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Five Year-End Tax Planning Considerations



Legislation passed in December of 2010 extended lower tax rates, deductions, and other expiring provisions for an additional one to two years. As a result, you can consider 2011 year-end tax planning moves with a relative degree of certainty. Here are five

things to keep in mind.

1. Tax rates unchanged

The same six federal income tax rates that apply this year will apply next year (these are the same rates that applied in 2010). So, depending on your taxable income, you'll fall into either the 10%, 15%, 25%, 28%, 33%, or 35% rate bracket. The rates that apply to long-term capital gains and dividends also remain unchanged; long-term capital gains and qualifying dividends continue to be taxed at a maximum rate of 15% in 2011 and 2012. If you're in the 10% or 15% income tax bracket, a special 0% rate will generally apply.

2. AMT "fix" expires at end of year

While 2010 regular income tax rates as well as the rates that apply to long-term capital gains and qualifying dividends were extended through 2012, the latest in a long line of alternative minimum tax "fixes" (in the form of increased AMT exemption amounts) is effective only through the end of this year. So, if AMT is a factor in your year-end planning, potential year-end moves are somewhat complicated by the uncertainty of the AMT for 2012. Of course, many expect another AMT "fix" for 2012, but as things stand today, AMT exemption amounts will drop significantly for 2012, increasing the reach and impact of the AMT in 2012.

3. Retirement plan contributions

Traditional IRAs (assuming that you qualify to make deductible contributions) and employer-sponsored retirement plans such as 401(k) plans allow you to contribute funds pretax, reducing your 2011 taxable income. Contributions that you make to a Roth IRA (assuming you meet the income requirements) or a Roth 401(k) plan are made with after-tax dollars, but qualified Roth distributions are

completely free from federal income tax, making these retirement savings vehicles very appealing. For 2011, you can contribute up to \$16,500 to a 401(k) plan (\$22,000 if you're age 50 or older), and up to \$5,000 to a traditional or Roth IRA (\$6,000 if you're age 50 or older). The window to make 2011 contributions to an employer plan closes at the end of the year, while you generally have until the due date of your federal income tax return to make 2011 IRA contributions.

4. Retirement plan distributions

Once you reach age 70½, you're generally required to start taking required minimum distributions (RMDs) from any traditional IRAs or employer-sponsored retirement plans you own. Take any distributions by the date required--the end of the year for most individuals. The penalty is steep for failing to do so: 50% of the amount that should have been distributed.

Note: *The year 2011 may be the last opportunity for individuals age 70½ or older to make qualified charitable distributions of up to \$100,000 from an IRA directly to a qualified charity. These charitable distributions can be excluded from your income, and count toward satisfying any RMDs that you would otherwise have to take from your IRA for 2011.*

5. Expiring provisions

Barring additional legislation, 2011 will be the last opportunity to take advantage of some expiring provisions:

- "Bonus" depreciation and IRC Section 179 expensing limits drop significantly in 2012.
- The increased (100%) exclusion of capital gain from the sale or exchange of qualified small business stock (certain requirements, including a five-year holding period, apply) will not apply to qualified small business stock issued and acquired in 2012.
- The credit for energy-efficient improvements made to your home expires at the end of 2011. The credit is limited, however, and you may not be able to claim a credit for 2011 if you've claimed it in past years.

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Long-Term Care Planning Is Important for Women



Women are more likely than men to face the need for long-term care without the help of their spouse. According to the United States Administration on Aging, 42% of older women were widows in 2010 and half of the women over age 75 lived alone (www.aoa.gov). And the Centers for Disease Control reports that over 70% of nursing home residents are women (www.cdc.gov).



The prospect of needing long-term care is an important, yet sometimes overlooked, part of financial and retirement planning. Yet it may be especially vital for women to consider as they often face the need for long-term care as both a caregiver and recipient.

Women as caregivers

While you may think most long-term care is received in a nursing home setting, the National Clearinghouse for Long-Term Care Information (National Clearinghouse) estimates that about 80% of care is provided at home by informal (unpaid) family caregivers. Of those caregivers, about 60% are women (www.longtermcare.gov).

In many instances, the care provided for chronically disabled older adults is quite intensive and time-consuming. Women who act as family caregivers of older people with high levels of personal-care needs may face considerable financial, emotional, and physical strain. For instance, caregivers may face financial challenges due to lost wages from reduced work hours, time out of the workforce, extended family leave, or early retirement. Reduced work hours or extended time out of work may also affect the ability to contribute toward retirement savings, potentially resulting in a loss of retirement income.

Caregivers also may face emotional strains and poor health related to their caregiving responsibilities. This may be especially true for older women caregivers and younger women who may be caring for an older family member in addition to managing their own household.

