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How Pre-Retirees Benefit From The Recovery Act

The American Recovery and Reinvestment Act of 2009, the keystone of the Obama administration's plan to jump-start the U.S. economy, contains a passel of new tax breaks for individual taxpayers as well as business owners. Most of those for individuals are retroactive to the beginning of the year. Though provisions are largely targeted at low- and middle-income taxpayers—and are phased out for those earning more—some might lighten your tax load this year.

Making Work Pay Credit. This is the linchpin of the President's tax plan. Whether you work for an employer or you're self-employed, as a single filer you're entitled to a payroll tax credit equal to 6.2% of earned income or $400, whichever is less. The maximum credit is doubled to $800 for joint filers. If you receive a paycheck and are subject to withholding, your employer is supposed to adjust the amount that's taken out of your earnings, increasing take-home pay. This new credit applies retroactively to the beginning of 2009 and will also be available in 2010, but many taxpayers will earn too much to qualify. This benefit begins to phase out at a modified adjusted gross income (MAGI) of $75,000 for single filers and $150,000 for joint filers.

American Opportunity Tax Credit. This year's legislation revamps the Hope credit for qualified education expenses and gives it a new name. The maximum American Opportunity credit for 2009 and 2010 is $2,500 (up from the Hope's $1,800), and it will be available for all four years of college study (the Hope covered just the first two). In addition, 40% of the credit may come as a tax refund. And though this credit, too, will be out of bounds for many taxpayers, it's more generous than the Hope credit was. The phase-out in the new version begins at $80,000 of MAGI for single filers (up from $48,000) and $160,000 for joint filers (compared with $96,000).

Alternative minimum tax. Usually, Congress waits until the eleventh hour to "patch" the AMT for the current year. This time it acted early, building relief into the recovery act. The legislation lets individuals continue to use personal credits as AMT offsets in 2009 while bumping up AMT exemption amounts once again—to $46,700 for single filers (up from $46,200 in 2008) and $70,950 for joint filers (compared with $69,950 in 2008).

New car deduction. A late addition to the recovery act provides a deduction for state and local sales or excise taxes attributable to the first $49,500 of the price of a new vehicle. It applies to any vehicle weighing no more than 8,500 pounds—including cars, SUVs, light trucks, and motorcycles—purchased after Feb. 17, 2009 and before January 1, 2010. Motor homes also qualify. This special deduction is phased out for single filers

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Roth Conversions: Open To Everyone In 2010 & Beyond

The new year has finally arrived and taxpayers with modified adjusted gross income (MAGI) of more than $100,000 will now be allowed to convert a traditional IRA to a Roth IRA. This change applies to 2010 and (at the moment) every year thereafter.

What's more, the income tax due on any conversion made in 2010 can be spread over two years. So any money you move from a traditional to a Roth account may be included as taxable income in 2011 and 2012—helping to spread out the tax liability that you would otherwise have to pay in 2010. Conversions in subsequent years are included as income during the current tax year in which the conversion is completed.

This will be most advantageous to people who have the ability to pay the tax with non-IRA funds. Of course, there are many different variables to consider before deciding if a conversion is right for you, so you should consult with your tax advisor.

Please contact Chad, Wade, or David to see if a conversion makes sense for you.

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Financial Tips For Those Out Of Work

The numbers are scary. From December 2007 through October 2009, unemployment in the U.S. doubled from 7.6 million to 15.1 million. But the statistic that matters most is your own, and if you've been laid off or your company has gone under, you're competing with an army of others for the few available jobs. Still, manage your financial affairs carefully and you'll certainly survive the economic crisis. You might even emerge in better shape than you were before. These eight suggestions could help.

1. Don't panic. It's normal to be nervous if you've suddenly been sent packing after years of gainful employment. But now's the time to take stock of your situation as calmly as possible. Keeping your emotions under control will make it easier to find the way forward.

