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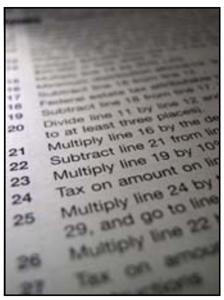
The Importance Of Year-Round Tax Planning

Chances are, you prefer to think about taxes as little as possible. But just avoiding the subject won't keep the Internal Revenue Service at bay. And paying attention long before tax season gives you time to implement strategies that could save you money. "You can't plan backwards," says Victoria Serles, partner and director of the Private Client Wealth Management Practice with the Seattle office of BDO Seidman, a national accounting firm. "But people who consider their taxes months ahead of time tend to be very satisfied with the results."



You could put these strategies into effect at any time (and sooner is almost always better than later):

Profit from tax losses. Call this the silver lining of a dark cloud. With markets struggling recently, you may be sitting on investment losses. But there could also be unrealized gains in your long-term holdings, and if you had planned to sell appreciated assets—but feared the tax bite—now could be the time to act.

You can offset gains with losses dollar for dollar. So a $50,000 loss will totally negate a $50,000 gain. If you sell a stock or fund at a loss, the loss is disallowed for tax purposes if you buy the same investment again 30 days before or after the date of sale; this "wash sale rule" is meant to discourage people from selling shares for tax purposes and then immediately repurchasing them.

However, you can jump right back into a similar investment—a stock in the same industry or another fund that tracks the same index, for example. If you sell, as a loss, a mutual fund of one investment objective, you could purchase a different fund with the same objective—therefore harvesting the tax loss without changing your overall allocation.

If your losses exceed your gains, you can use up to $3,000 in losses to offset ordinary income each year, and you can save leftover losses for future years.

Maximize retirement savings. In 2007 and 2008, annual contribution ceilings for retirement plans edged up to a maximum of $15,500 in pre-tax dollars going into a 401(k) and $5,000 for an individual retirement account. Catch-up contributions for savers 50 or older extend those limits by $5,000 a year for 401(k)s and $1,000 for IRAs. Any deductible contributions you divert into these accounts come off the top of your income, immediately reducing your taxes. So if you're saving less than the maximum, consider boosting your contributions now to spread the increase over the rest of the tax year. Wait until year-end and "you might not have the cash flow available to maximize that opportunity," says Serles.

Minimize the alternative minimum tax. The alternative minimum tax, or AMT, was originally designed to ensure that the very wealthy couldn't avoid taxes entirely by taking advantage of abundant tax

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Lend A Hand To Friends In Need

So far, 2008 has been one for the record books. From the global credit crisis to our own national elections, the news can keep anyone guessing, and all the uncertainty has had its impact on the market. In fact, plenty of people you know who are still taking a "buy-and-hold" approach to investing have made no money over the last decade and may now need professional help achieving their financial goals.

What we've noticed in the past is that uncertainty creates questions. You may find people you know asking for your opinion or advice on which way to turn, or even which questions to ask a potential advisor. If we can be of help, please let us know. We can certainly offer objective, professional advice that you can be proud of.

This current market environment and time of year creates a great opportunity to circle the wagons and focus on what we can control: ourselves. In this issue, enjoy articles around retirement planning, long-term care insurance, taxes, or a topic that's commonly overlooked—planning for the care of your pet! This will not only give you the peace of mind to know that things are taken care of; it will also take the burden off your heirs and people you love.

We want to welcome the new clients who have joined us and thank you all for sharing our services with others.

Happy Holidays!

Jim Joseph, CFP®
Vice President

Getting Old Is A Part Of Life You Can Plan For

For a couple, aging together can be wonderful, with each spouse looking out for the other. But once you reach your sixties, it's important to plan for what will happen if one of you should pass on before the other. Each spouse needs to know how the other feels about the use of life support, and older couples should consider creating a living will. This may be complemented by a durable power of attorney regarding all health care decisions. A lifetime of savings can be depleted in a matter of months if an elderly couple doesn't address this issue.

