



# Your Bottom Line

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*Navigating a clear course toward your financial security.*



Warren Mackensen

## Energy Conservation Incentives . . . . .

The Energy Tax Incentives Act of 2005 remains in effect until December 31, 2007. The law contains many homeowner-friendly tax credits that encourage energy conservation through the purchase and construction of energy-saving equipment and property.

Energy-saving improvements: You may claim a tax credit, up to a maximum of \$500, for improvements to your principal residence. There are two parts to the credit.

Part 1 is a 10% credit for qualifying improvements to the “building envelope.” These include insulation material, exterior windows (including skylights), and exterior doors that meet certain energy standards. The maximum credit for windows is \$200, while the maximum for doors, roofing, and insulation is \$500.

Part 2 is a credit of (a) \$50 for each advanced main air circulating fan; (b) \$150 for each qualified natural gas, propane, or oil furnace or hot water boiler; and (c) \$300 for qualified energy-efficient property, including heat pumps, water heaters, and central air conditioners.

Residential alternative energy credit is available for the acquisition of equipment that heats water or generates electricity for use around the home. A homeowner may claim an energy credit for up to 30% of the cost of photovoltaic cells (i.e., solar electric panels), up to a maximum credit of \$2,000. Similarly, an energy credit of up to 30% is allowed for the installation of a solar hot water system, up to a maximum credit of \$2,000. ❖

## Cash Donations without Receipts . . . . .

For 2007 and later, out-of-pocket cash donations require a receipt from the recipient organization in order to be deductible. For example, if you simply drop a \$20 bill in the Sunday collection plate or put a few dollars in the Christmas kettle outside a department store, you will no longer be able to deduct it.

You may deduct donations where you have a bank record or a written communication from the recipient organization showing the name of the organization and the date and amount of the donation. For example, if your monthly bank statement shows images of your checks, your monthly statement will serve as the necessary documentation to corroborate your deduction. ❖

## Caution Urged on Tax-Free Exchanges . . . . .

We have seen a number of people run afoul of the rules on tax-free exchanges, especially with regard to vacation homes. In general, Section 1031 of the tax code allows the tax-free exchange of business and investment properties without any income tax implications. A qualified intermediary is necessary to effectively complete an exchange. One or more replacement properties must be identified within 45 days of the closing on the relinquished property, and the closing on the replacement property must occur within 180 days of the sale of the relinquished property.

The definition of “like-kind” is fairly loose, e.g., a land investment can be exchanged for an apartment building. However, one aspect is very clear: the exchanged properties must be for business or investment purposes. Vacation homes are generally deemed to be personal property. Even if a vacation home is held for a long time, such that one might consider it an “investment” property, the use of the vacation home is determinative.

If the vacation home is used for recreational purposes and never rented out, the vacation home is clearly personal property – and therefore ineligible for a Section 1031 exchange. ❖



David A. Batchelder

## Grandchildren's Education

One of the best gifts grandparents can give their grandchildren is helping to pay for their education.

Here are the cost-effective ways of going about it.

**Outright gifts.** The vast majority of grandparents give outright gifts of cash or securities. This is certainly the easiest option. Each grandparent can annually give away, free of estate- or gift-tax liability, up to \$12,000 a grandchild — \$24,000 a year per grandchild if both grandparents contribute.

But this method has its drawbacks. Even \$24,000 a year may not be enough money for the grandchild's education (private colleges can easily exceed \$30,000 a year). Second, the gift could reduce the amount of available financial aid, particularly if the gift is made directly to the grandchild instead of to the parents. Third, the grandchild could end up using the money for a new car or a vacation.

**Pay tuition directly.** By paying the money directly to the school for tuition, you can contribute as much as necessary without the gift counting as part of the annual \$12,000 gift exemption. You also ensure that the money is spent for education. The major drawbacks are that the gift applies only to tuition and it may reduce financial aid.

**Coverdell Education Savings Accounts.** Grandparents who have earned income can directly open one of these accounts for a grandchild under the age of 18 and contribute up to \$2,000 a year. If they do not have earned income,

they could gift the money to the parents to open the account. The grandparents can direct the investments as they choose, and the funds can be used for public and private elementary as well as secondary education.

There are some major drawbacks: the size of the annual contribution is limited, donors whose income is too high cannot contribute, and states do not provide any income-tax deductions. Also, the contributions and earnings belong to the beneficiary (the student), not the donor, and financial aid may be affected. Of course, like any investment, there is the risk of losing money in the account.

**529 Plans.** 529 plans are state-sponsored college savings plans that invest money on behalf of participants. Under current law, earnings grow tax deferred from federal income tax and often state income tax, and withdrawals used for qualified education expenses will remain free of tax. The grandparents remain in control of the funds, yet the funds do not count toward their estate for estate tax purposes.

Donors also can consolidate five years' worth of tax-free gifting into a single year (\$60,000 per person or \$120,000 as a couple) as long as they do not contribute any more money within that five-year period. Most 529 plans allow total investments of at least \$200,000 and some allow over \$250,000. And unlike Coverdells, they are free of donor income limitations.

The plans are vulnerable to performance swings, just like mutual funds, and critics warn about potentially high investment

fees. Nonetheless, these remain a popular option for many parents, and can be very beneficial for grandparents.

**Prepaid tuition plans.** These plans, operated by some states and now by a consortium of private colleges, allow investors to buy part or all of tomorrow's tuition at today's prices. Typically, an investor buys "units," which might equal a semester, a year, or several years' worth of today's tuition, and the state or private consortium guarantees returns that will match the inflation rate for that system's college costs. The poor market returns in recent years and the high rate of tuition increases have prompted some states to drop these plans or freeze enrollment. ❖

## Business Continuity Planning

With this copy of *Your Bottom Line*, clients are receiving a copy of our *Privacy Statement* and our *Client Communications Handout*. Please keep the communications information handy so that you may contact us if the need arises during a natural disaster in our area. ❖

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