The Abel Advisor

a Financial Stewardship Newsletter

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Hi Everyone,

The year is off to a great start so far. January was a month that saw most all of the equity markets increase, especially the United States. As I said in my email a few weeks ago there has been an elimination of many of the issues and uncertainty that have plagued the markets for the last 2 years. Housing is improving along with auto sales. Capital spending and hiring has started to increase. Europe is in a recession but further away from the edge of the cliff that they were at last spring/summer and also in 2011. Congress and the President found common ground on the Fiscal Cliff in the US.

We still have some head-winds such as the Debt Ceiling but hopefully the powers dealing with that have learned from the last time.

Winter has given us some snow and some unseasonably warm times, and the groundhog didn't see his shadow. Spring is on the way. Green grass and balmy weather!

God's Peace,
A.W.

February 2013

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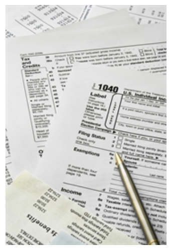
Federal Income Tax Filing Season Is Here



The due date for 2012 federal income tax returns is April 15, 2013. Whether you're preparing your own taxes or paying someone else to do them for you, you'll want to start pulling things together sooner rather than later. That includes gathering a copy of last year's tax return, W-2s, 1099s, and deduction records.

Filing for an extension

If you're not going to be able to file your federal income tax return by the due date, file for an extension using IRS Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. Filing this extension gives you an additional six months (to October 15, 2013) to file your return. Don't make the mistake of assuming that the extension gives you additional time to pay any taxes due, though. If you do not pay any taxes you owe by April 15, 2013, you'll owe interest on the tax due, and you may owe penalties as well. Special rules apply if you're living outside the country or serving in the military outside the country on April 15, 2013.

There's still time to contribute to an IRA

You generally have until the due date of your federal income tax return (April 15) to make contributions to either a Roth IRA or a traditional IRA for the 2012 tax year. That means there's still time to set aside up to $5,000 ($6,000 if you're age 50 or older) in one of these retirement savings vehicles. It's worth considering, in part because contributing to an IRA can have an immediate tax benefit. That benefit comes in the form of a potential tax deduction--with a traditional IRA, if you're not covered by a 401(k) or another employer-sponsored retirement plan (if your spouse is covered by an employer plan, you're considered to be covered as well), you can generally deduct the full amount of your contribution. (If you're covered by an employer-sponsored retirement plan, whether or not you can deduct some or all of your traditional IRA contribution depends on your filing status and income.)

It's a little different with a Roth IRA; if you qualify to make contributions to a Roth IRA (whether you can contribute depends on your filing status and income), the contributions you make aren't deductible, so there's no effect on your 2012 taxes. Nevertheless, a Roth IRA may be worth considering because qualified Roth distributions you take in the future are completely free from federal income tax.

There's also still time to undo a 2012 Roth conversion

Did you convert a traditional IRA to a Roth IRA in 2012, only to see the account drop in value? Wish you could go back in time so that you wouldn't have to pay tax on the value of the IRA assets lost in the downturn? Turns out, you can. If you undo ("recharacterize") the conversion, you're treated for tax purposes as if the conversion never happened--you wind up with a traditional IRA again and no tax bill for the conversion. You generally have until the due date of your 2012 return, including extensions, to recharacterize a 2012 Roth conversion (note that special rules allow individuals who file timely 2012 returns to recharacterize up until October 15, 2013--talk to a tax professional about the details).

If you do recharacterize your 2012 conversion in 2013, you're allowed to convert those dollars (and any earnings) back to a Roth IRA ("reconvert") after waiting 30 days, starting with the day you transferred the Roth dollars back to a traditional IRA. If you reconvert in 2013, then all taxes due as a result of the reconversion will be included on your 2013 federal income tax return.

Review casualty loss deduction rules

If you were one of the many individuals who suffered property damage or loss as a result of late-2012 storms (e.g., October's Hurricane Sandy), be sure to familiarize yourself with the casualty loss rules--you may be entitled to a deduction for storm-related losses that weren't covered by insurance. Review IRS Publication 547, Casualties, Disasters, and Thefts for details.

See disclaimer on final page

Low interest rates favor certain estate planning strategies over others, and the interest rates used by the IRS are at or near historic lows.

Estate Planning Strategies in a Low-Interest-Rate Environment

The federal government requires the use of certain interest rates to value various items used in estate planning, such as an income, annuity, or remainder interest in a trust. The government also has interest rates that a taxpayer may be deemed to use in connection with certain installment sales or intra-family loans. These rates are currently at or near historic lows, presenting several estate planning opportunities.

