita, as some of the leading nations. South Korea has invested in childhood nutrition and medical technology, and although the U.S. spends more of its total GDP on healthcare than any other nation, the quality of health tends to be top-heavy; the richer Americans can afford much better care than their less-wealthy counterparts.

Sources:

- https://www.washingtonpost.com/news/to-your-health/wp/2017/02/21/us-life-expectancy-will-soon-be-on-par-with-mexicos-and-croatias/?tid=sm_tw&utm_term=.cb737a6fb684
- http://www.cnn.com/2017/02/21/health/life-expectancy-increase-globally-by-2030/index.html

The Good and Bad of Millennial Finances

Millennial Americans saving their money at a higher rate than their Baby Boomer counterparts at a similar age. Research from the Transamerica Center for Retirement Studies shows that nearly three-quarters of Millennials are saving for retirement at an earlier age than past generations. Half are putting away 6% of their income or more—a statistic that makes Millennials the best cohort of savers since the Great Depression, despite having to carry record high levels of student loan debt. Those who participate in their workplace retirement plans are saving 7% a year, on average.

Alas, Millennials are not doing an equally good job of investing. The research suggests that many younger Americans are frightened and confused by the topic of investing, and keep their money in their bank accounts. That's a problem, since low interest rates essentially drop the return on investment to 0% a year. In the Transamerica survey, 25% of Millennial respondents said they weren't sure how their retirement savings were invested, and, when they were prompted to check, they reported higher allocations to bonds, money market funds and other low-return investments than their Baby Boomer or Generation X counterparts.

There are a variety of prescriptions for the problem of being under-invested, which is much more easily fixed than bad savings habits. Millennials need to be educated about investing—a subject which is not taught in high school or college. They need to become more comfortable with risk, understanding that, although markets do go down from time to time, they have always recovered and beaten their previous highs.

Sources:

- http://www.forbes.com/sites/arielleoshea/2017/02/21/5-essential-investing-moves-for-millennials/?ss=personalfinance#743c36582ab5
- http://www.csmonitor.com/Business/Saving-Money/2017/0221/Why-Millennials-are-better-with-their-money-than-their-parents

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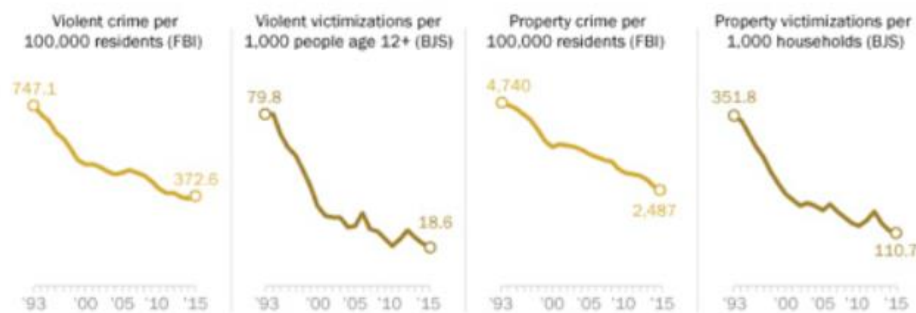
Real Crime vs. Imagined

Crime in America is totally out of control these days, right? Every day you read about some new shooting, robbery, kidnapping etc., and the impression you get is that we live in an age where the streets aren't safe and neither is your home.

When the Pew Research Center looked at the FBI figures for the quarter century from 1993 through 2015, they came to a somewhat different conclusion. Crime in America is actually falling at an impressive rate, when measured by violent crime per 100,000 residents, violent victimizations per 1,000 people, property crime per 100,000 residents or property victimizations per 1,000 households. (See chart) The news about crime, despite relentless headlines, is almost uniformly good—and has been for some time.

Crime rates have fallen since the early 1990s

Trends in violent crime and property crime, 1993-2015



Note: FBI figures include reported crimes only. BJS figures include unreported and reported crimes. 2006 BJS estimates are not comparable with other years due to methodological changes.
Source: FBI, Bureau of Justice Statistics

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The FBI data covers 18,000 different U.S. jurisdictions, while the victimization figures come from the Bureau of Justice Statistics. The former reflects reported crimes only, while the latter is a series of polls of individuals who are asked whether they were victims of a crime in the past six months, whether they reported it or not. The decline in violent crime ranged from 50% (FBI statistics) to 77% (BJS data), while the drop in property crime ranged from 48% to 69% respectively.

It appears that this story is not getting out to a mainstream audience. Twenty one Gallup surveys conducted since 1989 show that most Americans believed there was more crime in the U.S. compared with the year before, despite the general trend downward. In late 2016, a Pew Research Center survey found that 57% of registered voters believed crime had gotten worse since 2008, even

though the actual statistics showed that violent and property crime rates had declined by double-digit percentages during that span.

Where are you more likely to be a victim in our safer world? The reports show that there were more than 600 violent crimes per 100,000 residents in the states of Alaska, Nevada, New Mexico and Tennessee. The least violent states, with fewer than 200 violent crimes per 100,000 residents, were Maine, New Hampshire, Vermont and Virginia.

Source:

- http://www.pewresearch.org/fact-tank/2017/02/21/5-facts-about-crime-in-the-u-s/