Some Thoughts on the Ford Buyout Offer to Salaried Employees

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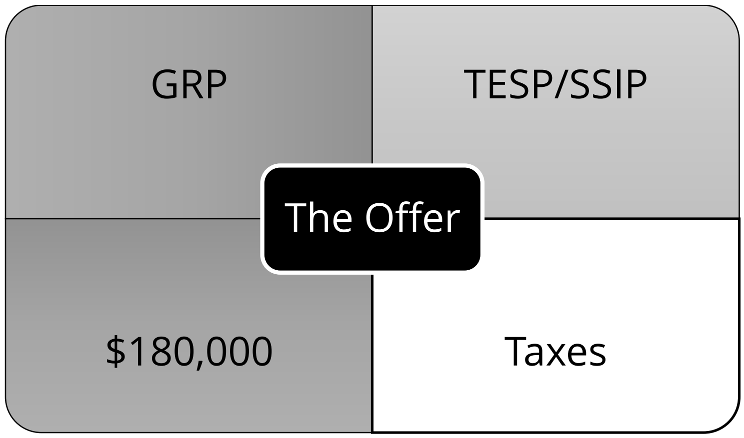
Ford is offering a buyout to select salaried employees in an effort to reduce its salaried workforce. The terms are a payment of up to 18 months pay (in addition to regular pay) to offered employees to take the offer. They must leave employment by 09/30/17. For example, a salaried employee with 20 years making $120,000 a year would be offered 18 months pay, or $180,000 to leave employment. They'd also make their regular pay, about $90,000, and receive the normal benefits for a Ford salaried employee, like pension, TESP/SSIP, and health care, as eligible. There are moving parts to analyzing such an offer, so we thought we'd highlight some points that should be considered in evaluating an offer.

About us: We're not writing this for Ford, so if we and Ford disagree, they're probably right. We're an independent, full-service Registered Investment Advisor that has been operating since 1989. I'm an attorney, CPA, Certified Financial Planner, and Chartered Financial Analyst. I've worked in the CPA profession, and in higher education (as a graduate professor of tax and finance) before I started LJPR Financial Advisors. We don't sell any products, and we are a full-service shop. The purpose of this overview is to help people make a good decision. Read on, consult your advisors, and if you want a second opinion, or a first opinion, we're here.

Work here or don't? I've been working with Ford folks since 1985, ranging from writing retirement programs to videos to individual planning. The first thing that strikes me is how we personify Ford in a way quite different than other companies. We work at 'Fords', like we work directly for Edsel or Bill. It has a different feel. The second thing is that everyone jumbles up this decision on 'retirement' offers or buyouts. We hear "I'm not ready to retire", or "I don't know enough about retirement." This offer presents a question that I think is simple: "Work at Ford, or don't work at Ford?" Another way to look at it is "Ford will pay you not to work here." When you frame the offer that way, then you can decide what course of action you want to take, and decide if you want to be paid to not work at Ford, then what should you consider. What happens with the pension? Should I take a buyout from the GRP? What about my TESP/SSIP? What about taxes? What about new taxes?

The bundle. For this paper, I'm going to work with someone with 20 years who is getting the whole 18 months. To make the read easy, I'm putting their salary at $120,000, or $10,000 a month: your mileage will vary (like my F150 when I drive it versus when my 23 year old son drives it). So, we've already had someone like that come in and these were the pieces of the pie:



Taxes: the top layer of the cake is not the sweetest. Our first point is that a buyout is not a pension enhancement or qualified plan money: it's pay. If Ford pays $180,000 in October for you to leave, you have $180,000 more of income. So if you made $90,000 through September 30, that's $270,000. Congratulations, you get to taste the big brackets. Taxes are like a layered cake: You get (for now) your personal exemptions, greater of standard deduction or itemized deductions, and certain expenses, like pre-tax TESP or HSA, then you apply taxable income to one of 7 tax brackets (this may change, more on that later). In our sample person who had the $120,000, if that was the family's only income, they would be using up the lower brackets of 10% and 15% and be in the 25% (if married) or 28% (single) brackets. Toss another $180,000 on the pile, and you're probably in the 33% bracket. Note that doesn't mean you pay 33% on the whole $180,000, but it pushes your income through the brackets. We have a tax estimator on our website that will let you get a handle on the federal taxes.

