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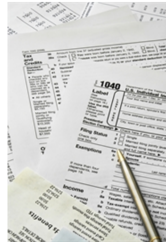
INVESTMENT HOUSE, LLC

Financial Solutions Under One Roof

Federal Income Tax Filing Season Is Here



The due date for 2012 federal income tax returns is April 15, 2013. Whether you're preparing your own taxes or paying someone else to do them for you, you'll want to start pulling things together sooner rather than later. That includes gathering a copy of last year's tax return, W-2s, 1099s, and deduction records.

Filing for an extension

If you're not going to be able to file your federal income tax return by the due date, file for an extension using IRS Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. Filing this extension gives you an additional six months (to October 15, 2013) to file your return. Don't make the mistake of assuming that the extension gives you additional time to pay any taxes due, though. If you do not pay any taxes you owe by April 15, 2013, you'll owe interest on the tax due, and you may owe penalties as well. Special rules apply if you're living outside the country or serving in the military outside the country on April 15, 2013.

There's still time to contribute to an IRA

You generally have until the due date of your federal income tax return (April 15) to make contributions to either a Roth IRA or a traditional IRA for the 2012 tax year. That means there's still time to set aside up to $5,000 ($6,000 if you're age 50 or older) in one of these retirement savings vehicles. It's worth considering, in part because contributing to an IRA can have an immediate tax benefit. That benefit comes in the form of a potential tax deduction--with a traditional IRA, if you're not covered by a 401(k) or another employer-sponsored retirement plan (if your spouse is covered by an employer plan, you're considered to be covered as well), you can generally deduct the full amount of your contribution. (If you're covered by an employer-sponsored retirement plan, whether or not you can deduct some or all of your traditional IRA contribution depends on your filing status and income.)

It's a little different with a Roth IRA; if you qualify to make contributions to a Roth IRA (whether you can contribute depends on your filing status and income), the contributions you make aren't deductible, so there's no effect on your 2012 taxes. Nevertheless, a Roth IRA may be worth considering because qualified Roth distributions you take in the future are completely free from federal income tax.

There's also still time to undo a 2012 Roth conversion

Did you convert a traditional IRA to a Roth IRA in 2012, only to see the account drop in value? Wish you could go back in time so that you wouldn't have to pay tax on the value of the IRA assets lost in the downturn? Turns out, you can. If you undo ("recharacterize") the conversion, you're treated for tax purposes as if the conversion never happened--you wind up with a traditional IRA again and no tax bill for the conversion. You generally have until the due date of your 2012 return, including extensions, to recharacterize a 2012 Roth conversion (note that special rules allow individuals who file timely 2012 returns to recharacterize up until October 15, 2013--talk to a tax professional about the details).

If you do recharacterize your 2012 conversion in 2013, you're allowed to convert those dollars (and any earnings) back to a Roth IRA ("reconvert") after waiting 30 days, starting with the day you transferred the Roth dollars back to a traditional IRA. If you reconvert in 2013, then all taxes due as a result of the reconversion will be included on your 2013 federal income tax return.

Review casualty loss deduction rules

If you were one of the many individuals who suffered property damage or loss as a result of late-2012 storms (e.g., October's Hurricane Sandy), be sure to familiarize yourself with the casualty loss rules--you may be entitled to a deduction for storm-related losses that weren't covered by insurance. Review IRS Publication 547, Casualties, Disasters, and Thefts for details.

February 2013

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Estate Planning Strategies in a Low-Interest-Rate Environment

Questions and Answers about Social Security

I'm going on a cruise--do I need to purchase travel insurance?

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Low interest rates favor certain estate planning strategies over others, and the interest rates used by the IRS are at or near historic lows.

Estate Planning Strategies in a Low-Interest-Rate Environment

The federal government requires the use of certain interest rates to value various items used in estate planning, such as an income, annuity, or remainder interest in a trust. The government also has interest rates that a taxpayer may be deemed to use in connection with certain installment sales or intra-family loans. These rates are currently at or near historic lows, presenting several estate planning opportunities.

Low interest rates favor certain estate planning strategies over others. For example, low interest rates are beneficial for a grantor retained annuity trust (GRAT), a charitable lead annuity trust (CLAT), an installment sale, and a low-interest loan. On the other hand, low interest rates have a detrimental effect on a qualified personal residence trust (QPRT) or a charitable gift annuity. But interest rates have little or no effect on a charitable remainder unitrust (CRUT).

