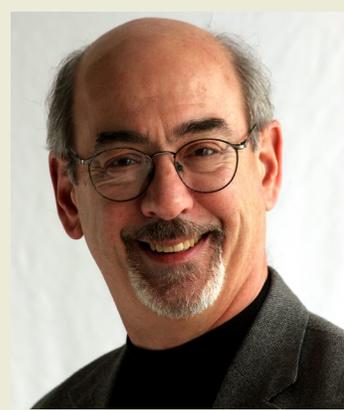


# THE PERSONAL PLANNER

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



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## A Month To Forget

June and July were frustrating but August was truly a month we could have done without. The only-for-now resolution of the federal budget impasse, S&P's downgrade of US Treasury securities, continuing sovereign debt concerns in Europe, and renewed concerns about a double-dip recession all combined to produce the greatest losses in two years during the first week of August. Markets have spent the rest of the month trying to recover and those efforts continue yet again today. Our Active Portfolio Risk Management strategy took us out of equities in early August and we're still out, waiting for confirmation that a real market recovery is in place. See the *Monthly Bulletin* for more.

Please note that Kate and I will be away on vacation during much of September (about a week of that out of the country) but I will be checking email daily.

Bruce Heling  
Aug 29, 2011

## September 2011

### The Spousal IRA Rule

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Bringing the Personal to Financial Planning

## The Spousal IRA Rule



Generally, you can contribute up to \$5,000 to an IRA in 2011 (\$6,000 if you'll be age 50 or older by the end of the year), as long as you have taxable

compensation at least equal to the amount of your IRA contribution. But what if you have little or no taxable compensation for the year? The spousal IRA rule may help. If you're married, file a joint federal income tax return, and earn less than your spouse, the amount you can contribute to an IRA is based on the combined compensation of you and your spouse.

### How it works

The rule is especially helpful if one spouse has little or no compensation. For example, Mary (age 45) and Joe (age 50) are married and file a joint return for 2011. Mary earned \$100,000 in 2011 and Joe, a stay-at-home dad, earned nothing for the year. Mary contributes \$5,000 to her IRAs for 2011. Even though Joe has no earnings, he can still contribute up to \$6,000 to his IRAs for 2011, because Joe and Mary's combined compensation is at least \$11,000.

It gets just a little more complicated if your combined compensation is less than the maximum IRA contribution allowed. Assume Nicole earns \$4,000 in 2011, and Jack earns \$2,000, for total compensation of \$6,000. If Nicole makes no contribution at all to her IRAs in 2011, Jack can contribute up to \$5,000 to his IRA (\$6,000 if he's 50 or older). If Nicole contributes \$4,000 to her IRAs for 2011, then Jack can contribute up to \$2,000 to his IRA. Note that the spousal IRA rule applies only to the spouse with the lesser amount of compensation. In the previous example, the maximum amount that Nicole (the higher earning spouse) can contribute to her IRAs is \$4,000, because she's not entitled to take Jack's earnings into account.

Here's the actual contribution formula, as stated by the IRS: The spouse with the lesser amount of taxable compensation can contribute the smaller of the following two amounts:

1. \$5,000 (\$6,000 if age 50 or older)
2. The total amount the couple includes in gross income for the year, reduced by the amount the higher earning spouse contributes to his or her own IRAs (traditional or Roth) for that year

### Source of funds

The spousal IRA rule only determines how much you can contribute. It doesn't matter where the money you use to fund your IRA actually comes from. For instance, in the first example, Mary earned \$100,000 and Joe earned nothing in 2011. But Joe could still contribute up to \$6,000 to his IRA because of the spousal IRA rule. It doesn't matter if the money Joe actually uses to fund his IRA comes from Mary, from savings, from a gift Joe receives, or from any other particular source. The spousal IRA rule doesn't require you to track the source of your contribution.

