

# financial focus



Pinnacle Financial Concepts, Inc.

A Registered Investment Advisor



7025 Tall Oak Drive, Suite 210  
Colorado Springs, CO 80919  
719-260-9800

www.PinnacleFinancialConcepts.com

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BRIDGING THE GAP  
BETWEEN YOUR LIFE AND YOUR MONEY

Linda Y. Leitz, CFP, EA

Jane M. Young, CFP, EA

## WINTER 2011 - 2012

### SMART TAX SAVINGS STRATEGIES

by Judy Stewart, CFP® Carlsbad, CA

**L**ike it or not, you will pay taxes. But understanding the tax code sometimes seems like it requires a rocket scientist. Even Albert Einstein said, "The hardest thing in the world to understand is the income tax." But there is hope, and that's where your ACA advisor comes in. Let's look at some ways that your taxes can be reduced for 2011:

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you used up your account this year. You can no longer claim tax-free reimbursements for over-the-counter drugs such as allergy pills and antacids.
- Sell the stock/mutual fund losers in your taxable portfolio and capture the losses. Unused losses carry forward to future tax years. If you have excess losses, you can always claim at least \$3,000 in losses in any one year. That's a savings of \$1000 in taxes for most people.
- Postpone income until 2012 and accelerate deductions into 2011 to lower your 2011 tax bill.
- Consider converting traditional IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA before December 31. The conversion will increase your adjusted gross income for 2011. However, Roth IRAs are tax free forever.



- What if you converted assets in a traditional IRA to a Roth IRA earlier this year and the assets in the Roth IRA account have declined in value? If you leave things as is, you will wind up paying more tax than is necessary. You can back out of the transaction by re-characterizing the conversion, that is, by transferring the converted amount (plus earnings or minus losses) back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA.
- Consider deferring any bonuses into early 2012.
- Consider using a credit card to prepay expenses that can generate deductions for this year.
- If you expect to owe state/local income taxes when you file your return next year, consider asking your employer to increase withholdings of state/local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2011 if doing so won't create an alternative minimum tax (AMT) problem.
- Estimate the effect of any year-end planning moves on the AMT for 2011, keeping in mind that many tax breaks used to calculate regular taxes are disallowed for AMT purposes. These include deductions for state property taxes on your residence, state income taxes (or state sales tax if you elect this deduction option), miscellaneous itemized deductions, and personal exemptions.
- Accelerate big-ticket purchases (and the sales tax on them) into 2011 to assure a deduction for sales tax if you will claim a state/local general sales tax deduction instead of a state/local income tax deduction. Unless Congress acts, this election won't be available after 2011.
- You may be able to save taxes this year and next by "bunching up" miscellaneous itemized deductions, medical expenses, and other itemized deductions

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### HOW TO GET THE BEST MORTGAGE

by Bert Whitehead, MBA, JD Franklin, MI

To get a new mortgage or refinance at the lowest rates, you must show that you “qualify” for the mortgage. Here is a quick summary of the standards banks seek:

1. Clean credit record (FICO score = 700+). FICO scores are the credit scores most lenders use to determine your credit risk.
2. 80% loan-to-value (LTV). The mortgage should be less than 80% of the value of the home.
3. Currently employed.
4. Monthly payments on current debts (including mortgage) less than 40% of income.

There are some exceptions to these standards. For example, if you replace a mortgage on your primary residence and you have always made the payments, some banks let you refinance 90 to 100% of the home’s value. But, in general, you won’t get the best rates available unless you meet the criteria just listed.

Mortgage financing is a very competitive field, so check with at least three banks or mortgage companies. Rates move daily, so it’s preferable to call all three institutions on the same morning. I suggest that clients request a quote on “a 30-year fixed-rate mortgage with no points, no prepayment penalty, and with the closing costs rolled in.”

Be aware that even with no points and no prepayment penalty, there will still be certain costs that you are expected to pay at the closing. The appraisal fee, for example, is an out-of-pocket cost to the lender. Property taxes also have to be paid as well as interest payable from the date you close to the beginning of the next month. Many people prefer that property tax and insurance costs be “escrowed” so that an amount is added to the monthly payment to pay for these costs as they come due.

Having your closing costs rolled into the mortgage means adding any costs that are normally due at closing to your mortgage balance. The cost of those will be covered by your monthly payment. You should ask each lender to e-mail you a “good faith estimate” of the mortgage they propose. Then you can verify that the terms offered are those you requested and compare

the closing costs.

