

# FINANCIAL MUSINGS

Gerri A Harrison CFP EA

## Charitable Contributions and your IRA

As part of the new pension law passed by Congress and the President in 2006 you can now make a charitable contribution directly from your IRA account if you are age 70 1/2 or older without having to pay the taxes first.

The effect can have a major impact on the amount of taxes that you pay. Lets say you normally donate \$2000 a year to your church. Instead of giving the church a monthly or weekly check you can request your IRA holder to make a distribution to the church in the amount of \$2000.

Since the check will be made out to the charity and not to you there will be no tax consequences for you. That means if you are in the 15% bracket it will save you \$300 in taxes if you normally do not itemize. If you are in the 25% bracket and give \$10000 that means a \$2500 savings.

It may save you even more in taxes if less of your social security becomes taxable due to a smaller modified income. You may even be able to deduct more of your medical expenses since your adjusted gross income will be less.

The donation is not limited to churches. You can donate to the Cancer or Heart Society, United Way, CHOW, St Jude's, your college as an alumni or any qualified charity. The check must be payable to the charitable organization and not you. This amount can be your minimum distribution amount or any amount up to \$100,000. If your IRA holder allows it you can do multiple charities.

There is a drawback however. Currently you must make this distribution in the calendar year 2007 (or could have done it in 2006). The advantage then goes



Giving in 2007

away unless it gets extended in one of the new tax bills. So consider giving what you would normally give over two or three years all in 2007 if you want to get the benefit of no taxation on your IRA.

Note however in 2008 and later years you will still be required to make minimum distributions from your IRA account even if you gave the larger amount in 2007. The minimum will be less however since there is less in your IRA account. Contact your IRA holder to find out their procedures if you are interested.

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**My business works because of you and people like you. If you are happy with the service that I provide for you please consider referring me to your family, friends, co-workers and others. I am looking to expand my financial planning practice in addition to the income tax practice.**

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## Time to get your financial house in order

While getting your tax documents ready for me do one other thing to help get your financial house in order.

Request you free credit report from AnnualCreditReport.com. Your credit report and credit score an impact on how much interest you are paying on your loans and credit cards. It may also impact if an insurance company is willing to insure you and at what rate. Employers l

look to determine if you are willing to hire you. More and more places are turning to your credit report to see what kind of risk you are.

Get your report and review it for inaccuracies. Write the credit agencies to have them correct any discrepancies. Do not bother with a credit repair service—they generally are not worth the money. You should be able to do corrections on your own.

Once your credit report has been corrected consider paying the money to get your credit or FICO score at myFICO.com. This will cost you about \$15. A good score is considered above 720, the most is 850. If your score is below 720 you are probably paying higher costs to borrow money. If you need help on how to raise or to correct your credit score make an appointment to come see me.

## Sign up for Medicare at 65

Most people are aware that the full retirement age is gradually increasing to age 67. For those born in 1941 the full retirement age is 65 and 8 months. For those born in 1942 it is 65 and 10 months.

If you want collect social security prior to full retirement age you will receive reduced benefits for life. To determine what the reduced amount is go to [www.SSA.gov](http://www.SSA.gov).

When you turn 65 even if you chose not to begin collecting social security you need to sign up for Medicare. Failure to sign up for Medicare at age 65 results in having to pay an

extra 10% premium for life.

Starting in 2007 the amount of the Medicare premium will vary from person to person. Depending on your filing status for the 2005 tax year and your adjusted gross income the premium for Medicare Part B will range from \$93.50 to \$161.40 per month.

If you are still working and covered by an insurance plan through work you still need to sign up for Medicare. However, you can get a letter from you employer that exempts you from paying the Medicare premium while you are still employed.



*Protect yourself at 65*

In addition to Medicare Part B you will also need to sign up for Medicare Part D. This is the new prescription drug coverage for Medicare.

Again, if your employer's plan is at least as good as the Medicare Part D coverage you can substitute the employer's coverage. Your insurance company should be able to tell you if it meets the criteria. Failure to sign up in a timely fashion can result in a penalty.

