

Financial Intelligence

2019, Issue 1

The First Quarter of a Century

by Terry Hefty

It seems like only yesterday that I was writing this column celebrating Peak Asset Management's 20th year. Five more years have flown past and now it is our 25th anniversary- a quarter of a century. During these last five years, Peak has had substantial growth, and as of Dec 31, 2018 we now serve 310 clients and manage about 527 million dollars of assets for those clients. I continue to have the privilege of working with Peak's team of talented professionals consisting of Noel Bennett, John McCorvie (CFA), Joe Glasman (CFA, CFP®, CPA), Tara Hefty (CFA, FRM) and Terry Robinette. More recently joining this distinguished group are Brent Yanagida (CFP®, EA), and Julie Pribble (CFA). Brent brings his comprehensive knowledge of Financial Planning for the benefit of all Peak's clients and Julie brings her 30 years of experience helping clients reach their financial goals. You have come to know our friendly and efficient support staff consisting of Debbie Harper, Angela Dwinal, Yvette Green and Deanna Meek-Brien. They have been doing an amazing job of dealing with the increasing technological and regulatory aspects of the

business as well as being the welcoming voices with whom our clients love to speak. We also recently welcomed Matt Chrabot to the fold. He is an example of Peak's commitment to recruiting younger colleagues to help provide a seamless transition of services for our clients and their families into the future, along with bringing his new ideas and opinions from a more youthful perspective. Peak's philosophy continues unchanged over these 25 years, simplifying our clients' financial lives by implementing a customized plan for each, focused on the three distinct components: structure, strategy, and discipline. All of us at Peak are also committed to consistently increasing the range and quality of service to you, without sacrificing the personal touch and attention that you expect.

We appreciate the trust that our clients put in Peak and we will strive to continue to earn that trust in the future. Thank you all for your past and continuing support.

Financial Planning Past, Present, and Future

by Brent Yanagida, CFP®, EA

For individuals committed to planning and investing to reach their financial goals, much has transpired in the financial services business over the last 25 years that has increased the ability to reach such goals. The growth of discount brokerages and the availability of lower cost investment choices have made it more viable for everyone to have and implement an investment plan. Although Peak began as a fee-only Registered Investment Advisory firm, the vast majority of financial advisors/planners 25 years ago worked as a registered broker and/or licensed insurance agent, dependent on earning commissions through product sales and transactions. Such was the case for myself at the time, and although I was working under one of the few Certified Financial Planner professionals in the community, the planning software and tools available for use were primarily written by the companies that offered specific products, and thus had limitations. From a regulatory viewpoint, commissioned advisors can sell products and make transactions that are deemed "suitable" to the client, and putting client interests ahead of their own is not required.

For myself and other advisors that have moved over to fee-only firms such as Peak, there is no focus on product sales or transactions as commissions are eliminated. As registered fee-only advisors, we are subject to a higher regulatory standard, and are always required to place client interests ahead of our own. To support us and our clients, custodians such as Schwab and TD

Ameritrade have made available an ever-increasing suite of investment choices, including many not available through retail channels. The technology by which we can do research, build and rebalance portfolios, and offer financial planning recommendations has improved significantly in the last 25 years, with independent software firms being the main resource for leading edge tools which we can use to support our clients.

Along with the improvement in investment choices and resources, legislation since 1994 has created many new and expanded tax advantaged vehicles for saving and investing. These changes include the following:

- Maximum traditional IRA contributions have grown from \$2,000 (for all ages) to \$6,000 if under 50 and \$7,000 if age 50 or older for the tax year 2019. For the charitably minded, age 70 ½ or older, the Qualified Charitable Distribution (QCD) became available in 2006, such that donating part of one's Required Minimum Distribution to charity could offer a tax break. Although not related to IRA's, the Donor Advised Fund (first recognized by the IRS in 2006) is another strategic tool that can help maximize charitable deductions.
- Roth IRA's (one of the best long term vehicles by which one can invest) became available in 1997, and have maximum contributions equal to the traditional IRA. The ability to convert from traditional IRA's and other retirement plans to Roth IRA's at any income level became available in 2010:
- 401k type retirement plans have increased maximum em-

employee contributions from \$9,240 (for all ages) to \$19,000 for under age 50 and \$25,000 for ages 50 and above for the tax year 2019:

- Other small business retirement plans have expanded and been introduced, such as the SIMPLE IRA plan in 1996.
- College 529 savings plans, which offer a tax-advanced way to save and pay for college costs, were first introduced in 1996.
- Health Savings Accounts (HSA's), a tax advantaged way to save and pay for medical costs if qualified, were first introduced in 2003. Maximum contribution for the 2019 tax year is \$3,500 for a single person plan, and \$7,000 for a family plan, with a \$1,000 extra contribution allowed to each plan if 55 or older.