FICA. When my oldest daughter got her first paycheck, she was as mad as a wet hen. "Who's this FICA and why did they take money from me?" Earned income is subject to payroll taxes in addition to income taxes. There are two forms: Social Security taxes of 6.2% of the first $127,200 (2017 number) of earned income and Medicare taxes of 1.45% of all earned income. In addition, for now (since when I'm writing this the American Health Care Act is at the Senate), there is an additional 0.9% high income Medicare tax (HI tax) on earned income over $200,000 (single) or $250,000 (married). For most people taking the buyout, a portion of it will not be subject to the Social Security taxes, but all of the buyout will be subject to Medicare taxes, and maybe the additional HI tax.

State. The buyout will be subject to state income taxes, most likely in the state you work in. California and New York have high individual income tax rates and a progressive tax system. States like Michigan have a flat tax rate of 4.25%. Seven states have no income taxes.

No roll. The buyout is income and not pension money. You can't defer it or roll it over to a retirement plan. Your total freight on the buyout will be federal taxes at probably 25-39.6%, maybe some Social Security taxes at 6.2% of your total earned income (regular salary plus buyout) over $127,200, Medicare taxes of 1.45% plus 0.9% if your earned income is over the HI level, plus state income taxes. Simple, right? If you are roughing it in, use about 40%.

Pension: taking LSD and other questions. Of course, if you decide to leave Ford, you probably have some vested money in the pension plan, including a frozen General Retirement Plan benefit. If you are eligible for SERP (you'd know if you are), recognize there is a special rule on Social Security taxes and Medicare for the year you terminate. On the Ford pension, you'll have to decide whether to take LSD (Lump-Sum Distribution - what did you think I meant?), or a monthly pension. If you intend to continue working, or aren't going to use the monthly income, you might consider the lump-sum. We wrote a whole white paper on the topic, which is on our website. If you take a lump-sum, you can roll it tax-free into an IRA. If you've been contributing to the GRP, which most Ford Salaried employees have, the after-tax contributions can be rolled to a Roth IRA.

Recognize that if you are retirement eligible and take the monthly pension that it will also add to your taxable income. In addition, if you are eligible for Social Security benefits, those will be taxable (partially) in the year you begin taking benefits. Since Social Security benefits increase for every year you delay, you may want to consider holding off collecting Social Security until 2018, when your income will likely be lower. There are other things to consider in Social Security, like earning limitations and spousal benefits. Too much for here. We run a simulation on collecting strategies. For example, I intend to delay mine until I'm age 70, but have my wife take hers at age 62.

Take it or leave it? The pension decision will likely come down to take it in a lump-sum or monthly if you are eligible, or leave it at Ford until you would be eligible to receive it.

TESP/SSIP: max and mad max. When you leave Ford, you have a similar decision on 'take it or leave it.' We'll get into that. First thing is if you take the offer, maximize your TESP. Tax-Efficient Savings is the pre-tax 401(k) portion of the SSIP which you can contribute up to $18,000 per year (if you are under 50) or $24,000 per year (50 or older). That comes off your taxable income before any deductions, so you are saving federal and state taxes for 2017 at your higher tax rate. There is the possibility of after-tax savings as well, which leads us to the 'mad max'. The IRS has ruled that after-tax savings can be rolled into a Roth IRA. So if you know you are leaving Ford in 2017, and you want to stash a whole bunch, you can max the TESP at $18,000 or $24,000 and put more in after-tax. When you leave Ford, you can roll the pre-tax monies (your pre-tax contributions, Ford's matching contributions and all investment earnings) into a regular IRA and roll the after-tax portion into a Roth IRA. How much can you max? It is subject to something called the §415 limit, which is the total amount that can go into a qualified plan in a given year. This is a combination of all additions to your SSIP account, but the overall 415 limit is $54,000 per year if you are under age 50 and $60,000 per year if you 50 or over. This and a bunch of (OK, 49) other good 401(k) ideas are in our book, **50 Good 401(k) Ideas**. Drop us an e-mail or a call and we'll send you one.