## Tax credits for 2006

There are a few new tax credits for 2006 that may affect the amount of income tax you pay.

In a previous newsletter I mentioned the telephone excise tax credit. If you paid excise tax for long distance telephone service between February 28, 2003 and July 1, 2006 you will get a credit for the amount of tax paid.

If you do not have telephone bills to determine this amount you can take the standard amount which ranges from \$30 to \$60 based on the number of personal exemptions claimed on the tax return.

To claim the credit for a business you must use actual tax paid and cannot use the stan-

dard. If you are operating a business out of the home and claim the long distance calls as a deduction you cannot use the standard and must use the actual expenses. You will only get one credit for business and personal unless the business is a corporation.

New York state has a new solar energy system equipment credit. The equipment that qualifies can be found at [www.energystar.gov](http://www.energystar.gov). The amount of the credit is up to \$3750 for equipment purchased before 9/1/2006 and up to \$5000 for equipment purchased after.

The credit for hybrid vehicles is still around. The amount of the credit will vary depending

*Tax credits are better than a tax deduction since they are dollar for dollar.*

on which vehicle and when it was purchased. For a list of the vehicles available for the credit go to [www.irs.gov](http://www.irs.gov).

Remember tax credits are better than a tax deductions since they are dollar for dollar. If your credit is \$60 then your tax is reduced by \$60. If it is a deduction you only save the percentage that is being paid on your highest income.

## Day camps may not be deductible

If your child is under the age of 13 in the past you were able to deduct the cost of that sports camp or educational camp as a child care expense. This was true even if you did not have any day care expenses for the balance of the summer.

Now you must have child care expenses for the entire summer in order to claim the expenses for that camp.



For example if you normally send your son to a babysitter and for two weeks you send him to soccer camp then you can take a deduction for the camp.

If however the only child care expense you have is the two weeks of soccer camp, you are no longer eligible to claim the child care credit.

Overnight camps are never deductible as a

child care expense.

Another change in the child care credit is that you no longer can claim kindergarten expenses incurred at a private school as a child care expense. Kindergarten is now considered an integral part of education. Expenses for pre-school can still be claimed as child care expenses if they are a substitute for other child care expenses.

## Loss from flooding may be deductible

So many of you have been affected by the flooding in June or in November. If you sustained a loss you may be able to deduct it on your tax return. You can elect to amend your 2005 or claim it on your 2006, whichever is better for you.

The casualty loss will be divided into two parts—the real estate or actual house and the contents. Amounts need to be calculated separately for each type of property.

The first piece of information you need to know is what the fair market value of the property was prior to the flooding. This is the amount that you would have been able to sell it to an unrelated party.

You also need to calculate the original cost of

the property as close as you can. This is what you paid for the property or if you inherited the property the fair market value at the time of the inheritance.

Next you need to determine what the fair market value was after the flooding. This can be determined by having an appraisal done on the property. Or using the cost of repairs and cleaning up. This method can only be used if the repairs have actually been made.

I have worksheets available that can help you with making sure you have accounted for all your contents. Contact me and I will send you a set. Or you can go to [www.irs.gov](http://www.irs.gov) and look



What a mess!

for Publication 584. If you filled out itemized worksheets for your FEMA application these can be used for determining the contents loss, you do not need to do it again.

To claim the casualty loss you must have submitted any claims to insurance and applied for any federal aid available. Any casualty loss you claim will be reduced by an insurance reimbursement received. It will not be reduced by any FEMA or NYS monies received.

If your deductions exceed your income you will have a net operating loss that can be used in future years to reduce your tax liability.

## New rules coming for Roth IRAs, and the Roth 401k

It does not happen until 2010, but you can start taking advantage of the change now if you like. Effective for the tax year 2010 there will no longer be an income limitation for converting to a Roth IRA. Currently if your adjusted gross income is in excess of \$100,000 you cannot do a Roth conversion.

Consider this: make contributions to a traditional IRA now that are nondeductible. There are no maximum income limitations for a nondeductible IRA so anyone with earned income can do one.

