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Tax Planning As You Age

While tax planning should be a consideration through all phases of life, the nature of that planning changes as you approach retirement age. During your working years, your primary tax planning objectives are to reduce your current income taxes while saving for retirement. After decades of accumulating money, you now need to ensure you withdraw and manage that money properly. Here are some tips:

Rolling out of a 401(k) — If you don't want to leave your funds in your 401(k) plan, you should consider transferring your money to an individual retirement account (IRA). You can now transfer directly to a Roth IRA, provided your adjusted gross income does not exceed $100,000 in 2008 or 2009. Starting in 2010, there is no income requirement. While there are no income tax ramifications if you roll over from a 401(k) plan to a traditional IRA, you do have to pay taxes on the amounts that would be taxable when withdrawn when converting to a Roth IRA (i.e., contributions and earnings in deductible IRAs and earnings in nondeductible IRAs). However, if you pay the income taxes from funds outside the IRA, you have essentially increased the value of your IRA, since you won't have to pay income taxes on qualified withdrawals.

If you own stock in the company you work for in your 401(k) plan, consider those assets separately. There is a provision in the tax code that may save you a substantial amount of taxes. Instead of rolling over the company stock, have the shares distributed to you and put them in a taxable account. You will owe ordinary income taxes on the cost basis of those shares, which equals the price that was paid when the stock was purchased. (If you take the distribution prior to age 59 1/2, you may also owe the 10% federal penalty on the cost basis.) At this point, you do not pay taxes on any appreciation in the stock's value. When you sell the stock, provided you have held it for over one year, you will owe capital gains taxes at a maximum rate of 15% on the net unrealized appreciation, rather than ordinary income taxes that would be paid on other traditional IRA distributions. If you have substantial appreciation in your company stock and are in a high marginal tax bracket, this strategy can save you a substantial

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Buying a Home in a Weak Market

The purchase of a home is a major financial commitment. While it is a decision that should always be made with care, the weak real estate market means you should exercise even more caution. Don't let the excitement of looking for your dream home prevent you from following these tips:

Set an upper limit for your home's purchase price and don't exceed it. Before you start looking, carefully analyze your expenses and decide how much you can afford to pay for a home. An often-cited guideline indicates that your mortgage payment, insurance, and property taxes should not exceed 28% of your gross income. While lenders recently allowed up to 40% of gross income to be spent on housing costs, you will likely find more lenders are going back to traditional guidelines. However, make sure that you are comfortable with the mortgage payment. Don't raise the limit as you look at houses, thinking you can reduce your living expenses to cover the difference. It's very difficult to change your spending habits.

Consider how your down payment will impact your home's financing. A lower down payment makes it easier to purchase a home, but also increases the size of your mortgage. While in the recent past you could get by with no down payment, more and more lenders are now requiring a sizable down payment. Expect to put down at least 10% to 20% of the purchase price. With a down payment of 20% or more, you don't have to obtain private mortgage insurance, which typically runs from .25% to 1.25% of your total mortgage amount.

Familiarize yourself with housing prices in the area. No one likes to purchase a major asset like a home and then find it decreasing in value. However, it is difficult to predict market bottoms, and you may not be able to delay a home purchase until there is clear evidence that the market has bottomed. To protect yourself, get a comparative market analysis to see how much homes have sold for in the recent past. Base your offer to purchase a home on that analysis, even if your offer is substantially below the seller's asking price.

Choose a home you'll be comfortable living in for several years. When home prices are rising rapidly, you can purchase a home, live in it for a couple of years, and then sell it at a profit. With modestly increasing or declining prices, it's difficult to sell at a profit after a couple of years, due to sales commissions and other costs associated with buying and selling a home. Thus, you should purchase a home you'll want to live in for at least five or 10 years. If you know you'll need to move in less than five years, consider renting.

Sell your current home before buying another home. It is taking longer to sell homes now. If you can't afford mortgage payments on two homes, make sure you sell your current home before purchasing another.

