



THE PERSONAL PLANNER

Personal Financial Planning Tips for Today and the Rest of Your Life

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A week into April, S&P warned that US Treasury securities might lose their AAA rating in a couple years if the government doesn't make progress on reducing the structural deficit. Equity markets got concerned for a few days but then recovered.

I'm not a market analyst, but it seems to me that the equity markets are running a bit on inertia right now. Even though real market analysts expect earnings growth to slow, and though economic and job growth remain sluggish, housing prices continue to decline, and Washington's deficit woes continue... the stock market is still rising. There's plenty of reason for a market correction or decline, so don't be surprised if one develops. But for now equities are still rising. So we're staying invested, at least until we see evidence of a significant decline.

So stay cool, get those flowers planted, and enjoy the beauties of emerging Springtime.

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Inflation or Deflation: Watching for Warning Signs

There's been much debate in investing circles over the last year about whether inflation or deflation represents a more likely threat to the future of the U.S. economy. With a recovery that's still tentative compared to previous recessions, measures designed to stimulate the economy or cut spending to rein in the budget deficit provoke warnings about their potential to create one or the other.

The case for inflation

As the economy has begun to recover, worries about the potential for future inflation have become widespread. The Fed has undertaken extraordinary measures to make sure there is plenty of money in circulation, but some experts worry that the increased money supply will eventually cut the dollar's purchasing power, especially if interest rates are kept at historically low levels for too long. They cite the easy availability of money as contributing to the late-1990s tech bubble and the mid-2000s housing bubble, and fear that another could be on the way.

The Federal Reserve Board's monetary policy committee maintains that inflation currently is too weak to support normal economic growth, let alone launch an inflationary spiral. However, those who see inflation in our future watch for warning signs such as increased Treasury yields, particularly on longer-term bonds. Higher yields when bonds are auctioned suggest that investors are increasingly wary of tying up their money for long periods at a fixed interest rate if they feel that inflation is going to erode the buying power of those fixed payments over time. Wholesale prices also are watched closely; higher prices at the wholesale level can be a precursor of higher prices at retail (that is, if retailers are able to pass those costs along to buyers, which is not always the case).

The case for deflation

At first blush, the falling prices that characterize deflation don't sound like such a bad thing. Who wouldn't like to be able to buy things for less than they cost now, especially when times are

tough? The problem is that those falling prices can harm the economy in several ways, as Americans were reminded during the recent recession. When prices are dropping, people tend to postpone purchases, hoping to pay less in the future (consider what's happened with real estate since 2007). Delayed spending puts pressure on corporate profit margins and companies tend to cut spending themselves, creating financial difficulties for companies that rely on business spending. Cutbacks begin to ripple through the economy.

Deflation typically affects not only prices but wages; scarce jobs can lead to pay cuts even for those who stay employed. And lower incomes can start a new round of cost-cutting by both consumers and business. If this process sounds familiar, it's because for much of 2009, the U.S. experienced negative annual inflation rates for the first time since 1955.

Though consumers have loosened their purse strings in recent months, deflationistas argue that if another financial crisis were to reduce credit availability, or if high ongoing unemployment once again begins to weigh on consumers' willingness and ability to spend, the threat of deflation could return. Those concerned about the possibility of a new round of deflation at some point keep an eye on consumer spending, the state of the credit and housing markets, and the stability of banks and other financial institutions.

Seeing shades of gray

Inflation and deflation aren't necessarily an either-or proposition. It's possible to have inflation in some areas and deflation in others; anyone who has watched food prices or health-care costs increase while their paycheck stayed the same and the value of their house declined can vouch for that.

From an investing standpoint, inflation isn't black-and-white, either. Some industries and asset classes benefit from inflationary forces, while companies that are highly dependent on both commodity prices and cheap labor can be more challenged by rising prices.

Don't Be Nickeled-and-Dimed by Account Fees

Interest rates on deposit accounts, such as savings accounts, interest-bearing checking accounts, and money market accounts have been persistently low, and rates aren't likely to improve any time soon. To make matters worse, financial institutions are under pressure to raise account fees, as they look to recapture some of the revenue lost in the wake of stricter financial regulations. The result is that some account holders now earn less interest on their money than they pay in account fees.

Though it's hard to find attractive interest rates, it's relatively easy to save on account fees if you're willing to do your homework. Start by reviewing your account statements to determine your spending and saving habits. What average account balance do you generally maintain? Do you pay monthly account maintenance or service fees? How many ATM transactions do you have in a month? Are you overdrawing your account? Once you know your financial habits, you'll be ready to take steps to reduce account fees.

If you pay account maintenance fees

An account maintenance or service fee is a common monthly service charge that applies to some accounts. Financial institutions offer a variety of products, each with their own fee structure. Often, higher maintenance or service fees may apply to accounts that pay higher interest rates. To help avoid these fees:

- Shop around, and compare your options--not all banks and credit unions charge maintenance fees.
- Make sure you understand and follow account requirements. For example, monthly maintenance fees may be reduced or waived if you sign up for direct deposit or online bill pay, maintain another account, or tie your account to a loan or mortgage.
- Read your account statements and notices you get from your financial institution. Otherwise, months may go by before you notice that fees have gone up or account requirements have changed.
- Reevaluate your needs regularly. They change over time, and you may want to switch your money to another type of account, or even find another bank or credit union that better suits your needs.