2. Reduce spending. Food and shelter are necessities, but other purchases are discretionary. Consider ways to trim your cable TV bill and think twice about dining out. Finding things you can do without may also help you overcome the feeling of powerlessness that often comes with unemployment.

3. Eliminate unnecessary debt. Cut up your credit cards? Maybe not, but charge only what you can afford to repay each month. Otherwise, a small debt could quickly spiral out of control.

4. Take advantage of benefits. These days, you can likely avoid those dispiriting visits to the unemployment office and apply for jobless benefits by mail or online. And if you need to continue your health insurance coverage under COBRA, a provision of the American Recovery and Reinvestment Act of 2009 will subsidize 65% of the cost for nine months.

5. Network, network, network. Applying for posted jobs pits you against a host of other applicants. You may do better reaching out to friends, family, and business associates. Be casual—you don't want to seem desperate—but be sure they know you're job hunting.

6. Consider a career change. If your industry or profession seems unlikely to rebound, you might broaden your search to include related fields—from print media, say, to work on a website, in public relations, or in another job requiring writing and editing.

7. Start a new business. If you've always dreamed of turning a hobby or other passion into a profitable business, this might give you the push you need to go for it. If you can fill a niche with high-quality services or products while keeping startup costs low, you'll stand a good chance of success.

8. Stay positive. An extended job search may sap the energy you had when you were first laid off. But perseverance will pay off. And remember: If you're middle-aged or near retirement, your wealth of experience is an asset, not a liability.

Finally, in a pinch, you may need to tap your retirement plans. But money you pull out now will be difficult to recoup later on, so consider this option only for emergency purposes. ●

Rule Change Helps Non-Spouse Rollovers

Most 401(k)s and other employer-sponsored retirement plans are bequeathed to spouses, and with good reason. Until a recent change in rules, only a spouse could inherit a retirement plan other than an IRA and avoid immediate taxes. Now, although the process must be handled carefully, any beneficiary should be able to receive a retirement plan and enjoy the same tax-postponing benefits that a husband or wife always could.

Under the old rules, if your spouse got the money, it could be rolled over into his or her own IRA and lifetime withdrawals would be permitted. Though each year's required distribution would add to your spouse's taxable income, the rest of the account would continue to compound, and there might be a sizable balance left at your spouse's death.

But what about your daughter? Most employer plans require an account to be emptied within five years of an employee's death. She would have had to take the money and, under the old rules of not being allowed to move it into an IRA, would have been stuck paying income tax immediately, which likely would have diminished her inheritance by a third or more.

The new rules are much kinder to non-spouse beneficiaries. Now, any beneficiary that you name may roll over the inherited plan to an IRA. But the law is prickly about the process. To make a successful rollover, your heir must do the following:

• Open an inherited IRA to take the money. A spouse who inherits a 401(k) can merge the account with her own IRA, but others must set up a new account specifically created to receive funds transferred from the deceased's retirement plan.

Help Loved Ones With Tax-Free Gifts

Today's severe economic crisis is taking its toll on virtually every segment of the population. Young newlyweds are finding it difficult to set aside funds for the down payment on a home, despite the now lower prices. Middle-aged parents are struggling to make ends meet and still squirrel away cash for their children's college costs. And older workers and retirees have seen their nest eggs eroded by the recent stock market downturn.

If you've been fortunate (and foresighted) enough to escape major damage to your own finances, you may want to consider helping family members overcome economic hurdles. Providing tax-free gifts could improve their situations while benefiting your own estate planning as well. If you stay within tax law boundaries, you don't have to pay gift tax on cash or property transferred to relatives or any other recipient. At the same time, the gifts will reduce the size of your taxable estate.

