THE H GROUP, INC. | SALEM

June 2015 / Vol. 24, No. 2

Financial Perspective

Lending Money to Family and Friends

The odds are high that you have been asked by a friend or family member to loan them money and if not, you would. You are not alone. A Federal Reserve survey calculates that loan transactions between friends and relatives in the US total $89 billion every year. Furthermore, a 2013 survey by American Consumer Credit Counseling found that 82% of respondents of all ages would lend money to a family member that has fallen on hard times, and 66% would give money to a needy friend.

Unfortunately these loans don't always have a happy ending. Unlike a downturn in the stock market, a loan to a family member or friend can be a permanent loss of assets. Maybe worse, these types of loans might strain family relationships and ruin friendships. As Shakespeare wrote in Hamlet, "Neither a borrower nor a lender be…for loan oft loses both itself and friend."

How do you prudently lend money to friends and family? Here are seven suggestions.

1. **Ask questions as a banker would.** What is the purpose of the loan? Why can't other sources be used? How and when will it be paid back? Be sure to ask yourself about the creditworthiness and dependability of the borrower. Will the loan really make a difference, given the need? Also ask yourself how this loan may affect family relationships and your relationship with the borrower, especially if the loan isn't repaid. How will you deal with late payments and defaults?
2. **Be prepared to say no.** At least allow yourself time to think about it and assess your own financial situation. Perhaps the amount requested consists of money you have earmarked for emergencies or other important goals, such as upcoming home repairs or retirement plan contributions. Quite often young adult children see their parents living comfortably and just assume that "mom and dad can afford it." Little do they know what it takes to retire and stay retired.
3. **Never lend more than you can afford to lose.** Even the most well-meaning borrower might fall on hard times and default. This means that you must be prepared to lose that money, treating it more like a gift than a loan.
4. **Loan cash only.** Never open a credit card in their name or co-sign. If you do, you are put into a position where someone else's actions could affect your credit score if payments are missed.
5. **Put it in writing.** Spell out the details, then have it signed and notarized, even if it is for your mom or best friend. You can find sample promissory note forms online or in business supply stores. A written agreement helps avoid misunderstandings later on and family disagreements after death. A debtor-child may "forget" that the received amounts were loans and not gifts. A written agreement will allow the beneficiaries to equalize the inheritance by offsetting the amount due and owning against the debtor-child's share.
6. **Charge interest.** This makes it feel more like a loan than a gift, and it keeps you in good graces with the IRS. The Applicable Federal Rate (AFR) set each month by the IRS is a good benchmark. Actually, at today's low interest rates, it is probably too low. You can charge more, and your borrower will still get a better deal than if he or she could have

Continued on page 4

Ron Kelemen, CFP® • Mary Way, CPA, CFP®
Larry Hanslits, CFP® • Brenna Baucum

INSIDE

THE H GROUP INC©
INDEPENDENT WEALTH MANAGEMENT SOLUTIONS™

Providing Fee-Only Wealth Management and Creative Planning for Your Family, Business and Estate

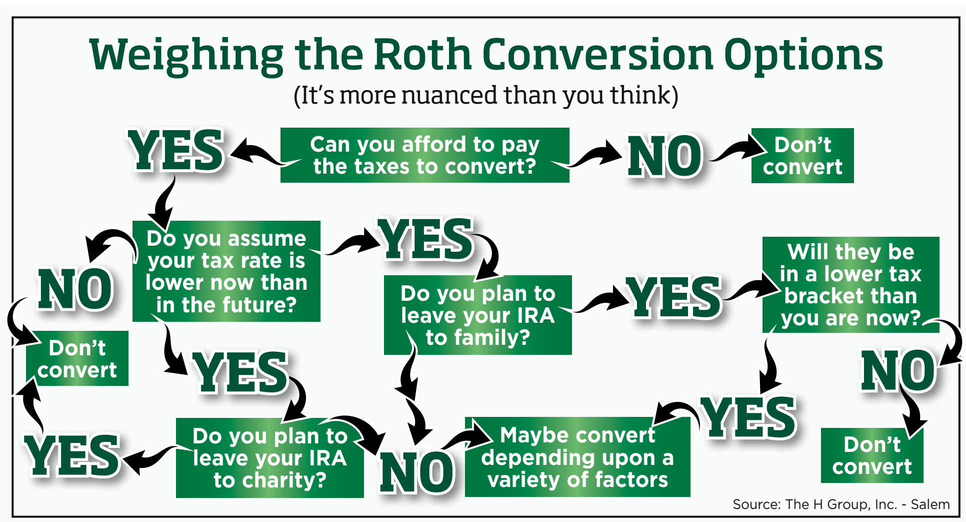
500 Liberty Street SE
Suite #310
Salem, OR 97301
(503) 371-3333

