

RBC Wealth Management

WealthMonitor

RBC Wealth Management
Hegge Wealth Management
Rick Hegge
400 N Robert Street Suite 1400
St Paul, MN 55101
651-228-6920
800-765-3246
rick.hegge@rbc.com
www.heggewealthmanagement.com

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Going Public: An IPO's Market Debut May Not Live Up to the Hype

Protect Your Heirs by Naming a Trust as IRA Beneficiary

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Quiz: Financial Facts That Might Surprise You



If you have a penchant for financial trivia, put your knowledge to the test by taking this short quiz. Perhaps some of the answers to these questions will surprise you.

Questions

1. The first organized stock market in New York was founded on Wall Street under what kind of tree?

a. Maple

b. Linden

c. Buttonwood

d. Elm

2. Who invented the 401(k)?

a. Congress

b. Ted Benna

c. The IRS

d. Juanita Kreps

3. Which three U.S. bills together account for 81% of the paper currency in circulation?

a. $1, $20, $100

b. $1, $5, $20

c. $1, $10, $20

d. $1, $10, $100

4. Small businesses comprise what percentage of U.S. businesses?

a. More than 39%

b. More than 59%

c. More than 79%

d. More than 99%

5. Which U.S. president signed Medicare into law?

a. President John F. Kennedy

b. President Lyndon B. Johnson

c. President Richard M. Nixon

d. President George W. Bush

Answers

1. c. Buttonwood. On May 17, 1792, 24 New York City stockbrokers and merchants met under a buttonwood tree outside of what is now 68 Wall Street. Their two-sentence brokers' agreement is known as the Buttonwood Agreement.[1]

2. b. Ted Benna. A 401(k) is a tax-deferred, employer-sponsored retirement savings plan. Although the name comes from Section 401(k) of the Internal Revenue Code, this type of retirement savings plan was created by Ted Benna in 1979. At the time, he was a co-owner of The Johnson Companies, a small benefits consulting firm.[2]

3. a. $1, $20, $100. The $1 bill represents about 29% of the total paper currency in circulation. The $20 bill represents about 22%, and the $100 bill represents about 30%.[3]

4. d. More than 99%. Despite their size, small businesses are a big part of the U.S. economy. According to the U.S. Small Business Administration, small businesses (independent businesses with fewer than 500 employees) comprise 99.9% of all firms and account for 62% of net new jobs.[4]

5. b. President Lyndon B. Johnson. President Kennedy recommended creating a national health insurance program in 1961, but it was President Johnson who signed the Medicare bill into law on July 30, 1965. President Nixon extended Medicare eligibility to certain people under age 65 in 1972, and President Bush expanded Medicare to include prescription drug benefits in 2003.[5]

[1] NYSEData.com

[2] 401kbenna.com

[3] Federal Reserve, Currency in Circulation: Volume, December 2017

[4] U.S. Small Business Administration, August 2017

[5] Centers for Medicare & Medicaid Services

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The IPO process is important to the financial markets because it helps fuel the growth of young companies and adds new stocks to the pool of potential investment opportunities.

An initial public offering (IPO) is the first public sale of stock by a private company. Companies tend to schedule IPOs when investors are feeling good about their financial prospects and are more inclined to take on the risk associated with a new venture.

Thus, IPOs tend to reflect broader economic and market trends. And not surprisingly, 2017 was the busiest year for the global IPO market since 2007.[1]

Company insiders who have been waiting for the opportunity to cash out may have the most to gain from an IPO. The higher the price set on IPO shares, the more money the company and its executives, employees, and early investors stand to make.

Nevertheless, the IPO process is important to the financial markets because it helps fuel the growth of young companies and adds new stocks to the pool of potential investment opportunities.

IPO market trends

Newer, smaller companies have traditionally used IPOs to raise capital for expansion. However, some companies are relying on private capital to fund their early growth and development, so they can wait longer to test public markets. These companies often become larger, more mature, and more valuable before they are publicly traded.

This trend may help explain why the amount of money raised through IPOs has increased over the past decade, even as the number of new IPOs has waned. From 2007 to 2016, the number of corporate IPOs averaged 164 per year, down 47% from the previous decade. But average annual IPO proceeds rose 82% over the same period to $284 million.[2]

A privately held company with an estimated value of $1 billion or more is often called a "unicorn," and it's estimated that there are now more than 200 of them in the technology sector alone.[3]

Since the term was first coined in late 2013, unicorns have received most of the media's attention, even though they still make up a relatively small part of the IPO market. The proceeds of 18 unicorn IPOs accounted for 5% of the capital raised from 2014 through 2016.[4]

Pop or fizzle

When IPO share prices shoot up on the first day of exchange trading, it's referred to as a "pop." A significant first-day gain may suggest that investor demand for the company's shares was underestimated. Of course, this doesn't mean that the company will outperform its peers in the long run.

