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Russia and Ukraine account for only about 2% of global gross domestic product, but high energy prices and supply shocks caused by the war could have a far-reaching impact on a global economy that has not fully recovered from the pandemic.

Is the Russia-Ukraine War a Threat to the Global Economy?

Before Russia stunned the world by invading Ukraine, it was widely believed that the economic ties formed through globalization would help promote peace. But the war is testing that assumption and drawing attention to the vulnerabilities in far-flung supply chains, which were already under pressure because of the pandemic and recovery.

In response to the brutal invasion of Ukraine, the United States, European Union (EU), United Kingdom (UK), and their allies are using financial sanctions to inflict severe damage on Russia's economy and pressure its leaders to end the war. But that effort likely comes at a significant cost to the global economy.

Punishing Russia

Western nations acted together in unprecedented fashion to isolate Russia from world trade and the global financial system. Some of Russia's largest banks have been expelled from SWIFT, an international payments system. Assets that Russia's central bank held in North America and Europe have been frozen, restricting its ability to prop up the value of its currency, the ruble.[1]

Germany shelved the opening of a new gas pipeline that would have supplied natural gas from Russia, and the United States and the United Kingdom have announced bans on Russian oil imports.[2] Hundreds of Western companies have suspended operations or pulled out of Russia, the world's 11th largest economy, either to comply with sanctions or because of public outrage over the war. Some wealthy oligarchs believed to be close to the Kremlin have also had their assets frozen or seized.[3]

The effects of sanctions have clearly been felt in Russia, where the central bank raised its key interest rate to 20%, and it's estimated that the Russian economy could contract up to 10%.[4-5] Until recently, Russia was a full participant in the global economy, so being cut off from Western supply chains and technologies could be painful for Russian businesses and consumers. It remains to be seen whether China will step in to fill the void left behind by the West.

Supply Shocks

Russia is a major producer and exporter of food, energy, metals, and other raw materials that often fluctuate in price based on the balance between supply and demand across global markets.[6] Therefore, supply shocks stemming from the war and sanctions have caused price spikes for some high-demand goods.

Russia is a top energy exporter, so crude oil and natural gas prices have surged since the conflict began, largely due to concerns about supply constraints. The EU relies heavily on energy imported from Russia (about 40% of its gas supply and almost 25% of its oil). Thus, reductions in energy deliveries from Russia would be difficult to replace and could worsen shortages in the global market.[7]

Russia is also a major producer of metals such as palladium (needed for catalytic converters), platinum, aluminum, copper, and nickel (needed for batteries).[8] In addition, about half of the world's supply of the neon gas used to make semiconductors came from Ukrainian companies that have been forced to close their operations. Until neon production is ramped up elsewhere, shortages could exacerbate the chip shortage that has been slowing the production of new cars, computers, electronic devices, and other products.[9]

Russia and Ukraine account for nearly 30% of global wheat exports, 17% of corn, 32% of barley, and 75% of sunflower seed oil. Financial sanctions have largely blocked Russia from exporting food, while the conflict has prevented Ukraine from transporting food out of the country. Russia is the world's top producer of fertilizer, providing about 15% of the global supply. Thus, crop yields throughout the world could be hindered by a shortage of fertilizer, which has risen to record prices alongside the natural gas from which it is often made.[10]

The bottom line is that consumers everywhere may soon face even higher grocery bills. The United Nations projects that global food costs, which are already at an all-time high, could soar another 22% due to the war. Egypt and other developing nations in North Africa, the Middle East, and Asia are especially dependent on grains from Russia and Ukraine. Disrupted food supplies and elevated prices are expected to cause a notable increase in world hunger.[11]

Ripple Effects

Russia and Ukraine account for only about 2% of global gross domestic product, but high energy prices and supply shocks caused by the war could have a far-reaching impact on a global economy that has not fully recovered from the pandemic. The Organization for Economic Cooperation and Development (OECD) estimates that global economic growth in the first year after the war began will be 1.1% lower, and inflation will be about 2.5% higher, than they would have been without the invasion. The impact will be greatest for countries with closer trade and financial ties to Russia and Ukraine. Throughout the world, people with lower incomes will likely suffer more because food and energy account for a larger share of spending.[12]

According to the same OECD report, inflation could rise an additional 2% in the euro area and 1.4% higher in the United States than it would have without the war. The OECD expects 2022 economic growth to be reduced by about 1.4% in the euro area and 0.9% in the United States.[13]

Russian aggression has caused a humanitarian disaster and an economic catastrophe in Ukraine that are nearly impossible to measure. More than 4 million people have already fled Ukraine, and many more could follow. Without outside help, accommodating the flood of refugees is likely to strain the finances of host governments such as Hungary, Moldova, Poland, Romania, and Slovakia.[14]

Europe has more exposure to the Russia-Ukraine conflict than the United States, but in both economies, inflation had already climbed to levels that haven't been seen for decades.[15] In the coming months, the world's key central banks will face the tricky task of raising interest rates enough to control inflation without causing a recession. There could also be longer-term repercussions, such as the reorganization of global supply chains and less integrated financial markets.

Estimates and projections are based on current conditions, are subject to change, and may not come to pass.

1) *The Wall Street Journal,* March 18, 2022

2) *The Wall Street Journal,* March 23, 2022

3) *The New York Times,* March 22, 2022

4, 15) *The Wall Street Journal,* March 7, 2022

5) *The Wall Street Journal,* March 16, 2022

6-8, 12-13) OECD, March 2022

9) Reuters, February 25, 2022

10) *The New York Times,* March 20, 2022

11) Bloomberg, March 13, 2022

14) Associated Press, March 30, 2022

Managing Bond Risks When Interest Rates Rise

Rising interest rates should not affect the return on a bond you hold to maturity, but may affect the price of a bond you want to sell on the secondary market before it reaches maturity.