Low interest rates favor certain estate planning strategies over others. For example, low interest rates are beneficial for a grantor retained annuity trust (GRAT), a charitable lead annuity trust (CLAT), an installment sale, and a low-interest loan. On the other hand, low interest rates have a detrimental effect on a qualified personal residence trust (QPRT) or a charitable gift annuity. But interest rates have little or no effect on a charitable remainder unitrust (CRUT).

Grantor retained annuity trust (GRAT)

In a GRAT, you transfer property to a trust, but retain a right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your beneficiaries, such as family members. The value of the gift of a remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. Also, if you survive the trust term, the trust property is not included in your gross estate for estate tax purposes. If the rate of appreciation is greater than the IRS interest rate, more of the value of trust assets escapes gift and estate taxation. Consequently, the lower the IRS interest rate, the more effective this technique is.

Charitable lead annuity trust (CLAT)

In a CLAT, you transfer property to a trust, giving a charity the right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your beneficiaries, such as family members. This trust is similar to a GRAT, except that you get a gift tax charitable deduction. Also, if structured so that you are taxed on trust income, you receive an up-front income tax charitable deduction for the gift of the annuity interest. The lower the IRS interest rate, the more effective this technique is.

Installment sale

You may also wish to consider an installment sale to family members. With an installment sale, you can generally defer the taxation of any gain on the property sold until the installment payments are received. However, if the family member resells the property within two years of your installment sale, any deferred gain will generally be accelerated. The two-year limit does not apply to stocks that are sold on an established securities market.

You are generally required to charge an adequate interest rate in return for the opportunity to pay in installments, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, your family members can pay for the property in installments, while paying only a minimal interest cost for the benefit of doing so.

Low-interest loan

A low-interest loan to family members might also be useful. You are generally required to charge an adequate interest rate on the loan for the use of the money, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, you can provide loans at a very low rate and family members can effectively keep any earnings in excess of the interest they are required to pay you.

Effect of low rates on other strategies

- **Charitable remainder unitrust:** You retain a stream of payments for a number of years (or for life), after which the remainder passes to charity. You receive a current charitable deduction for the gift of the remainder interest. Interest rates have no effect if payments are made annually at the beginning of each year, and low interest rates have only a minimal detrimental effect if payments are made in any other way.
- **Qualified personal residence trust:** You transfer your personal residence to a trust, retaining the right to live in the home for a period of years, after which the residence passes to your beneficiaries, such as family members. The value of the gift of a remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. The lower the IRS interest rate, the less effective this technique is.
- **Charitable gift annuity:** You transfer property to a charity in return for the charity's promise to make annuity payments for your life (or for you and your spouse's lives). You receive a current charitable deduction for the gift of the remainder interest. The lower the interest rate, the lower the amount of your charitable deduction will be. Also, charities have generally been forced to reduce payout rates offered because of the economic downturn and the low-interest-rate environment.

Questions and Answers about Social Security

Did you know that according to the Social Security Administration, 94% of all workers are covered under Social Security?

Whether you're close to retirement or years away from receiving Social Security benefits, you may not know much about the intricacies of this important program. Here are some questions and answers that can help you learn more.

Will Social Security be around when you need it?

You've probably heard media reports about the worrisome financial condition of Social Security, but how heavily should you weigh this information? While it's very likely that some changes will be made to Social Security (e.g., payroll taxes may increase, benefits may be reduced by a certain percentage, or cost-of-living adjustments may be calculated differently), there's been no proposal to eliminate Social Security. Although no one knows what will happen, if you're approaching retirement, it's probable that you'll receive the benefits you've been expecting. If you're still a long way from retirement, it may be wise to consider various scenarios when planning for Social Security income.

How does the Social Security Administration know how much you've earned?

If you work for an employer, your employer will deduct Social Security taxes from your paycheck and report your wages to the Social Security Administration (SSA). If you're self-employed, you pay your self-employment Social Security taxes and report your earnings to the SSA by filing your federal income tax return. To view your lifetime earnings record, you can sign up to access your Social Security Statement online at the SSA's website, www.socialsecurity.gov.

Will a retirement pension affect your Social Security benefit?

If your pension is from a job where you paid Social Security taxes, it won't affect your Social Security benefit. However, if your pension is from a job where you did not pay Social Security taxes (such as certain government jobs) two special provisions may apply.

The first provision, called the government pension offset (GPO), may apply if you're entitled to receive a government pension as well as Social Security spousal retirement or survivor's benefits based on your spouse's (or former spouse's) earnings. Under this provision, your spousal or survivor's benefit may be reduced by two-thirds of your government pension (some exceptions apply).

The second provision, called the windfall elimination provision (WEP), affects how your Social Security retirement or disability benefit is figured if you receive a pension from work not covered by Social Security. The formula used to figure your benefit is modified, resulting in a lower Social Security benefit.

If someone else receives benefits based on your earnings record, will your benefit be reduced as a result?

