Newsletter

JUNE 2020

Freddi Eberhart & Associates Inc. would like to thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time. Also, thank you for recommending us to your family, friends, and associates. We truly appreciate your referrals.

This Month:

June 21

- Father's Day

This month's newsletter details several reasons why you should look for other sources of cash instead of tapping into your retirement funds, along with identifying potential tax surprises if you are using any of the pandemic-related relief programs, including unemployment benefits.

Also included is information regarding length of time for record retention of financial and tax documents and tips for retiring in a bear market.

Please call if you would like to discuss how this information could impact your situation. If you know someone who can benefit from this newsletter, feel free to send it to them.

Think Before Tapping 401(k) as Emergency Fund

Do you need a quick infusion of cash?

Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, you may be able to take money out of a qualified plan, like a 401(k), or an IRA, with favorable tax consequences. But should you do it? You might view withdrawing money from a retirement account as a last resort.

Background

Among other changes in the CARES Act relating to qualified plans and IRAs, a participant can withdraw up to $100,000 of funds without paying the usual 10% tax penalty on distributions before age 59½. Plus, you can take as long as three years to pay the resulting tax bill, spread out evenly over the three years. If you repay the full amount within three years, you owe no tax.

To qualify for this program, you or your spouse must be diagnosed with COVID-19 or experience adverse financial consequences due to the virus such as being laid off, having work hours reduced or being quarantined or furloughed.

~ Continued on Page 2 ~

Think Before Tapping 401(k) as Emergency Fund (Cont'd)

What are the pitfalls?

There are several reasons why you may want to avoid taking money out of your retirement accounts unless it's an absolute emergency:

You're diluting your retirement savings. Although the money comes in handy now, you're chipping away at your nest egg and forfeiting growth. For example, if you withdraw the maximum amount of $100,000 that would have earned 6% annually tax-deferred for ten years, the value would have been $179,000.

It may be bad timing. Experts say it is difficult to time the markets in the current volatile environment. If you sell some holdings right now, you may be locking in losses that would miss the recovery in the next few months or years.

You still owe income tax. Income tax is due unless you replace the full amount within three years. Also, depending on your situation, you could end up paying tax at higher rates than you would in your retirement years.

Better options might exist. Arranging a hardship loan from your 401(k) might be a better alternative for your situation. You avoid the taxable event of the withdrawal and you pay back yourself with interest. Other options include refinancing a mortgage with lower interest rates, taking advantage of payment relief from mortgage, rent or student loan payments or deferred credit card billing.

Be Prepared for Pandemic Tax Surprises

Numerous new laws provide economic relief to individuals and businesses hardest hit by this year's pandemic. This much-needed financial assistance, however, comes with a few strings attached.

Here are three potential surprises if you use the available economic relief packages:

- **Getting a tax bill for unemployment benefits.** While the $1,200 economic impact payments most Americans received does not have to be reported as taxable income on your 2020 tax return, there is currently no such luck with unemployment benefits. In addition to paying federal taxes on your unemployment compensation, more than half of states also impose a tax on unemployment benefits.

~ Continued on Page 3 ~

Be Prepared for Pandemic Tax Surprises (Cont'd)

What you need to do: *See if your unemployment compensation check withholds a portion of your pay for taxes. Even if your check does have withholding for income tax purposes, the withholding amount may not be enough. If possible, talk to your state unemployment office and try to get withholding amounts revised.*

- **Paying estimated tax payments.** If you normally receive a paycheck from your employer, you may have never needed to write a check to the IRS to pay estimated future taxes. Your employer withholds your taxes from your paychecks and sends it to the IRS for you. If you're collecting unemployment benefits, however, you may be required to pay tax on the unemployment benefits received during the first six months of 2020 by July 15, 2020.

  What you need to do: *Estimate the amount of tax you owe for all sources of income, then compare that number with the amount of money withheld from your income to pay these taxes. If necessary, send in quarterly estimated tax payments to the U.S. Treasury and, in some cases, state revenue departments. This must be done each quarter with the next payment due July 15. You may need to send money in on September 15, 2020 and January 15, 2021 as well.*

- **Reporting emergency distributions from retirement accounts:** You may withdraw up to $100,000 in 2020 from various retirement accounts to help cover pandemic-related emergency expenses without incurring penalties. While you will not be required to pay an early withdrawal penalty, you will still be subject to income tax when filing your 2020 tax return.