Finally, the last 25 years have been good to many disciplined investors despite going through two recessions, including the worst one since the Great Depression of 1929. The stock market has rebounded from each recession and is at all-time highs as I write this. This means that if a long term investor had taken advantage of the pre-mentioned resources/savings vehicles, saved consistently, and held true to a strategic asset allocation mainly consisting of stocks (equity portion) and government and corporate bonds (fixed income portion), one's long term financial goals are much more likely being achieved.

Greatest Challenges for the Next 25 Years

Despite the aforementioned improvements and availability of investment choices, resources, and savings vehicles, most Americans have not, or are not, taking full advantage of the opportunities, and as such could find their standard of living much lower in retirement. Reasons for such a possibility are many, but key factors include the following:

Cost of Living Keeps Going Up

Over the last 25 years, general inflation as measured by the consumer price index has averaged 2.24% per year. If this continues over the next 25 years, \$100,000 of purchasing power today would only buy \$57,475 in 25 years, or stated another way, you would need \$173,989 in 25 years to pay for expenses worth \$100,000 today. If life expectancies continue to go up as they have in the last 25 years (e.g., due to health practices and medical breakthroughs), then average life expectancy for males age 65 will go up by 3 years and females age 65 by 2 years (females are still expected on average to outlive males by 2 years). Average life expectancies would be in the upper 80's for both men and women, and the probability of living much longer will be increased. Potentially needing to cover 25+ years of expenses in retirement means that a nest egg of considerable size would need to be accumulated before retiring to be able to maintain a similar lifestyle as in pre-retirement, especially since other income resources such as company pensions (rarely offered today) and Social Security (see next challenge) can be depended upon less in the future.

Compounding this problem is that certain costs are expected to go up faster than the average inflation rate over the next 25 years. This includes college costs and medical costs, which based on historical trends could both be closer to 5%/year.

Medicare (Part B), prescription drug (Part D), and supplemental (Medigap) premiums have been rising faster than general inflation, and such plans do not cover all medical costs such as expenses related to dental care, vision care, hearing aids, and specialty and non-prescription drugs. For an average married couple aged 65 today, total medical costs (including all premiums mentioned above) can expect to be close to \$12,000 in the first year on Medicare. As an example of what this could mean long term, Fidelity just put out their annual lifetime cost of health care estimate for a couple at 65 in 2019, showing that such a couple with average lifespans could expect to have lifetime medical costs of \$285,000 in today's money, and this does not include costs for dental care, over-the-counter medications, and long-term care.

Future of Social Security and Medicare

The reality for most retirees today is that Social Security is heavily relied upon to pay for much of their expenses in retirement. Of currently retired workers, 62% lean on Social Security to provide at least half of their monthly income and 34% rely on the program for 90% to 100% of their income. The average benefit in 2019 is projected to be \$1,461/mo. or \$17,532 a year. The maximum amount a retired worker can be paid in a month at full retirement age in 2019 is \$2,861. (\$34,332/year). Roughly three out of five retired workers take their benefit prior to reaching their full retirement age, and only 10% wait until after their full retirement age to claim their payout, even though benefits increase by 8% for every year delayed until age 70. In theory, Social Security is only designed to replace about 40% of ones working wages, and could be much less for higher earners. With several studies suggesting that retirees need annual retirement income sources of close to 80% of their former annual earnings to maintain a similar lifestyle, Social Security should not be depended upon to be the major source of income in retirement.

