Summer 2005

Your Bottom Line

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Navigating a clear course toward your financial security.

Mid-Year Financial Checkup

Warren Mackensen

An annual financial review usually involves revisiting your goals and objectives, assessing the performance of your investment portfolio, reviewing your cash flow requirements, checking your estate plan, and examining insurance coverages. Consider doing a mid-year mini-review just to make certain that you are still on track. Here are some places to start:

Taxes. Did you receive a sizable refund or owe a chunk of money last April? A substantial refund suggests you may be overpaying taxes again this year. That's money you could be investing or saving. To reduce the size of next year's refund, increase the number of allowances you claim on your W-4 at work (or pay a little less when estimated payments are due this September and January.) Do the reverse if you owed a substantial amount.

Budget. Review your household budget or spending plan. Do you have a good handle on where you are spending your money? Do some categories need adjusting? Are you saving 10 to 15 percent of each paycheck?

Fringe Benefits. Many companies hold open enrollment in the fall for fringe benefits, so summer is a good time to start thinking about them. Your employer may have changed health care plans, for example, or the existing plans may have new wrinkles, prompting you to switch. Perhaps your family circumstances have changed, such as the addition of a child, so a new plan is warranted.

Retirement Accounts. Have you received a raise this year that might allow you to put more into your retirement plan at work? If a plan is not available at work, consider an individual retirement account.The 2005 IRA account contribution limit is $4,000 ($4,500 if you are age 50 or older).

Flexible Spending Accounts (FSA). These employer-sponsored accounts allow you to divert wages into and take money out of an FSA account tax-free to pay for qualified out-of-pocket medical expenses. They can be a very good deal for employees. The catch is that you forfeit any balance not spent by the end of the year – a deadline that the U.S. Treasury has recently extended from December 31st to March 15th of the following year.

Now is a good time to see what's left in your FSA account and to begin estimating how much to have withheld from your wages next year. Remember that you can use FSA money for items such as eyeglasses and for many over-the-counter drugs.

Charitable Donations. Yes, you can wait until the end of the year to make planned donations, but consider avoiding the rush, which can lead to mistakes. Perhaps appreciated securities would make the perfect donation.

Required Minimum Distributions. If you are 70½ years of age, or if you have inherited an IRA account, required minimum distributions must be taken by December 31. We can help you with the calculation and then sort out what you should sell to meet the distribution. There is a 50% penalty if the required minimum distribution is not taken by December 31.

Net Worth Statement. Take an inventory of your assets and liabilities to see if you are making financial progress. Compare the mid-year net worth statement with your prior year-end net worth statement.

Educational Funding. Ask your parents and grandparents to help with your child's educational expenses. Payments made directly to educational institutions are not subject to gift tax. Hence, an unlimited exclusion from gift tax is available to a parent or grandparent who pays tuition costs for a child directly.

Beneficiary Designations. Ensure that new retirement plans at work, or transitions from one retirement plan to another, appropriately reflect your heirs. Having only a primary beneficiary is insufficient. You should also name a secondary beneficiary. ❖

Rebalancing Your Portfolio

David A. Batchelder

An initial portfolio asset allocation is established by assigning percentages of the portfolio to stocks, bonds, cash, and perhaps other types of investments such as real estate and commodities. The allocations are further broken down by sub-categories, such as different types of stocks and bonds. Rebalancing a portfolio involves periodically readjusting the mix of asset classes back to the initial portfolio asset allocation.

The target allocations within a portfolio should be appropriate for your investment goals and financial circumstances. You should also have a comfort level with the types of investments chosen. For example, an older person with no children at home who is nearing retirement will likely have a different mix than a family in its early years of wealth accumulation. Also, target allocations need to be readjusted to reflect major changes in personal financial circumstances.

Does a portfolio periodically need to be rebalanced back to the target allocations? Absolutely.

Example: An investor held 60 percent in stocks and 40 percent in bonds in the early 1990s and did not rebalance his portfolio during the decade. By the end of 1999, that mix migrated outside the target asset allocation range and the investor ended up holding 80 percent in stocks and 20 percent in bonds. When the stock market declined steeply over the next three years, this stock-heavy portfolio suffered more than it would have if the investor had maintained a target asset allocation of 60% stocks and 40% bonds by periodically rebalancing.

A safe guideline is to allow up to a 10 percent variation from a specific asset category target before it is readjusted. To rebalance, consider directing future investment funds into under-represented categories until the portfolio is back in balance. Readjustment can also be achieved by selling some of the over-represented assets (the "winners") and then buying the under-represented ones (the "laggards"). By selling high and buying low, a safer portfolio stance is achieved. It is usually better to execute this strategy within tax-favored accounts to avoid taxes on gains, but if rebalancing of taxable accounts is appropriate, the investment decisions should be allowed to outweigh the tax concerns. ❖

Deducting Car Donations

The American Jobs Creation Act of 2004 introduced new documentation requirements for deductions of cars donated to charities. In Notice 2005-44, the IRS recently provided guidelines on the new deduction rules.

No deduction is allowed for car donations valued at over $500 unless proper substantiation is obtained. This means obtaining a written acknowledgment from the charity, usually within 30 days of (1) the donation (if the charity keeps the car), or (2) the date of the car's disposition (if the charity sells the car), whichever is later. The acknowledgment must identify the donor and the car, and if the car was sold, it must show the gross sales proceeds. A copy of the acknowledgment must be attached to the donor's tax return.

Generally, the donor cannot deduct more than the amount of the sale proceeds, even if the car's fair market value is higher. There are certain exceptions, such as for significant intervening use by the charity, material improvement of the car, or transfer to a needy person.

For contributions made on or before September 1, 2005, an acknowledgment will be treated as timely if received by the taxpayer by October 1, 2005, even if this is later than the applicable 30-day deadline described above.

A new form, Form 1098-C, has been created specifically for car (and truck) donations. Charities will use the Form 1098-C to report car donations to the IRS. Donors must attach Copy B of the Form 1098-C to their tax return (or any other reasonable acknowledgment form) in order to ensure the deduction will be allowed. ❖

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