Your benefit will not be affected if other people, such as your spouse, former spouse, or dependent children, receive Social Security benefits based on your earnings record.

If you delay receiving benefits until after full retirement age, should you still sign up for Medicare at age 65?

Even if you plan on waiting until full retirement age or later to take your Social Security retirement benefits, make sure to sign up for Medicare three months before you reach age 65. If you enroll late for Medicare Part B (medical insurance) your coverage may be delayed or cost more later. Visit the Medicare website, www.medicare.gov to learn more.

Do IRA withdrawals count toward the Social Security earnings limit?

Prior to full retirement age, an earnings limit applies if you receive Social Security benefits. If you earn more than this amount, your benefit will be reduced. However, only wages from a job or net earnings from self-employment count toward this limit. Unearned income, such as IRA withdrawals, investment earnings, or capital gains, does not count.

What if you change your mind about when to begin Social Security benefits?

You have a limited opportunity to change your mind after you've applied for benefits. You can complete Form SSA-521, Request for Withdrawal of Application, and reapply at a later date. But if you're already receiving benefits, you can withdraw your claim only if it has been less than 12 months since you first became entitled to benefits, and you're limited to one withdrawal per lifetime. In addition, there are financial consequences--you must repay all benefits already paid to you or your family members based on your application, as well as any money withheld from your checks, including Medicare premiums or income taxes.

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What health-care provisions are effective in 2013?

With the Supreme Court's favorable ruling on the constitutionality of the Patient Protection and Affordable Care Act (ACA), more of the law's provisions will become effective in 2013. Here are some of the new features that may be important to you.

Medicare Part D participants who reach a gap in their drug coverage (the "donut hole") are required to pay the entire cost of prescription drugs out-of-pocket. In 2013, the ACA will continue to close this gap by increasing subsidies to reduce the cost of brand-name and generic drugs to participants who reach the donut hole. These subsidies will continue until 2020, when the participant's maximum contribution toward the cost of prescriptions will be reduced to 25%.

The threshold for the itemized deduction for medical expenses increases from 7.5% to 10% of adjusted gross income, beginning in 2013. However, this increase is waived for taxpayers age 65 and older through 2016.

In 2013, the annual pretax employee contribution to a Section 125 cafeteria plan flexible spending account (FSA) is reduced to $2,500, subject to annual increases for cost-of-living adjustments. The reduction does not apply to certain employer nonelective contributions (e.g., flex credits).

Beginning in 2013, the hospital insurance (HI) portion of the payroll tax, commonly referred to as the Medicare portion, increases by 0.9% for individuals with wages exceeding $200,000 ($250,000 for married couples filing a joint federal income tax return, and $125,000 for married individuals filing separately).

In addition, 2013 marks the imposition of a new 3.8% Medicare contribution tax on the unearned income of high-income individuals. This 3.8% contribution tax generally applies to the net investment income of individuals with modified adjusted gross income that exceeds $200,000 ($250,000 for married couples filing a joint federal income tax return, and $125,000 for married individuals filing separately).

Looking ahead, 2014 brings the implementation of the health insurance exchanges, premium and cost-sharing subsidies, and the requirement that most individuals have health insurance.

How does health-care reform affect women?

The Patient Protection and Affordable Care Act (ACA) expands women's access to health insurance and adds several reforms to the existing health-care system that are specifically beneficial to women.

Access to care and affordability are important issues for women. According to the U.S. Department of Health and Human Services, because almost twice as many women than men who receive employer-provided health insurance are covered as dependents, they are susceptible to losing that coverage should they become widowed, divorced, or if their husbands lose their jobs.

In addition, the cost of coverage may significantly impact women. Women earn less than men, on average, and are more likely to be out of the workforce to care for children, parents, or other dependents. Because of this trend, out-of-pocket costs such as co-pays, deductibles, and premiums can pose a particular threat to women's access to affordable care.

The ACA provides for the creation of state-level health insurance exchanges, available to small businesses and uninsured individuals, that will serve as a marketplace of private and public health plans. Individuals and families purchasing insurance through insurance exchanges may be eligible for subsidies or tax credits (based on income) that can be applied towards the cost of insurance. According to the U.S. Census Bureau, 20% of women between the ages of 18 and 64, or about 19 million women, are uninsured. Of those, it is estimated that 36% will be eligible for tax credits and subsidies.

ACA specifies essential health benefits for women that must be offered by nongrandfathered plans. These benefits include maternity and newborn care, including prenatal visits and pediatric services. Several preventive services must be offered without co-payments or deductibles, including mammography exams; Pap tests; colonoscopies; type 2 diabetes screening; obesity screening; several immunizations including hepatitis, influenza, and HPV; and alcohol and tobacco counseling. Specific coverage benefits will continue to be shaped by U.S. Health and Human Services regulations.

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