After dropping the benchmark federal funds rate to a rock-bottom range of 0%–0.25% early in the pandemic, the Federal Open Market Committee has begun raising the rate toward more typical historical levels in response to high inflation. At its March 2022 meeting, the Committee raised the funds rate to 0.25%–0.50% and projected the equivalent of six more quarter-percentage-point increases in 2022 and three or four more in 2023.[1]

Raising the federal funds rate places upward pressure on a wide range of interest rates, including the cost of borrowing through bond issues. Regardless of the rate environment, however, bonds are a mainstay for investors who want to generate income or dampen the effects of stock market volatility on their portfolios. You may have questions about how higher rates could affect your fixed-income investments and what you can do to help mitigate the effect in your portfolio.

Rate sensitivity

When interest rates rise, the value of existing bonds typically falls, because investors would prefer to buy new bonds with higher yields. In a rising rate environment, investors may be hesitant to tie up funds for a long period, so bonds with longer maturity dates are generally more sensitive to rate changes than shorter-dated bonds. Thus, one way to address interest-rate sensitivity in your portfolio is to hold short- and medium-term bonds. However, keep in mind that although these bonds may be less sensitive to rate changes, they will generally offer a lower yield than longer-term bonds.

A more specific measure of interest-rate sensitivity is called *duration.* A bond's duration is derived from a complex calculation that includes the maturity date, the present value of principal and interest to be received in the future, and other factors. To estimate the impact of a rate change on a bond investment, multiply the duration by the expected percentage change in interest rates. For example, if interest rates rise by 1%, a bond or bond fund with a three-year duration might be expected to lose roughly 3% in value; one with a seven-year duration might fall by about 7%. Your investment professional or brokerage firm can provide information about the duration of your bond investments.

If two bonds have the same maturity, the bond with the higher yield will typically have a shorter duration. For this reason, U.S. Treasuries tend to be more rate sensitive than corporate bonds of similar maturities. Treasury securities, which are backed by the federal government as to the timely payment of principal and interest, are considered lower risk and thus can pay lower rates of interest than corporate bonds. A five-year Treasury bond has a duration of less than five years, reflecting income payments received prior to maturity. However, a five-year corporate bond with a higher yield has an even shorter duration.

When a bond is held to maturity, the bond owner would receive the face value and interest, unless the issuer defaults. However, bonds redeemed prior to maturity may be worth more or less than their original value. Thus, rising interest rates should not affect the return on a bond you hold to maturity, but may affect the price of a bond you want to sell on the secondary market before it reaches maturity.

Bond ladders

Owning a diversified mix of bond types and maturities can help reduce the level of risk in the fixed-income portion of your portfolio. One structured way to take this risk management approach is to construct a bond ladder, a portfolio of bonds with maturities that are spaced at regular intervals over a certain number of years. For example, a five-year ladder might have 20% of the bonds mature each year.

Bond ladders may vary in size and structure, and could include different types of bonds depending on an investor's time horizon, risk tolerance, and goals. As bonds in the lowest rung of the ladder mature, the funds are often reinvested at the long end of the ladder. By doing so, investors may be able to increase their cash flow by capturing higher yields on new issues. A ladder might also be part of a withdrawal strategy in which the returned principal from maturing bonds provides retirement income.

In the current situation, with rates projected to rise over a two- to three-year period, it might make sense to create a short bond ladder now and a longer ladder when rates appear to have stabilized. Keep in mind that the anticipated path of the federal funds rate is only a projection, based on current conditions, and may not come to pass. The actual direction of interest rates might change.

Laddering ETFs and UITs

Building a ladder with individual bonds provides certainty as long as the bonds are held to maturity, but it

Mutual funds, ETFs, and UITs are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

can be expensive. Individual bonds typically require a minimum purchase of at least $5,000 in face value, so creating a diversified bond ladder might require a sizable investment. Diversification is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss.

A similar approach involves laddering bond exchange-traded funds (ETFs) that have defined maturity dates. These funds, typically called target-maturity funds, generally hold many bonds that mature in the same year the ETF will liquidate and return assets to shareholders. Target maturity ETFs may enhance diversification and provide liquidity, but unlike individual bonds, the income payments and final distribution rate are not fully predictable.

Another option is to purchase unit investment trusts (UITs) with staggered termination dates. Bond-based UITs typically hold a varied portfolio of bonds with maturity dates that coincide with the trust termination date, at which point you could reinvest the proceeds as you wish. The UIT sponsor may offer investors the opportunity to roll over the proceeds to a new UIT, which typically incurs an additional sales charge.

Bond funds

Bond funds — mutual funds and ETFs composed mostly of bonds and other debt instruments — are subject to the same inflation, interest rate, and credit risks associated with their underlying bonds. Thus, falling bond prices due to rising rates can adversely affect a bond fund's performance. Because longer-term bonds are generally more sensitive to rising rates, funds that hold short- or medium-term bonds may be more stable as rates increase.

Bond funds do not have set maturity dates (with the exception of the target maturity ETFs discussed above), because they typically hold bonds with varying maturities, and they can buy and sell bonds before they mature. So you might consider the fund's duration, which takes into account the durations of the underlying bonds. The longer the duration, the more sensitive a fund is to changes in interest rates. You can usually find duration with other information about a bond fund. Although helpful as a general guideline, duration is best used when comparing funds with similar types of underlying bonds.

