



# THE BACK BAY ADVISOR

745 Boylston Street, Suite 503 • Boston, MA 02116 • (617) 247-0518 • www.backbayfinancial.com

## Tax Planning for Major Life Events

Most of life's major financial decisions have tax ramifications. As you encounter those events, keep these tax-planning tips in mind:

**Marriage or divorce** — Either event should prompt a thorough review of your tax situation. In both cases, your tax filing status will change, which may have an impact on your tax-planning situation. Your filing status is determined as of December 31, so if you are planning to get married or divorced around year-end, review the tax ramifications first. Consider these specifics:

- **Check income tax withholdings.** You may need to adjust your allowances for income tax withholding purposes, or review any estimated taxes that are being paid.
- **Review fringe benefits.** In the case of marriage, you will want to coordinate your fringe benefits with your spouse's benefits. In a divorce, you may have to find another source for fringe benefits you obtained from your spouse's employer.
- **Understand the tax ramifications of any divorce agreements.** Determine who will claim minor children as dependents on tax returns. Determine whether any payments are classified as child support or alimony, which have significantly different tax ramifications. Review how the division of property will affect your gain

or loss when you sell the asset.

**Birth of a child** — Each exemption on your tax return reduces your taxable income by \$3,400 in 2007, although high-income taxpayers may find these exemptions reduced. Other tax items to review include:

- **Plan for other tax benefits.** A \$1,000 child tax credit is available every year until your child is age 17, but the credit is phased out at

higher income levels. You may also be eligible for a child care credit if you pay for child care so you can work. Check at your place of employment to find out if child care reimbursement accounts are available, which allow you to pay child care expenses from pretax earnings.

- **Start saving for college.** It's
- Continued on page 2

## Investment Tax Strategies

With marginal tax rates of up to 35%, taxes can seriously erode your investment's total return. Consider these strategies, which can help you reduce income taxes:

- **Consider your holding period before selling.** Gains on investments held for longer than one year are taxed at the capital gains tax rate of 15% (5% if you are in the 10% or 15% tax bracket), rather than at ordinary income tax rates. Thus, before selling an investment, review your holding period. If the one-year holding period will be reached in a short time, you might want to wait to sell the investment. On the other hand, you might want to sell immediately if you're concerned that the investment's value could drop during that period.
- **Review realized gains and losses before year-end.** If you have realized gains but are holding

investments with losses, you might want to sell them before year-end to offset those gains. You can offset all of your capital gains plus take an additional \$3,000 of loss against ordinary income. This strategy might be particularly useful if your adjusted gross income is close to the eligibility limits for various tax benefits. If you still want to hold an investment with a loss, you can sell it to deduct the loss and later repurchase it, provided you avoid the wash sale rules. These rules state that you must repurchase the investment at least 31 days before or after you sell the original investment to recognize the loss for tax purposes.

- **Specifically identify which shares you are selling.** If you purchased an investment over time, you may have varying

Continued on page 3

## Major Life Events

Continued from page 1

never too early to start saving for college. There are a variety of tax-advantaged ways to save for college, including section 529 plans and Coverdell education savings accounts. Once your child starts college, be aware of other ways to reduce the cost of college, including the Hope and lifetime learning credits, the above-the-line education deduction, and interest deductions for qualified higher education loans.

- **Consider annual gifts to your child.** In 2007, you can gift \$12,000 (\$24,000 if the gift is split with your spouse) to each child on a tax-free basis. This amount increases annually for inflation, in \$1,000 increments. This reduces your taxable estate and you avoid paying taxes on any earnings on those assets. Be aware, however, of the “kiddie tax,” which refers to the way children’s investment income is taxed. In the past, it applied to children under age 14, but now applies to children under age 18. In 2007, the first \$850 of investment income is tax free, the second \$850 is taxed at the child’s marginal tax rate (typically 10%), and any remaining investment income is taxed at the parents’ marginal tax rate. Once the child is age 18 or older (previously age 14 or older), all investment income is taxed at his/her marginal tax rate. Thus, until your child turns age 18, you might want to select investments with lower tax burdens.
- **Think about individual retirement accounts (IRAs).** Once your child starts earning income, consider setting up an IRA for him/her. If the child does not want to use his/her money for the IRA, you can gift the money to the child.