It's not enough simply to say to your spouse, "Do not revive me if I become very ill." This is a subject you need to discuss in considerably more detail, preferably with the help of your family physician and attorney. They should be able to provide a form for use as a living will.

Consider making your religious leader part of this dialogue as well. He or she can guide you through in-depth conversations in which you address important questions. For instance, do you want to remain alive with the help of feeding tubes? That's frequently an issue after a serious stroke, which can leave a patient bedridden indefinitely. Making well-considered plans about such things now will help your spouse make difficult decisions when the time comes.

Once you've completed your living wills, it may be wise to tell your children and other family members. Their support will be important when times get tough.

For spouses determined to ease the way for a surviving husband or wife, taking care of funeral arrangements also makes sense. Establish whether you want to be buried or cremated, and write down details about your funeral or memorial service. Dealing with such issues is much easier while you are still in good health.

Consider, too, what kind of social infrastructure will be there for a surviving spouse. A couple that is active in their community will have friends to help whichever of them outlives the other. Having a support group in place, whether through your house of worship, volunteer activities, or a hobby, will be a tremendous benefit as well.

Similarly, a couple should develop a network of trusted advisors to assist the surviving spouse. It's common for a husband to handle all of a couple's financial matters, and a husband is statistically more likely to die before his wife. This often forces a widow to make financial decisions she has never made before. Having a financial advisor, attorney, and accountant lined up to help is only prudent.

If you want to deal with all of these issues systematically, you may want to consider hiring a geriatric care manager, a new kind of professional who crosses over the lines between social work and medicine. For a referral, please call our office. ●

Self-Employed Get Deductions For Long-Term Care

If you're self-employed, the good news is you can deduct some or even all of what you spend for long-term care (LTC) insurance. But complex rules make this a potential mine field.

Normally, qualified medical expenses—including premiums paid for regular health insurance and LTC coverage—are deductible only to the extent that they exceed 7.5% of your annual adjusted gross income (AGI). For example, if your AGI this year is $150,000 and your family incurs $12,000 in unreimbursed medical expenses, your deduction is limited to $12,000 – 0.075 ($150,000), or $750.

If you're self-employed, however, the situation improves. Thanks to recent tax law changes, you can deduct 100% of your qualified health insurance expenses, including premiums for long-term care insurance, on page 1 of Form 1040. The 7.5%-of-AGI floor doesn't apply. What's more, you can also deduct what you spend to cover your spouse and any dependents.

To qualify for this tax break, your business must establish the LTC insurance plan, and you can't deduct more than your earned income from the business. Moreover, you can't take a deduction for any month during which you're eligible to participate in a subsidized health plan maintained by your business or your spouse's employer. So if you can obtain LTC coverage through your spouse's job this year but choose to buy it through your business, you're out of luck on the tax deduction, though you might be able to claim a partial deduction if the spouse's job situation changes.

Even if you qualify for a deduction for LTC premiums, the IRS imposes limits on how much you can deduct. The ceiling varies according to the age of the person who's insured. (See "Your LTC Tax Break" for the latest figures, which are adjusted annually for inflation.)

What's A Post-Retirement Job Worth?

It's time to retire, your nest egg is in place, and you could drive the route to your favorite golf course blindfolded. Yet while you may have enough money to take care of your needs during retirement, what would happen if you worked a little longer? What impact would a few more years in the work force, perhaps at a part-time job, have on your situation? Could it make the difference between just getting by during your later years and living very comfortably, between exhausting your savings and having something left to give to your kids?

Working one additional year at your current job will boost your annual retirement income by an average of 9%, according to a recent study by The Retirement Policy Center at the Urban Institute. Staying on the job five extra years adds an average of 56%.

And increasing your ultimate retirement "paycheck" isn't the only benefit of postponing your exit from the workaday world. It might also increase Social Security and pension benefits, and by working longer, you shorten the time during which you must depend on your retirement savings.