www.TheHGroup-Salem.com
Salem@TheHGroup.com

Rethinking Inherited Roth IRAs

Since 2010, anyone can convert his/her IRA to a Roth IRA regardless of income level. Since then much has been written about Roth conversions. Many financial pundits make it seem like a no-brainer, especially when it comes to leaving an inheritance. It's time to reexamine that premise. But first, the very basics.

In exchange for paying taxes on your IRA now, a Roth IRA can provide tax-free withdrawals for you and your heirs. No taxable minimum distributions are required after age 70½. If you make your conversion before starting Social Security, the distributions received don't affect the taxation of your Social Security benefits or increase your Medicare premiums. Roth IRA distributions could also help you with the 3.5% Medicare surtax on investment income if you are in that situation.



Finally, the income taxes you paid to make the conversion are removed from your taxable estate, which can be a big deal in Oregon.

However, there is a tax cost. For some of our readers, a conversion could cost 38%-43% of the amount converted at today's combined federal and state marginal income tax rates. On a $100,000 conversion, that translates to $38,000-$43,000.

It makes no sense mathematically to pay the taxes from your IRA. If you have cash sitting in a bank account earning nearly a 0% interest rate, prepaying your IRA taxes upfront may be a better deal than just letting it waste away in cash. However, looking ahead—do you have college tuition bills to pay, vehicle purchases pending, your retirement plan to fund, credit cards to pay off, or other needs for that cash in the near term? If your non-IRA assets are invested and earning more than your cash, do you want to take that money off the table to pay the taxes?

Leaving a Roth IRA as an Inheritance?

You can name a beneficiary on both traditional and Roth IRAs accounts. Under current laws your beneficiaries are required to take required minimum distributions (RMDs) of their inherited IRAs over their life expectancies, whether a Roth or a traditional. A 30-year old, for example, would need to take a minimum distribution of 2.3%, leaving the rest to continue compounding tax-free. By age 55 he or she would need to withdraw 3.3% of the account value. Even with a traditional IRA this is powerful. With a Roth, it's even better because it can provide tax-free income.

That's the good news. However, in our experience and visiting with colleagues at conferences, few heirs actually employ the stretch option. They often take it all at once. This makes a strong case for leaving them a Roth IRA so that they won't take a big tax hit when they cash it in.

It is more nuanced than that. You need to consider the tax differences between you and your heirs. Because of the Great Recession, lack of wage growth, etc., many young adults are not doing as well as their parents. You may be in the 43% combined bracket in Oregon, but a daughter working as a barista in Washington with no state income taxes may be in only the 15% bracket. Perhaps she should pay the imbedded tax liability of a traditional IRA at her lower bracket, not yours. Depending on the circumstances, she could actually receive a larger after tax inheritance.

Other Considerations

- The Supreme Court's *Clark v. Ramake* decision last year removed the creditor protection of IRA accounts for non-spousal beneficiaries. Thus, for some beneficiaries with spendthrift issues or high-risk professions, it may be better to leave IRA assets in a specially-drafted irrevocable trust. This is a whole new layer of complexity and expense, perhaps the right solution for some, but not for all.
- Another wrinkle is a proposal floating around Washington DC to limit the stretch-out period on an inherited IRA to five years. This would make an inherited Roth better than a traditional IRA.
- How many beneficiaries do you have, and what are their ages? The individual tax hit on a $1 million IRA divided among four beneficiaries in their 20's and 30's is less than to two siblings in their 50's.
- What are your beneficiaries' individual circumstances and where do they live? It may be better to leave a Roth to one, a traditional to another, and non-IRA assets to another.