Perhaps a bigger concern for most that are, or would be, heavily dependent on Social Security and Medicare to cover their expenses in retirement is the fact that the future of these governmental programs are far from certain. Because of demographic and economic factors including higher retirement rates and lower birth rates, there will be fewer workers per beneficiary over the long term to fund these programs. Each year, the Trustees of the Social Security and Medicare Trust Funds release lengthy annual reports to Congress that assess the health of these important programs. The newest reports, released on June 5, 2018, discuss the current financial condition and ongoing financial challenges that both programs face.

- This year, for the first time since 1982, Social Security's total cost is projected to exceed its total income (including interest), and remain higher for the next 75 years. Consequently, the U.S. Treasury will start withdrawing from trust fund reserves to help pay benefits in 2018. The Trustees project that the trust fund reserves will be depleted in 2034 unless Congress acts.
- Once the combined Social Security trust fund reserves are depleted, payroll tax revenue alone should still be sufficient to pay about 79% of scheduled benefits for 2034, with the percentage falling gradually to 74% by 2092.
- Annual costs for the Medicare program exceeded tax in-

come each year from 2008 to 2015. Although last year's report projected surpluses in 2016 through 2022, this year's report projects that costs will exceed income (excluding interest income) in 2018.

- The Hospital Insurance Trust Fund (for hospital care covered by Medicare Part A) is projected to be depleted in 2026, three years earlier than projected last year. Once the Hospital Insurance Trust Fund is depleted, tax income would still cover 89% of estimated program costs, declining to 78% by 2043 and then gradually increasing to 85% by 2092.
- The Medicare funds that help cover other non-hospital medical costs via Part B and Part D are expected to be adequately financed because premium income and general revenue income are reset each year to cover expected costs. Such financing, however, would have to increase faster than the economy to cover expected increase in costs, thus Medicare premiums will continue to rise.

The reports urge Congress to address the financial challenges facing these programs soon, so that solutions will be less drastic and may be implemented gradually, lessening the impact on the public. Some possible solutions include:

- Raising the current Social Security payroll tax rate. According to this year's report, an immediate and permanent payroll tax increase of 2.78 percentage points would be necessary to address the long-range revenue shortfall (3.87 percentage points if the increase started in 2034).
- Raising the ceiling on wages currently subject to Social Security payroll taxes (\$132,900 in 2019).
- Raising the full retirement age beyond the currently scheduled age of 67 (for anyone born in 1960 or later).
- Reducing future benefits. According to this year's report, scheduled benefits would have to be reduced by about 17% for all current and future beneficiaries, or by about 21% if reductions were applied only to those who initially become eligible for benefits in 2018 or later.
- Changing the benefit formula that is used to calculate benefits.
- Calculating the annual cost-of-living adjustment for benefits differently.
- To keep the Hospital Insurance Trust Fund solvent for the long term (75 years), the current 2.90% payroll tax would need to be increased immediately to 3.72% or expenditures reduced immediately by 17%. Alternatively, other tax or benefit changes could be implemented gradually and might be even more drastic.

The Possibility of Long Term Care

With life expectancies increasing at a steady rate, the odds increase that we'll need some form of long term care (LTC) during our lives. According to federal government projections, about a quarter of Americans turning 65 between 2015 and 2019 will need up to two years of LTC. 12% will need up to 2 to 5 years, and 14% will need more than 5 years.

To compound the problem, the cost of LTC is on the rise with annual increase in costs expected to continue to outpace overall inflation. For example in Colorado, annual costs have been increasing at 4%/year on average, and today average in home health aide care (for 44 hours per week, 52 weeks) is now

\$58,916. For nursing home care, average annual costs in Colorado are \$94,703 for a semi-private room and \$107,996 for a private room. If you consider a 65-year-old today planning for just one year of LTC in the future at a \$100,000 cost today, with 4% annual inflation, that cost would be \$266,584 in 25 years (age 90). For a 55-year-old needing one year of LTC in 35 years, that \$100,000 one year cost today would at a 4% increase a year be \$394,609 at age 90. The thought of multiple years of LTC costs can be quite daunting.

To cover possible costs, government assistance is very limited through Medicare, as it might only cover some of the costs during the first 100 days of nursing home care after being released from a hospital. Getting any assistance for in home care through Medicare is even more restrictive. Medicaid might be a last resource for those that have very little income or assets, but choices of where to receive care can be limited.