One catch is that it is often difficult to obtain "allocated" stock. Investors who don't have the opportunity to buy shares at the offering price — the price at which insiders are selling to the market — can buy the stock after it starts trading on the exchange. However, much of an IPO's pop can take place between its pricing and the first stock trade. This means investors who buy shares after trading starts often miss out on a large part of the appreciation.

Investors who buy IPO shares on the first day might even pay inflated prices because that's when media coverage, public interest, and demand for the stock may be greatest. Share prices often drop in the weeks following a large first-day gain as the excitement dies down and fundamental performance measures such as revenues and profits take center stage.

Back to reality

A young company may have a limited track record, and an established one may have to disclose more information to investors after it becomes publicly traded. If you're interested in the stock of a newly public company, you should have a relatively high risk tolerance because shares can be especially volatile in the first few months after an IPO. You might even consider waiting until you can evaluate at least two quarters of earnings.

The return and principal value of all stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments offering the potential for higher rates of return also involve a higher degree of risk.

[1, 4] EY, 2017

[2-3] Bloomberg.com, September 11, 2017

Protect Your Heirs by Naming a Trust as IRA Beneficiary



While trusts offer numerous advantages, they incur up-front costs and often have ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional and your legal and tax advisers before implementing such strategies.

Often, tax-qualified retirement accounts such as IRAs make up a significant part of one's estate. Naming beneficiaries of an IRA can be an important part of an estate plan. One option is designating a trust as the IRA beneficiary.

Caution: *This discussion applies to traditional IRAs, not to Roth IRAs. Special considerations apply to beneficiary designations for Roth IRAs.*

Why use a trust?

Here are the most common reasons for designating a trust as an IRA beneficiary:

- Generally, inherited IRAs are not protected from the IRA beneficiary's creditors. However, IRA funds left to a properly drafted trust may offer considerable protection against the creditors of trust beneficiaries.
- When you designate one or more individuals as beneficiary of your IRA, those beneficiaries are generally free to do whatever they want with the inherited IRA funds, after your death. But if you set up a trust for the benefit of your intended beneficiaries and name that trust as beneficiary of your IRA, you can retain some control over the funds after your death. Your intended beneficiaries will receive distributions according to your wishes as spelled out in the trust document.
- Through use of a trust as IRA beneficiary, you may "stretch" IRA payments over the lifetimes of more than one generation of beneficiaries. Payments to IRA trust beneficiaries must comply with distribution rules depending on the type of IRA plan.

What is a trust?

A trust is a legal entity that you can set up and use to hold property for the benefit of one or more individuals (the trust beneficiaries). Every trust has one or more trustees charged with the responsibility of managing the trust property and distributing trust income and/or principal to the trust beneficiaries according to the terms of the trust agreement. If the trust meets certain requirements, the beneficiaries of the trust can be treated as the designated beneficiaries of your IRA for purposes of calculating the distributions that must be taken following your death.

Special rules apply to trusts as IRA beneficiaries

Certain special requirements must be met in order for an underlying beneficiary of a trust to qualify as a designated beneficiary of an IRA. The beneficiaries of a trust can be designated beneficiaries under the IRS distribution rules only if the following four trust requirements are met in a timely manner:

- The trust beneficiaries must be individuals clearly identifiable from the trust document as designated beneficiaries as of September 30 following the year of the IRA owner's death.
- The trust must be valid under state law. A trust that would be valid under state law, except for the fact that the trust lacks a trust "corpus" or principal, will qualify.
- The trust must be irrevocable, or by its terms become irrevocable upon the death of the IRA owner.
- The trust document, all amendments, and the list of trust beneficiaries must be provided to the IRA custodian or plan administrator by October 31 following the year of the IRA owner's death. An exception to this rule arises when the sole trust beneficiary is the IRA owner's surviving spouse who is 10 years younger than the IRA owner, and the IRA owner wants to base lifetime required minimum distributions (RMDs) on joint and survivor life expectancy. In this case, trust documentation should be provided before lifetime RMDs begin.