### Impact on other IRA rules

The spousal IRA rule doesn't change any of the other rules that generally apply to IRAs. You can contribute to a traditional IRA, to a Roth IRA, or both. However, you can't make regular contributions to a traditional IRA for the year you turn 70½ or thereafter. And your contributions to a traditional IRA are deductible only if neither you nor your spouse is covered by an employer retirement plan or, if either of you is covered by a plan, your combined income is within certain limits.

If you aren't eligible to make deductible contributions to a traditional IRA because you and your spouse earned too much, you can make nondeductible contributions instead. However, you may be better off contributing to a Roth IRA (if you qualify) instead of making nondeductible contributions to a traditional IRA.

Your ability to make annual contributions to a Roth IRA may also be limited, or eliminated, depending on the amount of your combined income. If you're eligible, though, you can contribute to a Roth IRA at any age—the 70½ rule doesn't apply. And it doesn't matter if you or your spouse is covered by an employer plan.



**Portability allows a surviving spouse to use the unused basic exclusion amount of the first spouse to die to shelter property from federal gift and estate taxes. Portability of the exclusion between spouses would seem to make estate planning easier for many estates. However, unless extended by Congress, portability of the unused basic exclusion amount between spouses is set to expire in 2013.**

**Your estate plans and documents may need to be revised to reflect the tax changes for 2011 and 2012 and for the uncertainty for 2013 and beyond. Flexibility will be key.**

## Portability of Basic Exclusion Amount between Spouses

Transfers of property during life or at death are generally subject to federal gift or estate taxes. Each taxpayer has an applicable exclusion amount, which is the amount of property that can be sheltered from federal gift and estate taxes by the unified credit.

Prior to 2011, each spouse was entitled to his or her own applicable exclusion amount, and any amount that a spouse did not use was lost, absent special planning.

But, thanks to legislation passed in 2010, the estate of the first spouse to die can now elect to transfer any basic exclusion amount that is not used to the surviving spouse. This is known as "portability." For 2011 and 2012, the applicable exclusion amount is redefined as equal to the sum of the basic exclusion amount of the surviving spouse and the unused basic exclusion amount of the last deceased spouse. For 2011 and 2012, the basic exclusion amount is \$5 million (plus indexing in 2012).

Portability of the exclusion between spouses and an increase in the basic exclusion amount would seem to make estate planning easier for many estates. However, unless extended by Congress, in 2013, portability of the unused basic exclusion amount between spouses is set to expire and the exclusion is scheduled to decrease to \$1 million.

### Simple planning with portability

If you're planning today, you could transfer everything to your spouse and, if you die in 2011 or 2012, your estate can elect to transfer your unused basic exclusion amount to your surviving spouse. Your spouse will then have an applicable exclusion amount equal to the sum of his or her own basic exclusion amount and your unused basic exclusion amount, which your spouse can use for gift or estate tax purposes. For example, if you transfer your \$5 million unused basic exclusion to your surviving spouse, who also has a \$5 million basic exclusion amount, your spouse then has a \$10 million applicable exclusion amount to shelter property from gift and estate taxes. Such simple planning might be very practical for some married couples, especially where the spouses' combined estates are expected to be less than the applicable exclusion amount.

### Potential need for more complex planning

There are a number of reasons why such simple planning with portability may not produce the desired or best results. These include:

- Portability is set to expire in 2013, and tax rates are scheduled to increase while the

applicable exclusion amount is set to decrease.

- You have family members or individuals other than your spouse that you would like to benefit prior to the death of your spouse.
- You have grandchildren or younger generations that you would like to benefit. The \$5 million generation-skipping transfer (GST) tax exemption is not portable between spouses (and is scheduled to decrease to \$1 million as indexed in 2013).
- State exclusion amounts may be lower than the federal applicable exclusion amount and may not be portable between spouses.

