

October 2008 Issue

In This Issue...

- [Year-End Tax Planning Tips](#)
- [Accelerate Your Retirement Savings](#)
- [You're Never Too Old for a Roth IRA](#)
- [Should You Defer Income Taxes?](#)
- [Your Family's Finances](#)



Year-End Tax Planning Tips

As year-end rapidly approaches, it's a good time to take a look at your tax situation. You still have time to take action that could reduce your income tax liability for 2008. Once you have an idea of where you stand for 2008 with your income tax situation, you can evaluate some tax planning strategies that may reduce your income tax burden in 2008. Here are some tips to consider:

- **Sell stocks with losses to offset capital gains.** If you have capital gain income but are holding stocks with losses, consider selling those stocks to offset the capital gains. Excess losses may be used to offset up to \$3,000 of ordinary income, and the unused portion can be carried forward until utilized.
- **Contribute the maximum amount to your 401(k) plan.** Take a look at your financial situation, making sure you are contributing as much as possible to your 401(k) plan. Unless you have a Roth 401(k), contributions are made from pretax dollars. The maximum contribution to a 401(k) plan in 2008 is \$15,500, plus individuals age 50 and over can make an additional catch-up contribution of \$5,000, if permitted by the plan.
- **Decide which type of IRA to contribute to and then do so as soon as possible.** Although you have until April 15, 2009, to make your 2008 contribution, contribute as soon as possible to allow your funds to compound tax deferred or tax free for a longer time. The maximum IRA contribution in 2008 is \$5,000, with an additional \$1,000 catch-up contribution for individuals age 50 or older.
- **Replace loans that generate personal interest with mortgage loans or home-equity loans.** Personal interest cannot be deducted on your tax return, while mortgage interest and home-equity loan interest can, as long as the mortgage does not exceed \$1,000,000 and the home-equity loan does not exceed \$100,000.
- **Determine whether you should bunch income or expenses for 2008.** Depending on your overall tax situation, it may make sense to accelerate

or defer income and expenses. Some deductions that can be accelerated or deferred include payment of property taxes, estimated state taxes, medical expenses, and charitable contributions. Income that can typically be deferred includes self-employment income and year-end bonuses or commissions.

- **Donate appreciated stock held over a year to a charitable organization.** You can deduct the stock's fair market value as a charitable contribution without paying the capital gains tax on the sale.
- **Sell assets on the installment basis.** You can use this method to sell certain capital assets, particularly real estate, which will typically allow you to recognize the gain as the installments are collected, rather than in total in the year of sale. You may also want to consider a like-kind, or Section 1031, exchange, which allows you to defer any taxes.
- **Consider transferring appreciated assets to children.** If the children are in the 10% or 15% tax bracket, they can sell the asset and pay no capital gains taxes in 2008. These transfers can be made as part of your annual tax-free gifts, with a maximum tax-free transfer of \$12,000 in 2008 (\$24,000 if the gift is split with your spouse). However, be aware that the "kiddie tax" rules changed last year, raising the age limit for application of the "kiddie tax" to all children under age 19 (previously under age 18) and to students under age 24. The "kiddie tax" refers to the manner in which unearned income is taxed for children. In 2008, the first \$900 of unearned income is tax free, the second \$900 is taxed at the child's marginal tax rate, and any remaining unearned income is taxed at the parents' marginal tax rate. Once the individual exceeds the age limits, all unearned income is taxed at his/her marginal tax rate.
- **Familiarize yourself with all types of income tax deductions, exemptions, and credits.** There are a wide variety available, and you should be aware of any that apply to you. For example, many tax benefits exist for higher-education expenses, including Coverdell education savings accounts (ESAs), Section 529 plans, and the Hope Scholarship and Lifetime Learning credits. Each has different eligibility criteria, so you need to be familiar with all of them to determine which will work best in your situation.
- **Consider your long-term planning needs.** In addition to lowering income taxes for 2008, you also want to find strategies to lower taxes in future years. Thus, it is a good time to review your entire tax situation to see if other changes are warranted. For instance, you may want to invest more in municipal bonds, whose interest income is generally exempt from federal, and sometimes state and local, income taxes.

