



Leal Financial Planning

Planning For Your Future

Leal Financial Planning
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1040 Tax Tips



You don't want to pay more in tax than you have to. That means taking advantage of every deduction and credit that you're entitled to. You also need to recognize potential opportunities to save. So here are a few things to keep in mind this filing season.

There's still time to contribute to an IRA

You generally have until the due date of your federal income tax return (April 18 this year) to make contributions to either a Roth IRA or a traditional IRA for the 2010 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, 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 2010 taxes. Nevertheless, a Roth IRA may be worth considering because qualified Roth distributions are completely free from federal income tax.

Individuals with lower incomes may also be able to qualify for a tax credit of up to \$1,000 when they contribute to a traditional or Roth IRA.

Decision time on 2010 Roth conversions

If you converted funds from a traditional IRA or an employer plan like a 401(k) to a Roth in 2010, you can report half the income that results from the conversion on your 2011

federal income tax return, and half on your 2012 federal income tax return. Good deal, right? Sure. But in some cases, you might be better off making an election to claim the entire amount on your 2010 return instead. This could be true if, for example, your 2010 taxable income is significantly lower than you think it will be in 2011 and 2012, or if you've got unusually high deductions for 2010.

Other considerations for 2010 returns

- For the first time in many years, itemized deductions and dependency exemptions will not be reduced for high-income individuals.
- If you claim a large number of dependency exemptions, deductible medical expenses, state and local taxes, or miscellaneous itemized deductions, you're more likely to be subject to the alternative minimum tax (AMT), essentially a parallel federal income tax system with its own rates and rules.
- If you purchased a new home in the first half of 2010, check to see if you meet the timing, purchase price, and income requirements to qualify for the first-time homebuyer tax credit, worth up to \$8,000. Even if you weren't a first-time homebuyer, it's still possible to qualify for a tax credit of up to \$6,500 if you maintained the same principal residence for five out of the eight years preceding the purchase, and meet all other requirements.
- If you made energy-efficient improvements to your home in 2010 (e.g., new windows, a new furnace), you might be entitled to a 30% tax credit, up to \$1,500. Check the requirements closely, though, and note that if you claimed the full \$1,500 credit in 2009 you can't claim the credit for 2010.

Legislation in late December extended a host of expiring tax credits, deductions, and provisions, so it could pay to take a little extra time to carefully review IRS instructions this year. And as always, if you have questions, discuss your situation with a tax professional.

Don't Be Nickeled-and-Dimed by Account Fees



If you encounter a fee you don't agree with, talk to an account representative at your bank or credit union. He or she may be willing to rebate the fee, or suggest alternatives to help you reduce or avoid future charges.

Interest rates on deposit accounts, such as savings accounts, interest-bearing checking accounts, and money market accounts have been persistently low, and rates aren't likely to improve any time soon. To make matters worse, financial institutions are under pressure to raise account fees, as they look to recapture some of the revenue lost in the wake of stricter financial regulations. The result is that some account holders now earn less interest on their money than they pay in account fees.

Though it's hard to find attractive interest rates, it's relatively easy to save on account fees if you're willing to do your homework. Start by reviewing your account statements to determine your spending and saving habits. What average account balance do you generally maintain? Do you pay monthly account maintenance or service fees? How many ATM transactions do you have in a month? Are you overdrawing your account? Once you know your financial habits, you'll be ready to take steps to reduce account fees.

If you pay account maintenance fees

An account maintenance or service fee is a common monthly service charge that applies to some accounts. Financial institutions offer a variety of products, each with their own fee structure. Often, higher maintenance or service fees may apply to accounts that pay higher interest rates. To help avoid these fees:

- Shop around, and compare your options--not all banks and credit unions charge maintenance fees.
- Make sure you understand and follow account requirements. For example, monthly maintenance fees may be reduced or waived if you sign up for direct deposit or online bill pay, maintain another account, or tie your account to a loan or mortgage.
- Read your account statements and notices you get from your financial institution. Otherwise, months may go by before you notice that fees have gone up or account requirements have changed.
- Reevaluate your needs regularly. They change over time, and you may want to switch your money to another type of account, or even find another bank or credit union that better suits your needs.