Continued on page 4

Taking a Peek at the Backstage of Our Team Approach

Most people who know us have heard us use the term, "The Team Approach." Our goal of this is to provide coordinated service so that every client gets the full range of our team's expertise without ever needing to explain things over again to another team member. ***How do we pull it off? Documentation and collaboration.***

We document all client interactions which are updated in real time. This includes all transaction and portfolio activity with our investment managers and portfolio administrative team in Portland. Additionally our entire Salem team meets every Monday morning to review the past week, ask and answer questions, collaborate, and to get ready for the week ahead. As a result, any of us can help a client when taking a call because we are up-to-speed on the background.

Our Team Approach to Client Service

Documentation	Collaboration
Meeting notes	Monday meetings
Phone calls/emails	Biweekly advisor meetings
Service requests	Informal meetings
Transaction tracking	Frequent email cc
Work products	Advisor delegations
Correspondence	Problem solving

Although we have generally operated this way for several years, two very positive changes helped us refine the process. They started with a desire to ensure business continuity. First, Larry merged his practice with Ron's in 2011, and Brenna joined us in 2013. This greatly expanded our capacity to better serve our clients and for each of us to work in our areas of expertise. Last January, as part of the succession planning, Larry became the owner of The H Group, Inc.'s Salem office.

With this extra capacity, Ron's "new" role is focused around research, strategic planning, business development, and marketing, very similar to what he has done in the past. While traveling and volunteering a little more, he is still down the hall and very much engaged, but no longer directly involved in client meetings. The rest of us (Larry, Brenna, and Mary) are taking care of client needs, and working in our areas of unique ability.

While some roles have changed, much remains the same. We will continue to work for our clients with proactive service, integrity, and sound advice. Our highly qualified portfolio team in Portland continues to help us manage client assets to the highest fiduciary standard. Above all, we continue to work as a team to improve the financial lives of our clients.

Will Higher Interest Rates Derail Stocks?

It is popular in some circles to suggest that stocks are going to fall immediately once the Federal Reserve (the Fed) starts raising interest rates. While low short-term interest rates set by the Fed have certainly helped make stocks competitive, we don't agree. The Fed can only set the very short-term overnight interest rates. When our team applies the dividend discount model to value equities, we look at five and 10-year bond maturities, which more closely match reasonable stock holding periods. (Many other portfolio managers do as well.) The rates on those are driven more by inflation expectations, supply and demand, and stock dividends. According to Indexarb.com, the May 14 average dividend yield on the 422 stocks of the S&P 500 index that pay dividends is a whopping 2.13%. ***In this low inflationary environment and with bond yields paying the same or less than the dividend rate, companies would have to take huge hits to their earnings and dividends before we could see a major and prolonged market correction.*** When the Fed eventually does raise short-term rates, it will most likely be due to an improving economy, which is also good for stocks. As with previous interest rate increases by the Fed, rates would need to dramatically increase over a period of raises to sustain a prolonged downturn in stocks. We won't see that unless we start experiencing a spike in inflation.

The Team Advantage™

Larry Hanslits, Mary Way, and Ron Kelemen are independent CERTIFIED FINANCIAL PLANNER™ certificants. Together with Investment Advisory Associate Brenna Baucum, they jointly serve their clients as a team with over 82 years of combined experience. They work on a fee-only basis and do not accept any third party compensation or finder's fees. Their practice focuses on wealth planning and investment management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., one of the largest independent fee-only registered investment advisory firms in the Northwest with 10 professionals in five offices with over $700 million under active management.

About Larry Hanslits, CFP®

In practice since 1985, Larry merged his practice with Ron's and Mary's in 2011. He sits on the investment policy committee of The H Group, Inc., provides advanced estate planning case writing services to attorneys nationwide, and is a teacher and a judge for the financial planning scholarship competition at Oregon State University.

About Mary Way, CPA, CFP®

Mary joined the practice in 1995. She is also a non-practicing CPA with 16 years' experience in banking, business, and finance. She is President-Elect of the 185-member Rotary Club of Salem, and like Ron, a past president of the Willamette Valley Estate Planning Council.

About Brenna Baucum

Brenna joined the practice in 2013. She is a licensed investment advisory associate and is nearing completion of her CFP® certificate. She is a member of the Rotary Club of Salem and a board member of the Chemeketa Community College Foundation and serves on the Financial Planning Association's Mid-Winter Conference Committee.