But what if you're anxious to leave your old job? You could try something new, maybe a little less stressful, and even if your salary dropped sharply, you might improve your long-term financial outlook.

Consider Jack and Jill, a fictional couple retiring this year. Jack is 68 and Jill is 67. They're millionaires, but just barely, with $700,000 in an individual retirement account and $300,000 in a taxable brokerage account.

The couple's goal is to generate $40,000 a year from that nest egg, supplementing the nice pensions they both have as well as their Social Security benefits. To get there on an inflation-adjusted basis, their financial advisor has suggested an asset allocation plan that could potentially provide about a 6% average annual return.

In this scenario, Jack and Jill are likely to spend all of their assets by the time they die. Jack's life expectancy is 91 and Jill's is 93.

But let's say Jack is worried about being bored and takes a part-time job as a night manager in a shoe store, earning $25,000 a year. If he works at the shoe store for three years, what effect will that have on the couple's retirement picture?

Depending on their goals, such a change could allow them to choose among these options:

- Adding $3,000 a year to their retirement income, bringing the total generated by their nest egg to $43,000 a year during their expected lifetimes. That extra money could fund additional travel or nicer gifts for the kids and grandkids.
- Giving them a cushion of two extra years of income before their money runs out, assuming they continue to spend just $40,000 a year.
- Passing along $334,000 to their heirs, assuming they continue to spend just $40,000 a year (taking inflation into account, along with the fact that the added income would allow the IRA assets to grow tax-deferred for an extra year or so). This reflects the benefit of saving the additional part-time income to pass to their heirs, vs. consuming the additional income.

That's not a bad return on a low-stress, part-time job that still leaves Jack plenty of time to putter around on the golf course during the day.

Of course, gaining extra income isn't the only benefit of working longer. Because work and personal identity tend to be crucially intertwined, retiring sometimes leads to feelings of loss and even depression. Working keeps you involved with people and provides a social support system. And staying physically active is another bonus. In the Retirement Policy Center study, many of those who continued to work reported improved emotional well-being and physical health.

Indeed, higher numbers of older people are remaining in or rejoining the work force. Between 1992 and 2007, participation rates for men age 62 to 64 increased from 41% to 51%, according to the Retirement Policy Center study. Men in the 65 to 69 age group increased their participation rate from 22% to 34%. And older women, too, are staying on the job longer. Between 1988 and 2007, the work force participation rate among women age 55 to 61 increased from 44% to 64%, while women age 65 to 69 and those 70 and older doubled their participation rates, to 26% and 8%, respectively.

A note about taxes: Since the taxable portion of your Social Security benefits depends on the amount of other income you have, continuing to work may make more of your benefits taxable. However, the taxable amount is based on your modified adjusted gross income along with half your Social Security benefits, so, while it may increase the taxes due, it would not significantly impact the overall financial picture. ●

To see how this might play out, suppose that you're self-employed and pay $3,000 in LTC premiums in 2008 to cover yourself and $2,000 for your spouse. You're age 55 and your spouse is 49 years old. The IRS stipulates that the most you can deduct this year is $1,110, and the maximum for your spouse is $580. Assuming your spouse can't get long-term care insurance at work, you're entitled to deduct total business expenses of $1,690. That partially offsets your out-of-pocket cost of $5,000.