Note: *Withdrawals from tax-deferred retirement plans are taxed as ordinary income and may be subject to a 10% federal income tax penalty if withdrawn by the IRA owner prior to age 59½, with certain exceptions as outlined by the IRS.*

Disadvantages of naming a trust as IRA beneficiary

If you name your surviving spouse as the trust beneficiary of your IRA rather than naming your spouse as a direct beneficiary, certain post-death options that would otherwise be available to your spouse may be limited or unavailable. Naming your spouse as primary beneficiary of your IRA provides greater options and maximum flexibility in terms of post-death distribution planning.

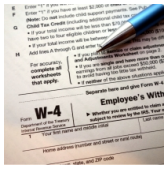
Setting up a trust can be expensive, and maintaining it from year to year can be burdensome and complicated. So the cost of establishing the trust and the effort involved in properly administering the trust should be weighed against the perceived advantages of using a trust as an IRA beneficiary. In addition, if the trust is not properly drafted, you may be treated as if you died without a designated beneficiary for your IRA. That would likely shorten the payout period for required post-death distributions.



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I received a large refund on my tax return this year. Should I adjust my withholding?

You must have been pleasantly surprised to find out you'd be getting a refund from the IRS — especially if it was a large sum. And while you may have considered this type of windfall a stroke of good fortune, is it really?

The IRS issued over 112 million federal income tax refunds, averaging $2,895, for tax year 2016.[1] You probably wouldn't pay someone $240 each month in order to receive $2,900 back, without interest, at the end of a year. But that's essentially what a tax refund is — a short-term loan to the government.

Because you received a large refund on your tax return this year, you may want to reevaluate your federal income tax withholding. That way you could end up taking home more of your pay and putting it to good use.

When determining the correct withholding amount, your objective is to have just enough withheld to prevent you from having to owe a large amount of money or scramble for cash at tax time next year, or from owing a penalty for having too little withheld.

It's generally a good idea to check your withholding periodically. This is particularly important when something changes in your life; for example, if you get married, divorced, or have a child; you or your spouse change jobs; or your financial situation changes significantly.

Furthermore, the implementation of the new tax law at the beginning of 2018 means your withholding could be off more than it might be in a typical year. Employers withhold taxes from paychecks based on W-4 information and IRS withholding tables. The IRS released 2018 calculation tables reflecting the new rates and rules earlier this year. Even so, the old W-4 and worksheet you previously gave to your employer reflect deductions and credits that have changed or been eliminated under the new tax law.

The IRS has revised a useful online withholding calculator that can help you determine the appropriate amount of withholding. You still need to complete and submit a new W-4 to your employer to make any adjustments. Visit irs.gov for more information.

[1] Internal Revenue Service, 2018



What is the difference between a tax deduction and a tax credit?

Tax deductions and credits are terms often used together when talking about taxes. While you probably know that they can lower your tax liability, you might wonder about the difference between the two.

A tax deduction reduces your taxable income, so when you calculate your tax liability, you're doing so against a lower amount. Essentially, your tax obligation is reduced by an amount equal to your deductions multiplied by your marginal tax rate. For example, if you're in the 22% tax bracket and have $1,000 in tax deductions, your tax liability will be reduced by $220 ($1,000 x 0.22 = $220). The reduction would be even greater if you are in a higher tax bracket.

A tax credit, on the other hand, is a dollar-for-dollar reduction of your tax liability. Generally, after you've calculated your federal taxable income and determined how much tax you owe, you subtract the amount of any tax credit for which you are eligible from your tax obligation. For example, a $500 tax credit will reduce your tax liability by $500, regardless of your tax bracket.

The Tax Cuts and Jobs Act, signed into law late last year, made significant changes to the individual tax landscape, including changes to several tax deductions and credits.

The legislation roughly doubled existing standard deduction amounts and repealed the deduction for personal exemptions. The higher standard deduction amounts will generally mean that fewer taxpayers will itemize deductions going forward.

The law also made changes to a number of other deductions, such as those for state and local property taxes, home mortgage interest, medical expenses, and charitable contributions.

As for tax credits, the law doubled the child tax credit from $1,000 to $2,000 for each qualifying child under the age of 17. In addition, it created a new $500 nonrefundable credit available for qualifying dependents who are not qualifying children under age 17. The tax law provisions expire after 2025.

For more information on the various tax deductions and credits that are available to you, visit irs.gov.

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