A fund's sensitivity to interest rates is only one aspect of its value — fund performance can be driven by a variety of dynamics in the market and the broader economy. Moreover, as underlying bonds mature and are replaced by higher-yielding bonds in a rising interest rate environment, the fund's yield and/or share value could potentially increase over the long term. Even in the short term, interest paid by the fund could help moderate any losses in share value.

It's also important to remember that fund managers might respond differently if falling bond prices adversely affect a fund's performance. Some might try to preserve the fund's asset value at the expense of its yield by reducing interest payments. Others might emphasize preserving a fund's yield at the expense of its asset value by investing in bonds of longer duration or lower credit quality that pay higher interest but carry greater risk. Information on a fund's management, objectives, and flexibility in meeting those objectives is spelled out in the prospectus and also may be available with other fund information online.

The return and principal value of individual bonds, UIT units, and mutual fund and ETF shares fluctuate with changes in market conditions. Fund shares and UIT units, when sold, and bonds redeemed prior to maturity may be worth more or less than their original cost. ETFs typically have lower expense ratios than mutual funds, but you may pay a brokerage commission whenever you buy or sell ETFs, so your overall costs could be higher, especially if you trade frequently. Supply and demand for ETF shares may cause them to trade at a premium or a discount relative to the value of the underlying shares. UITs may carry additional risks, including the potential for a downturn in the financial condition of the issuers of the underlying securities. There may be tax consequences associated with the termination of the UIT and rolling over an investment into a successive UIT. There is no assurance that working with a financial professional will improve investment results.

1) Federal Reserve, March 16, 2022

Required Distributions: Changes You Need to Know

The RMD 10-year rule substantially reduces the ability of most nonspouse beneficiaries to stretch distributions from an inherited defined contribution plan or IRA after the death of the original owner.

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 changed the rules for taking distributions from retirement accounts inherited after 2019. The so-called 10-year rule generally requires inherited accounts to be emptied within 10 years of the original owner's death, with some exceptions. Where an exception applies, the entire account must generally be emptied within 10 years of the beneficiary's death, or within 10 years after a minor child beneficiary reaches age 21. This reduces the ability of most beneficiaries to spread out, or "stretch," distributions from an inherited defined contribution plan or an IRA.

In February 2022, the IRS issued proposed regulations (generally applicable starting in 2022) that interpret the revised **required minimum distribution (RMD)** rules. Unless these proposals are amended, some beneficiaries could be subject to annual required distributions as well as a full distribution at the end of a 10-year period. Account owners and their beneficiaries may want to familiarize themselves with these new interpretations and how they might be affected by them.

RMD Basics

If you own a traditional IRA or participate in a retirement plan like a 401(k), you generally must start taking RMDs for the year you reach age 72 (age 70½ if you were born before July 1, 1949). If you're age 72 or older and still working for the employer that maintains the retirement plan, you may be able to wait until the year after retiring to start RMDs from that account. No RMDs are required from a Roth IRA during your lifetime (beneficiaries are subject to inherited retirement account rules). Failing to take an RMD can be costly: a 50% penalty generally applies to the extent an RMD is not made.

The **required beginning date** for the first year you are required to take a lifetime distribution is no later than April 1 of the next year. After your first distribution, annual distributions must be taken by the end of each year. (Note that if you wait until April 1 to take your first-year distribution, you would have to take two distributions for that year: one by April 1 and the other by December 31.)

When you die, the RMD rules also govern how quickly your retirement plan or IRA will need to be distributed to your beneficiaries. The rules are largely based on two factors: (1) the individuals you select as beneficiaries of your retirement plan, and (2) whether you pass away *before* or *on or after* your required beginning date. Because no lifetime RMDs are required from a Roth IRA, Roth IRA owners are always treated as dying before their required beginning date.

Who Is Subject to the 10-Year Rule?

The SECURE Act does still allow certain beneficiaries to continue to "stretch" distributions, at least to some extent. These **eligible designated beneficiaries (EDBs)** include your surviving spouse, your minor children, any individual not more than 10 years younger than you, and certain disabled or chronically ill individuals. Generally, EDBs are able to take annual required distributions based on remaining life expectancy. However, once an EDB dies, or once a minor child EDB reaches age 21, any remaining funds must be distributed within 10 years.

Significantly, though, the SECURE Act requires that if your designated beneficiary is not an EDB, the entire account must be fully distributed within 10 years after your death .

What If Your Designated Beneficiary Is Not an EDB?

If you die *before* your required beginning date, no distributions are required during the first nine years after your death, but the entire account must be distributed in the tenth year.

If you die *on or after* your required beginning date, annual distributions based on the designated beneficiary's remaining life expectancy are required in the first nine years after the year of your death, then the remainder of the account must be distributed in the tenth year.

What If Your Beneficiary Is a Nonspouse EDB?

After your death, annual distributions will be required based on remaining life expectancy. If you die *before* your required beginning date, required annual distributions will be based on the EDB's remaining life expectancy. If you die *on or after* your required beginning date, annual distributions after your death will be based on the greater of (a) what would have been your remaining life expectancy or (b) the beneficiary's remaining life expectancy. Also, if distributions are calculated each year based on what would have been your remaining life expectancy, the entire account must be distributed by the end of the calendar year in which the beneficiary's remaining life expectancy would have been reduced to one or less (if the beneficiary's remaining life expectancy had been used).

After your beneficiary dies or your beneficiary who is your minor child turns age 21, annual distributions based on remaining life expectancy must continue during the first nine years after the year of such an event. The entire account must be fully distributed in the tenth year.

What If Your Designated Beneficiary Is Your Spouse?

There are many special rules if your spouse is your designated beneficiary. The 10-year rule generally has no effect until after the death of your spouse, or possibly until after the death of your spouse's designated beneficiary.

What Life Expectancy Is Used to Determine RMDs After You Die?