### Use of A/B trust arrangement

Prior to the 2010 legislation, many married couples with estates that were greater than the applicable exclusion amount would set up an A/B (or A/B/C) trust arrangement. In general, the first spouse to die would transfer an amount equal to the applicable exclusion amount to the "B" or credit shelter (bypass) trust. The B trust could benefit the surviving spouse and their children, but the B trust would be designed to bypass the surviving spouse's estate. The balance of the estate would be transferred to the surviving spouse, either outright or by using an "A" marital trust, and qualify for the marital deduction. In some cases, a "C," "Q," or QTIP marital trust was also used if the first spouse to die wanted to control who received the marital trust property at the second spouse's death. The A/B trust arrangement typically assured that there would be no estate tax at the first spouse's death and that neither spouse's applicable exclusion amount was wasted.

An A/B trust arrangement may still be useful whether or not portability is available. For example, the B trust can assure that the applicable exclusion amount of the first spouse to die is not lost, even if portability is not available in the future. The B trust can be used to provide for family members or individuals other than your spouse (and even your spouse) prior to the death of your spouse. You could also allocate your GST tax exemption or state exclusion to the B trust. The A trust could use your spouse's applicable exclusion amount, GST tax exemption, and state exclusion.

### Review estate plans and documents

Your documents and plans may need to be revised to reflect the tax changes for 2011 and 2012 and for the uncertainty for 2013 and beyond. To help guide you through these opportunities and uncertain times, consult an experienced estate planning attorney.

## Could You Handle a Financial Windfall?



Receiving a financial windfall is often a life-changing event. It's a relatively common one, too. You might never win the lottery, but the odds are that at some point you'll receive a significant amount of money, perhaps from an inheritance, bonus, insurance settlement, or the sale of a home or business. If so, would you be prepared for the financial decisions you might suddenly face?

### **Proceed with caution**

The first thing you'll want to do after receiving a large sum of money is to take a deep breath. You may feel the urge to spend, invest, move, quit your job, or give to others. But if you want your windfall to last, don't do anything until you've had a chance to come to terms with the personal and financial consequences. Regrettably, some people who suddenly come into money lose it all within a few years because they fail to plan. Taking the time to make well-thought-out financial decisions will help ensure that your money will last.

### **Put your money somewhere temporarily**

Until you've had time to explore your options, there's nothing wrong with putting a lump sum into a relatively liquid account, such as a savings or money market account. You don't have to leave it there forever--just set it aside until you've had time to formulate a plan.

### **Assemble a support team**

Because your finances are likely going to be a lot more complex now, one of the first things you should do is to get unbiased advice from a financial professional who can help you put together a financial plan. You may also need to work with an accountant, an attorney, or an insurance professional who can help address any tax, estate planning, or insurance planning concerns. Although receiving a windfall should be a happy event, it's sometimes very stressful, and you may need help from trusted professionals to help you handle the pressure.

### **Avoid spending and giving impulsively**

Spend or give your money away too quickly and you risk depleting your nest egg. Although it's tempting to go out and buy something you've always wanted but couldn't afford before, watch your spending. A financial windfall can turn even a financially conservative person into an impulsive shopper. If your ultimate goal is to create lasting wealth, take time to consider your future needs, not just what you need (and want) today.

What about giving or loaning money to family and friends, or making a charitable donation? Again, it's best to wait until you've set priorities

and developed a financial plan. Otherwise, your personal relationships could suffer (will your sister be hurt if you give \$10,000 to your brother?), and your generosity might have unintended consequences (will you be approached by dozens of charities once you donate to one?).

### **Watch out for too-good-to-be-true opportunities**

Unfortunately, more than one person has become the target of unscrupulous individuals looking to profit from the good fortune of others. And even if you're approached by a well-meaning friend, family member, or business associate, you should thoroughly investigate any investment or business opportunities presented, instead of relying on someone else's judgment. If you have trouble saying no, consider referring any requests you receive to a third party, such as an attorney or financial professional you're working with.

### **Look at your financial needs and goals**

An important part of handling a financial windfall is to evaluate your short- and long-term needs and goals. This will serve as a foundation for your financial plan.