Ford stock and NUA. There is an important special rule about Ford stock called Net Unrealized Appreciation, or NUA. Many Ford folks we know have Ford stock in their SSIP. This special rule says you can take your Ford stock out of the SSIP at the *lower* of cost or market. Cost is your basis in Ford stock, which you get from the plan custodian. So if you bought Ford stock in your SSIP back in the spring of 2009 at $2 a share and Ford is $11 today, you have $9 of NUA. You can take the Ford stock out in-kind, and your taxes will be on the $2 a share. When you sell the Ford stock, regardless of how long you hold it, the gain is long-term capital gain. This can be a great planning tool if you have appreciated Ford stock in your SSIP. This only works if the stock has appreciated, so if your basis is $12 a share, and it's worth $11, the rule doesn't apply. Also note that the NUA rule only works if you have not taken any distributions from the SSIP, so you need to apply NUA before any rollovers. Complicated stuff, so talk to someone knowledgeable if you are considering it.

Age 70½ or older. There are Required Minimum Distribution (RMD) rules on SSIP and the pension lump-sum once you leave Ford if you are over age 70½. In the pension, Ford uses an annuitization method, so they force a distribution to you of the amount of pension you would have taken during the year. This can cause a lot of tax liability if you took a buyout, got paid and had an RMD in 2017.

Trump taxes. For 2017, there is a lot of talk about tax changes. We've covered a lot of these (see our 2017 Outlook on our website), but they include changing the number of brackets from 7 to 3, lowering the rates, eliminating some deductions, Alternative Minimum Tax and personal exemptions. At the time I wrote this (June 9, 2017), there is only speculation as to tax law changes. It's my opinion that any tax law change will be prospective and not retroactive. A possible exception to this may be the retroactive repeal of the Medicare HI tax in the American Health Care Act. Given this, if you are taking the offer, you would likely want to maximize tax deductions for 2017.

Tax planning. Here are some ideas on reducing 2017 taxable income. See a good tax advisor to see how these may be useful for you. Recognize that if you take a buyout, it could make you subject to the Alternative Minimum Tax, which flips the planning aspect, particularly on paying state and local taxes.

- **Charity.** A logical place to save taxes is charitable contributions. If you are charitably inclined, you can make a large charitable contribution to a Donor Advised Fund, or DAF. This is a fund that you direct to make charitable donations over time. You deduct the contribution to the DAF. So if you knew you were going to make $30,000 of donations over the next 5 years, you could donate $30,000 to a DAF and then direct donations to your charities. You don't have a time limit on a DAF, and you can direct a DAF to any qualified charity. You can also donate appreciated property to a DAF and, within limits, deduct the fair market value of the donation. So in my previous example, my Ford person had $270,000 of income in 2017, a DAF donation of $30,000 would save probably $10,000 of taxes. They could make contributions in the future to any charity they chose. If the standard deduction increased, this lets them get the use of a deduction now that they might not use later. The DAF is a solid planning tool if you make charitable contributions.

- **State and Local Taxes.** This one has some moving parts. You can deduct, if you itemize, your state and local taxes, including income taxes and property taxes. Obviously, Ford will withhold state income taxes from your buyout check, but you want to make sure you pay as much state income taxes in 2017 as you may owe, maybe even a bit more. The reason is, again, that you are likely to be in a higher bracket in 2017. Another good reason is the Trump tax proposal and the GOP blueprint both eliminate the deduction for State and local taxes. This may be the only year you can deduct them. Property taxes are also deductible. If you pay taxes twice a year, like in Michigan, you'd probably want to pay the Winter 2018 taxes (usually due February 2018) before the end of 2017. Other ad valorem taxes might be license plates on cars, if based on the value of the vehicle.

