Nexus Financial Monthly

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Hi Everyone,

Well, another year is behind us and we start anew! The beginning of 2011 is a good time to review your own general financial and personal status. Let us know if there have been any changes over the last year that we may not be aware of.

We all at Nexus wish you a healthy, happy and prosperous New Year! We thank you for your business over the years and hope to continue the good working relationships we have had in the past. As always, if you have any questions or concerns, we are only a telephone call or e-mail away.

May 2011 treat you well!

Dick, Dave, Lynn and Kathy

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Five Hot Topics in 2011

Roth conversions, mortgages, and health-care reform were a few of the most talked about topics in 2010. Here's a look at five topics you're bound to hear about in 2011.

Social Security: saving the system

How to strengthen Social Security has been a political hot potato for many years, but calls for reform are growing louder as the time when program costs will permanently exceed tax revenues draws closer. The most recent annual report from the Social Security Board of Trustees projects that this will occur in 2015 (one year earlier than last year's report predicted) and notes that trust funds will be exhausted in 2037. Social Security is the most common source of income for retirees, and debate over how to save it will rage in 2011.

Microlending: small loans count

Microlending--the practice of extending small loans to individuals and businesses who otherwise could not borrow money--has traditionally targeted entrepreneurs in developing countries. But as the credit crunch prevents many Americans from borrowing money through traditional channels, more are turning to microlending sites and companies to obtain funds. And more investors are offering to make microloans in return for the potential to earn somewhat higher returns than a savings account can offer. Until the economy improves, look for this trend to continue.

Microlending recently got a boost from the Small Business Jobs Act, passed in September, that expanded the Small Business Administration's microlending program. Funding for the program was increased, and business owners may now be able to borrow up to $50,000 (previously, the limit was $35,000) to use for working capital or other needs.

Education: expanding opportunities

Education-related debates will certainly heat up in 2011. The current administration is committed to reforming primary and secondary education and has drawn up a blueprint for overhauling the Elementary and Secondary Education Act. This Act (currently known as No Child Left Behind) is long overdue for reauthorization, and Congress will likely be debating it in 2011.

In addition, much attention is being focused on ways to make college more accessible and affordable. One initiative funded by the Bill and Melinda Gates Foundation awards grants to nonprofit and governmental institutions to develop effective online education opportunities. Currently the focus is on developing online courses and tools that can help more Americans attend college and prepare for careers, while saving students and schools money.

Energy: greener days ahead

"Going green" is a catchphrase that's likely to get even more press in 2011. One important green initiative currently pending in the Senate is the Homestar Act. This Act provides substantial rebates to homeowners who purchase and install energy-saving equipment or goods or who complete whole home retrofits.

Even the lowly lightbulb finally gets a makeover in 2011. The Federal Trade Commission is requiring that lightbulb packages carry labels that estimate yearly energy costs, the bulb's life span and light appearance, and brightness measured in lumens so that consumers can better compare new energy-efficient bulbs.

Wellness: saving lives and money

Look for employers to roll out, or expand, employee wellness programs this year in an effort to promote healthier living and curtail health insurance costs. The Health-Care Reform Act passed last year included funding for new wellness programs established by small employers, and makes it easier for all employers to offer substantial incentives to employees for participating. Also, new health insurance plans and many existing plans (including Medicare) must now fully cover preventive care services such as immunizations and screenings for certain health conditions.

2011: An Estate Tax Odyssey

At the stroke of midnight, December 31, 2010, Cinderella's coach magically turned back into a pumpkin and... umm... I mean... the federal estate tax repeal of 2010 turned back into the federal estate tax burden of 2000. That means that the estate tax is back in full force, with a top rate of 55% and a lifetime exemption equivalent amount of $1 million.

How we got here--a brief recap

The federal estate tax was reduced over the past decade as a result of a 2001 law that said the tax would disappear totally in 2010, and then return in 2011 at pre-2001 law levels. It was expected that Congress would deal with the matter before the tax disappeared, with most people believing that the 2009 treatment of estates would be made permanent. This would have effectively excluded the first $3.5 million of an estate from taxation ($7 million for a couple), with any excess being taxed at 45%. While the House did enact this change, the Senate failed to do so. So, the current status of the estate tax is as follows:

It's possible that Congress will reinstate the estate tax retroactively, that is, back to January 1, 2010. Heirs who have already received their inheritance may have to reimburse the estate to enable it to pay the reinstated estate tax.

For deaths in 2010

The federal estate tax and the federal generation-skipping transfer tax (a separate tax on assets transferred to grandchildren) are repealed for 2010. The federal gift tax remains in effect with a lifetime exemption equivalent amount of $1 million and a top tax rate of 35% (also, if you file as single, you can exclude gifts of up to $13,000 per recipient, or if you're married and file jointly, you can exclude gifts of up to $26,000 per recipient).

