financial *focus*

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SPRING 2013

MOVING INTO 2013 WITH THE ATRA

by Troy Von Haefen Nashville, TN

We're almost through the first quarter of 2013, and I'm still trying to get a handle on all of the provisions of the American Taxpayer Relief Act (ATRA) of 2012. Although President Obama signed the bill into law on January 2, some laws are retroactive to January 2012 (yes, January 1, 2012). This law creates a wide swath of changes that mostly come down to taxation. Here are a few highlights that may have the most impact on you (my clients, family, and friends).

Income tax rate

Most income tax rates will remain the same and become "permanent," at least until Congress decides to change them again. A new upper tax bracket is created for those with taxable income above $450,000 (married filing jointly [MFJ]), $425,000 (head of household [HOH]), and $400,000 (single [S]). These brackets will be indexed for inflation, which means they will creep up little by little each year.

Payroll tax holiday goes away

In tax years 2010 and 2011, Congress reduced the amount of payroll tax due by 2%. Congress did not extend this reduction in payroll taxes, which means we will all pay 2% more on our individual earnings up to $113,700. Many people have already seen their take-home pay reduced by 2%. We are simply putting a tax back into place, but it will still affect your bottom line.

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Dividends and capital gains

Qualified dividends and long-term capital gains will permanently enjoy preferential rates. Those in the upper tax bracket (39.6%) will be taxed at a rate of 20% (up from 15%) on this income. Although preferential rates on dividend and capital gains have been in place for years, dividends and capital gains may also be subject to an additional new tax of 3.8%.

Phaseout of itemized deductions and personal exemptions

Both itemized deductions and personal exemptions will be reduced when adjusted gross income rises above $300,000 (MFJ), $275,000 (HOH), and $250,000 (S). Itemized deductions will be reduced by 3% of the excess above the threshold. Personal exemptions vanish by 2% of each $2,500 above the threshold.

Alternative minimum tax

A real bright spot of the act relates to the alternative minimum tax (AMT), which is now permanently indexed for inflation. Indexing AMT instead of a yearly fix by Congress will alleviate a huge headache experienced by those of us who plan proactively for taxes—and those of you who wait for the AMT patch every year.

Estate tax

ATRA also makes permanent those estate tax exemptions that have been in place for the last few years. Thankfully, the permanence of this provision does include indexing for these exemptions. For 2013, the exemption for estate tax is $5.25 million. So almost all estates of $5.25 million or less will not be subject to estate tax. However, the top rate for estate, generation-skipping transfer tax (GST), and gift tax was increased to 40% (up from 35%).

What you may not know

Although most of what we have heard from the media revolves around the increased tax rate for the highest income earners, new provisions will affect those making less as well. If you fall under the $450,000 taxable income limit, don't relax just yet. Several provisions may impact

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STRATEGIES FOR EVERYDAY LIVING

FINANCIAL ADVICE, THEN ROMANCE?

by Howard Cadwell, CFP®, AIF ®   Hampton, NH

Are you trying to make a decision about using a financial advisor? Or have you been asked to recommend an advisor for a friend? Are you looking for someone mostly to manage investments? (They all do that, don't they?) Or should you look for a "financial planner"? Or even an "integrated" or "holistic" financial planner?

Like most ACA advisors, I am a holistic financial planner, although I rarely say that. When describing what I do for a living in a casual conversation, I sometimes break the ice by suggesting that I "help couples have a better love life"! No one would confuse me with a psychotherapist, so I connect the dots by citing the common (and proven) fact that finances are the leading cause of marital conflict and I work with people to solve their money problems.

Looking beyond this facetious attempt to jazz up the image of our profession, there is a kernel of truth: the difference between what we holistic planners accomplish in a retainer relationship with our clients and mere technical advice.

Maintaining financial health in a household overlaps with what's required to sustain a healthy marriage. For example, if there's a spending problem, the easy availability of debt and the distant consequences of inadequate saving may build a habit of noncommunication. This kind of neglect can lead to financial insecurity and perhaps even inadvertent deception.

