Capital Financial Planners, LLC

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Avoiding Taxes By Moving Abroad Only Sounds Good

The top few percent of taxpayers already contribute the vast majority of personal income tax revenue, and the top tax rate, 35%, is scheduled to rise to 39.6% in 2011, when tax cuts from a decade ago expire. New legislation could target even more of your income, and recession-battered states and municipalities are also eyeing higher rates, particularly for the wealthiest residents. It's enough to make you feel like getting the heck out of Dodge—perhaps emigrating to Switzerland or to one of the Caribbean nations that offer incentives to attract American millionaires. But before you pull up stakes for good, consider all of the implications, some of which have nothing to do with taxes. The benefits for expatriates may not be as promising as you expect.

To avoid paying U.S. taxes, it's not enough simply to leave the country; you'll also have to renounce your U.S. citizenship through a formal declaration of renunciation to the U.S. State Department. That's a major step you might come to regret. Once you voluntarily renounce your citizenship, it won't be easy to reacquire it if you change your mind, and as a non-citizen, you'll no longer be able to seek help from the U.S. Embassy if you run into trouble abroad. And moving out of the U.S. is likely to involve a dramatic change in lifestyle, culture, and customs. (If you do decide to make the change, be sure to acquire citizenship in another country before you give up your U.S. citizenship. Otherwise, you may not be able to travel freely.)

Meanwhile, leaving the country may bring fewer tax advantages than it did a few years ago. Changes included in a 2008 tax law for military personnel—the Heroes Earnings Assistance and Tax Relief Act (known as HEART, or the Heroes Act)—have diluted the savings wealthy expatriates might otherwise realize from leaving the country. Now, if you terminate your U.S. citizenship, you're generally treated as if you had sold all of your assets on the day before expatriation, and you'll owe taxes on those implied proceeds. This rule normally applies to anyone who meets one of the following three criteria (though people with dual citizenship in the U.S. and another country as well as those who relinquish U.S. citizenship before age 18½ may be exempt).

- During the five-year period preceding expatriation, you had an average annual U.S. tax liability of at least $145,000. That cut-off, which applies for those who give up their citizenship in 2010, is indexed annually for inflation.
- Your net worth is at least $2 million.
- You fail to certify that you have satisfied all applicable U.S. obligations during the five years before expatriation.

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Adventures With Taxes Continue

We are currently experiencing an unusually uncertain tax environment, and may very well enter 2011 without knowing what the 2011 federal income tax brackets will be. Who knows whether some or all of the "Bush tax cuts" will be extended to provide continued tax relief in an effort to further the economic recovery.

In addition to uncertainty surrounding income taxes, there is also some uncertainty surrounding capital gains tax rates for 2011. Capital gains rates may be headed higher in 2011, so please contact us if you wish to take advantage of 2010's rates by making a sale before the end of the year

The new year will bring some certainty to taxes, in that it will mark the first year that asset custodians will be required to report cost basis information to the IRS. When placing a sale, the default reporting used by most custodians will be to sell the longest-held assets first. Please let us know prior to a sale if you and your tax preparer would like to use a different cost basis reporting method.

With the end of the year fast approaching, we take this opportunity to thank you for the privilege of working with you this year, and look forward to continuing our work together in 2011.

Judy

Should Retirees Carry A Mortgage?

Your home mortgage is likely to be the biggest debt you ever take on. And if you've moved or refinanced a few times since your first home loan, you may be years or even decades away from owning your house free and clear. But that begs the question: What about retirement? If you're getting ready to retire or already have stopped working, does it make financial sense to keep making monthly payments? Or should you use some of your savings to retire that debt?

Traditionally, paying off the mortgage was a pre-retirement objective, but the recent trend has been to carry the debt longer. A study by the Center for Retirement Research at Boston College found that in 2007, 41% of households with people in their 60s still had a mortgage, even though more than half owned sufficient assets to repay the loan.

Why would you hold a mortgage in retirement? Depending on your situation, you may value the tax benefits and liquidity. Consider these four critical factors.

1. Investment returns. Recently, the average 30-year fixed rate for mortgages has been between 4% and 4½%. You might keep your mortgage if you think you can do better investing the money you would spend to retire it. But retirees who invest heavily in low-risk vehicles such as bank certificates of deposit (CDs) and Treasury securities are likely to come up short. And though stocks and mutual funds may provide higher rates of return, they carry greater risks, and if your portfolio plummets, you could have trouble making mortgage payments.