Annual required distributions based on life expectancy are generally calculated each year by dividing the account balance as of December 31 of the previous year by the applicable denominator for the current year (but the RMD will never exceed the entire account balance on the date of the distribution).

When your life expectancy is used, the applicable denominator is your life expectancy in the calendar year of your death, reduced by one for each subsequent year. When the nonspouse beneficiary's life expectancy is used, the applicable denominator is that beneficiary's life expectancy in the year following the calendar year of your death, reduced by one for each subsequent year. (Note that if the applicable denominator is reduced to zero in any year using this "subtract one" method, the entire account would need to be distributed.) And at the end of the appropriate 10-year period, any remaining balance must be distributed.

The rules relating to required minimum distributions are complicated, and the consequences of making a mistake can be severe. Talk to a tax professional to understand how the rules, and the new proposed regulations, apply to your individual situation.

The U.S. Department of Education recently announced a record sixth extension for federal student loan repayment, interest, and collections, through August 31, 2022.

Federal Student Loan Repayment Postponed for Sixth Time

On April 6, the U.S. Department of Education announced a record sixth extension for federal student loan repayment, interest, and collections, through August 31, 2022.[1] The fifth payment pause was set to end on April 30, 2022. The six extensions have postponed federal student loan payments for almost two and a half years — since March 2020 at the start of the pandemic.

Education Secretary Miguel Cardona stated: "This additional extension will allow borrowers to gain more financial security as the economy continues to improve and as the nation continues to recover from the COVID-19 pandemic.[2]

A "fresh start"

As part of the extension, the Department of Education noted that it will give all federal student loan borrowers a "fresh start" by allowing them to enter repayment in good standing, even those individuals whose loans have been delinquent or in default. More information about loan rehabilitation will be coming from the Department in the weeks ahead.

The Department's press release stated: "During the extension, the Department will continue to assess the financial impacts of the pandemic on student loan borrowers and to prepare to transition borrowers smoothly back into repayment. This includes allowing all borrowers with paused loans to receive a 'fresh start' on repayment by eliminating the impact of delinquency and default and allowing them to reenter repayment in good standing."[3]

What should borrowers do between now and September?

Approximately 41 million Americans have federal student loans.[4] There are a number of things borrowers can do between now and September 2022.

- Seek to build up financial reserves during the next few months to be ready to start repayment in September.
- Continue making student loan payments during the pause (the full amount of the payment will be applied to principal). Interest doesn't accrue during the pause. Borrowers who continue making payments during this time may be able to save money in the long term, because when the pause ends, interest will be accruing on a smaller principal balance.
- Apply for the federal Public Service Loan Forgiveness (PSLF) program if they are working in public service and have not yet applied.
- Visit the federal student aid website, studentaid.gov, to learn more about PSLF and loan repayment options, including income-based options.
- Pay attention to the news. There has been increased political pressure on the current administration to enact some type of student loan cancellation, ranging from $10,000 per borrower to full cancellation. There are no guarantees, however. So it wouldn't be a good idea for borrowers to put all their eggs in this basket.

1-3) U.S. Department of Education, 2022

4) *The Washington Post,* April 6, 2022

Tax-Advantaged Ways to Save for College

In the college savings game, all strategies aren't created equal. The best savings vehicles offer special tax advantages if the funds are used to pay for college. Tax-advantaged strategies are important because over time, you can potentially accumulate more money with a tax-advantaged investment compared to a taxable investment. Ideally, though, you'll want to choose a savings vehicle that offers you the best combination of tax advantages, financial aid benefits, and flexibility, while meeting your overall investment needs.

529 plans

Since their creation in 1996, 529 plans have become to college savings what 401(k) plans are to retirement savings — an indispensable tool for saving money for a child's or grandchild's college education. That's because 529 plans offer a unique combination of benefits.

There are two types of 529 plans — savings plans and prepaid tuition plans. Though each is governed under Section 529 of the Internal Revenue Code (hence the name "529" plans), savings plans and prepaid tuition plans are very different savings vehicles.

Note: Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing; specific plan information is available in each issuer's official statement. There is the risk that investments may not perform well enough to cover college costs as anticipated. Also, before investing, consider whether your state offers any favorable state tax benefits for 529 plan participation, and whether these benefits are contingent on joining the in-state 529 plan. Other state benefits may include financial aid, scholarship funds, and protection from creditors.

529 savings plans

The more popular type of 529 plan is the savings plan. A 529 savings plan is a tax-advantaged savings vehicle that lets you save money for college and K-12 tuition in an individual investment-type account, similar to a 401(k) plan. Some plans let you enroll directly, while others require you to go through a financial professional.

The details of 529 savings plans vary by state, but the basics are the same. You'll need to fill out an application, name a beneficiary, and select one or more of the plan's investment portfolios to which your contributions will be allocated. Also, you'll typically be required to make an initial minimum contribution, which must be made in cash.

529 savings plans offer a unique combination of features that no other education savings vehicle can match:

Federal tax advantages: Contributions to a 529 account accumulate tax deferred and earnings are tax free if the money is used to pay the beneficiary's qualified education expenses. (The earnings portion of any withdrawal not used for qualified education expenses is taxed at the recipient's rate and subject to a 10% penalty.)

State tax advantages: Many states offer income tax incentives for state residents, such as a tax deduction for contributions or a tax exemption for qualified withdrawals. However, be aware that some states limit their tax deduction to contributions made to the

in-state 529 plan only.

High contribution limits: Most plans have lifetime contribution limits of $350,000 and up (limits vary by state).

Unlimited participation: Anyone can open a 529 savings plan account, regardless of income level.

