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Your Bottom Line

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Navigating a clear course toward your financial security.

Warren Mackensen

Broker's Roles Change

After a long legal battle with the Financial Planning Association, the U. S. Securities and Exchange Commission (SEC) has accepted the court decision that prohibits stockbrokers from marketing themselves as financial advisors. This decision limits the financial advice that a stockbroker can now provide to clients.

Clients of brokers must now make a decision as to whether they want to execute individual trades on a commission basis, or whether they want financial advice. Clients can no longer obtain advice from their brokers without making this choice. If clients want more from their brokers than the technical duties they supply, they must move their accounts to the "advice side" of broker platforms. The fee structures for these platforms are comparable to those of other financial advisors.

This landmark decision from the SEC evolved, in part, from studies conducted by consumer focus groups. These studies revealed that investors were confused about the differences between financial service providers. The difference is now quite clear. Fiduciary advisors offer a lifelong financial planning commitment to their clients, while stockbrokers do not.

A financial advisory firm offering comprehensive advice that incorporates both investment decisions and life planning advice best serves clients. Mackensen & Company falls into this category. We embrace comprehensive planning and a fiduciary standard that fosters money management strategies without the conflicts of interest found in a commission-based relationship. ❖

College Tuition from IRAs

Withdrawals from traditional IRA accounts require the payment of income tax. Withdrawals from Roth IRA accounts are tax-free for the owner of the Roth. No matter, withdrawals from any IRA accounts are not recommended as payment sources for educational costs. Why? Fundamentally, you worked too hard to get the money into these accounts each year to dissipate the asset on education costs. What are you going to do for money when you retire? Although each person's situation is unique, there are many other financing options for education costs that are cheaper in the end than giving up the tax-deferred or tax-free nature of assets invested in IRA accounts. Talk to us before you make this mistake. ❖

Education Breaks Being Revamped

Congress is fiddling with the tax code again. The main goal this year is to simplify the current law regarding education credits and deductions. Three current tax breaks are likely to be axed: the HOPE credit, the Lifetime Learning Credit, and the above-the-line deduction for college tuition. There has always been a lot of confusion with these various tax breaks as to their applicability for each taxpayer. Determining the optimum credit or deduction has been a greater chore than pulling a college all-nighter.

It is expected that these current tax breaks will be replaced by a single, heftier credit of as much as $3,000 a year per student, with a lifetime maximum of $12,000. Middle income taxpayers will benefit because the new credit will not phase out as fast as those in the current law. Stay tuned as Congress resolves the details.

Other proposals being considered include a more generous deduction for teachers' school supplies and an increase in the student loan interest deduction. ❖

Kiddie Tax Update

David A. Batchelder

Forget the "No Child Left Behind" Act. The *Small Business and Work Opportunity Tax Act of 2007*, which President Bush signed into law on May 25, 2007, is being called the "No Tax Left Behind" Act. The law tightens a loophole that had allowed some higher-income families to shift income to their children, thereby avoiding higher tax rates.

A year ago, Congress increased the kiddie tax age from 14 to 18. That's the age below which a child's unearned income greater than $1,700 is taxed at the parent's rate. The recent legislation increases the threshold further, to 19 years of age. In addition, a child who is a student up to age 24 with unearned income greater than $1,700 will pay tax at his/her parent's rate on investment income. Effectively, these changes block higher income taxpayers from taking advantage of a child's lower tax rate by gifting stock and other securities to a child before liquidating them.

This law does not apply to financially independent students, those who provide more than half of their own support through work. The new law also does not apply to elderly parents or other relatives to whom gifts may be made.

One way to avoid the noose tightening is to invest a child's money in securities that generate little or no taxable income, such as growth stock mutual funds. ❖

Online Retirement Planning Tools

Consumers are often lulled into thinking that they are on track for retirement when the reality is quite different. The cookie-cutter retirement tools available on the Internet contribute to this complacency.

Retirement tools on the web are helpful for a first look at retirement possibilities, but they often lack the detail necessary to make a sound retirement projection. Here are some of the pitfalls:

- Underestimating the amount of money that you are likely to spend in retirement. Assumptions of less than 90% of your pre-retirement expenses are probably too low based on our experience over 16 years with retirees. We have found that retirees seldom reduce their living expenses in retirement. In fact, travel jaunts sometimes increase expenses dramatically.
- Underestimating inflation is another source of error. Average inflation today of 3% is too low for long-term planning. A more conservative assumption is 4% inflation.
- Overestimating investment returns can also be dangerous. Assumptions of more than a 6% return could be disastrous because so few consumers actually have a written investment policy for their investments. Studies of actual consumer investment behavior show that many consumers seemingly adopt a buy high, sell low investment process. Their overall investment returns are often no better than 6%.

In summary, use online retirement planning tools only as a guide to check your retirement savings rate requirements against conservative planning assumptions. Typically, you will find that your savings rate needs be at least 10% of annual pre-retirement income for a modest retirement, and closer to 15% of income for a more comfortable retirement. For pre-retirement planning when you need a high assurance of financial security, give us a call to help you develop a detailed retirement plan. ❖

Private Mortgage Insurance Deduction

If a loan is taken out with a loan-to-value ratio of 80% or higher, Private Mortgage Insurance (PMI) is required. Under the new tax law, households whose earnings are less than $100,000 may now deduct PMI payments. This tax break is currently for 2007 only, though another act of Congress for tax year 2008 could extend this benefit. ❖

Mackensen & Company, Inc., is a fee-only financial planning and investment management firm. No commissioned products are sold. For further information, call:

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