2. Tax breaks. You can generally write off mortgage interest if you itemize deductions. But people who claim the standard deduction—and that's almost two out of every three taxpayers—receive no tax benefit from mortgage interest payments. So if you're not an itemizer, it may make sense to pay off the mortgage. Also keep in mind that the tax benefit of itemized deductions will be reduced if your income is high.

3. Retirement accounts. It's generally not a good idea to pay off your mortgage if you have to invade your retirement accounts to do it. The money you pull out of a 401(k) plan or an IRA will be reduced by taxes—at ordinary income rates of as high as 35%—plus you'll be hit with an additional 10% penalty if you're under age 59½. And you'll be left with fewer funds to draw upon during retirement.

4. Refinancing. One alternative to paying off the mortgage may be to refinance it at a lower interest rate. That can reduce your payments, or you could use the opportunity to pull out equity you've built. But the deep decline in real estate values has underscored the risks of financial strategies built around home loans.

Choosing what to do about your mortgage is a major financial decision. We can help you choose the best approach for your situation. ●

Do You Know Estate Planning Basics?

With the future of the estate tax up in the air, you may be tempted to neglect estate planning. The federal tax on inherited wealth was repealed in 2010, and is scheduled to return in 2011 under less favorable terms. Congress may resolve this issue before year-end, perhaps exempting all but the wealthiest families from estate tax liability. Yet whatever the fate of the law, having a thoughtful, effective estate plan will continue to be crucial.

At a minimum, you need a legally enforceable Will that lays out how you want your assets to be distributed. An accompanying, non-binding letter of instruction could further spell out your wishes. You may also want to establish one or more Trusts designed to minimize taxes, manage assets for minors, provide asset protection for heirs, implement philanthropic plans, or protect assets from creditors. And a Living Will (or health care proxy) could provide valuable direction on end-of-life health care.

Are you familiar with estate planning basics? Use this quiz to test your knowledge.

1. Which of the following is true?

a) A Will is legally valid only if drafted by an attorney.
b) You can transfer jointly owned property through a Will.
c) A Will may appoint a guardian for minor children.
d) Your property must go through probate if you don't have a Will.

2. When can a Will be changed and remain legally enforceable?

a) Only if the changes are recorded by an attorney
b) Only when the heirs named in the Will provide their consent
c) Any time before your death or mental incompetence
d) Never

3. In 2009, the federal estate tax exemption was:

a) $1 million c) $3.5 million
b) $2 million d) Zero

A Good Time To Reassess Your Risk Profile

The recent past has given investors an invaluable lesson in risk, which makes now an ideal time to reconsider your "risk profile," the amount of volatility you're willing to accept. From the happy heights of late 2007, the Standard & Poor's 500 stock index lost 55% of its value by March 2009, and much of the damage came sickeningly fast, with a 40% freefall between September and November of 2008. Then came a dizzying recovery, as the S&P rallied 60% between March and December 2009. Yet even after the comeback, the large-company index remained some 30% below its record high.

How your portfolio has fared during this remarkable period depends on how much risk was built into your investments, and on how you responded when conceptual risks became all too real. Many investors, lured into volatile areas of the market when most investments were rising, were shocked when numerous sectors suddenly dropped by more than half. Some of these investors watched helplessly, unable to sell as holdings kept plummeting, while others got rid of everything, determined to stick with cash for the foreseeable future.

Neither predicted outcome was good or anticipated. The purpose of determining your risk profile is to use it to build a portfolio that minimizes disruptive surprises. If you think you can handle a 15% annual loss but would be apoplectic if your investments dropped twice that much, then you need a portfolio that, in most economic and market scenarios, wouldn't dip by much more than that "comfortable" 15%.

But markets don't always behave as predicted. The recent financial crisis highlighted the reality that assets under duress can move together. All manner of stocks—from shares of enormous, normally rock-solid companies to those of small, fast-growing firms and stocks in once-hot emerging markets—headed down together. And while some bonds fared a little better, Treasuries fared the best as safety-obsessed investors bid up prices and caused yields to decline considerably. And alternative investments, including real estate, commodities, and hedge funds, had major issues of their own.

As a result, most investment portfolios did worse than expected, and that exacerbated the problems of investors who had taken on too much risk. Panicking, many sold when investment values were at their lowest point, and with losses locked in, they've missed out on stocks' historic rally.