Wide use of funds: Money in a 529 savings plan can be used to pay the full cost (tuition, fees, room and board, books) at any college or graduate school in the United States or abroad that is accredited by the Department of Education, and for K-12 tuition expenses up to $10,000 per year.

Professional money management: 529 savings plans are offered by states, but they are managed by designated financial companies who are responsible for managing the plan's underlying investment portfolios.

Flexibility: Under federal rules, you are entitled to change the beneficiary of your account to a qualified family member at any time as well as roll over (transfer) the money in your account to a different 529 plan once per calendar year without income tax or penalty implications.

Accelerated gifting: 529 savings plans offer an estate planning advantage in the form of accelerated gifting. This can be a favorable way for grandparents to contribute to their grandchildren's education while paring down their own estate, or a way for parents to contribute a large lump sum. Under special rules unique to 529 plans, a lump-sum gift of up to five times the annual gift tax exclusion amount ($16,000 in 2022) is allowed in a single year, which means that individuals can make a lump-sum gift of up to $80,000 and married couples can gift up to $160,000. No gift tax will be owed, provided the gift is treated as having been made in equal installments over a five-year period and no other gifts are made to that beneficiary during the five years.

Transfer to ABLE account: 529 account owners can roll over (transfer) funds from a 529 account to an ABLE account without federal tax consequences. An ABLE account is a tax-advantaged account that can be used to save for disability-related expenses for individuals who become blind or disabled before age 26.

Variety: Currently, there are over 50 different savings plans to choose from because many states offer more than one plan. You can join any state's savings plan.

But 529 savings plans have a couple of drawbacks:

No guaranteed rate of return: Investment returns aren't guaranteed. You roll the dice with the investment portfolios you've chosen, and your account may gain or lose value depending on how the underlying investments perform. There is no guarantee that your investments will perform well enough to cover college costs as anticipated.

Investment flexibility: 529 savings plans have limited investment flexibility. Not only are you limited to the investment portfolios offered by the particular 529 plan, but once you choose your investments, you can only change the investment options on your existing contributions twice per calendar year. (However, you can generally direct how your *future* contributions will be invested at any time.)

529 prepaid tuition plans

Prepaid tuition plans are cousins to savings plans — their federal tax treatment is the same, but their operation is very different. A 529 prepaid tuition plan lets you prepay tuition at participating colleges, typically in-state public colleges, at today's prices for use by the beneficiary in the future. Prepaid tuition plans are generally limited to state residents, whereas 529 savings plans are open to residents of any state. Prepaid tuition plans can be run either by states or colleges, though state-run plans are more common.

As with 529 savings plans, you'll need to fill out an application and name a beneficiary. But instead of choosing an investment portfolio, you purchase an amount of tuition credits or units, subject to plan rules and limits. Typically, the tuition credits or units are guaranteed to be worth a certain amount of college tuition in the future, no matter how much college costs may increase between now and then.

However, if your child ends up attending a college that doesn't participate in the plan, prepaid plans differ on how much money you'll get back. Also, some prepaid plans have been forced to reduce benefits after enrollment due to investment returns that have not kept pace with the plan's offered benefits.

Even with these limitations, some college investors appreciate not having to worry about college inflation each year and want to lock in college tuition prices today. The following table summarizes the main differences between 529 savings plans and 529 prepaid tuition plans:

529 savings plans	529 prepaid tuition plans
Offered by states	Offered by states and private colleges
You can join any state's plan (though some plans may require you to enroll with a financial professional)	State-run plans require you to be a state resident

Contributions are invested in your individual account in the investment portfolios you have selected	Contributions are pooled with the contributions of others and invested by the plan
Returns are not guaranteed; your account may gain or lose value depending on how the underlying investments perform.	Generally a certain rate of return is guaranteed in the form of a percentage of tuition being covered in the future, no matter how much costs may increase by then
Funds can generally be used for the full cost of tuition, fees, room and board, equipment and books at any accredited college or graduate school in the U.S. or abroad, or K-12 tuition expenses up to $10,000 per year	Funds can be used only for tuition at participating colleges (typically state colleges); room and board and graduate school generally are not eligible expenses

Coverdell education savings accounts

A Coverdell education savings account (Coverdell ESA) is a tax-advantaged education savings vehicle that lets you save money for college, as well as for elementary and secondary school (K-12) at public, private, or religious schools. Here's how it works:

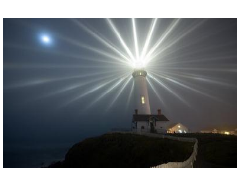
- Application process: You fill out an application at a participating financial institution and name a beneficiary. Depending on the institution, there may be fees associated with opening and maintaining the account. The beneficiary must be under age 18 when the account is established (unless he or she is a child with special needs).
- Contribution rules: You (or someone else) make contributions to the account, subject to the maximum annual limit of $2,000. This means that the total amount contributed for a particular beneficiary in a given year can't exceed $2,000, even if the money comes from different people. Contributions can be made up until April 15 of the year following the tax year for which the contribution is being made.
- Investing contributions: You invest your contributions as you wish (e.g., stocks, bonds, mutual funds, certificates of deposit) — you have sole control over your investments.
- Tax treatment: Contributions to your account grow tax deferred, which means you don't pay income taxes on the account's earnings (if any) each year. Money withdrawn to pay college or K-12 expenses (called a qualified withdrawal) is completely tax free at the federal level(and typically at the state level too). If the money isn't used for college or K-12 expenses (called a nonqualified withdrawal), the earnings portion of the withdrawal will be taxed at the beneficiary's tax rate and subject to a 10% federal penalty.
- Rollovers and termination of account: Funds in a Coverdell ESA can be rolled over without penalty into another Coverdell ESA for a qualifying family member. Also, any funds remaining in a Coverdell ESA must be distributed to the beneficiary when he or she reaches age 30 (unless the beneficiary is a person with special needs).