These are the most common stumbling blocks that clients encounter:

1. The house doesn’t appraise high enough. You can get your own appraiser to see if the bank’s appraisal is wrong, but they won’t accept it to lend you money. If it is under-appraised significantly, you might apply at another lender and they will have it appraised again. Although there can be wide variations in appraisals, there are no guarantees.
2. Unanticipated black marks appear on your credit score. You have to contact the credit bureau to correct these.
3. Your income is insufficient. This often happens to retirees who live on investment income. We

have clients set up a monthly transfer from their investment account to their checking account for the same amount each month on the first of the month. If you do this for a few years, lenders will accept these transfers as a reliable stream of retirement income.

Don’t let lenders talk you into a shorter term or adjustable rate

mortgage, which can be more profitable for them. Other mortgage options that may seem attractive have a lower interest rate. But a 30-year mortgage has three huge advantages:

1. You receive the lowest payments so you have more cash flow.
2. Because mortgage interest is tax deductible, a longer mortgage provides more tax shelter than shorter term mortgages at a lower rate.
3. Most importantly, a 30-year fixed-rate mortgage is your best protection against inflation.

By the way, if any of the offers sound too good to be true, that likely is the case. But be sure to pay attention to any offers made by your current lender. They want to keep their customers happy, so you might find some excellent offers made by a relationship that is already in place! ■ ■ ■

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### SUGGESTIONS FOR YEAR-END CHARITABLE GIVING

by Fran Goldman, MBA Washington, DC

***“We make a living by what we get.  
We make a life by what we give.”***

— *Variously attributed; author unknown*

**M**ost people include charitable giving as a part of their financial lives. In 2009, 65% of households gave to charity, with the average household contributing \$2,213. Many individuals focus on charitable giving at the end of the year.

In addition to thinking about charitable giving and its favorable tax treatment, it is important to think about how can we make our philanthropy more meaningful, both to us as donors and to the charities we want to support. Here are a few things to consider.

Do the research first by doing basic due diligence on the charities you support. The websites [www.charitynavigator.com](http://www.charitynavigator.com) and [www.guidestar.com](http://www.guidestar.com) research and evaluate public charities.

Connect your philanthropy to your values. What do you want to support? Do you want to spread your net wide or concentrate on a few areas of interest? Consider creating a spreadsheet to track your contributions by categories like education, health, religion, environment, social service, international aid, civil liberties, disaster relief, arts and culture.

Decide whether you'd prefer to make several small gifts or fewer larger donations. Unlike investing, where diversification is key, philanthropy allows you to think about your priorities and focus your generosity in those areas.

Will you contribute to small or large charities? Local, national, or international organizations? Given your financial resources, would you rather be a big fish in a small pond or a small fish in a big pond? Consider whether you want to engage with a charity beyond being a donor and become involved as a volunteer. Which organizations offer this opportunity?

Consider offering unrestricted gifts. Most charities prefer unrestricted gifts that they can apply as they see fit. If you wish to designate your gift for a particular purpose, contact the charity to be sure it aligns with their mission and priorities. Not all charities may offer the giving opportunities you would prefer.

You can minimize unwanted solicitations from charitable organizations. When you send in your year-end contribution, include a note stating you do not want

to receive more than one solicitation each year, do not want phone solicitations, and do not want your name shared with any other organization.

If you want to instill philanthropic values in your children, include them in discussions of charity. Explain why you've chosen certain charities, and ask their opinion about your choices.

Remember the basic rules. You must itemize deductions to be eligible to deduct your charitable contributions. Generally, you can deduct up to 50% of your adjusted gross income (AGI) on cash gifts and up to 30% on gifts of marketable securities.

Consider enhancing the value of your gift by donating appreciated stock. You receive the charitable deduction for the fair market value of the stock on the date of transfer, without paying tax on the capital gains you earned.

You might also consider donor-advised funds (DAFs), an increasingly popular philanthropic vehicle. The National Philanthropy Trust projects an increase of 10% in assets in DAFs in 2012. With a DAF, you get an immediate tax deduction for your contribution (often appreciated stock). In later years, you can make grant recommendations to specific charities over the life of the DAF. DAFs are easy

to establish, simple to manage, provide the ability to make anonymous gifts, and can establish a legacy for philanthropy. You can set up a DAF at your investment broker or with community foundations, faith-based organizations, universities, or specific charities. You may need to consider a DAF's fees, minimum initial contribution, minimum ongoing contribution, minimum grant, investment options, grant-making restrictions, and level of donor service.