If a couple has concerns that their financial house is even partly disordered or neglected, they may postpone personal dreams to deal with ongoing demands of work and raising children. These deferred aspirations may contribute to a lack of fulfillment in later life or perhaps provoke conflict. However it unfolds, a lack of financial progress eventually affects us personally.

We structure a process of personal communication and deliberate progress for a family or household that averts these kinds of issues, at least in the financial realm, and perhaps in others. Not therapy, but preventive medicine.

We assemble the facts about your situation and interpret them, so any troublesome issues are out in the open, along with specific ideas to solve them. With your situation in a realistic context, you know where you stand with respect to your progress toward financial independence. We show you how to control your financial progress directly, so you don't have to depend on a favorable stock market.

We help you understand issues related to personal money habits, or your "money personality," as they affect your financial progress. We assist you to put into place a safety net of protection against adversities such as job loss or disability. By its nature, this process puts both partners on a level playing field of knowledge and participation in key decisions, regardless of which partner takes care of the routine financial chores.

Some clients find an unexpected payoff once they share knowledge and a sense of control over their finances. We give them the chance to voice any deferred aspirations, both the mutual ones and the individual ones. This emerging sense of control over financial progress allows clients to think about other goals. We sometimes hear one partner comment to the other, "I never knew you wanted to do that," simply because there was never a good time to air those thoughts. The couple finds they do have the opportunity to do some of those things, as well as to save for retirement, get the kids through college, and satisfy the other necessities of family life.

We don't just support couples. We also work with parents and their adult children, with single people, and with small business owners. Implementing a structured method of progress on financial matters can, by its very nature, create more personal opportunities and better relationships. And yes, we also help you manage your investments!

COLLEGE LOAN COMMON SENSE

by Linda Leitz, CFP® Colorado Springs, CO

Many financial planners and consumers believe any type of debt is bad news. But the right kind of debt offers both opportunities and financial returns. Recognizing good debt and keeping it at the appropriate level is essential.

One type of potentially good debt is student loans. Think of them like a mortgage, which enables a family to enjoy their own home and build equity while paying it off. Student loans can ease the path to a good education and better earnings over a lifetime. But too much student loan debt can become a heavy burden that makes financial independence after college difficult or even impossible. So how much is enough, but not too much?

Many colleges use the Free Application for Federal Student Aid (www.fafsa.ed.gov) to determine if a student qualifies for grants or needs-based scholarships, which are free and preferable to loans. But filling out a FAFSA application also starts the process of applying for loans.

Here's my message to prospective students: You don't want to be too much in debt when you graduate, but you may not be eligible for certain loans later on. Rates are low–currently between 3.4% and 6.8% depending on the loan type–and some loans don't accrue interest or require payments until you're no longer a student. So going through the application process and discovering your alternatives is worthwhile.

For instance, in a school year you can max out the $3,500 you can have in subsidized loans that don't require payments or interest until after graduation. That might be a better alternative than using education funds all during your early years as a student, then having no funds later on and limited opportunities. If you have funds left over after college, you can pay them off when you're done or save them to go to graduate school.

One of the areas often out of sync with long-term school loan debt is a student's career path. If you're going to be a public school teacher, graduating with a teaching degree and $150,000 in student loans is not a good plan. But it might be feasible if you're headed to a prestigious law school. There are no right or wrong ratios, but generally you should have less in loans than your new job's annual salary if you graduate in your 20s.

College funding can be structured in many ways. There are lots of choices, and students and their families will benefit from exploring what makes sense for them. Excellent help is available from the school's financial aid office, through FAFSA, or working with a financial advisor who consults on this issue. ■ ■ ■

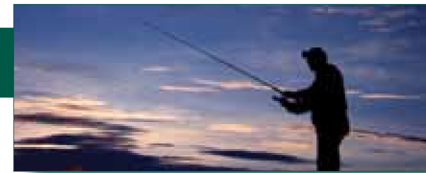
MOVING INTO 2013 WITH ATRA . . . . (continued from page 1)
your taxable bottom line. The Patient Protection and Affordable Care Act (PPACA), known popularly as Obamacare, slips additional taxes into the tax code that are in sync with our new tax brackets.