If you put the \$4000 a year into an IRA in 2010 you will have contributed \$20,000

(\$25,000 if over 50). In 2010 you can then convert from the traditional nondeductible IRA to a Roth IRA. You will have to pay tax on the earnings that the account has, but not on the initial contributions. After the conversion you will never need to pay tax on any future earnings.

If your employer allows you can immediately begin contributing to a Roth 401k. The advantage here is there is no income limitation; with a Roth IRA you can only make contributions if you are below \$150,000 for married filing joint and \$95,000 for single and head of household.

***If your employer allows you can immediately contribute to a Roth 401k.***

Additionally, the maximum you can contribute in 2007 to a 401k is \$15,500 (or \$20,500 if over 50). Your employer needs to amend his 401k documents to allow for Roth 401k contributions. If you make the maximum contribution to a Roth 401k you will not be able to contribute to a traditional 401k. You can, however, elect to split your contribution if you chose.

## Business owners need basis calculated

S corporations and partnerships have three tests that the business owner must meet before being able to claim a loss from their business entity.

The tests are basis test, at risk test, and passive loss test. Basis is determined by adding all your contributions to the entity, subtracting all monies removed, and adding or subtracting the income or losses claimed over the years. The basis must be positive to claim a loss.



Off to work we go!

At risk factors in any loans that have been guaranteed by the owner and again must be positive to claim any loss.

The passive loss calculation looks at whether or not you have actively participated in the running of the entity. If you have not then you can only claim a loss if you have passive income to offset the loss.

This information has not been maintained in the past since there was no need for it. Anyone having an S corporation or partnership needs to drop off all old returns since the entity came into existence. I will need to sort through the information and calculate the basis as of the end of 2005. I would appreciate if you would drop off as soon as possible.

This calculation need not be done for sole proprietors or C corporations.

## Avoiding the early withdrawal penalty

Over and over again you are told 59 1/2. You cannot withdraw monies from your retirement accounts until you are 59 1/2 or you will be subject to a 10% penalty.

There are ways to avoid the penalty even if you are under 59 1/2. For example you can withdraw from an IRA or 401k for education expenses for your child or grandchild and pay no penalty. If you have medical expenses that exceed 7.5% of your adjusted gross income you can take the excess out of your IRA without penalty. A first time home buyer is allowed to take up to \$10,000 out of an IRA without paying the 10%.

What if you need money on a regular basis however since you were downsized and forced into early retirement? You may want to take distributions using the 72t rule. Under the 72t you can take periodic, substantially equal distributions from a retirement plan for a minimum of five years or until you are 59 1/2, whichever comes later.

Say you have \$20,000 in an IRA and you are 53 years old. You can elect to take monthly payments in an amount such that the account would be liquidated by the time you are 59



*No penalty for you!*

1/2. Each year you recalculate the amount of the distribution depending on the new value of the IRA. You must be sure that the account is liquidated by the year you turn 59 1/2 or you risk incurring the penalty.

Don't want to liquidate your entire IRA? Divide the IRA into multiple IRAs. You do not have to liquidate every account. You can start with one account and add a second or third distribution later if you determine that you need more money. If you find work then you will still have part of your IRA intact.

## That job may actually be costing you money!

Is it costing you money to have that second income? Think about all the extra expenses that you are incurring because your spouse has that job making \$12,000 a year.

That \$12,000 is taxable for social security, Medicare, federal income tax and NYS income tax—combined that is probably at least 29% in taxes if not more. So right off the top you have “spent” \$3480 in tax money.

Lets say it cost \$15 a week for gas money—that is \$780. The extra wear and tear on the car will probably run you at least an extra \$1000 per year.

Eating lunch out once a week with your co-

workers will cost you another \$300. Grabbing a coffee, soda or candy bar out of the vending machine runs you \$325 per year. Clothes that you need to have for your job will probably cost you another \$1500 a year—unless you are buying suits which would be even more.

Studies show families where both parents work have a tendency to eat out more often and buy more convenience food to eat at home. One extra meal out every two weeks and an extra \$20 at the grocery store per week could run you an extra \$1800.

After school care, summer camps or fulltime child care can easily cost you another \$50 a

### *Is it costing you money to have that second income?*

week, more during the summer to the tune of \$2600 a year.