Unfortunately, not everyone can open a Coverdell ESA — your ability to contribute depends on your income. To make a full contribution, single filers must have a modified adjusted gross income (MAGI) of less than $95,000, and joint filers must have a MAGI of less than $190,000. And with an annual maximum contribution limit of $2,000, a Coverdell ESA can't go it alone in meeting today's college costs.

Custodial accounts

Before 529 plans and Coverdell ESAs, there were custodial accounts. A custodial account allows your child to hold assets — under the watchful eye of a designated custodian — that he or she ordinarily wouldn't be allowed to hold in his or her own name. The assets can then be used to pay for college or anything else that benefits your child (e.g., summer camp, braces, computer). Here's how a custodial account works:

- Application process: You fill out an application at a participating financial institution and name a beneficiary. Depending on the institution, there may be fees associated with opening and maintaining the account.
- Custodian: You also designate a custodian to manage and invest the account's assets. The custodian can be you, a friend, a relative, or a financial institution. The assets in the account are controlled by the custodian.
- Assets: You (or someone else) contribute assets to the account. The type of assets you can contribute depends on whether your state has enacted the Uniform Transfers to Minors Act (UTMA) or the Uniform Gifts to Minors Act (UGMA). Examples of assets typically contributed are stocks, bonds, mutual funds, and real property.
- Tax treatment: Earnings, interest, and capital gains generated by the account are taxed to your child each year under special "kiddie tax" rules that apply when a child has unearned (passive) income. Under the kiddie tax rules, a child's unearned income over a certain threshold ($2,300 in 2022) is taxed at parent income tax rates. The kiddie tax rules generally apply to children under age 18 and full-time college students under age 24 whose earned income doesn't exceed one-half of their support.



A custodial account provides the opportunity for some tax savings, but the kiddie tax reduces the overall effectiveness of custodial accounts as a tax-advantaged college savings strategy. And there are other drawbacks. All gifts to a custodial account are irrevocable. Also, when your child reaches the age of majority (as defined by state law, typically 18 or 21), the account terminates and your child gains full control of all the assets in the account. Some children may not be able to handle this responsibility, or might decide not to spend the money for college.

U.S. savings bonds

Series EE and Series I bonds are types of savings bonds issued by the federal government that offer a special tax benefit for college savers. The bonds can be easily purchased from most neighborhood banks and savings institutions, or directly from the federal government. They are available in face values ranging from $50 to $10,000. You may purchase the bond in electronic form at face value or in paper form at half its face value.

If the bond is used to pay qualified education expenses and you meet income limits (as well as a few other minor requirements), the bond's earnings are exempt from federal income tax. The bond's earnings are always exempt from state and local tax.

In 2021, to be able to exclude all of the bond interest from federal income tax, married couples must have a modified adjusted gross income of $128,650 or less at the time the bonds are redeemed (cashed in), and individuals must have an income of $85,800 or less. A partial exemption of interest is allowed for people with incomes slightly above these levels.

The bonds are backed by the full faith and credit of the federal government, so they are a relatively safe investment. They offer a modest yield, and Series I bonds offer an added measure of protection against inflation by paying you both a fixed interest rate for the life of the bond (like a Series EE bond) and a variable interest rate that's adjusted twice a year for inflation. However, there is a limit on the amount of bonds you can buy in one year, as well as a minimum waiting period before you can redeem the bonds, with a penalty for early redemption.

Roth IRAs

Though technically not a college savings account, some parents use Roth IRAs to save and pay for college. In 2022, you can contribute up to $6,000 per year. Earnings in a Roth IRA accumulate tax deferred. Contributions to a Roth IRA can be withdrawn at any time and are always tax free. For parents age 59½ and older, a withdrawal of earnings is also tax free if the account has been open for at least five years. For parents younger than 59½, a withdrawal of earnings — typically subject to income tax and a 10% premature distribution penalty — is spared the 10% penalty if the withdrawal is used to pay for a child's college expenses.

But not everyone is eligible to contribute to a Roth IRA — it depends on your income. In 2022, if your filing status is single or head of household, you can contribute the full amount to a Roth IRA if your MAGI is $129,000 or less. And if you're married and filing a joint return, you can contribute the full amount if your MAGI is $204,000 or less.

Financial aid impact

Your college saving decisions can impact the financial aid process. Come financial aid time, your family's income and assets are run through a formula at both the federal level and the college (institutional) level to determine how much money your family should be expected to contribute to college costs before you receive any financial aid. This number is referred to as your expected family contribution, or EFC. Your income is by far the most important factor, but your assets count too.

Note: Starting with the 2024-2025 FAFSA, the term "student aid index" (SAI) will replace EFC on the FAFSA. The change attempts to clarify what this figure actually is: an eligibility index for student aid, not an exact dollar amount of what a family can or will pay for college.

In the federal calculation, your child's assets are treated differently than your assets. Your child must contribute 20% of his or her assets each year, while you must contribute 5.6% of your assets. For example, $10,000 in your child's bank account would equal an expected contribution of $2,000 from your child ($10,000 x 0.20), but the same $10,000 in your bank account would equal an expected $560 contribution from you ($10,000 x 0.056).

Under the federal rules, an UTMA/UGMA custodial account is classified as a student asset. By contrast, 529 plans and Coverdell ESAs are counted as parent assets if the parent is the account owner. In addition, student-owned or UTMA/UGMA-owned 529 accounts are also counted as parent assets. For 529 plans and Coverdell accounts that are counted as parent assets, distributions (withdrawals) from the account that are used to pay the beneficiary's qualified education expenses are not counted as parent or student income on the federal government's aid form, which means that the money is not counted again when it's withdrawn.