  What you need to do: *If you plan to withdraw funds from your retirement account, reserve enough of the money to pay the tax! The amount you reserve depends on your potential tax situation so call for a tax review before taking money out of the account.*

Toss This. Not That.

Post tax filing record retention: With a sigh you are relieved that yet another tax return has been sent off to the government. Another 12 months before you need to do this again. But before you close that tax file, there is still some work to do. If the IRS or state revenue department selects your return for review, you will need to be prepared. Here is what you need to know:

Record Keeping Tips

1. As long as they are needed. The IRS says you should retain documentation for as long as they are needed to support your tax return. Normally tax records should be kept for three years from the later of the tax filing due date, the date you filed your taxes, or the date you paid your tax in full. But be careful, others may want it for a longer period of time.

~ Continued on Page 4 ~

Toss This. Not That. (Cont'd)

2. Some documents should be saved indefinitely. This includes things like:
   - Your tax return
   - Records related to a home purchase or sale
   - Stock transactions
   - Business/Rental records
3. The IRS does not require any special record keeping system. You just need to keep all documents that can support information on your tax return.
4. Here are common records worth retaining:
   - Canceled checks
   - Invoices
   - Other proof of payment for claimed deductions
   - Bank and credit card statements
   - Mileage logs
   - Receipts with time; place; and purpose noted
5. Be mindful of other record retention requirements
   - State record retention requirements are often 6 months to 1 year longer than Federal requirements
   - Social Security records often need to be proofed to ensure they match your pay stubs
   - Insurance, banking, and estate management may require other records
   - Federal retention requirements become 6 years if your return understates your tax obligation by more than 25%, and the record retention period is indefinite if fraud is involved.

Keep a good system

So the build up of paperwork does not overwhelm your attic, at the end of the tax year rotate your records. Decide how many years of records must be retained. Then count back from your current tax return filing year and shred unneeded, older documentation. Create new empty files for the current tax year to save receipts for the coming year. Consider scanning records to keep digital copies. A final word of caution. If you are unsure whether to retain or shred, keep it unless you know the document can be replaced.

~ Continued on Page 5 ~

Tips For Retiring into a Bear Market

You're approaching that long-awaited day when you can say goodbye to full-time employment. But you've been listening to the dire predictions of financial pundits. Not exactly encouraging stuff. Should you continue to plug along at work and ride out the storm? Or should you retire as planned, even if the market's headed for a significant downturn?

Tough questions. Unfortunately, there's not a one-size-fits-all answer.

Take a deep breath. Forget about the stuff you can't control: the stock market, interest rates, government programs, the world economy… etc. One of the biggest hazards of retiring into a declining market is "sequence of returns" risk. That's the problem of taking withdrawals — especially early in retirement — from a portfolio that's headed in the wrong direction. Once shares are sold, fewer shares are available to profit from future market recoveries.

Nevertheless, you can take steps to cushion the transition even when retirement accounts are performing poorly. Here are four suggestions:

- **Think about pulling funds from other assets.** If you have cash in "buffer accounts," tap those sources first. If not, consider reverse mortgage or home equity lines of credit. Both may have significant upfront costs, but establishing a line of credit early in retirement can help you defer substantial withdrawals from your retirement accounts.

- **Consider selling your house and moving.** Many people find that retirement is a great time to downsize and move to a less-expensive location. Proceeds from the sale can provide enough cash to cover expenses as you wait for the market to recover.

- **Set a realistic budget.** Don't just guess what you'll need. Do the math. Establish the habit of living within your means, before and after you leave your job.

- **Seek professional help.** A financial advisor can help you map out a plan for your golden years.

This newsletter provides business, financial, and tax information to clients and friends of our firm. This general information should not be acted upon without first determining its application to your specific situation. For further details on any article, please contact us.