Women as long-term care recipients

According to the Centers for Disease Control and Prevention (CDC), women outlive men by an average of 6 years (www.cdc.gov). Because they tend to live longer, women are at a higher risk than men of needing long-term care (source: National Clearinghouse). And the National Clearinghouse reports that women, on average, need care over a longer time than men (3.7 years vs. 2.2 years). With a longer life expectancy and a greater likelihood of needing long-term care, women often must confront their long-term care needs without the help of their spouse or other family members.

Paying for long-term care

Long-term care can be expensive. An important part of planning is deciding how to pay for these services.

Buying long-term care (LTC) insurance is an option. Many LTC insurance policies pay for the cost of care provided in a nursing home, assisted-living facility, or at home, but the premium paid generally depends on the age of the insured and the policy benefits and options purchased. And premiums can increase if the insurer raises its overall rates. Even with LTC insurance, you still may have some out-of-pocket contributions in addition to premium payments. For example:

- Not all policies provide coverage for care in your home, even though that's where most care is provided. While the cost of in-home care may be less than the cost of care provided in a nursing home, it can still be quite expensive.
- Most policies allow for the selection of an elimination period of between 10 days and 1 year, during which time the insured is responsible for payment of care.
- The LTC insurance benefit is often paid based on a daily or monthly maximum amount, which may not be enough to cover all of the costs of care.
- While lifetime coverage may be selected, it can increase the premium cost significantly, and some policies may not offer that option. Most common LTC insurance benefit periods last from 1 year to 5 years, after which time the insurance coverage generally ends regardless of whether care is still being provided.

Government benefits provided primarily through a state's Medicaid program may be used to pay for long-term care. To qualify for Medicaid, however, assets and income must fall below certain limits, which vary from state to state. Often, this requires spending down assets, which may mean using savings to pay for care before qualifying for Medicaid.

Women may have to confront particular challenges when planning for long-term care. A financial professional can help with some of the complex issues you may face when preparing for the possibility of long-term care, both as a caregiver and a receiver of care.

Can You Get to a Million Dollars?



In planning on how to get to \$1 million, you should generally consider how much you have now, how much you can contribute in the future, how much you might earn on your investments, and how long you have to accumulate funds. But remember, there are no guarantees—even when you have a clearly defined goal. For example, the market might not perform as expected, or you may have to reduce your contributions at some point. Review your progress periodically and be prepared to make adjustments when necessary.

Often in life, you have investment goals that you hope to reach. Say, for example, you have determined that you would like to have \$1 million in your investment portfolio by the time you retire. But will you be able to get to a million dollars?

In trying to accumulate \$1 million (or any other amount), you should generally consider the current balance of your investment portfolio available to meet your anticipated future need, any additional contributions that you anticipate you can make to your investment portfolio, any amounts that you can earn on your portfolio, and the time that you have to do so.

Current balance—your starting point

Of course, the more that you have today, the less you may need to contribute to your investment portfolio or earn on your investments over your time horizon.

Time (accumulation period)

In general, the longer your time horizon, the greater the opportunity you have to accumulate \$1 million. If you have a sufficiently long time horizon and a sufficiently large current balance, with earnings you may be able to reach your goal without making any additional contributions. With a longer time horizon, you'll also have more time to recover if the value of your investments drops. If additional contributions are required in order to reach your goal, the more time you'll have to target your goal, and the less you may have to contribute.

The sooner you start making contributions, the better. If you wait too long and the time remaining to accumulate funds becomes too short, you may be unable to make the large contributions required. In such a case, you may need to consider whether you can extend the accumulation period—for example, by delaying retirement.

Rate of return (earnings)

In general, the greater the rate of return (ROR) that you can earn on your investments, the more likely that you'll reach your investment goal of \$1 million. The greater the proportion of the investment portfolio that comes from earnings, the less you may need to contribute to the portfolio. Earnings can benefit from long time horizons and compound rates of return, as returns are earned on any earlier earnings.

However, higher rates of return are generally associated with greater investment risk and the possibility of investment losses. It's important to choose investments that meet your time horizon and tolerance for risk. And be realistic in your assumptions. What rate of return is

realistic given your current asset allocation and investment selection?

Amount of contributions

Of course, the more you can regularly contribute to your investment portfolio (e.g., monthly or yearly), the better your chances are of reaching your investment goal of \$1 million, especially if you start contributing early and have a long time horizon.