If you frequently use ATMs

Withdrawing money from an ATM is so quick, it's easy to overlook how much it's costing you. Fees for ATM transactions generally range from \$2 to \$5, and may be higher. One way to

minimize these fees is to choose a financial institution that owns many local ATMs, but that isn't your only option. To help reduce ATM costs:

- Ask for a list of surcharge-free ATMs. Many financial institutions participate in networks that enable account holders to withdraw cash from designated ATMs without paying a surcharge. You can also download an application to your mobile device to help you find surcharge-free ATMs anywhere in the country.
- Plan your spending. Withdrawing larger amounts when possible (at least enough to last for a week) will substantially reduce the number of ATM transactions you have.
- Look for a bank or credit union that rebates ATM fees imposed by ATMs owned by other financial institutions (limits may apply).
- Opt for cash back when you use your debit card (a minimum or maximum amount may apply). This is often a free or low-cost alternative to going to the ATM.

If you tend to overdraw your account

Overdrafts are common--a 2009 study by the nonprofit Center for Responsible Lending found that over 50 million Americans overdrew their checking account over a 12-month period. To help reduce or eliminate overdrafts:

- Look into online banking. Being able to track your account history whenever you want can help you avoid overdraft fees. You'll also be able to quickly transfer funds among accounts, should the need arise.
- Sign up to receive transaction or low balance alerts via your mobile device or computer.
- Link your savings account to your checking account so that money will be automatically taken out of your savings account should you overdraw your checking account (typically, little or no fee is charged).

The bottom line

Often, people choose a bank or credit union based on convenience--the location of branches, easy access to ATMs, and hours of service. Convenience is important, but so is cost. And you don't have to settle--there are plenty of banks and credit unions across the country that offer great products and excellent service, without hitting you too hard in the pocketbook.



If you encounter a fee you don't agree with, talk to an account representative at your bank or credit union. He or she may be willing to rebate the fee, or suggest alternatives to help you reduce or avoid future charges.

Estate Tax Exemption Is Portable (for Now)

Recent legislation introduced a new, but perhaps temporary, estate planning concept--exemption "portability." In short, the estate of a deceased spouse can transfer to the surviving spouse any portion of the federal estate tax exemption that it does not use. The surviving spouse's estate can then add that amount to the exemption it is entitled to, increasing the total amount that can be passed on to heirs tax free. This new feature makes it easier for married couples to minimize the potential impact of estate taxes.

The federal estate tax exemption defined

The federal government imposes a tax on the value of your property when you pass it along to your descendants at your death. Any amount that is passed to a surviving spouse is generally fully deductible. The estate is also allowed to exclude a certain amount that passes on to nonspouse beneficiaries. That amount is called the "basic exclusion amount," which is \$5 million in 2011.

How the exemption works for married couples

Prior to the new tax law, if a spouse died without having planned for his or her exemption, the deceased spouse's estate would have passed tax free to the surviving spouse under the unlimited marital deduction (assuming all assets passed to the surviving spouse), and the deceased spouse's exemption was lost or "wasted." The surviving spouse's estate could then only transfer an amount equal to his or her own exemption free from federal estate tax. To solve this dilemma, married couples typically set up what is commonly referred to as a credit shelter trust (aka "bypass" or family trust) that sheltered or preserved the exemption of the first spouse to die.

The following examples illustrate how portability can achieve a similar result without the use of a credit shelter trust.

Example: result without portability

Assume Henry and Wilma are married, have all of their assets jointly titled, and have a net worth of \$10 million. Henry dies first, when the federal estate tax exemption is \$5 million and there is no portability. Henry's estate passes to Wilma free from federal estate tax under the unlimited marital deduction and does not use any of his \$5 million exemption. Assume that at the time of Wilma's death, the exemption is still \$5 million, the federal estate tax rate is 35%, and Wilma's estate is still worth \$10 million.

With Henry's exemption completely wasted, Wilma can pass on only \$5 million free from federal estate tax. Assuming no other variables, Wilma's estate will owe about \$1,750,000 in federal estate tax: \$10 million estate - \$5 million exemption = \$5 million taxable estate x 35% estate tax rate = \$1,750,000.

Example: result with portability

Assume Henry and Wilma are married, have all of their assets jointly titled, and have a net worth of \$10 million. Henry dies first, when the federal estate tax exemption is \$5 million and there is portability. As above, Henry's estate passes to Wilma free from federal estate tax under the unlimited marital deduction and does not use any of his \$5 million exemption. Even though Henry's estate owes no tax, Henry's executor files a timely return on which he elects to transfer Henry's unused exemption to Wilma. Assume that at the time of Wilma's subsequent death, the exemption is still \$5 million, the federal estate tax rate is 35%, and Wilma's estate is still worth \$10 million. Since Wilma has "inherited" Henry's unused exemption, she can pass on the entire \$10 million estate free from federal estate tax. Portability of the estate tax exemption saves Henry and Wilma's heirs \$1,750,000 in estate tax.