Consider resale value while you are purchasing. While

you may like unusual features, consider how likely other buyers are to want those features. Be cautious of purchasing a home with a much higher selling price than other homes in the area. Homeowners typically want to be surrounded by homes of similar size and value.

Get a professional inspection. While the home may look like it is in great shape to you, an inspector will check things like the heating and air conditioning systems, plumbing and electrical, roof, foundation, drainage, garage, and basement.

Review your options before selecting a mortgage. Now is not the time to look at exotic mortgage options. Consider basic mortgages. Fixed-rate mortgages are typically a good option for homeowners who plan to stay in their home for many years. Adjustable-rate mortgages (ARMs) are popular with homeowners with rising incomes, those planning to move in a short time, and those who want the short-term cash flow benefits of lower interest rates. If you're not sure which is better, consider a convertible mortgage. These mortgages allow you to switch from an ARM to a fixed rate, from a fixed rate to an ARM, or from the original fixed rate to a lower rate if rates decline. ❍❍❍

Tax Planning

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amount of taxes.

Handling an inherited IRA — IRAs are becoming an increasingly significant asset for many people due to 401(k) rollovers and asset growth. Thus, it is becoming more likely that you will inherit an IRA. Don't immediately cash out an inherited IRA, which requires the payment of income taxes on the distribution. If you inherit a traditional IRA from a spouse, you can delay distributions to age 70 1/2 and then take distributions over your life expectancy. No distributions are required during your life if it is a Roth IRA. If you inherit the IRA from someone other than your spouse, you must start taking distributions in the year following the owner's death, but you can take those distributions over your life expectancy. Make sure to investigate whether you are entitled to an income in respect of decedent deduction, which is available when federal estate taxes are paid on IRA assets. This deduction can help offset income taxes due on distributions.

Dealing with a second home — If you plan on moving after retirement, you might want to acquire a home in that location before retirement. But first, be aware of the 1031 exchange rules. These rules allow you to sell one property and purchase another of like kind, deferring any gains. For instance, this tax rule can be used to help acquire a retirement home. Start out purchasing a small investment property. You can sell it at a later date and purchase a more expensive property, deferring the gains. You can continue this process until you eventually purchase your retirement home. However, before living in the home, you must first rent it out to defer the gain. While there are no clear-cut rules on how long the home must be rented, the Internal Revenue Service has validated a two-year period. After that, you can move into your retirement home and use it as your principal residence. Currently, as long as you live in the home for two of the last five years before selling, you could then sell the home and exclude up to $250,000 of gain if you are single and up to $500,000 of gain if you are married filing jointly. However, the Housing Assistance Tax Act of 2008 will affect sales and exchanges after December 31, 2008. The home sales exclusion won't apply to the extent gain from the sale or exchange of a principal residence is allocated to periods of nonqualified use. Generally, nonqualified use is any period (other than the portion of any period before January 1, 2009) during which the property is not used as the principal residence of the taxpayer. The amount of gain allocated to periods of nonqualified use would proportionately reduce the home sale exclusion amount.

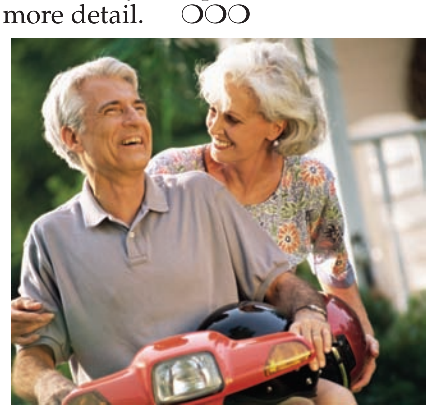
When purchasing the second home, be sure to get a mortgage on that property rather than a home-equity loan against your principal residence. Interest is only deductible on $100,000 of a home-equity loan, while the entire mortgage interest up to a $1,000,000 loan would be deductible.