### Purchasing or selling a home

— The tax benefits of owning a home are significant. Consider these tax aspects:

## 2007 Marginal Tax Rates by Filing Status

	Married Filing Jointly and Surviving Spouse	Single	Married Filing Separately	Head of Household
10%	\$0 – 15,650	\$0 – 7,825	\$0 – 7,825	\$0 – 11,200
15%	15,650 – 63,700	7,825 – 31,850	7,825 – 31,850	11,200 – 42,650
25%	63,700 – 128,500	31,850 – 77,100	31,850 – 64,250	42,650 – 110,100
28%	128,500 – 195,850	77,100 – 160,850	64,250 – 97,925	110,100 – 178,350
33%	195,850 – 349,700	160,850 – 349,700	97,925 – 174,850	178,350 – 349,700
35%	over 349,700	over 349,700	over 174,850	over 349,700

- **Mortgage interest and property taxes can be deducted on your tax return, reducing the cost of owning a home.** Mortgage interest is deductible on up to \$1,000,000 of original debt incurred to purchase a principal residence. Additionally, interest paid on up to \$100,000 of home-equity debt is deductible on your tax return. You may want to replace loans that generate personal interest, which is not tax deductible, with home-equity loan debt.
- **When you sell your home, significant capital gains can be excluded from income.** You can exclude up to \$250,000 of gain if you are a single taxpayer and up to \$500,000 of gain if you are married filing jointly, provided the home was your primary residence in at least two of the preceding five years. You no longer have to purchase another home to qualify for the exclusion. If you are forced to sell in less than two years due to employment changes, health reasons, or unforeseen circumstances, you can prorate the exclusion amount based on how long you lived in the home.

**Planning for retirement** — With all the other demands on your income, it’s easy to forget about planning for retirement. However, you should take advantage of tax-advantaged ways to save for your retirement.

- **Participate in your 401(k) plan.** Start contributing to a 401(k) plan as soon as you are eligible. In 2007, you can contribute a maximum of \$15,500, plus individuals

age 50 and older can make an additional catch-up contribution of \$5,000, if permitted by their plan. These contributions reduce your current-year taxable income, although you still have to pay Social Security and Medicare taxes on the contributions. If your employer matches contributions, make sure to contribute at least enough to maximize the match.

- **Review IRAs.** Even if you are contributing to a 401(k) plan, take a look at IRAs as well. In 2007, you can contribute a maximum of \$4,000 to an IRA, plus individuals age 50 and older can make an additional catch-up contribution of \$1,000. Traditional deductible IRAs will reduce your current-year taxable income. Roth IRAs do not reduce current-year taxable income, but qualified distributions can be taken income-tax free. Those who are not eligible for a deductible contribution to a traditional IRA or who are not eligible to contribute to a Roth IRA should consider a nondeductible contribution to a traditional IRA. Starting in 2010, all taxpayers, regardless of income level, can convert traditional IRAs to Roth IRAs.
- **Check your options before retiring.** The choices you make regarding distributions from your pension plans and IRAs will have a significant impact on your tax situation after retirement. Make sure you review all your options before deciding how to withdraw those funds.

Please call if you’d like to discuss tax-planning strategies in more detail. ■■■

## Investment Tax Strategies

Continued from page 1

basis amounts for different shares. Your gain or loss will be determined by which shares you sell. Thus, you should assess your overall tax situation, decide whether you want a higher or lower gain or loss, and then designate which shares you want to sell. Also consider your holding period if you have held some shares for less than one year and others for more than one year. If you don't specifically identify which shares to sell, the Internal Revenue Service will assume you sold the first shares purchased.