In prior years, inherited assets received a step-up (or step-down) in cost basis to the asset's fair market value on the date of death. In 2010, however, inherited assets generally receive a carryover basis instead (specifically, the lesser of the asset's date-of-death fair market value or the decedent's carryover basis). For the recipients of the inherited assets, that means that a subsequent sale of the assets may trigger capital gains taxes. This tax burden is mitigated to a certain extent, however, because estates can exempt up to $1.3 million of gain for assets left to heirs, and an additional $3 million exemption can be allocated to assets specifically left to a surviving spouse.

You can also make federal tax-free gifts by paying for someone else's medical expenses or college tuition. Payments must be made directly to the medical care provider or educational institution, and other requirements may apply.

Some of the individual states impose their own taxes on property transfers made at death (a handful of states also have a gift tax on lifetime transfers). These "death" taxes can take the form of an estate tax or an inheritance tax and/or a generation-skipping transfer tax. Prior to the federal 2001 law, estates filing a federal estate tax return were entitled to a tax credit for any state death taxes paid. From 2001 through 2009, estates were entitled to a state death tax deduction only (not a credit). In 2010, since there is no federal estate tax, there is no state death tax deduction or credit.

For deaths in 2011

As of January 1, 2011, the federal unified gift and estate tax system is again in force. Taxpayers can effectively transfer up to $1 million (during life and/or at death) tax free. Transfers (gifts or bequests) in excess of $1 million and up to $10 million are subject to a top tax rate of 55%, and transfers in excess of $10 million are subject to a top tax rate of 60%. Generation-skipping transfers are also taxed separately; transfers in excess of $1 million and up to $10 million are taxed at a top rate of 55%, and transfers in excess of $10 million are subject to a top rate of 60%. Also, if you file as single, you may give up to $13,000 per recipient gift tax free, or if you're married and file jointly, you may give up to $26,000 per recipient. Note that the $13,000 exclusion is indexed for inflation, so this amount may increase in future years. By contrast, the exemption equivalent amounts are not indexed for inflation, so they will remain fixed at $1 million in future years, unless of course, Congress enacts a law to change that.

Inherited assets will receive a step-up (or step-down) in cost basis to the asset's fair market value on the date of death (or an alternate valuation date, if that applies).

Estates will be entitled to a state death tax credit.

For the lucky (or unlucky) few

If (and that's a big if) Congress allows the 2010 estate tax repeal to stand, a few beneficiaries will receive their inheritances federal estate tax free. If that's the case, beneficiaries should procure documentation that will support the decedent's cost basis.

On the other hand, it's possible that Congress will reinstate the estate tax retroactively, that is, back to January 1, 2010. If so, heirs who have already received their inheritance may have to reimburse the estate to enable it to pay the reinstated estate tax.

New Adoption Assistance Opportunities and Requirements

Congratulations! You've adopted a child. Your family is growing, and so are your expenses. Fortunately, the federal government offers some financial assistance.

If you adopt a child, you may be able to claim a tax credit for qualifying expenses you paid. Further, certain amounts reimbursed by your employer for qualifying adoption expenses may be excludable from your gross income.

Increased dollar amounts for 2010

If your employer has an adoption assistance plan, for each adoption you can exclude from income up to $13,170 (in 2010) of adoption assistance paid by your employer or paid by you through salary reduction. For adoption expenses paid by you and for which this exclusion is not available, a tax credit is available for up to $13,170 of adoption expenses per adoption. The $13,170 amount is subject to phaseout and is reduced if you have modified adjusted gross income (MAGI) above $182,520 and is fully phased out if you have MAGI of $222,520 (in 2010). If you adopt a child with special needs, the $13,170 amount (subject to phaseout) is available regardless of the amount of actual adoption expenses. The dollar limit is for aggregate expenses for all years with respect to an adoption. (Same rules and limits--adjusted for inflation--apply to adoptions in 2011.)

When to claim adoption expenses

Domestic adoptions: You generally claim the exclusion for qualified adoption expenses in the year your employer pays the qualifying expenses. For qualified adoption expenses you paid in a year before the adoption is final, you claim the credit in the year after you paid the expenses. You claim the credit for qualified adoption expenses you paid in the adoption year or a later year in the year you paid the expenses.

Foreign adoptions: You claim the exclusion or the credit for qualified adoption expenses you (or your employer) paid in a year before the adoption is final in the year the adoption is final. You claim the exclusion or the credit for qualified adoption expenses you (or your employer) paid in the adoption year or a later year in the year the expenses are paid.

Example: *Veronica adopts a child in a domestic adoption that is final in 2010. Veronica paid qualified adoption expenses of $1,000 in 2008, $5,000 in 2010, and $2,000 in 2011. Veronica can claim a credit for $1,000 of qualified adoption expenses in 2009, $5,000 in 2010, and $2,000 in 2011.*

Refundable credit in 2010

Starting in 2010, the adoption expenses credit is refundable. That is, if the credit exceeds the amount of income tax otherwise due, the excess is refundable to you.