Selling a business — Many business owners find that their business comprises a substantial portion of their net worth. Thus, when it comes time to sell that business, they naturally want to negotiate as large a selling price as possible. But keep in mind that there are many ways to structure a sale. You might want to consider an installment sale, so the gain is recognized over a period of years rather than a single year. You may want to consider including a consulting contract for a period of years. If you are selling the business to employees, an employee stock ownership plan may make sense.

Reviewing your estate plan — As you approach retirement, it's a good time to review your entire estate plan. While the estate tax exemption is increasing (from $2,000,000 in 2008 to $3,500,000 in 2009) and the estate tax will be repealed in 2010, this amount will drop back to $1,000,000 in 2011 unless further legislation in enacted. Thus, individuals with estates over $1,000,000 still need to consider ways to use their exclusion amounts to minimize estate taxes. Those with large estates probably don't want to leave their entire estate to their spouse. While that will avoid estate taxes on the first spouse's death, estate taxes may be owed after the second spouse's death if the estate is larger than the estate tax exemption.

While increasing estate tax exemption amounts can make it more difficult to plan, you should still consider leaving part of your estate to other heirs. If you don't want to make outright distributions in case your spouse needs the assets, you can set up a trust (commonly referred to as a credit shelter or bypass trust) to hold those assets. Your spouse can then use the income and even some of the principal, with the remaining assets distributed to your heirs after his/her death. This preserves the use of your exclusion amount. You may also want to add a disclaimer provision to your estate planning documents, detailing what would happen if one of your heirs disclaims his/her inheritance. With the estate tax exemption amount fluctuating over the next several years, this provides a way for heirs to decide after your death how much should be placed in various trusts.

These are only a few situations to consider as you approach retirement age. Please call if you'd like to discuss your specific situation in more detail. ❍❍❍



What Is a Short Sale?

Many homeowners are faced with the fact that their home's market value is less than their outstanding debt. Rather than going through a foreclosure or turning the home over to the lender, some homeowners are attempting a short sale, which is a home sale for less than the outstanding mortgage. According to the National Association of Realtors, short sales account for approximately 18% of home sales now.

If the lender agrees to the short sale, the seller eliminates the mortgage debt without foreclosure or personal bankruptcy. The lender agrees to the short sale if the loss would be less than going through a foreclosure. The Joint Economic Committee estimates that a foreclosure costs the lender up to $50,000. A recent study found that a short sale resulted in an average loss of 19% of the loan amount, compared to 40% for foreclosures (Source: MSN, May 12, 2008).

However, short sales are not easy to complete. Typically, the seller puts the home up for sale and gets an offer on the property. The offer is then presented to the lender, who can take weeks or even months to make a decision. In most cases, the lender won't even consider the short sale unless the seller appears unable to make the mortgage payment. If the lender feels the seller can pay, there is no incentive to accept a loss on the property.

A short sale gets even more complicated when there is more than one loan against the home. In that situation, all lenders have to agree to the short sale. In many cases, the second lender will get an even smaller percentage of the loan, so that lender has even less incentive to accept the deal. ❍❍❍

Credit Issues As You Age

To help ensure that you don't have credit problems as you age, consider these tips:

✔ **Apply for major loans while you are still working.** If you are getting close to retirement and know you'll need a loan, perhaps for a retirement home or new car, apply for credit a few years before retirement.

✔ **Make sure that credit cards are obtained as joint accounts.** If you have an individual account with your spouse listed as an authorized user, the lender can close the account if you die. However, if the account is a joint one, the creditor cannot automatically close the account or change its terms.

✔ **Ensure that both you and your spouse have a good credit history.** Review your credit reports, ensuring that all information is accurate and that you each have a sufficient history. That way, either of you will be able to obtain credit if the other dies.

✔ **If you are denied credit, find out why.** It could have been an error, or you may convince the lender to consider other information. ❍❍❍

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