- Do you have enough money set aside in an emergency account?
- Do you have outstanding debt that you'd like to pay off?
- Do you plan to pay for your children's education?
- Do you need to bolster your retirement savings?
- Are you planning to buy a first or second home?
- Would you like to quit your job or go into business for yourself?
- Are you considering giving or loaning money to loved ones or donating to a favorite charity?
- What would you like to accomplish with your wealth over time?

### **Have a little fun**

Once you've made some initial decisions and set aside money needed to pay taxes, consider spending a small portion of your windfall on something you'd like. There's no reason to deprive yourself, as long as you've taken care of business first. If you plan well and control the urge to spend lavishly, your windfall may provide you with financial security and comfort for many years to come.

## Ask the Experts

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### What happens to my online accounts when I die?

These days, using a personal computer is just a normal part of life. You may have e-mail or online accounts that require a password, or you may have pictures, videos, or documents stored online or on your hard drive. You may even maintain a blog or website. Like your physical assets, these "digital" or "cyber" assets can have both sentimental and economic value. Chances are, nobody else knows your cyber assets even exist, and if they do, they may not know where those assets are stored or how to access them. It's important that you make plans for the disposition of your cyber assets in the event of your incapacity or death. If you don't, your survivors may have to deal with time-consuming and costly searches, or worse, the assets may be overlooked and lost altogether.

What happens to your cyber assets at your death depends on what type of asset it is, and while the laws regarding cyber assets are not well settled, there are some broad guidelines. Domain names, once registered, become your personal property under property law, and your websites and blog content are yours under

federal copyright law. These types of cyber assets are clearly defined by law and are transferable to your heirs (e.g., through your will). On the other hand, certain online accounts, such as e-mail accounts, Facebook, Twitter, eBay, or PayPal, may not be classified as property in the legal sense; you are merely given a license by the website when you agree to its terms of service. Under these terms of service, transferability of your accounts may be limited or even prohibited altogether. Terms of service vary widely from site to site. Some sites, such as YouTube, will allow persons with legal power of attorney to access your accounts, and they post instructions on how to do so. Other sites, such as Facebook, will put your accounts into a "memorial state." Many sites, however, will terminate and permanently delete your accounts upon notification of your death. You should read and understand all terms of service and make any necessary legal arrangements so your heirs will have access to your accounts.

Note: On the flip side, you may have certain private accounts to which you want to ensure that no one is given access and which will be terminated immediately upon your death.



### How do I include my cyber assets in my estate plan?

Your cyber (or digital) assets may have sentimental and/or economic value, and you should consider including them in your estate plan.

Here's how:

1. Identify your cyber assets. They include (a) domain names, websites, and blogs, (b) photos, videos, and documents stored on sharing sites such as Flickr, YouTube, and Google Docs, (c) e-mail accounts, (d) online bank, credit card, investment, and other such accounts that typically require a password, (e) accounts with online companies such as Facebook, Twitter, and eBay, and (f) documents, spreadsheets, photos, and other such items that are stored on your computers, hard drives, DVDs, smartphones, flash drives, and other offline or online servers or backup servers.
2. Understand which assets are transferable to other persons and which are not. Your domain names, websites, and blogs are transferable under property and copyright laws; however, your online accounts may or may not be transferable, depending on the online site's terms of service (you may
3. Inventory your cyber assets. List all your assets indicating (a) where they are located, (b) how they are accessed, including URLs, usernames, and passwords, (c) what you wish to have happen to the asset at your death (e.g., transfer to an heir, terminate, memorialize), and (d) who will be responsible for carrying out those wishes (e.g., spouse, executor). Refer to but do not include this inventory in your will, because wills become public and this is private information. Put it in a safe place and let others know of its existence.
4. Include specific bequests of certain valuable cyber assets (domain names, websites, blogs) in your will, and execute powers of attorney for those accounts that will require it.