Keep in mind that the cost of LTC premiums may vary widely, depending on the terms of the policy, your age, your health status, and other factors. It pays to shop carefully to get the coverage you need at the best price. And remember to keep detailed records to back up your deduction in case of an IRS challenge. ●

Your LTC Tax Break

Here's the maximum tax deduction for long-term care insurance premiums in 2008

Age on December 31, 2008	Deduction Limit
Age 40 or younger	$ 310
Age 41 through 50	$ 580
Age 51 through 60	$ 1,110
Age 61 through 70	$ 3,080
Age 71 or older	$ 3,850

When You Can No Longer Care For A Pet

If you own a pet, you know that somewhere ahead lies the heartbreaking day your companion will die. But what if you die first? Or become incapacitated? Under U.S. law, pets are counted as personal property, in the same category as clothes, a home, vehicles, and other possessions. If you die without making provisions for a pet, the beneficiaries of your estate will become the animal's legal owners. Similarly, if your health deteriorates or you have to go into the hospital or a nursing home, you'll have to hope family members or friends will take in your pet.

That may be fine; your children, for example, may be more than happy to take care of your cat or dog either temporarily or permanently. But if you know they couldn't or wouldn't want to take on that responsibility, a "pet trust" could establish who will take your pet, how it will be cared for, and how the care will be funded. This may be a necessity if you live alone and have no heirs; if you are elderly or ill; if your pet has special needs; or if your pet has a long life expectancy, such as certain birds and snakes that may survive for decades. Of course, even dogs and cats may live for more than 20 years.

Setting up a trust is one option in a five-step process to protect your pet, according to estateplanningforpets.org.

• Select a caretaker. The person or organization that will care for your pet must be willing and able to do it. Make sure the designated caretaker understands your pet's needs, and arrange a time for them to get to know each other. Also discuss funding for care and any compensation for the caretaker.

• Get paperwork in order. You'll need documentation identifying your pet, veterinary information, care instructions, and any trust or other legal documents.

• Ensure access. Give the caretaker keys to your home and the location of pet-related documents.

• Calculate funding needs. Estimate what it will cost to take care of your pet. Take into account everything from food and vet bills to grooming, boarding, and other costs.

• Make legal arrangements. You can simply draw up a written plan, have the caretaker sign it, and make a gift of any caretaking funds. Or you could have your attorney create a pet trust. Although more costly, it will mean appointing a trustee to oversee the caretaker actions under a trust agreement.

A pet trust is a legal document mandating care and maintenance of pets in the event of the owner's death or disability. You place the pet and caretaking funds in the trust, designate a caretaker, and appoint a trustee. This may have several advantages over providing for your pet in a will, which may not take effect until days or weeks after your death. A trust clicks in immediately, and it can cover both death and disability and exclude your pet from a lengthy probate process. ●

Year-Round Tax Planning

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loopholes. These days, though, almost anyone can get snared by the AMT. For non-business owners, several things can trigger AMT liability: claiming personal exemptions, paying state and local taxes, taking miscellaneous itemized deductions, deducting medical expenses, or exercising incentive stock options. Any combination of these could push you into AMT territory.

Sitting down early with your tax professional to run an AMT projection could help you see whether you'll pay the AMT this year. It could also give you a chance to head off some of your liability. "If you are going to fall into the AMT area, you want to be thinking about the possibility of timing some of your deductions," Serles says.

For example, if it looks like you'll have to pay the AMT this year, but not next year, you might push some of your state and local tax deductions into next year, when you'll be able to use them to full effect. Or you could think about delaying the exercise of your incentive stock options until later, or bunching charitable deductions in years that you won't have to pay AMT and will receive the full benefit of the deduction.

Manage your business taxes. If you're self-employed or receive income from a side business, mid-year is a good time to make sure you're on track with your estimated taxes. Check with your tax specialist to see whether you're sending the government the correct amount each quarter. The longer you wait, the shorter the time you'll have to pay what you owe, and if you end up underpaying estimated taxes, you could be hit with a penalty. To reduce business taxes, you might consider employing your children. "That provides a deduction to you, and their income is taxed in a lower bracket," say Serles. Or you could increase the tax-deductible benefits you provide to your employees or yourself. Acting well before the end of the year will let you maximize the amount you deduct.

Other tax planning strategies include Roth IRA conversions and the use of charitable trusts. However, many of these strategies are complicated, so please give us a call for guidance in navigating the decisions. ●