Grantor retained annuity trust (GRAT)

In a GRAT, you transfer property to a trust, but retain a right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your beneficiaries, such as family members. The value of the gift of a remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. Also, if you survive the trust term, the trust property is not included in your gross estate for estate tax purposes. If the rate of appreciation is greater than the IRS interest rate, more of the value of trust assets escapes gift and estate taxation. Consequently, the lower the IRS interest rate, the more effective this technique is.

Charitable lead annuity trust (CLAT)

In a CLAT, you transfer property to a trust, giving a charity the right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your beneficiaries, such as family members. This trust is similar to a GRAT, except that you get a gift tax charitable deduction. Also, if structured so that you are taxed on trust income, you receive an up-front income tax charitable deduction for the gift of the annuity interest. The lower the IRS interest rate, the more effective this technique is.

Installment sale

You may also wish to consider an installment sale to family members. With an installment sale, you can generally defer the taxation of any gain on the property sold until the installment payments are received. However, if the family member resells the property within two years of your installment sale, any deferred gain will generally be accelerated. The two-year limit does not apply to stocks that are sold on an established securities market.

You are generally required to charge an adequate interest rate in return for the opportunity to pay in installments, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, your family members can pay for the property in installments, while paying only a minimal interest cost for the benefit of doing so.

Low-interest loan

A low-interest loan to family members might also be useful. You are generally required to charge an adequate interest rate on the loan for the use of the money, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, you can provide loans at a very low rate and family members can effectively keep any earnings in excess of the interest they are required to pay you.

Effect of low rates on other strategies

- **Charitable remainder unitrust:** You retain a stream of payments for a number of years (or for life), after which the remainder passes to charity. You receive a current charitable deduction for the gift of the remainder interest. Interest rates have no effect if payments are made annually at the beginning of each year, and low interest rates have only a minimal detrimental effect if payments are made in any other way.
- **Qualified personal residence trust:** You transfer your personal residence to a trust, retaining the right to live in the home for a period of years, after which the residence passes to your beneficiaries, such as family members. The value of the gift of a remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. The lower the IRS interest rate, the less effective this technique is.
- **Charitable gift annuity:** You transfer property to a charity in return for the charity's promise to make annuity payments for your life (or for you and your spouse's lives). You receive a current charitable deduction for the gift of the remainder interest. The lower the interest rate, the lower the amount of your charitable deduction will be. Also, charities have generally been forced to reduce payout rates offered because of the economic downturn and the low-interest-rate environment.

Questions and Answers about Social Security

Did you know that according to the Social Security Administration, 94% of all workers are covered under Social Security?

Whether you're close to retirement or years away from receiving Social Security benefits, you may not know much about the intricacies of this important program. Here are some questions and answers that can help you learn more.

Will Social Security be around when you need it?

You've probably heard media reports about the worrisome financial condition of Social Security, but how heavily should you weigh this information? While it's very likely that some changes will be made to Social Security (e.g., payroll taxes may increase, benefits may be reduced by a certain percentage, or cost-of-living adjustments may be calculated differently), there's been no proposal to eliminate Social Security. Although no one knows what will happen, if you're approaching retirement, it's probable that you'll receive the benefits you've been expecting. If you're still a long way from retirement, it may be wise to consider various scenarios when planning for Social Security income.

How does the Social Security Administration know how much you've earned?

If you work for an employer, your employer will deduct Social Security taxes from your paycheck and report your wages to the Social Security Administration (SSA). If you're self-employed, you pay your self-employment Social Security taxes and report your earnings to the SSA by filing your federal income tax return. To view your lifetime earnings record, you can sign up to access your Social Security Statement online at the SSA's website, www.socialsecurity.gov.

Will a retirement pension affect your Social Security benefit?

If your pension is from a job where you paid Social Security taxes, it won't affect your Social Security benefit. However, if your pension is from a job where you did not pay Social Security taxes (such as certain government jobs) two special provisions may apply.

The first provision, called the government pension offset (GPO), may apply if you're entitled to receive a government pension as well as Social Security spousal retirement or survivor's benefits based on your spouse's (or former spouse's) earnings. Under this provision, your spousal or survivor's benefit may be reduced by two-thirds of your government pension (some exceptions apply).

The second provision, called the windfall elimination provision (WEP), affects how your Social Security retirement or disability benefit is figured if you receive a pension from work not covered by Social Security. The formula used to figure your benefit is modified, resulting in a lower Social Security benefit.

If someone else receives benefits based on your earnings record, will your benefit be reduced as a result?