If you frequently use ATMs

Withdrawing money from an ATM is so quick, it's easy to overlook how much it's costing you. Fees for ATM transactions generally range from \$2 to \$5, and may be higher. One way to minimize these fees is to choose a financial institution that owns many local ATMs, but that

isn't your only option. To help reduce ATM costs:

- Ask for a list of surcharge-free ATMs. Many financial institutions participate in networks that enable account holders to withdraw cash from designated ATMs without paying a surcharge. You can also download an application to your mobile device to help you find surcharge-free ATMs anywhere in the country.
- Plan your spending. Withdrawing larger amounts when possible (at least enough to last for a week) will substantially reduce the number of ATM transactions you have.
- Look for a bank or credit union that rebates ATM fees imposed by ATMs owned by other financial institutions (limits may apply).
- Opt for cash back when you use your debit card (a minimum or maximum amount may apply). This is often a free or low-cost alternative to going to the ATM.

If you tend to overdraw your account

Overdrafts are common--a 2009 study by the nonprofit Center for Responsible Lending found that over 50 million Americans overdrew their checking account over a 12-month period. To help reduce or eliminate overdrafts:

- Look into online banking. Being able to track your account history whenever you want can help you avoid overdraft fees. You'll also be able to quickly transfer funds among accounts, should the need arise.
- Sign up to receive transaction or low balance alerts via your mobile device or computer.
- Link your savings account to your checking account so that money will be automatically taken out of your savings account should you overdraw your checking account (typically, little or no fee is charged).

The bottom line

Often, people choose a bank or credit union based on convenience--the location of branches, easy access to ATMs, and hours of service. Convenience is important, but so is cost. And you don't have to settle--there are plenty of banks and credit unions across the country that offer great products and excellent service, without hitting you too hard in the pocketbook.





Bonds don't respond uniformly to interest rate changes. The differences, or spreads, between the yields of various types of debt, such as corporate, government, emerging market, and municipal debt, can mean that some bonds are under- or overvalued compared to others. Don't forget that the total return on bonds is a combination of yield and price return. Financial professionals have many ways to adjust a bond portfolio to help you cope with rising rates.

Rising Interest Rates: The Downside of Economic Recovery

Over the last several years, investors have grown accustomed to historically low interest rates. Ever since the Federal Reserve Board's target fed funds rate--the rate at which banks lend to one another--hit a high above 19% in mid-1981, the long-term direction of rates has been downward. In the last decade, the Fed's data* shows the target rate has never been much higher than 6%. And since December 2008, the Fed has kept it at a previously unheard-of level between 0.25% and zero to try to ensure that credit would be available to promote economic recovery.

Because bond prices typically rise when interest rates fall, that decline in yields has produced a bull market in bonds over the last decade. But what happens when the trend reverses? Even if they continue to remain relatively stable for a while, ultra-low interest rates have nowhere to go but up. When the economic recovery begins to show signs of strength, at some point the Federal Reserve Board will begin to raise the target rate again. When that happens, bond prices also will begin to reverse their long-term direction.

Here are some factors to consider in anticipation of a future with rising interest rates.

Bond maturities: when short is sweet

When interest rates rise, longer-term bonds typically feel the impact the most. In an extended period of rising interest rates, bond buyers become reluctant to tie up their money for longer periods because they foresee higher yields in the future; the later the bond's maturity date, the greater the risk that its yield will eventually be superseded by that of newer bonds. As demand drops and yields increase to attract purchasers, prices fall.

There are various ways to manage that impact. If you own individual bonds, you always have the option of holding them to maturity; in that case, you would suffer no loss of principal unless the borrower defaults. Bond investments also can be laddered. This involves buying a portfolio of bonds with varying maturities; for example, a five-bond portfolio might be structured so that one of the five matures each year for the next five years. As each bond matures, it can be reinvested in an instrument that carries a higher yield. Laddering also can be used with certificates of deposit (CDs).

If you own a bond fund, you can check the average maturity of the fund's holdings, or the fund's average duration, which takes into account the value of interest payments and will generally be shorter than the average maturity. The longer a fund's duration, the more sensitive it may be to interest rate changes.

Rising rates and other assets

Higher interest rates often are an attempt to prevent rising prices. When prices go up, purchasing power goes down, including the purchasing power of a bond's fixed interest payments. That can make bonds less attractive to buyers. However, not all investments are hurt by higher prices. For example, commodities such as oil and wheat typically do well in inflationary periods; in fact, increases in commodity prices are often what trigger a bout of inflation. If you're primarily interested in the overall value of your portfolio rather than a regular income stream, your financial professional can help you explore whether you should consider diversifying into asset classes that tend to benefit from inflation and that might help counteract the potential impact of falling bond prices.