Medicare surtax: A tax of 0.9% will be accessed on wage income above $250,000 (MFJ), $200,000 (HOH), and $125,000 (S). This tax is accessed on wage income (what you earn) as compared to taxable income (used in income tax calculation), which is all income minus adjustments, exemptions, and deductions. If you earn more than the thresholds just cited, your employer will be required to withhold the additional 0.9% tax.

Additional Medicare tax on unearned income: This tax is imposed on unearned income (investment income, such as capital gains and dividends, as well as rental income). The threshold for the net investment income subject to this additional tax is modified adjusted gross income (MAGI) above $250,000 (MFJ), $200,000 (HOH), and $125,000 (S). MAGI is determined differently than wage income used for the 0.9% Medicare surtax threshold, which makes calculating these new taxes rather complicated.

Obviously, many other provisions are included in ATRA. Some of them are permanently fixed; some are extended for a finite amount of time.

This bill adds another layer of complexity to our already confusing tax code. Those making in the $250,000 to $450,000 range could move between tax brackets, lose deductions and exemptions, pay additional taxes on investment income, and pay a Medicare surtax, so the importance of tax planning is even more critical. I don't mean to exclude those making less or those making more because tax planning will continue to be of great benefit, as it has always been in the past. ◆ ◆ ◆



THE GENERAL PURPOSE OF INSURANCE

by Tedd Oyler J.D.   Douglas, MI

The general purpose of insurance is to protect you, the insured, against catastrophic loss. We purchase insurance so the occurrence of an insured event—an automobile accident, a house fire, a slip and fall on your property—won't result in personal or business financial ruin. I bet I know what you're thinking: "insurance" is so boooorrrrrring. And who could disagree with that? I feel the same way.

The truth is that insurance should be boring. We should do the best job we can when we buy it and then never worry about it again until it is time to renew, the very essence of boring.

But before you click back to the cat videos, think about this: Over the course of your adult life, it is entirely possible you'll spend $300,000 and probably more, on various types of insurance including life insurance, homeowners insurance, automobile insurance, and disability insurance. If you own a business, you'll pay several times that when you account for liability insurance, workers' compensation insurance, and health insurance.

Without a clear understanding of what you are actually purchasing, it would be very easy to overpay for all that insurance. I worked with one client who, when we reworked his insurance, reduced premiums by about $6,000 per year — and we actually increased the coverages in the process. So it behooves you to educate yourself before you start throwing all that money around.

The purpose of insurance is spreading the risk of loss among all the policyholders. When you purchase an insurance policy, you essentially lump your premiums and your risk together with an entire class of other similarly situated insurance purchasers, so no single person or business is alone in the assumption of risk.

Insurance provides you, the purchaser, with peace of mind, knowing you have done what you can to protect the assets and financial freedom you have acquired. In other words, you should have enough insurance that no particular catastrophic loss will ruin you.

Too many of us think of insurance as a savings account into which we pay premiums and then anticipate getting that money back by filing enough claims to at least break even. This approach misses the mark. The best insurance is never used but is always running in the background, quietly protecting us.

If we purchase insurance coverage in the hopes of breaking even, we will end up paying too much. With that mindset, we'll set our deductibles too low and end up paying higher premiums because of those low deductibles and probably file many claims. Insurers nowadays punish us for filing multiple claims.

Here are some suggestions to follow when buying insurance:

1. Know exactly what you are trying to protect. If you have $1 million in assets, you should be interested in having at least that much liability protection, whether it is your homeowners or your automobile policy. You want the insurance company to have more at risk than you do, which means the insurer will hire the best lawyer to defend you if there's a lawsuit.

2. Go with the highest deductible you can. You should be able to "self-insure" for at least $500 or even $1,000. Each of us should have enough in emergency savings to cover such exigencies. Ask the agent to quote you at several levels of deductible, and then do the math. Calculate what the cost of insurance over several years, and then measure that against the exposure you are assuming by opting for a higher deductible.

3. Once you have insurance, try not to use it unless you have experienced a truly expensive loss. In today's insurance climate, carriers are increasingly likely to dump policyholders after claims are filed. And, in some instances, the carrier may treat even making inquiries about possible claims as if a claim had been filed. Thus a higher deductible may be viewed as one way to discourage you from even thinking about filing small claims. ◆ ◆ ◆