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OPTIMUM EXPERIENCE

NEWSLETTER FOR CANANDAIGUA NATIONAL BANK & TRUST OPTIMUM CHECKING CUSTOMERS

College Saving: How Does a 529 Plan Compare to a Roth IRA?

529 plans were created 22 years ago, in 1996, to give people a tax-advantaged way to save for college. Roth IRAs were created a year later, in 1997, to give people a tax-advantaged way to save for retirement. But a funny thing happened along the way — some parents adapted the Roth IRA as a college savings tool.

Tax benefits and use of funds

Roth IRAs and 529 plans have a similar tax modus operandi. Both are funded with after-tax dollars, contributions accumulate tax deferred, and qualified distributions are tax-free. But in order for a 529 plan distribution to be tax-free, the funds must be used for college or K-12 education expenses. By contrast, a qualified Roth distribution can be used for anything — retirement, college, travel, home remodeling, and so on.

In order for a distribution from a Roth IRA to be tax-free (i.e., a qualified distribution), a five-year holding period must be met and one of the following must be satisfied: The distribution must be made (1) after age 59½, (2) due to a qualifying disability, (3) to pay certain first-time homebuyer expenses, or (4) by your beneficiary after your death.

For purposes of this discussion, it's the first condition that matters: whether you will be 59½ or older when your child is in college. If the answer is yes (and you've met the five-year holding requirement), then your distribution will be qualified and you can use your Roth dollars to pay for college with no tax implications or penalties. If your child ends up getting a grant or scholarship, or if overall college costs are less than you expected, you can put those Roth dollars toward something else.

But what if you'll be younger than 59½ when your child is in college? Can you still use Roth dollars? You can, but your distribution will not be qualified. This means that the earnings portion of your distribution (but not the contributions portion) will be subject to income tax.

Also, if you use Roth dollars to pay for college, the 10% early withdrawal penalty that normally applies to distributions before age 59½ is waived. So the bottom line is, if you'll be younger than 59½ when your child is in college and you use Roth dollars to pay college expenses, you might owe income tax (on the earnings portion of the distribution), but you won't owe a penalty.

If 529 plan funds are used for any other purpose besides the beneficiary's qualified education expenses, the earnings portion of the distribution is subject to income tax and a 10% federal tax penalty.

Financial aid treatment

At college time, retirement assets aren't counted by the federal or college financial aid formulas. So Roth IRA balances will not affect financial aid in any way. (Note: Though the aid formulas don't ask for retirement plan balances, they typically do ask how much you contributed to your retirement accounts in the past year, and colleges may expect you to apply some of those funds to college.)

By contrast, 529 plans do count as an asset under both federal and college aid formulas. (Note: Only parent-owned 529 accounts count as an asset. Grandparent-owned 529 accounts do not, but withdrawals from these accounts are counted as student income.)

Eligibility and contribution amounts

Unfortunately, not everyone is eligible to contribute to a Roth IRA. For example, your income must be below a certain threshold to make the maximum annual contribution of $5,500 (or $6,500 for individuals age 50 and older).

By contrast, anyone can contribute to a 529 plan; there are no restrictions based on income. Another significant advantage is that lifetime contribution limits are high, typically $300,000 and up. And 529 plan rules allow for large lump-sum, tax-free gifts if certain conditions are met — $75,000 for single filers and $150,000 for married joint filers in 2018, which is equal to five years' worth of the $15,000 annual gift tax exclusion.

CNB Can Help

If you have any questions about college savings strategies, please contact me or your local Bank Office to schedule an appointment.

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Four Tips for Downsizing in Retirement

It may sound like a daunting and emotionally draining task, but downsizing could be a savvy financial move, especially if you haven't reached your retirement savings goals.

1. Set goals for downsizing

Before you make any decisions, think about why you might want to downsize. Is it to save on mortgage payments or other monthly expenses? Or are you looking to free up some cash to help pursue your lifestyle goals in retirement?

No matter what your specific goals may be, understanding the connection between them and downsizing can help motivate you to follow through with it.

2. Determine the best time to downsize

Choosing when to downsize is an important decision. One benefit of downsizing early in retirement is that mortgage payments and other related expenses could decrease. This could mean you have extra funds to pursue new hobbies and activities. You might even be fortunate enough to have sufficient funds from the sale of a larger home to pay for a smaller home with cash, thus eliminating or decreasing your mortgage payment, or significantly increasing your cash flow.

But there may be advantages to delaying downsizing. If you wait to do it later in retirement, you might have a better sense of just how much you need to downsize to support your current lifestyle. Plus, timing your downsizing plans with the real estate market could mean that you sell and/or purchase a new home at a more opportune time.

3. Research associated costs with downsizing

There are several costs to think about if you are downsizing your home: the worth of your current home, the cost of a new home, and the fees and expenses associated with relocating. You can start by contacting local real estate agents to receive estimates of your home's value. Compare the estimates to have an idea of how much you might be able to get for your home. Research online to see what homes in your neighborhood have sold for recently.

One option that might be available is to rent a house or apartment for a length of time before buying it. That way, you'll learn whether the home and the location suit you.

If you're buying a new home, don't forget to account for the down payment, home inspection, closing costs, and other associated charges. Factoring all of the numbers into the equation may reveal whether downsizing makes the most sense for you and your financial situation.

4. Consider downsizing belongings, not just your home

For some people, downsizing might simply mean cutting down on clutter rather than relocating. When purging your home, consider the following:

- **Take your time.** Don't feel pressured to clear out your entire home in one fell swoop. Instead, make a plan to do one room or section of your home at a time.
- **Involve your children.** If you have kids, consider asking them for their help. Many hands make light work, and your children may end up expressing interest in items they would like to have.
- **Sell valuables.** Maybe you have jewelry or collectibles the family is not interested in. Consider having those items appraised and selling them to an auction house or online. Depending on how many items you're selling and their worth, you could wind up with quite a bit of money that you can use to help cushion your retirement fund.
- **Donate gently used items.** Find a local organization to donate furniture, clothing, or other possessions in good condition to. Some donation outlets may even offer free pickup of certain items, saving you time and hassle.
- **Clear out junk.** Chances are you've accumulated items that you simply won't be able to give away or sell. Discard belongings that serve no purpose other than taking up space. You might be surprised by how much room you could free up.

CNB Can Help

If you have any questions about your retirement strategies, please contact me or your local Bank Office to schedule an appointment.

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Annual Optimum Picnic at Sonnenberg Gardens!

Save the Date

Wednesday – August 15, 2018
11:30am – 1:00pm

Sonnenberg Gardens
151 Charlotte Street, Canandaigua, NY

Watch your mailbox or email for more information in mid-July.

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