Though bonds are affected most directly, equities aren't necessarily immune to rate increases. Though many companies borrowed money in recent years to take advantage of low rates and postpone the need to issue bonds for some time, those that haven't may see their borrowing costs increase, which could affect their bottom lines. Even those that squirreled away cash could be hit when they return to the bond markets eventually. Also, if interest rates rise to a level that's competitive with the return on stocks, that could reduce investor demand for equities.

Higher rates aren't all bad news

For those who've been diligent about saving, or who have kept a substantial portion of their investments in cash, higher rates could be a boon. Savings accounts, CDs, and money market funds are all likely to do better at providing income than they have in recent years. The downside, of course, is that if higher rates are accompanied by inflation, such cash alternatives might not keep pace with rising prices. And bear in mind that a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at \$1 per share, it is possible to lose money investing in a money market fund.

**Source: Federal Reserve Statistical Release Historical Data for Fed funds rate weekly since 1954.*



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Can I make charitable contributions from my IRA?

Yes, if you qualify. The law authorizing "qualified charitable distributions," or QCDs, has recently been extended through 2011.

You simply direct your IRA trustee to make a distribution directly from your IRA (other than a SEP or SIMPLE) to a qualified charity. You must be 70½ or older, and the distribution must be one that would otherwise be taxable to you. You can exclude up to \$100,000 of QCDs from your gross income in 2011. If you file a joint return, your spouse (if 70½ or older) can exclude an additional \$100,000 of QCDs in 2011. But you can't also deduct QCDs as a charitable contribution on your federal income tax return--that would be double dipping.

QCDs count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to take from your IRA in 2011, just as if you had received an actual distribution from the plan. However, distributions that you actually receive from your IRA (including RMDs) that you subsequently transfer to a charity cannot qualify as QCDs.

For example, assume that your RMD for 2011 is \$25,000. In June 2011, you make a \$15,000

QCD to Qualified Charity A. You exclude the \$15,000 of QCDs from your 2011 gross income. Your \$15,000 QCD satisfies \$15,000 of your \$25,000 RMD. You'll need to withdraw another \$10,000 (or make an additional QCD) by December 31, 2011, to avoid a penalty.

You could instead take a distribution from your IRA and then donate the proceeds to a charity yourself, but this would be a bit more cumbersome, and possibly more expensive. You'd include the distribution in gross income and then take a corresponding income tax deduction for the charitable contribution. But the additional tax from the distribution may be more than the charitable deduction, due to IRS limits. QCDs avoid all this by providing an exclusion from income for the amount paid directly from your IRA to the charity--you don't report the IRS distribution in your gross income, and you don't take a deduction for the QCD. The exclusion from gross income for QCDs also provides a tax-effective way for taxpayers who don't itemize deductions to make charitable contributions.



Can I name a charity as beneficiary of my IRA?

Yes, you can name a charity as beneficiary of your IRA, but be sure to understand the advantages and disadvantages.

Generally, if you name a spouse, child, or other individual as beneficiary of a traditional IRA, they must pay federal income tax on any distribution they receive from the IRA after your death. By contrast, if you name a charity as beneficiary, the charity will not have to pay any income tax on distributions from the IRA after your death (provided that the charity qualifies as a tax-exempt charitable organization under federal law), a significant tax advantage.

After your death, distributions of your assets to a charity generally qualify for an estate tax charitable deduction. In other words, if a charity is your sole IRA beneficiary, the full value of your IRA will be deducted from your taxable estate for purposes of determining the federal estate tax (if any) that is due. This can also be a significant advantage if you expect the value of your taxable estate to be at or above the federal exclusion amount (\$5 million for 2011).

Of course, there are also nontax implications. If you name a charity as sole beneficiary of your

IRA, when you die your family members and other loved ones will obviously not receive any benefit from those IRA assets. If you would like to leave some of your assets to your loved ones and some assets to charity, consider leaving your taxable retirement funds to charity and other assets to your loved ones. This may offer the most tax-efficient solution, since the charity will not have to pay any tax on the retirement funds. If the retirement funds are a major portion of your assets, you might consider leaving those funds to a charitable remainder trust. Under this type of trust, the trust receives the funds free from income tax at your death, then pays a lifetime income to individuals of your choice. When those individuals die, the remaining trust assets pass to the charity. Finally, another option is to name the charity and one or more individuals as co-beneficiaries.

The issues discussed here are complex. Be sure to consult an estate planning attorney for further guidance.