Your benefit will not be affected if other people, such as your spouse, former spouse, or dependent children, receive Social Security benefits based on your earnings record.

If you delay receiving benefits until after full retirement age, should you still sign up for Medicare at age 65?

Even if you plan on waiting until full retirement age or later to take your Social Security retirement benefits, make sure to sign up for Medicare three months before you reach age 65. If you enroll late for Medicare Part B (medical insurance) your coverage may be delayed or cost more later. Visit the Medicare website, www.medicare.gov to learn more.

Do IRA withdrawals count toward the Social Security earnings limit?

Prior to full retirement age, an earnings limit applies if you receive Social Security benefits. If you earn more than this amount, your benefit will be reduced. However, only wages from a job or net earnings from self-employment count toward this limit. Unearned income, such as IRA withdrawals, investment earnings, or capital gains, does not count.

What if you change your mind about when to begin Social Security benefits?

You have a limited opportunity to change your mind after you've applied for benefits. You can complete Form SSA-521, Request for Withdrawal of Application, and reapply at a later date. But if you're already receiving benefits, you can withdraw your claim only if it has been less than 12 months since you first became entitled to benefits, and you're limited to one withdrawal per lifetime. In addition, there are financial consequences--you must repay all benefits already paid to you or your family members based on your application, as well as any money withheld from your checks, including Medicare premiums or income taxes.

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I'm going on a cruise--do I need to purchase travel insurance?

It depends. The decision to purchase travel insurance really comes down to whether the financial benefit outweighs the cost of the policy premium. For example, if you had to cancel your trip, could you afford to lose the money you paid for the trip? If not, a travel insurance policy might be right for you. You can purchase travel insurance from a travel agency, tour operator, cruise line, car rental company, or directly from an insurance company. There are a number of different types of travel insurance, and the type of coverage offered, policy terms, and cost will vary.

The most common type of travel insurance policies are those that offer trip cancellation/trip interruption coverage. This type of coverage will reimburse you if you have to cancel your travel plans before you leave or cut your trip short due to an unforeseen event. Covered contingencies can include anything from a hurricane to your cruise line operator going out of business. Other types of coverage that are marketed to travelers include baggage protection, which provides 24-hour protection for your belongings, and accidental death and dismemberment insurance (AD&D), which compensates you if you lose a limb or eye or compensates your beneficiary(ies) if you die in an accident. Keep in mind that before you purchase travel insurance, you'll want to make sure that you don't already have other types of insurance that offer duplicate forms of coverage. For example, your homeowners policy may cover your belongings if they are lost or stolen while you are traveling, or your life insurance policy may provide coverage for accidental death and dismemberment.

Finally, whenever you travel, you should make sure that you'll be adequately covered by your health insurance policy. If you aren't covered or if the coverage provided is limited, you should consider purchasing a temporary health insurance policy. These policies pick up where your current health insurance coverage leaves off and provide coverage if you are hurt, injured in an accident, or get sick while you are traveling. They can even provide coverage for medical evacuations--something that is especially important if you are traveling outside of the United States.

My laptop was stolen and my personal financial information was stored on it. How can I protect myself against identity theft?

You are right to be concerned about identity theft since identity thieves can use your personal financial information to access bank accounts and credit cards, and make unauthorized transactions in your name. As a result, it's important to act fast in order to protect yourself from any potential attempts at misusing your financial information.

Your first step should be to contact one of the three major credit reporting agencies, i.e., Equifax, Experian, or Transunion, and place a fraud alert on your credit report to prevent someone from opening a new account in your name. The agency you contact will then forward your information to the other two agencies. You can also find out if your state allows you to "freeze" your credit report, which will prevent any unauthorized access to your credit information. Once you place a fraud alert on your credit report, you are entitled to a free copy of your report from each of the credit reporting agencies. Review each of your credit reports and notify the agencies of any fraudulent or suspicious activity. You should also contact any financial institutions or credit card companies with which you have accounts. Ask to have your current accounts closed and open new ones with new account numbers. If possible, you should also request that your new accounts include additional safeguards such as password protection.

Finally, if you suspect that your financial information has already been misused, you'll want to consider taking the following steps:

- Contact the appropriate financial institution and dispute any unauthorized charges or transactions as soon as possible. Generally, your liability will depend on how quickly you notify them.
- Consider filing a complaint with the Federal Trade Commission (FTC), which will entitle you to certain identity theft protections. You can go to www.ftc.gov for more information.
- File a police report with your local law enforcement agency. A police report can be helpful when filing an extended fraud alert or disputing unauthorized transactions.

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