The value of the latter benefit depends on the future of the federal estate tax, which remains uncertain. The estate of an individual who dies in 2009 can shelter up to $3.5 million of assets from federal estate tax. That's an increase from a $2 million exemption in 2008, as stipulated by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which calls for the outright repeal of the estate tax in 2010. But that provision of the legislation expires at the end of 2010, and in 2011, pre-EGTRRA rules return. The estate tax exemption is scheduled to revert to just $1 million, and the estate tax rate will rebound to 55% from the current 45% unless Congress acts to change the law.

While a legislative compromise on the estate tax is likely, the tax will almost certainly continue in some form. And that likelihood only increases the appeal of making gifts now to help loved ones hurt by the recession. In 2009 and 2010, you can provide tax-free gifts of as much as $13,000—in any combination of cash and property—to as many recipients as you choose. (A periodic inflation adjustment resulted in an increase in this exclusion amount from $12,000 in 2008.) You don't even have to file any tax forms or otherwise inform the IRS about such gifts (if those are the only gifts made and unless gift splitting with a spouse is elected).

The chance to provide unlimited numbers of tax-free gifts could multiply the benefits not only for recipients but also to your estate plan. For instance, if you have two children and three grandchildren, giving each of them $13,000 in 2010 adds up to a total of $65,000. If your spouse also makes such gifts (or consents to a joint gift by filing a gift tax return), that exemption jumps to $26,000 per relative and a total of $130,000 for five, all without gift-tax consequences. Continue this gift-giving program for five years and you'll have cut the value of your estate by $650,000 while providing generous assistance at a time when it may be sorely needed.

If the recipient is in a lower tax bracket, gifting shares of stock, mutual funds, or other assets that have appreciated will save you from paying capital gains taxes. But if you have assets with unrealized losses that you want to donate, it's better to sell them first so that you can deduct the loss on your tax return and give your gift in cash.

If you exceed the annual limit on tax-free gifts, you still won't necessarily owe money to the IRS. But larger gifts would count against your lifetime $1 million gift-tax exemption, which might be put to better use in funding trusts or for other estate planning purposes. Plus, you'll have to file a gift tax return—or potentially two gift tax returns if you're married.

Meanwhile, there are two special situations in which the normal giving limits don't apply. The first involves money you provide directly to an educational institution on behalf of a student. The second is for direct payments to health care providers.

The unlimited exemption for education payments means you won't owe gift tax if you cover college costs for children or grandchildren. Suppose your granddaughter is attending an Ivy League institution and the annual bill for tuition is $50,000. You can pay that amount directly to the university and still give her an additional $13,000 gift (or $26,000 with your spouse) that won't be subject to gift tax.

If children or grandchildren are still years away from college, an even better approach might be to fund a Section 529 college savings plan that names the child as beneficiary. Income earned by plan investments won't be taxed, and withdrawals to pay qualified educational expenses will also be tax-free. Plus, a special provision allows five years' gifts to be sent to a 529 plan in one fell swoop. That means you and your spouse could immediately provide $130,000 to jump-start a 529 plan without gift-tax consequences (provided you file a gift tax return to elect to front-load the gift). ●

- Be sure to title the new account correctly. For instance, "Dad IRA (Deceased) FBO Daughter."
- Make sure the money goes directly from the company plan to the heir's new IRA. If your beneficiary touches the money, he or she will be immediately taxed.

If you've ever changed jobs, you may already have transferred retirement funds from your former employer to an IRA. Until the rules changed, that was the only way to ensure favorable tax treatment for a non-spousal heir. And even now, a rollover to an IRA of your own is often advisable. IRAs tend to offer a wider range of investment options than you get in a typical 401(k), and it's easier to monitor investments in a single account. Moreover, you may feel a lot more comfortable having the funds deposited in your own IRA rather than an account being administered by a former employer.

There is at least one advantage to keeping money in a 401(k), however. If you retire, you may begin taking distributions from an employer plan at age 55 without incurring the 10% early withdrawal penalty you would owe for withdrawing assets from an IRA before age 59½. Under the new rules, you can have the penalty-free early access of a 401(k) while also accommodating non-spousal heirs. ●

Do You Really Need That Inheritance?