About Ron Kelemen, CFP®

In practice since 1981, Ron is the author of The Confident Retirement Journey, a financial columnist for local medical and dental societies, and a contributing author of three financial planning reference books. He is frequently quoted in the national press and professional journals. He is active in Rotary and several non-profit organizations.

Page 1 photo courtesy of Caren Ann Jackson

Team Update

March and April are always very busy times of the year for us, especially because of income tax questions and retirement plan funding. We've been working on backstage improvements and are gearing up to start recruiting for an additional advisor. This is also the season when we wrap up our charitable sponsorships and fundraisers, such as the Liberty House Child Abuse Assessment Center and a speaking engagement by ABC's Robin Roberts for the Medical Foundation of Marion and Polk Counties. You can see photos and more details about us and these activities at our blog tab at TheHGroup-Salem.com.

Michelle keeps busy by keeping us busy by scheduling client update meetings. She and Brenna have been working on some computer enhancements to our activity tracking system. She took a few days off in April to spend with her family.

Debbie, after a busy tax season, enjoyed 10 days on the island of Oahu, Hawaii.

Brenna completed the capstone course for her CFP® certification. This summer, she will take an exam prep course, then sit for the board exam in November. She became a board member of the Chemeketa Foundation and joined the Women's Leadership Group. She's again working on the Financial Planning Association's Mid-Winter Conference committee, and wrapping up an incredible year of participation with the Chamber of Commerce Leadership Salem program.

Larry has been working on some complex estate planning cases and judged the annual financial planning scholarship competition for OSU's senior seminar. He and wife Laurie have been working on numerous landscaping projects and took a few days to explore the sights of Astoria.

Mary logged many hours of professional continuing education courses for her CPA license renewal. She has also been gearing up to assume the role of president of the Rotary Club of Salem. Knowing her as we do, she will be an outstanding one. She and husband Steve took a short trip to San Francisco to see The Book of Mormon musical.

Ron continues to work on several behind-the-scenes projects for us. Due to our workload and the weather, he and Kathy don't travel much this time of year, but they did get away for a few days to Ashland, OR for an Airstream Rally and some road trips with the exchange daughter Feruza, now a nurse in New York.

THE H GROUP INC®
INDEPENDENT WEALTH MANAGEMENT SOLUTIONS™

The H Group, Inc. | Salem Financial Perspective
500 Liberty Street SE, Suite #310 • Salem, OR 97301

ADDRESS SERVICE REQUESTED

PRESORT STD
U.S. POSTAGE
PAID
SIPRINT

Lending Money to Family and Friends . . . *Continued from page 1*

qualified for a bank loan. A good example of this would be to help a child refinance 8% student loan debts by paying you 3% interest over 10 years. Both of you win if your child pays you back on schedule.

7. Distance yourself from the loan. Try to keep your relationship as it was before the loan. Don't micromanage that person's spending, because the money that you lent is no longer in your control. If you must worry about it, focus instead on repayment, not how it is spent.

Lending to family members or friends may not be the best financial decision you can ever make; however, sometimes relationships trump traditional money sense. If you must make a loan, do so with your head, not just your heart. Relationships need not trump common sense.

Rethinking Inherited Roth IRAs . . . *Continued from page 2*

- Are you planning to leave some assets to charity? A traditional IRA is the best because it avoids income and estate taxation for both your estate and heirs. Paying taxes to convert to a Roth and then leaving some or all of it to a tax-exempt charity is just plain crazy, hurting both you (by paying unnecessary taxes) and possibly the charity and your heirs (by leaving a lower net bequest after taxes).
- Conversions don't need to be done all at once. Use low income years to partially convert some of your IRA. Your tax advisor can dial in the conversion amount for you to avoid breaking into a higher bracket.
- If your adult children need help now, why wait until you are long gone to help them? Consider giving them now the amount you would have paid in taxes to convert to a Roth, as long as it doesn't jeopardize your own financial security.
- If you are living on or are going to be heavily depending upon your IRA for retirement income, don't convert. As the flight attendants say, "Put your own mask on first before helping your children." If there is any air left in your IRA at you and your spouse's death, they can have it then. It might be small enough that taxes won't be a concern to them.

Remember, the basic concept is this: Pay taxes when your rates are lowest. It could be this year, but not the next. It could be during retirement, but not now during your peak earning years. Or it could be later by your children in a lower tax bracket than you are today.