Credits carried over to 2010

The adoption expenses credit was not refundable prior to 2010. As a result, you may have a credit from a prior year carried over to 2010. Such a credit is refundable in 2010. Furthermore, a credit carried over to 2010 is not subject to the phaseout income limitations in 2010.

Example: *John and Mary adopted a child in 2009. They paid $10,000 of qualified adoption expenses and claimed a $10,000 adoption expense credit for 2009. Their income tax liability was $6,000 before the adoption expense credit, so they could use only $6,000 of the credit in 2009. John and Mary can carry forward $4,000 of adoption expense credit from 2009.*

In 2010, John and Mary's income tax liability before the adoption expense credit is $3,000. John and Mary can offset their income tax liability with $3,000 of the adoption expenses credit and receive a refund of the remaining $1,000 of credit in 2010.

Substantiating the adoption

Starting with your 2010 tax return, you must substantiate the adoption or attempted adoption in order to claim the adoption expenses exclusion or credit. For a domestic or foreign adoption that has been finalized in the United States, you must attach a copy of an adoption order or decree to your federal income tax return. For a domestic adoption that is not final, you can use an adoption taxpayer identification number or attach various documents to your federal income tax return. If you claim adoption expenses under the special provision for a child with special needs, you must attach a copy of the state determination of special needs.

You must file paperwork

If you claim the adoption expenses exclusion or credit, you must send in a printed-out income tax form along with any substantiation documents--even if you file electronically.

Form 8839

For 2010, you claim the adoption expenses exclusion and credit on IRS Form 8839, Qualified Adoption Expenses.

There may be substantial tax benefits for your adoption expenses, but you will need to substantiate the adoption and file paperwork.

State adoption assistance programs may be available, but reimbursed expenses do not qualify for the federal adoption expenses credit.

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Ask the Experts

Is buying a condo for my college student a good idea?

When parents estimate the amount of money they'll be spending on dorm rooms and off-campus apartments for the next several years, it's easy to see why many parents like the idea of buying a condo for their college student. But, assuming your child is responsible enough to take care of such a property, whether it makes financial sense to do so depends on several factors.

Recouping costs: The costs of owning the condo, minus any rent paid by roommates, should be less than what you would pay for a dorm or apartment over the same time period. Costs may include a mortgage (including points and fees), property taxes, homeowners insurance, condo dues, and maintenance costs. And if your child plans on having roommates, you may want to add an umbrella liability policy to your homeowners insurance to protect you now that you're a landlord.

Will you come out ahead in the end? The rate of housing appreciation varies by geographic area, so research the location you're targeting. And don't forget to factor in a broker's commission when you sell the property.

The right mortgage: For long-term real estate ownership, it often makes sense to choose the certainty of a fixed-rate mortgage. But for short-term real estate ownership, a three- or five-year adjustable-rate mortgage may make more financial sense because the lower initial interest rate translates into a lower monthly payment. But be aware that if housing prices drop before you can sell the property, you may end up owing more than the house is worth--a situation you want to avoid.

Tax benefits: You may be able to deduct mortgage interest and property taxes on a second property; however, the IRS limits the amount of itemized deductions high-income taxpayers can take. In addition, if rent is collected, rental property rules will apply: rent you receive will be considered income, and you'll be entitled to claim some expenses as business deductions. But second homes and rental property aren't eligible for the $250,000 per person exclusion that you get when you sell your primary residence. To learn more, consult a tax professional.

I plan to buy my child a condo for off-campus college housing. Is this purchase considered a qualified 529 plan expense?

Money withdrawn from a 529 plan to pay the beneficiary's qualified higher education expenses is tax free at the federal level (and typically at the state level too). Unfortunately, the purchase price of your child's condo is not a qualified higher education expense for 529 plans under IRS rules. But a room-and-board allowance may be.

IRS Publication 970, *Tax Benefits for Education,* spells out the rules for counting your child's room-and-board costs as qualified higher education expenses under your 529 plan. (Publication 970 refers to a 529 plan as a "qualified tuition program" or QTP.)

First, the student needs to be enrolled at college at least half-time.

Next, for students who live on campus, the room-and-board allowance figure is equal to the actual amount charged by the college.

For students who live off campus, the amount of room-and-board expenses that you can safely withdraw tax free from your 529 plan is equal to the "allowance" figure that the college determines for off-campus housing.

This room-and-board allowance figure is the one included in the official cost of attendance for your child's school and used for purposes of awarding federal financial aid. If you can't find this figure in the college's literature or website, call the bursar's office to determine the current qualified room-and-board costs for off-campus housing. The allowance for off-campus housing will not be greater than the amount for on-campus housing.

Before you buy your child a condo for college housing, make sure you understand the potential risks involved in such a transaction. Be careful not to overestimate your possible savings or the potential appreciation of the property, especially considering today's real estate market. And don't forget to objectively evaluate your child's ability to responsibly care for the property and act as landlord if roommates will be in the picture.