However, the situation is different for grandparent-owned 529 plans and Coverdell accounts. If a 529 plan or Coverdell account is owned by a grandparent instead of a parent, the account isn't counted as a parent asset — it doesn't count as an asset at all. However, money withdrawn from a grandparent-owned account is counted as student income, and student income is assessed at 50% in the federal aid formula.

Note: Starting with the 2024-2025 FAFSA, distributions from a grandparent-owned 529 plan will no longer be counted as student

income.

Other investments parents may own in their name, such as mutual funds, stocks, U.S. savings bonds, certificates of deposit, and real estate, are also classified as parent assets. However, the federal government doesn't count retirement assets at all in its financial aid formula, so Roth IRAs aren't factored in to aid eligibility.

Regarding institutional aid, colleges generally dig a bit deeper than the federal government in assessing a family's assets and their ability to pay college costs. Most colleges use a standard financial aid application that considers assets the federal government might not, for example, home equity. Typically, though, colleges treat 529 plans, Coverdell accounts, UTMA/UGMA custodial accounts, U.S. savings bonds, and Roth IRAs the same as the federal government.

Tax Planning for the Self-Employed

Self-employment is the opportunity to be your own boss, to come and go as you please, and oh yes, to establish a lifelong bond with your accountant. If you're self-employed, you'll need to pay your own FICA taxes and take charge of your own retirement plan, among other things. Here are some planning tips.

Understand self-employment tax and how it's calculated

As a starting point, make sure that you understand (and comply with) your federal tax responsibilities. The federal government uses self-employment tax to fund Social Security and Medicare benefits. You must pay this tax if you have more than a minimal amount of self-employment income. If you file a Schedule C as a sole proprietor, independent contractor, or statutory employee, the net profit listed on your Schedule C (or Schedule C-EZ) is self-employment income and must be included on Schedule SE, which is filed with your federal Form 1040. Schedule SE is used both to calculate self-employment tax and to report the amount of tax owed.

Make your estimated tax payments on time to avoid penalties

Employees generally have income tax, Social Security tax, and Medicare tax withheld from their paychecks. But if you're self-employed, it's likely that no one is withholding federal and state taxes from your income. As a result, you'll need to make quarterly estimated tax payments on your own (using IRS Form 1040-ES) to cover your federal income tax and self-employment tax liability. You may have to make state estimated tax payments, as well. If you don't make estimated tax payments, you may be subject to penalties, interest, and a big tax bill at the end of the year. For more information about estimated tax, see IRS Publication 505.

If you have employees, you'll have additional periodic tax responsibilities. You'll have to pay federal employment taxes and report certain information. Stay on top of your responsibilities and see IRS Publication 15 for details.

Employ family members to save taxes

Hiring a family member to work for your business can create tax savings for you; in effect, you shift business income to your relative. Your business can take a deduction for reasonable compensation paid to an employee, which in turn reduces the amount of taxable business income that flows through to you. Be aware, though, that the IRS can question compensation paid to a family member if the amount doesn't seem reasonable, considering the services actually performed. Also, when hiring a family member who's a minor, be sure that your business complies with child labor laws.

As a business owner, you're responsible for paying FICA (Social Security and Medicare) taxes on wages paid to your employees. The payment of these taxes will be a deductible business expense for tax purposes. However, if your business is a sole proprietorship and you hire your child who is under age 18, the wages that you pay your child won't be subject to FICA taxes.

As is the case with wages paid to all employees, wages paid to family members are subject to withholding of federal income and

employment taxes, as well as certain taxes in some states.

Establish an employer-sponsored retirement plan for tax (and nontax) reasons

Because you're self-employed, you'll need to take care of your own retirement needs. You can do this by establishing an employer-sponsored retirement plan, which can provide you with a number of tax and nontax benefits. With such a plan, your business may be allowed an immediate federal income tax deduction for funding the plan, and you can generally contribute pretax dollars into a retirement account. Contributed funds, and any earnings, aren't subject to federal income tax until withdrawn (as a tradeoff, tax-deferred funds withdrawn from these plans prior to age 59½ are generally subject to a 10 percent premature distribution penalty tax — as well as ordinary income tax — unless an exception applies). You can also choose to establish a 401(k) plan that allows Roth contributions; with Roth contributions, there's no immediate tax benefit (after-tax dollars are contributed), but future qualified distributions will be free from federal income tax. You may want to start by considering the following types of retirement plans:

- Keogh plan
- Simplified employee pension (SEP)
- SIMPLE IRA
- SIMPLE 401(k)
- Individual (or "solo") 401(k)

The type of retirement plan that your business should establish depends on your specific circumstances. Explore all of your options and consider the complexity of each plan. And bear in mind that if your business has employees, you may have to provide coverage for them as well (note that you may qualify for a tax credit of up to $5,000 for the costs associated with establishing and administering such a plan). For more information about your retirement plan options, consult a tax professional or see IRS Publication 560.

Take full advantage of all business deductions to lower taxable income

Because deductions lower your taxable income, you should make sure that your business is taking advantage of any business deductions to which it is entitled. You may be able to deduct a variety of business expenses, including rent or home office expenses, and the costs of office equipment, furniture, supplies, and utilities. To be deductible, business expenses must be both ordinary (common and accepted in your trade or business) and necessary (appropriate and helpful for your trade or business). If your expenses are incurred partly for business purposes and partly for personal purposes, you can deduct only the business-related portion.