[Back to topics.](#)



Accelerate Your Retirement Savings

Don't just give up on your retirement goals if you find you've entered middle age with little to no retirement savings. Sure, it may be harder to reach your retirement goals than if you had started in your 20s or 30s, but here are some strategies to consider:

- **Reanalyze your retirement goals.** First, thoroughly analyze your situation, calculating how much you need for retirement, what income sources will be available, how much you have saved, and how much you need to save annually to reach your goals. If you can't save that amount, it may be time to change your goals. Consider postponing retirement for a few years so you have more time to accumulate savings as well as delay withdrawals from those savings. Think about working after retirement on at least a part-time basis. Even a modest amount of income after retirement can substantially reduce the amount you need to save for retirement. Look at lowering your expectations, possibly traveling less or moving to a less expensive city or to a smaller home.
- **Contribute the maximum to your 401(k) plan.** Your contributions, up to a maximum of \$15,500 in 2008, are deducted from your current-year gross income. If you are age 50 or older, your plan may allow an additional \$5,000 catch-up contribution, bringing your maximum contribution to \$20,500. Find out if your employer offers a Roth 401(k) option. Even though you won't get a current-year tax deduction for your contributions, qualified withdrawals can be taken free of income taxes. If your employer matches contributions, you are essentially losing money when you don't contribute enough to receive the maximum matching contribution. Matching contributions can help significantly with your retirement savings. For example, assume your employer matches 50 cents on every dollar you contribute, up to a maximum of 6% of your pay. If you earn \$75,000 and contribute 6% of your pay, you would contribute \$4,500, and your employer would put in an additional \$2,250.
- **Look into individual retirement accounts (IRAs).** In 2008, you can contribute a maximum of \$5,000 to an IRA, plus an additional \$1,000 catch-up contribution if you are age 50 or older. Even if you participate in a

company-sponsored retirement plan, you can make contributions to an IRA, provided your adjusted gross income does not exceed certain limits. Starting in 2010, everyone can convert from a traditional IRA to a Roth IRA, regardless of their income. Thus, if you aren't eligible to contribute to a deductible or Roth IRA, you may want to contribute to a nondeductible IRA, which can be converted to a Roth IRA in 2010.

- **Reduce your preretirement expenses.** Typically, you'll want a retirement lifestyle similar to your lifestyle before retirement. Become a big saver now and you enjoy two advantages. First, you save significant sums for your retirement. Second, you will be living on much less than you're earning, so you'll need less for retirement. For instance, if you live on 100% of your income, you'll have nothing left to save toward retirement. At retirement, you'll probably need close to 100% of your income to continue your current lifestyle. With saving 10% of your income, you're living on 90% of your income. At retirement, you'll probably be able to maintain your standard of living with 90% of your current income.
- **Move to a smaller home.** As part of your efforts to reduce your preretirement lifestyle, consider selling your home and moving to a smaller one, especially if you have significant equity in your home. If you've lived in your home for at least two of the previous five years, you can exclude \$250,000 of gain if you are a single taxpayer and \$500,000 of gain if you are married filing jointly. At a minimum, this strategy will reduce your living expenses so you can save more. If you have significant equity in your home, you may be able to use some of the proceeds for savings.
- **Substantially increase your savings as you approach retirement.** Typically, your last years of employment are your peak earning years. Instead of increasing your lifestyle as your pay increases, save all pay raises. Anytime you pay off a major bill, such as an auto loan or a child's college tuition, take the money that was going toward that bill and put it in your retirement savings.
- **Restructure your debt.** Check whether refinancing will reduce your monthly mortgage payment. Find less costly options for consumer debts, including credit cards with high interest rates. Systematically pay down your debts. And most important - don't incur any new debt. If you can't pay cash for something, don't buy it.

[Back to topics.](#)



You're Never Too Old for a Roth IRA

Even if you're retired, consider contributing to a Roth individual retirement account (IRA), provided you have some earned income. In 2008, single taxpayers with modified adjusted gross income (AGI) less than \$101,000 and married taxpayers filing jointly with modified AGI less than \$159,000 are eligible to make a nondeductible contribution to a Roth IRA. Contributions are phased out for married couples filing jointly with modified AGI between \$159,000 and \$169,000 and for single taxpayers with modified AGI between \$101,000 and \$116,000. In 2008, the maximum annual contribution is the lesser of \$5,000 or earned income. Individuals age 50 and older can make an additional \$1,000 catch-up contribution. Pension, investment, and rental income are not considered earned income.