If you want to have the most options on where to receive quality LTC, whether it be at home and/or in a facility, we suggest that most individuals save for the possibility of at least 1 (and preferably 2) year(s) of LTC expenses. By saving and investing a part of one's portfolio with that expense in mind, a more aggressive asset allocation could possibly be implemented that over time might have a higher probability of returning 4% or more on average per year over the long run. For the possibility of more than 1 or 2 years of LTC, consider that equity in a home can be tapped. This is especially true if only one spouse is alive, and the likelihood of returning to the home is remote, such that a home could be sold. To cover the possible expenses for a 1st spouse, tapping home equity could also be in the form of a down size or a reverse mortgage, which with government backing and flexible options for withdrawing cash, are starting to become more popular.

Another option to help cover the potential cost of multiple years of long term care is through the purchase of Long Term Care Insurance (LTCI). This insurance might be right for you if you meet the following criteria:

- You're healthy and probably less than 65 years old, as acceptance rates drop dramatically later in life.
- You have significant assets that you would want to preserve as an inheritance for others.
- You can afford LTCI premiums (now and in the future as rates increase) and know that you may never get those premiums back if you need little or no long-term care.

About a dozen insurers offer traditional LTCI policies; however, the industry is in flux, as the purchase of long term policies have dropped significantly over recent years and multiple carriers have exited the business. There are many options in a policy to vary the coverage and premium costs, and include coverage across both spouses. For those that also have a long term need for life insurance, or carry a policy with built up cash value, there may be an option to add a rider (or exchange to a policy that has a rider) that allows a permanent life insurance policy to be used for long term care. These so-called hybrid policies are growing in availability, but are also changing in complexity and options available, as insurance companies try to build profitable models that can also serve the ever-changing insurance landscape.

Savings/Investment Returns Not Meeting Expectations

With the likelihood of continued inflation, uncertain government entitlements, and potential long term care costs, it will become more important than ever to have a savings and investment plan that starts early in life and continues well into retirement. To offset the impact of inflation, the average saver will need to continue to look beyond the low interest rates paid on bank accounts and CD's, but in doing so will need to take on more risk. With the larger nest egg needed to cover increasing expenses, the impact of savings and investment decisions (what, where, when, and how) become magnified. The expected returns over the next decade for most investment assets is forecasted by most experts to be modest (but still overall higher than inflation), and so individual investors must make good decisions to fully capture potential asset returns. In reality, such decisions are often far from good. This reality is documented in the most recent "Quantitative Analysis of Investor Behavior", put out annually by Dalbar, reinforcing its overriding conclusions that the average investor consistently earns "much less" than market indices suggest. The firm has found that year after year investors are often their own worst enemies, failing to exercise the necessary discipline to capture the benefits markets can potentially provide over longer time horizons, while succumbing to short-term strategies such as market timing or performance chasing. A recent illustration of performance chasing is with Bitcoin, where in 2017 it became all the rage, which was then followed by a 73.56% loss in 2018. When you also factor the effect of taxes on potential savings/investment decisions, the real after tax returns of investments held by average investors could be significantly less, making it even more difficult to reach one's long term financial goals.

Opportunities and Keys to Success

Despite the significant challenges ahead, for those that plan and take action early and often, most can still feel good about meeting their financial goals.

For those that have saved and continue to save 15% or more of their paycheck for most of their careers, and follow general asset allocation and long term investing guidelines based on where one is in life, the power of compounding has and will likely continue to pave the way toward financial success. Many employers in this low unemployment rate environment are offering 401k matching and other benefits to be competitive. For those that haven't been disciplined in saving toward long-term goals, if a financial plan is created and followed, one's success rate in reaching such goals can be dramatically improved. Having a safety cushion of cash (at least 3-6 months of earnings) and necessary insurance to cover the unexpected loss of life,

income, or property is also key. After tax investment returns can be increased by knowing what vehicles to use for saving, investing, and withdrawing. Having different buckets (e.g., taxable account, IRA/401k, Roth IRA, HSA account) to strategically withdraw from in retirement can really help in reducing overall taxes paid. Tax planning may also help in offsetting the cost of long term care if higher medical deductions can be claimed. Government legislation will likely continue to offer new ways by which business owners and individuals can save for their future.