IRA owners age 70½ or older may make qualified charitable distributions up to \$100,000 from their IRAs through 2011. The distributions to charity, which would otherwise be taxable, are excluded from gross income for federal tax purposes and may be counted toward annual required minimum distribution (RMD) withdrawals.

And of course, remember that for contributions of \$250 or more, you must obtain and keep a written acknowledgment for a charitable contribution. Don't risk losing your tax deduction in an audit for lack of a written record from the charity. ■ ■ ■



## WHAT DOES IT ALL MEAN?



### TOWHEADS, BULLS, AND BEARS, OH MY!

by Karin E. McKarahan, MBA, CFP® Temecula, CA

**S**ome time ago, my young daughter asked me what it means to be a towhead; she was quite concerned she had been called a bad word by her own grandmother! She was relieved, after we looked up the word's origin, to learn that the word comes from *tow*, another name for flax, a light-colored fibrous plant once commonly used to make thread. Her inquiry made me wonder about the many financial and monetary terms that sound more like slang than "real" words. My curiosity piqued, I started doing some research into the origins of these words, many of which we all use everyday.

- **Nest egg.** This term has its origins in egg farming many years ago. A farmer would place an artificial or extra egg into an empty nest in a chicken coop to show a hen where she should lay her own eggs. This technique allowed the farmer to collect more eggs.
- **Bull and bear markets.** The origin of these commonly used terms is a little murky. Most believe that these two stock market terms appeared in the early 18th century. The term *bear* was probably introduced first and originally referred to what we today call "short selling," or the practice of selling stock one does not yet own for delivery at a future date. Buyers do so with the belief that the price will fall before delivery, which allows speculators to buy the promised stock at a lower price than they would subsequently sell it. Such speculators were called "bearskin jobbers" after the saying "To sell the bear's skin before one has caught the bear." The term gradually evolved to mean being pessimistic about the direction of stock prices. Because historically bears and bulls were considered opposites due to the once popular blood sport of bull-and-bear fights, the term *bull market* evolved because it is the opposite of a bear.

Another common explanation is that the terms are based on the fighting styles of the two animals. A bear pushes down on an opponent to crush him, whereas a bull uses its great horns to gore an enemy and lift him up.

- **Bucks.** The slang word for a dollar bill is very likely an abbreviated form of "buckskin," used as a form of money on the American frontier.
- **Bread.** Another slang term for money, this term has its origins in an ancient Cockney saying: "Give me your money; give me your bread and honey."
- **Ponzi scheme.** This term was recently made famous—again—by Bernie Madoff. The Ponzi scheme is named for the so-called pyramid investment scheme introduced by Charles Ponzi in the 1920s. He promised investors a 50% return in six months; however, his investors ended losing millions instead. Ponzi was simply paying his original investors with the funds he took in from newer investors.
- **Don't put all of your eggs in one basket.** This phrase is commonly credited to the author of the classic Spanish novel *Don Quixote* by Miguel Cervantes. Cervantes's original Spanish-language text, however, never uses this phrase. Instead, various English translators over the years adapted the phrase in an effort to convey his meaning. Although it didn't actually originate with Cervantes, it first appeared in a 1660 text, and based on its usage it is clear it had become a common adage. It is seen frequently from this time forward, always with the same meaning of "Don't put all your resources (money, time, energy) into the same project, in case that project fails." Much later, Mark Twain added his own comic twist when he said, "Put all your eggs in one basket—and watch the basket."

#### SMART TAX SAVINGS. . . . . continued from page 1

in alternating tax years. These deductions are allowed only after exceeding a percentage of adjusted gross income.

- If you are a homeowner, make energy saving improvements to your residence (extra insulation, energy-saving windows, or an energy-efficient furnace or air conditioner). You may qualify for a tax credit if the assets are installed in your home before 2012.
- Unless Congress extends it, the up-to-\$4,000 above-the-line deduction for qualified higher education expenses will not be available after 2011. Consider pre-paying eligible expenses to increase your qualified higher education expenses, if you qualify for this deduction.

- If you are age 70½ or older, own IRAs, and are thinking of making a charitable gift, consider arranging for the gift to be made directly by the IRA trustee. Such a transfer, if made before year-end, can achieve important tax savings.
- Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. You can give \$13,000 in 2011 to each of an unlimited number of individuals, but you can't carry over unused exclusions from one year to the next.

Remember, your ACA advisor is a pro and can help you navigate all the complex tax strategies mentioned here. Have a dialogue before year-end!