Having to have a second car, hiring people to do things because you do not have time, having your children buy lunch at school, extra medical costs because of the stress and any number of other expenses will easily take care of the remainder.

So I ask you, is that second job really costing you money? Run the numbers for yourself..

## Do you have TOD and POD?

Does TOD and POD sound like alphabet soup to you? If you have bank accounts or non-qualified investment accounts they should not. TOD means transfer on death and POD means payable on death.

You can attach TOD to a taxable investment account where no beneficiary is named to have it pass to that individual at death. For example it might read “TOD James Smith”. This means the assets in the account would go to James Smith on your death. The advantage— the assets do not



*Upon your death*

have to go through probate. They can go directly to the individual you named just like your IRA or pension plan with a named beneficiary.

POD does the same thing for checking and savings accounts and for CDs.

Why is this better than just putting your children on as a joint account holder? First— they have no access to the money until you pass away. So if they go

through a nasty divorce their spouse has no rights to your assets. If your child gets sued your assets cannot be touched to settle the lawsuit.

Realize that these assets avoid probate at death, but will still be part of your estate. They can be attached to pay any final bills that you might leave behind. If you have a large enough estate they will still be estate taxable.

## Saving for Education Expenses

Are you the parent or grandparent of a young child? Saving for college can be a frightening prospect. I just ran an estimated cost calculator for Mike's education. It says that I need to be saving an additional \$518 per month to be able to fully fund his education for four years at a state school. That is like making another mortgage payment each month! Mike is 14, imagine the cost it will be to send a newborn off to college with college costs increasing 5 to 7% per year.

No one says that you have to save the entire amount. Maybe you decide you will only fund 50% of the cost and let student loans or financial aid cover the rest. Be aware that the amount of federal aid is decreasing all the time. Give serious consideration of whether or not you want to saddle your child with a \$100,000 or more of student loans.

There are numerous ways that you can save for educational expenses. One of the most popular today is the 529 savings plan. A 529 plan can be set up by a parent, grandparent, or even an aunt, uncle or special friend. Each person can set up their own plan for the child or can contribute to the same plan.

The advantages of a 529 plan are many. First the earnings on any monies that you are saving avoid any tax while you are accumulating funds. If you withdraw the money and use it for college expenses= tuition, mandatory fees, room and board, at an accredited school there is no tax on the earnings ever.

The limit that you can put into a 529 plan is currently \$12,000 per year. There is a special feature that allows you to make five years' worth of contributions in one year as long as you forgo contributions for the following five years. This is especially a nice feature for grandparents who can contribute \$120,000 (\$60,000 each) for each grandchild and get the money out of their estate for planning purposes.

The key issue unique to the 529 plan is that the money remains in control of the person who is the custodian of the account, the parent or grandparent generally. The money stays in your control until you give up that right. That means if your child does not go to college he does not get access to the money. If you want

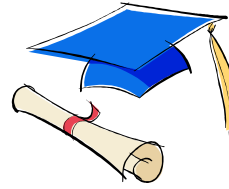
to disburse the money for non-college related expenses you will pay tax on the earnings.

You will also have the option of rolling the balance over to a sibling or to a grandchild once you have one.

You do not have to place "big" money into this account if you do not have it. Some plans will allow you to contribute as little as \$15 per month. Add birth-

day and Christmas money and it can accumulate to a nice tidy sum in eighteen years.

I know there are high demands on your income at this time with raising children, mortgages, high taxes and the ever increasing fuel costs. This is important however. It is estimated that a college graduate with a bachelor's degree will earn a million dollars more in his lifetime than a high school graduate. The longer that you wait to start saving the greater your monthly contribution will need to be. Consider starting with the \$15 a month now and increasing it by \$5 every six months or so.



*The College years*

## Good debt, bad debt

There is good debt and bad debt. Good debt is when you are purchasing something that will appreciate in value. For example using a mortgage to buy a home. You will have a place to live that is building equity instead of letting money go up in smoke by renting. Additionally you generally get a tax deduction for the mortgage interest and property taxes paid if you are able to itemize.