Sometimes it pays just to say "no thanks" to a generous bequest—even from your own spouse. There may be estate planning benefits to having the assets go directly to contingent beneficiaries named by the donor. If those beneficiaries are your children, this strategy could help them keep more of the bequest.

Officially declining an inheritance involves executing a legal document known as a "qualified disclaimer." This refusal, which can apply to all or part of a bequest, must be executed within nine months of the donor's death and before you've received any income from the inheritance. While this is generally a reactive measure, similar results can be obtained setting up a disclaimer trust as part of your estate plan.

One factor in deciding whether to refuse an inheritance is the uncertain future of the federal estate tax. Scheduled to be repealed for 2010, it will be revived in 2011 under unfavorable conditions. The amount of an estate that's exempt from federal tax, which has gradually increased to $3.5 million for those who die in 2009, will drop back to $1 million for 2011, unless Congress enacts new legislation.

Also, after gradually being reduced to 45%, the top estate tax rate will return to 55%. The new administration and Congress will likely adjust the rules or change the timetable, but most experts expect the estate tax to continue to exist in some form. A qualified disclaimer or a disclaimer trust could help you prepare for whatever comes.

Suppose that under your current will, all of your assets are to go to your spouse if you die first, and vice versa. Then, at the death of the surviving spouse, the remaining assets will be divided among your children. With this arrangement, there's no estate tax due after the first death—because a spouse can inherit an unlimited amount tax free—and the surviving spouse's estate can be reduced, for tax purposes, by whatever individual exemption is in effect at the time. But this wastes the first spouse's exemption. Instead, the surviving spouse could disclaim an amount equal to the estate tax exemption, passing it directly to contingent beneficiaries. The first spouse's exemption relieves the heirs of any current estate tax liability, and later the surviving spouse's own exemption can be used.

Before disclaiming any assets, one's current and future potential need for the disclaimed assets needs to be carefully analyzed by a financial planner, since this is an irrevocable decision. We can work with you and your attorney to consider whether turning down an inheritance might make sense for you, and help you follow the rules that govern the process. Also, if your net worth nears or exceeds federal estate tax exemption limits, we can discuss how setting up a disclaimer trust now can benefit your heirs. ●

Pre-Retirees Benefit

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with a MAGI of $125,000 and joint filers making $250,000.

First-time homebuyer credit. The stimulus legislation improves a credit for first-time homebuyers that first became available in 2008. It defines "first-time homebuyer" as anyone who hasn't owned a home during the past three years, and increases the credit to the lesser of 10% of the purchase price or $8,000 (up from $7,500) for homes bought after December 31, 2008 and before December 1, 2009. Also, you no longer have to repay the credit if you live in the home for at least three years. But the tax credit is phased out for certain high-income tax filers. Update: The credit has since been extended to May 1, 2010, with certain modifications, including higher phase-out levels and availability to a wider group of homebuyers.

Unemployment benefits. Anyone who has lost a job is eligible to deduct up to $2,400 of unemployment benefits received on 2009 federal income tax returns.

Child tax credit. Parents of children under age 17 are entitled to a $1,000 tax credit per child in 2009 and 2010.

Residential energy credit. The stimulus bill boosts the residential energy credit to 30% of the cost of qualified expenses (up from 10%) and increases the maximum dollar amount to $1,500. This credit covers insulation materials; exterior windows (including skylights); exterior doors; central air conditioners; natural gas, propane, and oil-fired water heaters or furnaces; hot water boilers; electric heat pump water heaters; certain metal roofs; stoves; and advanced air-circulating fans. These provisions are in effect for installations made in 2009 and 2010.

Even if you earn too much to qualify for some of these tax breaks, you may benefit indirectly as the stimulus legislation's hundreds of millions of dollars begin to flow into the economy. We can work with you and your tax advisor to gauge the law's impact on your financial situation. ●