

# **Improved Savings Opportunity The Tax Increase Prevention & Reconciliation Act of 2005**

**You need to be aware of these changes!!!**

Two major laws have been passed this year that shake up the rules for all kinds of personal financial planning. Viewed as "the most sweeping reform of America's pension laws in over 30 years,"<sup>1</sup> the new tax act gives you plenty of ways to save on your income taxes, and put aside money for retirement and college. One message is clear—if you make the effort to save, the federal government will give you a hand, in the form of tax advantages.

## **Saving more at work**

The tax act is good news if you work for an employer who offers a retirement savings plan such as a 401(k), 403(b), 457(b), or SIMPLE IRA. Now you may be able to take advantage of the higher annual pretax contributions made permanent by the new law to increase your savings. And, because these pretax contributions can effectively reduce your current taxable income (thereby lowering your overall income tax bill), you've got an even greater incentive to contribute more to your plan.

What's more, if you're age 50 or older and your plan allows it, you can make additional catch-up contributions. If made on a pretax basis, these extra contributions can usually lower your tax bill as well. The table below summarizes the limits for individual contributions to most retirement plans.

## ***Qualified plan rollovers to Roth IRAs simplified***

Under previous tax rules; it took two steps to convert workplace retirement plan assets to a Roth IRA. First, you had to roll your distribution over into a Traditional IRA and then you had to convert that account into a Roth IRA. Thanks to the new tax law, this two-step procedure will no longer be necessary, although you will generally still owe federal taxes on the amount converted.

Beginning in 2008, if you're eligible to make a Roth IRA conversion, the new law will allow you to arrange for a direct (trustee-to-trustee) rollover from your retirement plan into a Roth IRA. This Roth "conversion" opportunity will be available for assets from qualified retirement plans such as 401(k), 403(b), and governmental 457(b) plans.

***Income limits for Roth rollovers gone in 2010***

Thanks to tax law changes passed in early 2006,<sup>2</sup> retirement savers with more than \$100,000 in modified adjusted gross income will soon be able to take advantage of the direct Roth roll-over/conversion rule too. Starting in 2010, the income limit for Roth conversions will be eliminated, allowing savers to take advantage of the Roth rollover/conversion opportunity regardless of income level. If ordinary income tax rates go up in 2011 as scheduled, you should take advantage of converting in 2010 at the lower tax rates.

What's more, if you decide to convert any assets in 2010, your federal income tax bill can be spread out over two years in 2011 and 2012 unless you elect otherwise. (For conversions after 2010, the conversion tax bill can't be stretched out.)

**The new tax law also includes:**

***Saver's tax credit of up to \$1,000.*** For individuals with modest incomes who contribute to IRAs, 401(k)s, and certain other plans, the credit is now permanent. This could be especially valuable to young workers who are just beginning to save.

***Military early withdrawal option.*** Qualified reservists may take early withdrawals from retirement accounts without paying the usual 10% penalty. If you served, or will serve, on active duty between September 11, 2001 and December 31, 2007, you are eligible to withdraw from your Roth or Traditional IRA or your workplace plan. The tax relief is retroactive, so if you've already paid the penalty you can claim a refund from the IRS.

**Retirement Contribution Limits: don't let this opportunity pass you by!**

<b>Retirement Contribution Limits*</b>				
No matter what kind of savings plan you have, the new law may let you contribute more. Here's how much:				
	2006	2007	2008	2009 and after
401(k)	\$15,000	\$15,500	\$15,500**	\$15,500**
401(k) Catch-up	\$5,000	\$5,000	\$5,000**	\$5,000**
SIMPLE-IRA (Small Business)	\$10,000	\$10,500	\$10,500**	\$10,500**
SIMPLE-IRA Catch-up	\$2,500	\$2,500	\$2,500**	\$2,500**
Traditional/Roth IRA	\$4,000	\$4,000	\$5,000	\$5,000**
Traditional/Roth IRA Catch-up	\$1,000	\$1,000	\$1,000	\$1,000

\*Note that in certain cases, other requirements may apply in order to be eligible to contribute up to the above limits.  
 \*\*Subject to cost-of-living adjustments.

**Contribute more to your IRA—and save more on taxes**

The new law makes permanent higher contribution limits for Traditional and Roth IRAs—and the catch-up contributions for both types of accounts—for those age 50 and older. If you are eligible to contribute to an IRA in 2006 and 2007, you can generally contribute up to \$4,000 each year to your IRAs or up to \$5,000 if you are age 50 or older. For 2008 and beyond, the annual contribution limit increases to \$5,000, or \$6,000 if you are eligible to make catch-up contributions. Thanks to the new law, after 2008 the \$5,000 limit is indexed for inflation.

More welcome news under the new tax law for retirement investors—beginning in 2007, the income ranges for making tax-deductible Traditional IRA contributions and for making Roth IRA contributions will be increased for cost of living changes as well.

### ***Simpler savings with direct deposit of tax refunds***

Starting with the 2007 tax year, if you are eligible to contribute to an IRA and you expect to receive a federal income tax refund, the new tax law allows you to have all or part of this refund deposited directly into your IRA. It's a simple and direct way to jump-start your annual retirement savings. You may also be able to direct deposit some or all of your refund into your spouse's IRA if you file jointly. Remember these deposits are subject to IRA contribution eligibility and/or deductibility requirements and the maximum annual IRA contribution limit.