A second kind of good debt is student loans. The average four year graduate from college earns a million dollars more in their lifetime than a high school graduate. The difference is even greater for someone who earns a master's degree.

Interest on a student loan is generally at a lower rate than general unsecured debt so the borrowing costs are less. Additionally if you are below the income limitations up to

\$2500 worth of student loan interest is deductible on your tax return even if you do not itemize. The limitation for the 2006 tax year is adjusted gross income, not including a student loan interest deduction, of less than \$135,000 if married filing joint or \$65,000 if any other filing status.

Business improvement loans are good loans since they generally increase revenue. Home improvement loans are generally good loans as long as you are not over-improving your home and pricing yourself out of the market.

Other types of loans such as auto loans, credit card debts, and personal loans of all types (ie. for vacations, weddings, furniture, etc.) are bad debt. You are having to pay interest and

whatever you went into debt for is decreasing in value or has no value.

Think about how much that furniture or vacation will actually cost you if you are having to pay interest on the amount borrowed. Say you purchase a computer for \$500 and financed it for two years. That computer would actually cost you more than \$650 in the end. Is it really worth that?

If you want to determine the real cost of something use the credit card section at the web site [www.bankrate.com](http://www.bankrate.com). Enter the amount you are borrowing, the rate of interest and the period being financed over. This web site will calculate how much interest you will pay by the time the item is paid off and you will know the real cost.

Strive to only borrow using good debt and limit the use of bad debt as much as possible.



*Is it good or bad debt?*

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*Relax, I am here to help you*

*I hope you are enjoying Financial Musings. Please feel free to pass it onto a family member or friend. Or if you want give me a call with their names and addresses and I will add them to my mailing list to receive their own copy.*

*Gerri Harrison Financial Services provides financial planning and tax preparation services to individuals and small businesses. "I want to be part of the family. There for the good and the bad. Everyone has a job and purpose in the family. My job is to assist you in achieving your financial dreams and aspirations as well as meeting your financial obligations and concerns. I want to be there to pack your child off to college or pack you off to retirement. I want to be there through the christenings, weddings, illnesses and deaths. Whenever there is a financial matter you have a questions about I want the first thing you think of to be "Gerri will know how to handle it.".*

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## Get your child off the couch and using his imagination!

.Does your child spend all day in front of the television, playing video games or playing on the computer? You try everything but are unable to get him off. Try the "Chip System" that we used for Mike. We used three different colored poker chips—red, white and blue. Each chip represented a half hour of time. On Sunday he would receive 12 of each color chips.

The chips were good for a week. Every time Mike watched a half hour of TV show he had to give up one of his red chips. When he was out of red chips he could not watch any more TV that week until Sunday came around and he got his new supply. It taught Mike to budget his TV time and he did not simply sit in front of the TV because he was bored. Part of watching TV included if



*Get off the couch!*

he were watching videos—typical video cost him three chips. If we rented movies as a family to watch we did not count those against him. If he sat watching a sporting event we generally would allow one a week without counting it against him otherwise it would have taken most of his chips for the week. If he wanted to sit and watch baseball all day on Sunday though he would be using chips.

The white chips represented a half hour of time on the computer. Again once he was out of chips there was no more computer for the week unless he needed it to do homework.

The blue chips represented time on his Game Cube or using any hand held computer games such as a Game Boy that he might have. Six hours of time a week on these was certainly enough.

By limiting the time he could just sit and be entertained he was

forced to use his imagination and create his own fun. He would play board games or make up his own board games, make things with his Legos or play with his cars and trucks. One of the real benefits that came out of it is he would read a lot—to this day Mike generally reads an hour or two a day.

The other advantage came when Mike needed to be punished for some reason or another. I would warn him once that he was going to lose a chip or multiple chips for whatever infraction was occurring. If he did not stop whatever it was he would lose the use of that chip for the week.

The idea is that you limit the time you allow your child to just sit and not have to think. Force him to use his imagination and see where it will take him. He also learned to budget his time wisely. Plus it meant we did not watch the same video over and over again.