- **Capital gains and losses.** Capital gains and losses can be subject to a separate tax rate. This one can get complicated. If the Affordable Care Act (Obamacare) is repealed, the tax on unearned income (3.8%) would go away. This is a tax added to the capital gain tax on unearned income for people with incomes over $200,000 (single) or $250,000 (married). The maximum capital gain rate is currently 20%, and adding the 3.8% makes it 23.8% if the buyout pushes you over the $200-$250K threshold. Net losses, on the other hand, are deductible against ordinary income up to $3,000 a year and may be carried over. So in a temporary high income year, deferring gains and harvesting losses might pay off. Want a better idea? Donate the gainer to your DAF and harvest the loss. Say you have $20,000 worth each of two stocks: Edsel Corp. and Nikola Corp. You have a loss in Edsel Corp. of $10,000 and a gain in Nikola Corp. of $10,000. You want to sell Nikola (since its way up and isn't selling much product) and hang onto Edsel (because you're sentimental, and you think Edsel's stock might go up since they are cutting payroll). Suppose you held both for over 1 year. If you sell Nikola in 2017, you may pay taxes on the gain at 23.8%, or pay $2,380. On the other hand, if you donate Nikola to your DAF (and itemize), you write off $20,000, and if you are in the 33% bracket, saves you $6,667. Sell some Edsel ($6,000) and you can deduct $3,000 from ordinary income, which is another $1,000. If you still like Edsel stock, wait at least 31 days and buy it back (Look up 'Wash sale rule'). The point is to selectively harvest gains and losses in a high income year.

- **Spousal income.** If your spouse has a job or a business, there are a myriad of opportunities, ranging from maximizing your spouse's 401(k), 403(b) or 457, which would be obvious; to maximizing business deductions in a spouse's business, including buying assets used in the business and deducting them under something called the Section 179 deduction. Complicated, but very valuable.

If you take it, what do you do with it? If you do take the buyout, what do you do with the after-tax proceeds from the buyout? In our standing example, our Ford employee receiving a $180,000 buyout may net about $108,000. What to do with the $108,000?

- **Knock off some debt.** I'm a big fan of getting rid of debt, but only if you erase it and don't replenish it. Paying off $20K of nondeductible debts like credit cards, unsecured lines of credit, or car loans, saves you the payment and the interest. We favor paying debts off and not down. So if the choice is to pay off a $20,000 car loan with 4.9% interest and a $450 payment or pay down a 4.9% mortgage, pay the car loan off. You gain the $450 a month, which you can pay on the mortgage, or, use for living, or save. Knocking off debt is like making an investment: you keep the interest you save.

- **Bridge a gap.** Some, probably many folks who take the buyout will not kick back and retire, but continue to work, or go look for another job. In this case, stash the money in a nice safe place (Bank, credit union, or maybe Ford Interest Advantage) and draw it as your reserve.

- **Invest.** If you already have a job or a retirement lined up, save and invest it. You'd probably want to set up an investment account and buy some tax-advantaged investments. These may include municipal bonds (which generate tax-free interest), dividend-paying stocks, or index funds. Watch the loads and fees. Be sure that you title the investment correctly. Use a 'Pay on Death' (POD) beneficiary designation or title the account in the name of your Revocable Living Trust. (We have a free book on estate planning. Email or call). There are also opportunities to maximize your spouse's savings plans, or even a 'side-door' Roth, which is a nondeductible IRA that is converted to a Roth. It allows you to make Roth contributions even if you are over the Roth income limits. We cover this in our book **50 Good IRA ideas**, which like everything else I've offered, can be obtained from us for free.

Bottom line: The bottom line of this buyout discussion is that this is an important and complicated decision. There are lots of things to consider and a good plan is important. If you have an offer, you have a significant opportunity to make some important decisions. Make a plan, and evaluate all the options. If you want to talk to one of our advisors, please contact us (info@ljpr.com or 248-641-7400). We can have a live or virtual meeting. We offer a one-hour complementary consultation. We'd need some information before our conference to give you the best possible advice. I hope you enjoyed this paper and hope it gave you food for thought. Best wishes on your journey.

Leon

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