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Your Bottom Line

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Navigating a clear course toward your financial security.

New Tax Legislation

Warren Mackensen

On May 17, 2006, President Bush signed the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA 2005) into law. The Act carries a 2005 designation as it is a carryover from last year's budget. TIPRA impacts a broad cross-section of taxpayers. Here are the major provisions:

Dividends and Long-term Capital Gains. Most important, TIPRA extended the qualified dividend and long-term capital gains tax rate at 15% until 2010, extending the current rate for two more years. Taxpayers in the 10- and 15-percent tax brackets are eligible for an even lower rate of 5%. In 2008, the rate for taxpayers in the 10- and 15-percent tax bracket falls to zero. After 2010, the rates revert to 20% for long-term capital gains, and one's regular marginal tax bracket for dividends.

AMT. The Alternative Minimum Tax (AMT) exemption amount for married couples filing jointly was increased from $58,000 to $62,550, and for single taxpayers from $40,250 to $42,500. Note: These are *exemption amounts,* not income amounts. TIPRA should keep 15 million Americans from paying AMT in 2006. *Downside:* TIPRA reduces AMT for 2006 only. Congress will have to revisit the AMT issue in the near future to extend these new exemption amounts.

Kiddie Tax. The kiddie tax rules tax a child's unearned income, such as interest and dividends, at the parents' higher tax rate when the unearned income exceeds $1,700. Retroactive to January 1, 2006, the applicability of the kiddie tax now includes all children under the age of 18. Formerly, the kiddie tax affected only children under the age of 14.

As a practical matter, the kiddie tax affects very few families, especially if the portfolio has been designed to avoid substantial current unearned income. Using Uniform Transfer to Minors Act (UTMA) accounts to reduce the family tax burden still remains a viable option for building savings for children, including their secondary school and higher education needs.

Roth IRAs. TIPRA allows more taxpayers to convert traditional IRAs to Roth IRAs, although you may age a bit waiting for this provision to kick in. For tax years after 2009, TIPRA eliminates the $100,000 adjusted gross income ceiling for converting a traditional IRA to a Roth IRA. The conversion will be treated as a taxable distribution, but it will not be subject to the 10% early withdrawal penalty. Taxpayers who convert their traditional IRA to a Roth IRA in 2010, can elect to recognize the converted amount over two years in equal installments, i.e., half in 2010 and half in 2011.

Benefit: Conversions to a Roth IRA are beneficial because future tax rates are not likely to go down significantly.

Strategy: Convert a traditional IRA to a Roth if you expect your income tax rate in retirement to be higher than it is currently, and you are able to pay the upfront taxes on the Roth conversion with money from outside the Roth account. 2010 is the last year for the current low income tax rates before they sunset in 2011. Consequently, there may be a historic number of IRAs converted to Roth IRAs in 2010.

Footnote: Although the Roth conversion change to the tax code is beneficial to a number of Americans in the near-term, the Urban Institute for Tax Policy indicates that the provision is ultimately a revenue drain at the national level. In other words, the Roth conversion change is another short-sighted Congressional move – grab the money now and let someone else figure out the long-term problem. ❖

Pre-Retirement Sabbatical

David A. Batchelder

Before you make that irrevocable decision to retire from your long-time employer, consider taking a month off (or longer) and living the life that you have been dreaming about. In effect, you will be fast forwarding to retirement living on a trial basis to see if it suits you. If it does not, return to your job knowing that retirement is not what you expected it would be, or that it is still too early for you. On the other hand, if your sabbatical fits your lifestyle, return to work to complete your projects and then retire with the confidence that you are making the right decision. If possible, take a series of sabbaticals that last more than one month to test the idea over multiple seasons of the year.

Few retirees just sit in a rocking chair all day long. Retirees often fill their days with projects encompassing long-time avocations or community service projects that have been dear to them for many years. The classic report from most retirees with whom we work goes along the lines of, "Now that I am retired (and working on all my various projects), I've never worked so hard and hardly have any time left over at the end of the day." This is usually said with a smiling face!

A wealthy person is one who knows the answer to the question "How much is enough?" This is the crucial question as you approach retirement. We can help you assess whether or not you have enough assets to transition from your current occupation to your avocations. ❖

Goal Setting . . . .

We all have dreams, but many are never achieved. Why? Because we don't pursue them with the vigor that is necessary to achieve them. We are impractical about our approach.

Start by writing down your goals. The mere act of writing them down causes one of two things to happen: we either convince ourselves that the goals are worth pursuing, or we reject them as unimportant or unrealistic. One way or the other, the persistence of the written word helps us to focus on what gives us purpose, meaning and value.

Under each goal, list the steps necessary to begin achieving that goal. Alongside each step, write down the expected time or money commitment. A savings goal, for example, is less daunting if you state the goal as a small amount of money per paycheck, rather than the total amount of the long-term savings goal.

Planning for your goal well in advance of the goal deadline can be a lot of fun. For example, by saving money over a two-year period for an Alaskan trip, you get to spend two years of time looking at brochures and learning about the geography of our 49th state before you embark on the trip.

When you ultimately leave for vacation, you will not feel guilty during the trip about credit card bills that you will face on your return. There will be money in savings to pay for those impulse purchases that made the trip a true adventure and a lifetime memory. Tip: If you are considering an Alaskan adventure, take the small-boat approach and avoid the large cruise ships. We can help you with the details. ❖

Navigating a Clear Course

Our logo is a sextant, a device long-used by merchant mariners to navigate the seas. Establishing a fix using a sextant requires skill. The celestial bodies need to be clearly identified, a good horizon must be visible, and an accurate timepiece must be available. Using a sextant, the altitude of a star, a planet, the moon, or the sun is measured and the precise time is noted. Ideally, three altitude measurements on different celestial bodies are taken. The observations are then plotted to establish a fix. Knowing the ship's accurate position, a course may then be set for the destination.

The sextant symbolizes the long-term nature of our financial planning work. We need to get a fix on where you are today (your net worth statement), we learn about your goals (the destination) and we chart a course to get you there (a cash flow statement that includes income, savings and expense components). As the journey progresses, we help you with mid-course corrections to counter currents that take you off course. ❖

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