Portability does not eliminate the benefits of credit shelter trusts

Even with portability, there are still tax and nontax considerations that may lead you to use a credit shelter trust, such as:

- The portability feature is in effect for only two years and will expire after 2012, unless Congress enacts further legislation.
- The trust can help protect assets against creditors of the surviving spouse or future beneficiaries (typically children and grandchildren).
- The trust allows the first spouse to die to control the ultimate distribution of his or her assets. For example, in a second marriage situation, one spouse may wish to ensure that any assets remaining after his or her spouse's death pass to his or her children from a previous marriage.
- Appreciation of assets placed in the trust will escape estate taxation in the survivor's estate.
- The portability feature applies only to estate tax; it does not apply to the generation-skipping transfer (GST) tax. Without a trust, any unused GST tax exemption of the first spouse to die is lost.



To use the exemption portability, the first spouse to die must elect to use portability on his or her estate tax return. An estate tax return must be filed by the first spouse to die to use portability even if the return is not otherwise required to be filed.

Many states have state estate tax exemptions that are less than the federal estate tax exemption. So, while your surviving spouse might not be subject to federal estate tax upon your passing, your surviving spouse may have to pay significant state estate tax if you rely solely on the federal exemption portability.



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Ask the Experts



Can I make charitable contributions from my IRA?

Yes, if you qualify. The law authorizing "qualified charitable distributions," or QCDs, has recently been extended through 2011.

You simply direct your IRA trustee to make a distribution directly from your IRA (other than a SEP or SIMPLE) to a qualified charity. You must be 70½ or older, and the distribution must be one that would otherwise be taxable to you. You can exclude up to \$100,000 of QCDs from your gross income in 2011. If you file a joint return, your spouse (if 70½ or older) can exclude an additional \$100,000 of QCDs in 2011. But you can't also deduct QCDs as a charitable contribution on your federal income tax return--that would be double dipping.

QCDs count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to take from your IRA in 2011, just as if you had received an actual distribution from the plan. However, distributions that you actually receive from your IRA (including RMDs) that you subsequently transfer to a charity cannot qualify as QCDs.

For example, assume that your RMD for 2011

is \$25,000. In June 2011, you make a \$15,000 QCD to Qualified Charity A. You exclude the \$15,000 of QCDs from your 2011 gross income. Your \$15,000 QCD satisfies \$15,000 of your \$25,000 RMD. You'll need to withdraw another \$10,000 (or make an additional QCD) by December 31, 2011, to avoid a penalty.

You could instead take a distribution from your IRA and then donate the proceeds to a charity yourself, but this would be a bit more cumbersome, and possibly more expensive. You'd include the distribution in gross income and then take a corresponding income tax deduction for the charitable contribution. But the additional tax from the distribution may be more than the charitable deduction, due to IRS limits. QCDs avoid all this by providing an exclusion from income for the amount paid directly from your IRA to the charity--you don't report the IRS distribution in your gross income, and you don't take a deduction for the QCD. The exclusion from gross income for QCDs also provides a tax-effective way for taxpayers who don't itemize deductions to make charitable contributions.



Can I name a charity as beneficiary of my IRA?

Yes, you can name a charity as beneficiary of your IRA, but be sure to understand the advantages and disadvantages.

Generally, if you name a spouse, child, or other individual as beneficiary of a traditional IRA, they must pay federal income tax on any distribution they receive from the IRA after your death. By contrast, if you name a charity as beneficiary, the charity will not have to pay any income tax on distributions from the IRA after your death (provided that the charity qualifies as a tax-exempt charitable organization under federal law), a significant tax advantage.

After your death, distributions of your assets to a charity generally qualify for an estate tax charitable deduction. In other words, if a charity is your sole IRA beneficiary, the full value of your IRA will be deducted from your taxable estate for purposes of determining the federal estate tax (if any) that is due. This can also be a significant advantage if you expect the value of your taxable estate to be at or above the federal exclusion amount (\$5 million for 2011).

Of course, there are also nontax implications. If you name a charity as sole beneficiary of your IRA, when you die your family members and other loved ones will obviously not receive any benefit from those IRA assets. If you would like to leave some of your assets to your loved ones and some assets to charity, consider leaving your taxable retirement funds to charity and other assets to your loved ones. This may offer the most tax-efficient solution, since the charity will not have to pay any tax on the retirement funds. If the retirement funds are a major portion of your assets, you might consider leaving those funds to a charitable remainder trust. Under this type of trust, the trust receives the funds free from income tax at your death, then pays a lifetime income to individuals of your choice. When those individuals die, the remaining trust assets pass to the charity. Finally, another option is to name the charity and one or more individuals as co-beneficiaries.

The issues discussed here are complex. Be sure to consult an estate planning attorney for further guidance.