Contributions needed

Now that we've reviewed the primary factors that affect your chances of getting to a million dollars, let's consider this question: At a given rate of return, how much do you need to save each year to reach the \$1 million target? For example, let's assume that you anticipate that you can earn an annual rate of 5% (to be compounded monthly) on your investments. If your current balance is \$500,000 and you have 20 more years to reach \$1 million, you actually do not need to make any additional contributions (see scenario 1 in the table below), but if you only have 10 more years, you'll need to make annual contributions of \$13,956 (see scenario 2). If your current balance is \$0 and you have 30 more years to reach \$1 million, you'll need to contribute \$14,754 annually (see scenario 3), but if you only have 20 more years, you'll need to contribute \$29,873 annually (see scenario 4).

| Scenario | 1 | 2 |
|---------------------|-------------|-------------|
| Target | \$1,000,000 | \$1,000,000 |
| Current Balance | \$500,000 | \$500,000 |
| Years | 20 | 10 |
| ROR | 5% | 5% |
| Annual Contribution | \$0 | \$13,956 |

| Scenario | 3 | 4 |
|---------------------|-------------|-------------|
| Target | \$1,000,000 | \$1,000,000 |
| Current Balance | \$0 | \$0 |
| Years | 30 | 20 |
| ROR | 5% | 5% |
| Annual Contribution | \$14,754 | \$29,873 |

Note: This is a hypothetical example and is not intended to reflect the actual performance of any investment. Actual results may vary. Taxes and inflation are not considered.

Ask the Experts

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Does the federal financial aid formula count all parental assets?

The federal methodology for financial aid examines your family's income, assets, and household information to calculate your expected family contribution, or EFC. Your EFC represents the amount of money the government deems you can afford to put toward college costs each year before any financial aid is forthcoming.

The federal methodology counts some parental assets and excludes others in arriving at your EFC (these assets are referred to as assessable and non-assessable assets). The more assessable assets your family has, the higher your EFC. The following assets are excluded from the federal methodology:

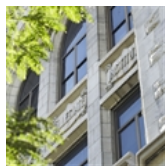
- Retirement accounts (e.g., 401(k)s, all IRAs)
- Annuities
- Cash value life insurance
- Home equity in primary residence
- Personal items (e.g., cars, furniture)
- A family farm

Keep in mind that your assets for financial aid purposes are those you own at the time you

sign the FAFSA.

Assessable assets are all other assets of the parent. These include items such as checking and savings accounts, money market accounts, certificates of deposit, stocks, bonds, mutual funds, U.S. savings bonds, certain 529 plans, trusts, limited partnerships, vacation homes, investment properties, and business assets.

When a family's total assessable assets are counted, the federal methodology grants parents an asset protection allowance that lets them exclude a certain portion of their assets from the final tally. The amount of the allowance varies, depending on the age of the older parent at the time the student applies for aid--the older the parent, the greater the allowance. For example, for the 2011/2012 school year, the asset protection allowance for a two-parent family where the older parent is 48 years old is \$46,200; the figure jumps to \$54,300 if the older parent is 54 years old.



How are 529 plans treated for federal financial aid purposes?

There are three instances when 529 plans--which include both college savings plans and prepaid tuition plans--need to be listed as an asset on the federal government's financial aid application, the FAFSA: (1) the account owner of the 529 plan is the parent; (2) the account owner of the 529 plan is the student, and the student files the FAFSA as a dependent student; or (3) the 529 plan is a custodial 529 account (UTMA/UGMA custodial funds have been used to establish and/or fund the 529 plan), and the student files the FAFSA as a dependent student. In each of these cases, the 529 plan must be listed as a parental asset on the FAFSA.

What does this mean? Under the federal methodology for financial aid, a parent's assets are assessed (counted) at a rate of 5.6%. This means that every year, the government deems 5.6% of a parent's assets available to contribute to college costs. (Student assets are assessed at a rate of 20%.)

When does a 529 plan not need to be listed on the FAFSA? Even if the account owner falls into one of the three categories above, if the

account owner has an adjusted gross income below \$50,000 (and a few other requirements are met), the 529 plan doesn't need to be listed. Also, if a grandparent, other relative, or friend is the account owner of the 529 plan, it doesn't need to be listed on the FAFSA.

A corollary to the rule that a parent-owned 529 plan must be listed as an asset on the FAFSA is that if a parent is the account owner of multiple 529 plans (which may be the case if a parent opens separate 529 accounts for each child in the family), then the parent must list the value of *all* 529 plans, even if only one beneficiary is currently applying for aid. Colleges, however, generally apply a more logical rule when deciding whether to count 529 plans for purposes of distributing their own institutional aid. Specifically, families must list the value of all 529 plans that name the student as beneficiary, so a plan owned by a grandparent with the student as beneficiary would have to be reported, while a plan owned by a parent with the student's younger sibling as beneficiary would not.