Government entitlements will change, but for those in or near retirement, changes might be minor in their lifetimes. Couples, divorcees, and survivors from current and past marriages may still be able to implement strategic social security planning to maximize lifetime benefits. For many that are retired or thinking of retirement, part-time working opportunities are becoming more plentiful, and in many cases such work will provide substantial emotional and intellectual benefits along with the obvious financial benefits. For those that have also invested in a home, real estate values have generally kept up with, and in some cases exceeded inflation, and such build up in equity will likely become a bigger source for funding retirement expenses in the future, or if not, becoming a key resource for those that inherit such assets.

Regarding discretionary expenses, there may even be a trend via social media and video streaming that show an acceptable and possibly more desirable lifestyle of smaller homes, less clutter, and life in a more laid back/lower cost community, so for those that are willing to change lifestyles, retirement goals might be more easily met. In the later stages of retirement, while medical expenses are going up, certain discretionary expenses could go down.

Our educational system (K-12), which has all but ignored the importance of financial planning in the past, is now in many cases requiring some sort of money management course to graduate. More colleges are offering financial planning degrees to help fulfill the expected heavy need for financial advisors in the future.

Finally, the professional resources to help you and others reach financial goals are readily available now. The advisors and staff at Peak Asset Management are in your court, and we look forward to helping you reach your financial goals in the next 25 years and beyond, no matter how big or small the challenges may be.

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Key Numbers 2019

Tax reference numbers at a glance.



Income Tax (2019 tax rate tables)

Taxable income	Tax due	plus	% of income*
Single			
Up to \$9,700	\$0	+	10%
\$9,700 to \$39,475	\$970.00	+	12%
\$39,475 to \$84,200	\$4,543.00	+	22%
\$84,200 to \$160,725	\$14,382.50	+	24%
\$160,725 to \$204,100	\$32,748.50	+	32%
\$204,100 to \$510,300	\$46,628.50	+	35%
Over \$510,300	\$153,798.50	+	37%
Married filing jointly			
Up to \$19,400	\$0	+	10%
\$19,400 to \$78,950	\$1,940.00	+	12%
\$78,950 to \$168,400	\$9,086.00	+	22%
\$168,400 to \$321,450	\$28,765.00	+	24%
\$321,450 to \$408,200	\$65,497.00	+	32%
\$408,200 to \$612,350	\$93,257.00	+	35%
Over \$612,350	\$164,709.50	+	37%
Married filing separately			
Up to \$9,700	\$0	+	10%
\$9,700 to \$39,475	\$970.00	+	12%
\$39,475 to \$84,200	\$4,543.00	+	22%
\$84,200 to \$160,725	\$14,382.50	+	24%
\$160,725 to \$204,100	\$32,748.50	+	32%
\$204,100 to \$306,175	\$46,628.50	+	35%
Over \$306,175	\$82,354.75	+	37%
Head of household			
Up to \$13,850	\$0	+	10%
\$13,850 to \$52,850	\$1,385.00	+	12%
\$52,850 to \$84,200	\$6,065.00	+	22%
\$84,200 to \$160,700	\$12,962.00	+	24%
\$160,700 to \$204,100	\$31,322.00	+	32%
\$204,100 to \$510,300	\$45,210.00	+	35%
Over \$510,300	\$152,380.00	+	37%

*The percentage applies to each dollar of taxable income within the range until the next income threshold is reached.



Standard Deduction

Single	\$12,200	Additional deduction for blind or aged (over age 65)	
Married filing jointly	\$24,400		
Married filing separately	\$12,200		
Head of household	\$18,350		
Dependent*	\$1,100*	Single or head of household	\$1,650
		Married filing jointly or separately	\$1,300

*Dependent standard deduction is the greater of \$1,100 or \$350 plus earned income.



Alternative Minimum Tax (AMT)

	Maximum exemption amount	Exemption phaseout threshold
Single or head of household	\$71,700	\$510,300
Married filing jointly	\$111,700	\$1,020,600
Married filing separately	\$55,850	\$510,300
26% rate applies to AMT income up to \$194,800*		
28% rate applies to AMT income over \$194,800*		

*\$97,400 if married filing separately.