Roth IRAs are a flexible way to save for retirement. Contributions are withdrawn at any time with no tax consequences. Earnings and capital gains can be withdrawn on a tax-free basis if a qualified distribution is made:

- at least five years after your first contribution, and
- you have attained age 59 1/2 or due to death, disability, or to pay up to \$10,000 of first-time home buyer expenses.

Other characteristics of a Roth IRA may make it an attractive investment for retirees:

- You can make contributions as long as you have earned income, no matter how old you are. With traditional deductible IRAs, you must stop making contributions when you reach age 70 1/2.
- Mandatory withdrawals after age 70 1/2 are not required. You can take out as much or as little as you want, whenever you want, after age 59 1/2. If you don't need the money, the balance can continue to grow on a tax-free basis.
- Qualified distributions from Roth IRAs are not included in AGI. Thus, these distributions will not affect income taxation of your Social Security benefits.
- Roth IRAs can provide a tax-advantaged way to accumulate assets for heirs. Both traditional and Roth IRAs are subject to estate taxes. However,

the beneficiaries of a traditional IRA must also pay income taxes on the proceeds, while beneficiaries of a Roth IRA receive qualified amounts income-tax free.

With all of the advantages, retirees with earned income should definitely take a look at Roth IRAs.

[Back to topics.](#)



Should You Defer Income Taxes?

Should you pay income taxes now, so you can withdraw funds after retirement tax free? Or are you better off delaying income taxes until after retirement? This is the basic decision when choosing between a traditional deductible individual retirement account (IRA) and a Roth IRA, or between a 401(k) plan and a Roth 401(k) plan. With the Roth options, you are paying taxes now so you can take qualified distributions income-tax free. With the traditional IRA and 401(k) plan, you are delaying taxes until distributions are taken.

The standard advice is to consider whether your tax bracket will be higher or lower in retirement. If you are likely to be in a higher tax bracket, you'll usually benefit from the Roth options, because you are paying taxes at a lower rate now. If you're likely to be in a lower tax bracket, you may benefit more from the traditional IRA and 401(k) plan, because you'll pay taxes at a lower rate after retirement.

Most people naturally assume that their tax rate will be lower in retirement, since their income will typically be lower. That assumes that income tax rates will stay constant over that time period, even though tax rates are at historically low levels. However, many believe that income tax rates have no where to go but up.

Thus, it may be prudent to use tax diversification for your portfolio. Tax diversification attempts to protect your portfolio against tax rate fluctuations. It is a concept similar to asset allocation, where you protect your portfolio against price fluctuations. With tax diversification, you invest in a number of investment vehicles with different tax ramifications. For instance, you might invest in a Roth IRA, where qualified distributions can be taken with no tax consequences; a

401(k) plan, where you save taxes now and pay ordinary income taxes of up to 35% on qualified distributions; and taxable accounts, where the capital gains tax of a maximum of 15% must be paid on sales of appreciated investments. Thus, during retirement, you can monitor your tax situation and withdraw money from the assets that make the most sense in any particular year.

[Back to topics.](#)



Your Family's Finances

In many families, one spouse takes primary responsibility for the family's finances, doing everything from paying bills to making investment decisions to reviewing insurance policies. If that spouse dies first, the other spouse may have difficulty taking over these tasks. Thus, as the primary money matters person in your marriage, one of your most important financial duties is to prepare your spouse to handle the family's finances. Some strategies to consider include:

- **Maintain good records.** Financial records should be well organized, located in one central place, and contain only pertinent information. Old or outdated information may confuse your spouse.
- **Prepare written instructions.** These instructions should cover everything from insurance policies to investments to company benefits to monthly bills, so nothing is overlooked. Also list all your assets, why you own them, and where important documents are kept. Update these instructions at least annually.
- **Discuss your finances with your spouse.** Go over your written instructions, explaining your rationale for major financial decisions. Your death may necessitate changes in investment allocations, insurance policies, and other financial matters, so encourage your spouse to explore all options before making decisions.
- **Involve your spouse in the family's finances now.** Your spouse can start by paying monthly bills, balancing the checkbook, or reviewing credit card charges. Increase his/her involvement as confidence builds.
- **Line up professionals for your spouse.** Even if your spouse assumes some financial duties, there may be areas he/she will never feel comfortable handling. Identify those areas, find knowledgeable professionals who can help, and introduce your spouse to them now.

These strategies can help smooth the transition if your spouse needs to take over the family's finances.

[Back to topics.](#)