### ***Tax advantages for college savers are here to stay***

The new law also renews incentives to save for college by making the favorable tax treatment of 529 college savings plans permanent, including tax-deferred growth of any earnings and qualified withdrawals that are free from federal income taxes.

### ***Rollover opportunities for plan beneficiaries***

With the new tax act, more people who inherit retirement plan assets will have the opportunity to defer taxes on those assets.

Beginning in 2007, individual workplace savings plan beneficiaries who are not spouses can make direct rollovers of inherited assets from a qualified retirement plan, 401(k), 403(a), 403(b), or governmental 457(b) plan into an Inherited IRA. In the past, only surviving spouse beneficiaries had the option to roll over inherited plan assets to an IRA. All other beneficiaries were required to receive their inherited distributions from the plan, in many cases soon after the death of the plan participant—often with a huge and unwelcome tax hit.

There are some caveats. To stay tax-deferred and to stretch out the distributions and tax payments, the inherited plan assets must be deposited into a special Inherited IRA through a direct trustee-to-trustee transfer. (You cannot receive a distribution directly or your opportunity to roll over will be lost and applicable income taxes will be due for that same year.)

In addition, once the rollover is complete, the beneficiary will need to begin taking annual distributions from the new Inherited IRA and pay any resulting income taxes according to the minimum required distribution rules generally applicable to IRAs. Fortunately, it's usually possible to stretch out these distributions, and the related income taxes, over the life expectancy of the beneficiary based on an approved IRS

table. So, particularly if you're young, you may still have many years of tax-deferral ahead.

### ***Favorable dividend and capital gains rates***

In early 2006, Congress also extended the lower federal income tax rates on long-term capital gains and qualified dividends, which is great news for those who invest in taxable accounts.

Through 2010, the maximum federal rate on most long-term capital gains and all qualified dividends is 15%. Unless Congress takes further action, the maximum rate on long-term capital gains will go back up to 20% in 2011, and the maximum rate on qualified dividends will go back up to 38.6%. But until then, you can reap the benefits of these lower rates on the assets in your taxable accounts.

If you think that taxes will increase in the future, you may want to sell securities sooner rather than later to take advantage of the fairly benign capital gains now. Current rates also present some interesting planning opportunities for transferring wealth to individuals in lower tax brackets. Parents and/or grandparents may want to gift appreciated stock to their children/grandchildren who will then be able to sell the securities and pay a much lower capital gains tax.

### ***Kiddie Tax changes***

“Kiddie Tax” refers to the tax that is owed on unearned income (like interest & dividends) of a minor child. Currently, if a child is under age 14, the first \$850 is tax exempt, the next \$850 is taxed at the child’s rate, and anything above \$1,700 is taxed at the parents’ rate. Under the old law, once the children were 14 and older, they paid income tax at their own lower rates.

The new law pushes up the age to 18. So, net unearned income above \$1,700 will stay taxable at the parents’ rate until the child is 18. (But keep in mind that it affects you only if your child’s portfolio is kicking off more than \$1,700 in income per year.)

### ***529 Plans***

The tax benefits of 529 plans are no longer scheduled to disappear after 2010. So if the “sunset” issue was holding you back from using a 529 plan, worry no more. Qualified withdrawals will be income tax free.

### ***Charitable Donations: Caution is now mandatory when contributing!***

If you- don’t have written documentation for any cash gift, you can’t claim a deduction. So for you church-goers, gone are the days you can throw money into the offering plate

and claim a deduction. You'll need to use your offering envelopes or other method your house of worship uses to document offerings, or you can't write it off.

### ***Random thoughts worth considering***

#### ***Your Credit Report***

Three major credit bureaus gather information on your loans, credit applications and bill payments. This information is used to create a picture of your credit worthiness. The credit score (FICO Score) derived from this information can influence everything from loan rates to some insurance premiums.

A federal study found 70% of reports contain a mistake. You should take advantage of a recent law mandating you must be given a free credit report annually from each reporting bureau. Either call 877-322-8228 or go to [annualcreditreport.com](http://annualcreditreport.com).

I'd suggest ordering a free report every January, May and September to check for errors or signs of ID theft.

#### ***Your Insurance History***

You can order a free annual report of home and auto claims by going to [choicetrust.com](http://choicetrust.com). Having lots of claims can lead to higher premiums. On a home it will not only affect you but potentially the next owner, making your home less attractive to a buyer.

Even if you call your insurer to ask a coverage question, your query might be listed as a \$0 claim on your history. Check annually to verify accuracy and challenge all \$0 claims, you might be able to get them wiped out.

We live in a complex world. Don't attempt to go it alone. Seek professional assistance and make the most of opportunities to enhance your financial future.

The information above does not constitute, and should not be considered to be, legal or tax advice. Tax rules are complicated and their impact on a particular individual may differ depending on specific circumstances.

1. President Bush's remarks on signing the Pension Protection Act of 2006 on August 17, 2006.
2. Tax Increase Protection and Reconciliation Act of 2006 (TIPRA)

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