If you're concerned about lowering your taxable income this year, consider the following possibilities:

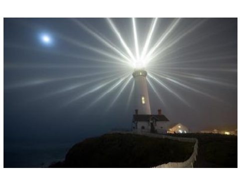
- Deduct the business expenses associated with your motor vehicle, using either the standard mileage allowance or your actual business-related vehicle expenses to calculate your deduction
- Buy supplies for your business late this year that you would normally order early next year
- Purchase depreciable business equipment, furnishings, and vehicles this year
- Deduct the appropriate portion of business meals and travel expenses
- Write off any bad business debts

Self-employed taxpayers who use the cash method of accounting have the most flexibility to maneuver at year-end. See a tax specialist for more information.

Deduct health-care related expenses

If you qualify, you may be able to benefit from the self-employed health insurance deduction, which would enable you to deduct up to 100 percent of the cost of health insurance that you provide for yourself, your spouse, and your dependents. This deduction is taken on the front of your federal Form 1040 (i.e., "above-the-line") when computing your adjusted gross income, so it's available whether you itemize or not.

Contributions you make to a health savings account (HSA) are also deductible "above-the-line." An HSA is a tax-exempt trust or custodial account you can establish in conjunction with a high-deductible health plan to set aside funds for health-care expenses. If you withdraw funds to pay for the qualified medical expenses of you, your spouse, or your dependents, the funds are not included in your adjusted gross income. Distributions from an HSA that are not used to pay for qualified medical expenses are included in your adjusted gross income, and are subject to an additional 20 percent penalty tax unless an exception applies.



Am I Having Enough Withheld?

If you fail to estimate your federal income tax withholding properly, it may cost you in a variety of ways. If you receive an income tax refund, it essentially means that you provided the IRS with an interest-free loan during the year. By comparison, if you owe taxes when you file your return, you may have to scramble for cash at tax time — and possibly owe interest and penalties to the IRS as well.

When determining the correct withholding amount for your salary or wages, your objective should be to have just enough taxes withheld to prevent you from incurring penalties when your tax return is due. (You may owe some money at the time you file your return, but it shouldn't be much.) You can accomplish this by reading and understanding IRS Publication 505, properly completing Form W-4 (and accompanying worksheets), and providing an updated Form W-4 to your employer when your circumstances change significantly.

Form W-4 helps you determine the proper withholding amount

Two factors determine the amount of income tax that your employer withholds from your regular pay: the amount you earn and the information you provide on Form W-4. This form asks you for three pieces of information:

- The number of withholding allowances you want to claim: You can claim up to the maximum number you're entitled to, claim less than you're entitled to, or claim zero.
- Whether you want taxes to be withheld at the single, married, or married with tax withheld at single rate: The married status, which is associated with a lower withholding rate, should generally be selected only by those taxpayers who are married and file a joint return. Those who are married and file separately should select married with tax withheld at single rate.
- The additional amount (if any) you want withheld from your paycheck: This is optional; you can specify any additional amount of money you want withheld.

When both spouses work and have taxes withheld at the married rate, they sometimes end up with insufficient taxes withheld. If this happens to you, remember that you can always choose to withhold at the single rate. In addition, you can determine the proper withholding amount by completing Form W-4's two-earner/two-job worksheet.

Complete the worksheets to claim the correct number of allowances

To understand Form W-4, you must understand allowances. Think of allowances as cash in your pocket at the time that you receive your paycheck. The more allowances you claim, the less taxes are taken from your paycheck (and the more cash ends up in your pocket on payday). For example, you can maximize the amount withheld from your paycheck to ensure that you have enough tax withheld to cover your tax liability by claiming zero allowances. This will reduce the amount of cash you take home in your paycheck. The following factors determine your number of allowances:

- The number of jobs that you work
- The deductions, adjustments to income, and credits that you expect to take during the year
- Your filing status
- Whether your spouse works

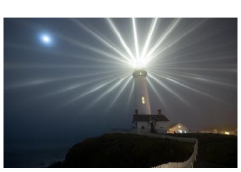
To claim the correct number of allowances, you should complete Form W-4's worksheets. These include a personal allowances worksheet, a deductions and adjustments worksheet, and a two-earner/two-job worksheet. IRS Publication 505 (Tax Withholding and Estimated Tax) explains these worksheets.

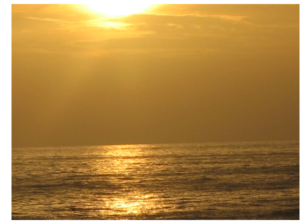
Check your withholding

To avoid surprises at tax time, it's a good idea to periodically check your withholding. If you accurately complete all Form W-4 worksheets and don't have significant nonwage income (e.g., interest and dividends), it's likely that your employer will withhold an amount close to the tax you'll owe on your return. But in the following cases, accurate completion of the Form W-4 worksheets alone won't guarantee that you'll have the correct amount of tax withheld:

- When you're married and both spouses work, or if either of you start or stop working
- When you or your spouse are working more than one job
- When you have significant nonwage income, such as interest, dividends, alimony, unemployment compensation, or self-employment income, or the amount of your nonwage income changes
- When you'll owe other taxes on your return, such as self-employment tax or household employment tax
- When you have a lifestyle change (e.g., marriage, divorce, birth or adoption of a child, new home, retirement) that affects the tax deductions or credits you may claim
- When there are tax law changes that affect the amount of tax you'll owe

In these cases, IRS Publication 505 can help you compare the total tax that you'll withhold for the year with the tax that you expect to owe on your return. It can also help you determine any additional amount you may need to withhold from each paycheck to avoid owing taxes when you file your return. Alternatively, it may help you identify if you're having too much tax withheld. If you find that you need to make changes to your withholding, you can do so at any time simply by submitting a new Form W-4 to your employer.





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