Reassessing your risk profile now, and making appropriate portfolio adjustments, could help you prepare for the next financial upheaval. This process may involve several steps. The first is to understand how you really feel about risk. How did you react in September and October of 2008, when account balances slid lower almost every day? Were you able to take a long view, assuming that even this bear market would pass, or did you treasure safety above all else? Would you rather stick with less volatile investments even if that means accepting lower long-term returns?

Your answer to that last question depends in part on what you need your portfolio to achieve, and re-examining your financial needs is step two of this process. Perhaps the prospect of postponing retirement or spending a little less during your later years seems like a reasonable trade-off for the comfort of holding less volatile investments.

Once you've figured out how much risk you're willing to accept, and how much you need to reach your goals, the third step of the process is to incorporate your readjusted risk profile into your portfolio. We can design a portfolio with the discipline of a plan built around your financial objectives, risk profile, and investing timetable.

You may need to rebalance your portfolio, selling some holdings and buying others, first to get in line with your risk profile and then to keep allocations steady as markets fluctuate. Finally, it's important to monitor your investments, periodically re-evaluating what you own in light of your evolving personal circumstances.

We have the tools, experience, and expertise to help investors successfully complete this crucial post-crash process, helping position investments for a potentially smoother ride through the next crisis and steady progress toward financial goals. If you would like to speak with us about your portfolio, please give us a call. ●

4. In 2010, the annual gift tax exclusion shelters gifts to individuals of up to:

a) $10,000 c) $1 million
b) $13,000 d) Zero

5. For estate tax purposes, the value of assets is based on:

a) Their fair market value, subject to exemptions, on the date of the owner's death (or six months from that date)
b) The amount received from the sale of those assets
c) The assets' original cost
d) The value stated in the owner's Will

6. A "power of attorney" is best described as:

a) A bequest in a legally validated Will
b) A document authorizing an agent to act on your behalf
c) A document allowing life support systems to be shut down
d) The use of a lawyer in estate planning matters

7. Which of the following is not true?

a) The value of your principal residence is excluded from your estate.
b) The value of property transferred to your spouse is exempt from estate tax at your death.
c) A Testamentary Trust takes effect when you die.
d) A Will normally determines who will care for minor children.

If you have questions about estate planning or need to refine your plan, please give us a call. We can work with you and your attorney to make sure all of your needs are met.●

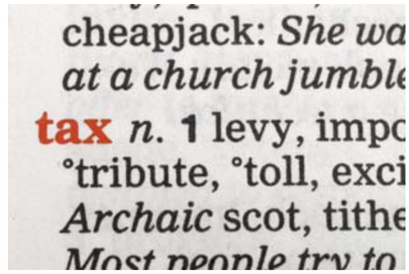
Answers: 1-c; 2-c; 3-c; 4-b; 5-a; 6-b; 7-a

Moving Only Sounds Good

(Continued from page 1)

If you are subject to this tax on expatriates, you're allowed an exemption of $626,000 in 2010 (the amount is indexed annually). Then you'll be taxed at a 35% rate for ordinary income and 15% for long-term capital gains. Considering that these levies apply to all of your assets, minus the exempt amount, the tax is likely to add up to a hefty penalty for leaving the country and could undercut future benefits.

And what if you later want to do something for family members back home? U.S. citizens and residents who receive gifts or bequests from expatriates may be assessed a special transfer tax of 45%. The tax applies to property directly or indirectly acquired as a gift from someone who is an expatriate at the time of the transfer, as well as to any property received, directly or indirectly, due to the death of an expatriate. However, the transfer tax may be reduced by foreign gift or estate taxes paid on the property.



Special rules also apply to deferred compensation (such as retirement plan benefits) that you receive after giving up your citizenship. In most cases, 30% of those payments must be withheld to cover U.S. income tax liability.

Finally, there could also be problems involving state taxes. In California, for example, expatriates may owe state tax on real estate they continue to hold in the state.

No matter how frustrating you find your current U.S. tax burden—and regardless of how much that burden may soon rise—choosing to emigrate and give up your citizenship isn't a move to make without carefully considering all that it could mean. If you're seriously considering leaving the country, we encourage you to first understand how that change will affect your financial and personal circumstances. There may be less drastic measures that might also reduce your taxes. ●

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