- **Donate investments with large capital gains to charitable organizations.** Of course, this strategy only makes sense if you were planning to make a charitable contribution anyway. You can deduct the fair market value of the investment (provided you held it over one year) as a charitable contribution, subject to limitations based on your adjusted gross income. By donating the investment, you do not pay capital gains taxes on the gain. For instance, assume you donate stock with a fair market value of \$10,000 and a basis of \$2,500. You receive a charitable contribution deduction of \$10,000, and you avoid capital gains taxes of \$1,125 (15% of your \$7,500 gain).
- **Keep track of your investments' bases so you don't overpay taxes.** For instance, reinvested dividends are part of your cost basis, since income taxes were paid when the dividends were received. For inherited assets, the cost basis is typically the value on the date of the previous owner's death.
- **Consider tax-deferred or tax-exempt investments.** The interest income from municipal bonds is typically exempt from federal

## What's Your Marginal Tax Rate?

If you answer that question by looking at the tax rate tables that show income tax rates of 10%, 15%, 25%, 28%, 33%, and 35%, you could be understating your real marginal tax rate. Your marginal tax rate could be higher due to numerous provisions that phase out or limit certain deductions, credits, and other tax benefits. Some of the more significant provisions include:

- **Limitation on itemized deductions** — Once adjusted gross income (AGI) exceeds \$78,200 in 2007 for married couples filing separately and \$156,400 for all other taxpayers, itemized deductions, with the exception of medical expenses, investment interest, and casualty losses, must be reduced by 3% of the excess over this AGI amount. The maximum reduction is 80% of itemized deductions. In addition, medical expenses can only be deducted to the extent they exceed 7.5% of AGI, while miscellaneous expenses must exceed 2% of AGI and casualty losses must exceed 10% of AGI.
- **Phaseout of personal exemptions** — The personal exemption amount of \$3,400 in 2007 is reduced by two-thirds of 2% of each \$2,500 of AGI over threshold amounts. Those amounts for 2007 are \$234,600 for married taxpayers filing jointly, \$195,500 for heads of household, \$156,400 for single taxpayers, and

\$117,300 for married taxpayers filing separately.

- **Exclusion of Social Security benefits from income tax** — Up to 50% of benefits are taxed when AGI plus tax-free interest plus one-half of Social Security benefits is over \$25,000 but less than \$34,000 for single taxpayers and is over \$32,000 but less than \$44,000 for married couples filing jointly. Up to 85% of benefits is taxed once income exceeds \$34,000 for single taxpayers and \$44,000 for married couples filing jointly.
- **Other phaseouts** — Numerous credits, deductions, and other benefits are phased out once income exceeds prescribed limits, including the earned income credit, the child credit, the dependent care credit, traditional and Roth individual retirement account (IRA) contributions, Coverdell education savings account contributions, Hope scholarship and lifetime learning credits, the above-the-line higher education expense deduction, student loan interest deductions, rental real estate losses under passive loss rules, the adoption credit, and the elderly and disabled credit.

While these items aren't called income taxes, the result is the same — an increase in your total income tax bill. ■■■

income taxes and possibly state and local income taxes. (There may be alternative minimum tax consequences and an impact on taxation of Social Security benefits.) Contributions to 401(k) plans and IRAs can grow on a tax-deferred or tax-exempt (for

Roth IRAs) basis. This deferral of income taxes can make a significant difference in the ultimate size of your portfolio.

Please call if you'd like to discuss how to structure your portfolio in a more tax-efficient manner. ■■■

## In the News

**John LeBlanc's** thoughts on solo retirement were quoted in business-week.com. The article, "Flying Solo in the Golden Years," focused on some of the unique financial and emotional challenges that single people may face in retirement.

The Boston Globe's July 29 "Money Makeover" column featured **Susan Brown**. She advised a young professional about how to invest within her employer's retirement plan.

## Client Services

A new tool to assist in the designing of client portfolios is under study by **Bob Siefert** and **Meghan Sanders**. The latest analytical research product, StyleAdvisor by Zephyr Associates, helps determine the reasoning behind rate of return characteristics of mutual funds, particularly those which differ from expected norms.

## Technology

The firm's Web site received a substantial overhaul. The new site sports the company's new brand identity and paves the way for the future addition of client account tools. The site may be viewed at [www.backbayfinancial.com](http://www.backbayfinancial.com).