Education Credits and Deductions

MAGI phaseout ranges		
	Single or head of household	Married filing jointly
Lifetime Learning credit (\$2,000 max)	\$58,000 to \$68,000	\$116,000 to \$136,000
American Opportunity credit (\$2,500 max)	\$80,000 to \$90,000	\$160,000 to \$180,000
Education loan interest deduction (\$2,500 max)	\$70,000 to \$85,000	\$140,000 to \$170,000
U.S. Savings bond interest exclusion for higher-education expenses	\$81,100 to \$96,100	\$121,600 to \$151,600



Estate Planning

Annual gift tax exclusion	\$15,000
Noncitizen spouse annual gift tax exclusion	\$155,000
Top gift, estate, and GST tax rate	40%
Gift tax and estate tax applicable exclusion amount	\$11,400,000 + DSUEA*
Generation-skipping transfer (GST) tax exemption	\$11,400,000**

* Basic exclusion amount plus deceased spousal unused exclusion amount (exclusion is portable).

**The GST tax exemption is not portable.

December 20, 2018

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Retirement Planning

Employee contribution limits to employer plans*	
401(k) plans, 403(b) plans, 457(b) plans, and SAR-SEPs (includes Roth contributions to these plans)	\$19,000
Annual catch-up contribution (age 50+)	\$6,000
SIMPLE 401(k) and SIMPLE IRA plans	\$13,000
Annual catch-up contribution (age 50+)	\$3,000
IRA contribution limits**	
Traditional and Roth IRAs (combined)	\$6,000
Annual catch-up contribution (age 50+)	\$1,000

* Lesser of these limits or 100% of participant's compensation.

** Lesser of these limits or 100% of earned income.

MAGI phaseout limits for deductible contributions to a traditional IRA (affects taxpayers covered by an employer-sponsored retirement plan)	
Single or head of household	\$64,000 to \$74,000
Married filing jointly when the spouse who makes the contribution is covered by a workplace plan	\$103,000 to \$123,000
Married filing jointly when the spouse who makes the contribution is not covered by a workplace plan but the other spouse is covered	\$193,000 to \$203,000
Married filing separately	Up to \$10,000

MAGI phaseout limits to contribute to a Roth IRA	
Single or head of household	\$122,000 to \$137,000
Married filing jointly	\$193,000 to \$203,000
Married filing separately	Up to \$10,000



Investment Taxes

Single filer	Married filing jointly	Married filing separately	Head of household	Tax rate
Long-term capital gain & qualified dividend tax (taxable income thresholds)				
Up to \$39,375	Up to \$78,750	Up to \$39,375	Up to \$52,750	0%
\$39,376 up to \$434,550	\$78,751 up to \$488,850	\$39,376 up to \$244,425	\$52,751 up to \$461,700	15%
More than \$434,550	More than \$488,850	More than \$244,425	More than \$461,700	20%
Net investment income tax (MAGI thresholds)				
Over \$200,000	Over \$250,000	Over \$125,000	Over \$200,000	3.8%*

*The 3.8% net investment income tax (also referred to as the unearned income Medicare contribution tax) applies to the lesser of (a) net investment income or (b) modified adjusted gross income (MAGI) exceeding the above thresholds. It does not apply to municipal bond interest or qualified retirement plan/IRA withdrawals.



Health Care

Flexible spending account (FSA) for health care	
Maximum salary reduction contribution	\$2,700
Health savings account (HSA)	
Annual contribution limit — individual coverage	\$3,500
Annual contribution limit — family coverage	\$7,000
Annual catch-up contribution (age 55+)	\$1,000
High-deductible health plan (HDHP)	
Minimum deductible — individual coverage	\$1,350
Minimum deductible — family coverage	\$2,700
Maximum out-of-pocket amount — individual	\$6,750
Maximum out-of-pocket amount — family	\$13,500



Social Security/Medicare

Maximum taxable earnings	
Social Security (OASDI only)	\$132,900
Medicare (HI only)	No limit



Standard Mileage Rates

Business purposes	58¢ per mile
Medical purposes	20¢ per mile
Charitable purposes	14¢ per mile
Moving purposes	20¢ per mile

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