## All Work and No Play...

**Lindsay McDonald** visited Montreal in June and attended friends' weddings throughout the summer.

Family was the focus of many other summer activities. **Francis Sellers** attended an annual July 4th gathering in Connecticut. **Susan Brown** and family explored California, driving the Pacific Coast Highway from Los Angeles to San Francisco, and then Yosemite National Park. **Erik Gudim** visited family and friends in Connecticut and attended a family reunion in the Berkshires. A Caribbean cruise for **Jeanne Gibson Sullivan** turned bumpy as Hurricane Dean exerted its force. She also spent a few days in Kansas City. **Philip Lee** vacationed in New York, Cape Cod and Delaware.

Cape Cod was a favorite destination for several staffers. **Mary Evans** spent as much time as possible enjoying her family's home on the Cape. **Becky Martz** spent a weekend in Province-

town and also went to New York in July and August for niece and nephew's baptisms. **Emily O'Hara** found solace at a nice barbeque on the Cape. Her parents also visited from California and she visited Yankee Stadium for the first time to see the Red Sox take on the Yankees.

One of the more exotic vacations was a two-week trip to the southwest by **Ed Childs** and his partner Charles. They explored New Mexico, Utah and Arizona. Santa Fe, Monument Valley and the Grand Canyon were among their favorite sights.

**John LeBlanc** began and ended the summer with week long vacations at his cottage in Maine.

**Mandy Magee** closed on her first house in July and spent her free time working on her new home. **Bob Siefert** did not take any extended vacation time, but managed to take some enjoyable short excursions visiting some clients and their newly purchased homes in Providence, R.I. and Boothbay, Maine.

## Continuing Education

Philosophy and modeling techniques were the focus of a two day Dimensional Fund Advisors (DFA) educational seminar attended by **Emily O'Hara** and **Mary Evans**. DFA was also on the mind of **John LeBlanc** who participated in a DFA practice management and investment study group.

**Philip Lee, Jeanne Gibson Sullivan** and **Susan Brown** participated

in National Association of Personal Financial Advisors (NAPFA) Massachusetts chapter meetings. Topics included Property and Casualty Insurance Strategies for high net-worth individuals/families. Speaker Jonathan Guyton also discussed his recently published research on Decision Rules and Maximum Initial Withdrawal Rates for retirees. Philip also attended a half-day trust education seminar in Natick. The session delved into the reasons for, and taxation of, trusts and integrating trust knowledge into estate planning. Jeanne is now teaching a case analysis course at Merrimack College's Financial Planning program.

**Mandy Magee** attended the Schwab Solutions Conference in July. The conference centered on new features aimed at increasing efficiency and accuracy relating to account setup and maintenance.

Internet security and Web identity theft was the focus of a Fidelity Technology symposium attended by **Becky Martz** in June. The keynote speaker discussed the evolution of the Internet.

## Giving Back

**Susan Brown** participated in a pro-bono financial planning clinic in Boston that provided one-on-one financial planning advice to the public. The clinic was sponsored by the Certified Financial Planner Board of Standards.

## Company News

**David Young**, who served as a staff assistant for two years, has left for Georgetown University Law Center, Washington, D.C. He was a valued employee to the firm and will be missed. **Erik Gudim** succeeds David in the modified position of research/operations analyst. He supports company operations related to investment research, compliance, operational analysis and special projects.

BBFG is proud to announce **Mary Evans** successfully passed the comprehensive CFP® Certification Examination in July! After three years of quali-



Erik Gudim

ifying full-time work, she will be one of seven CFP® practitioners at the firm.

In other company news: For the fifth consecutive year, BBFG was named in *WealthManager's* Top

Dog Report as one of the top advisory firms nationwide. The firm also made the list in *Financial Advisor's* Second Annual Top RIA Survey of growing firms.

The entire staff gathered in August for the firm's semi-annual off-site, planning meeting in South Yarmouth at the home of **Francis Sellers**. The meeting was organized, in part, by **Lindsay McDonald**.



David Young