

# FINANCIAL BRIEFS

Fulton Financial Planning, Inc.

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*Helping You Chart a Brighter Financial Future*



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This newsletter strives to provide factual and up-to-date information on the topics discussed, but it should not be regarded as a complete discussion of these issues. The reader is advised to engage the services of a competent professional before taking action on any subject matter discussed.

## Pension Protection Act of 2006

The Pension Protection Act of 2006 (PPA) is the largest piece of pension legislation to pass Congress in 25 years. To gauge the enormity, consider its size: 907 pages total, with an additional 386 pages of technical explanations.

While inspired by the collapse of Enron and WorldCom and selected larger employer pension plan terminations that threatened the solvency of the Pension Benefit Guaranty Corporation (PBGC), the Act also addresses areas which are likely of great interest to all individuals.

Let's take a brief look at some of the more significant provisions, especially as they may impact individuals.

It's that time again for open enrollment for Medicare Part D.

Before you skip to the next page, it may be wise to review the various options again this year, even if you think you will continue with the Part D choice you presently have.

Here's why.



One of the most significant provisions is the change which puts non-spouse beneficiaries closer to equal footing with spouses should they inherit a 401(k) account. Effective January 1, 2007 and later, non-spouse inheritors will no longer be required to withdraw the 401(k) balance immediately. Instead they will be able to stretch out withdrawals over their expected lifetimes by moving the funds to a

special IRA account. Stretching out the withdrawals over a period of years will let the bulk of the retirement money stay sheltered in a tax-deferred account for years, rather than losing a large portion to taxes in a single bite via the current lump-sum withdrawal requirement.

(Spousal beneficiaries do retain some unique advantages, chief of which is the ability to roll over the inherited 401(k) to his or her own IRA. Any required withdrawals could then be delayed until the beneficiary reached age 70 1/2.)

Other provisions include:

- the ability for employers to provide plan participants with access to independent, third-party investment advice. Certain

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## Medicare Part D Re-Visited

Some plan premiums have changed. Make sure your choice is still the most cost effective for your circumstances.

Some plan formularies have changed. Review your top plan choices to make sure that your current medications are still available under each plan. Also check to see which plans include a

wider range of your medications within their plan formulary and specific pricing tier.

By late October updated information on plan offerings, prices and other details should be available on the web. Check Medicare's Plan Finder at [www.medicare.gov](http://www.medicare.gov) and [www.mymedicare.gov](http://www.mymedicare.gov) to

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# Year End Planning Tips

Heading into the homestretch of 2006, there's a busy time ahead. Don't overlook the opportunity to trim your tax bill, by making a little time for proactive tax planning.

Here are some ideas:

**Withholding.** Update your projected tax liability for 2006. You may find that the projected totals will be lower than anticipated. If so, perhaps it makes sense to amend the number of your withholding allowances for the remaining pay periods this year.

**Contribute maximum amount to tax-deferred retirement account.** For employer-sponsored plans such as a 401(k)/403(b), the maximum contribution for 2006 is \$15,000. Add an additional \$5000 if you are age 50 and over. The funding deadline is by year-end, although a few additional days are granted for administrative purposes during which the actual deposits must be made.

The maximum contribution amount for Traditional and ROTH IRAs for 2006 is \$4000, with an additional \$1000 catch-up provision for those individuals age 50 and over. Accounts may be funded with 2006 contributions up until the deadline for filing your 2006 federal income tax return (generally April 15, 2007 plus extensions).

The maximum for Simple IRAs for 2006 is \$10,000, with an additional \$2500 catch-up provision available to individuals age 50 and over. However plans had to be established by October 1 in order to accept contributions for 2006.

**Use all funds in flexible spending accounts.** IRS regulations now permit any unused balances in these accounts to be carried forward to the following year, although some employers still require that any amounts unused in these accounts

## TAX TIPS



by year-end be forfeited. Check with your employer to find out the specific requirements for your account.

Go on a spending spree if you find that you've spent less than anticipated in your medical reimbursement account and if you cannot carry over the balance to next year. Consider new eyeglasses/contacts, dental work, preventative screenings or other needed items.

**Check for estimated mutual fund distributions.** This is the time of year when most mutual funds determine required pay-outs to shareholders. Check the website or contact each fund company to obtain estimates for any likely distributions for holdings in taxable accounts.

If you're planning a new purchase in a fund that projects a large payout, consider the merits of postponing that purchase until after the

distribution. Doing so will help you sidestep picking up a potential tax liability for this tax year.

**Harvest portfolio for tax losses.** Review your current holdings in taxable accounts and identify potential opportunities to lock in gains, while at the same time reduce any potential tax liability by selling poorer performers. Many oil, energy, international stocks, precious metals and some real estate holdings have achieved spectacular growth this year. Perhaps your portfolio allocations are in need of re-balancing, as a result. This is the perfect opportunity to sell some of the holdings with big gains — thereby locking in the profits — and re-position those dollars to other sectors.

At the same time perhaps some of your holdings have lagged. Use the tax regulations to your best advantage by selling the underperformers which have unrealized losses, thereby offsetting against any gains realized. Doing so can help you achieve 2 goals — lower potential tax liability and re-position your portfolio so it is focused on more attractive opportunities.

**Plan New Business Equipment Purchases.** Business owners who place new equipment in service by year-end may deduct upfront up to \$108,000 of the cost of the equip-

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## Sales, Kiddie Tax Updates

**Sales Tax Deduction (Likely) Not Extended.** One itemized deduction that's been helpful to Texas residents over the past 2 years appears to be history.

As of mid-October Congress had not yet extended the special provision authorizing a deduction for sales tax by residents who live in states with no personal income tax.

Watch for any year-end developments. But as of now, the sales tax deduction will likely not be available for 2006 returns.

**Kiddie Tax Changes.** The tentacles of the kiddie tax now reach further, thanks to a provision included in the Tax Increase Prevention and Reconciliation Act (TIPRA) of 2005

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## 529s The Clear Leader

Saving enough to cover anticipated college costs is never an easy task. In fact, just deciding how to go about saving is not an easy task, as various account types offer their own advantages or weaknesses.

That choice has now been made much easier.

529 accounts are now clearly the leader, outdistancing Coverdell accounts and UGMA/UTMA accounts, thanks to provisions signed into law as part of the Pension Protection Act of 2006.

The act removed earlier sunset provisions that had applied to 529 accounts, thereby giving permanent status to key portions. These include tax-free withdrawals from 529 accounts when used for qualified education expenses; tax deferred growth of earnings in the account; permitting contributions to both 529 and Coverdell accounts for the same beneficiary in the same year, along with increased amounts that can be used toward room and board expenses; and the ability to change (via rollover) 529 accounts to a different state plan once each year without requiring a change in beneficiary.

529 accounts also gained preferential treatment in financial aid formulas. The new law removed student-owned 529 plans and Coverdell education savings accounts from the

### Year-End Planning

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ment purchased in 2006. This special Section 179 deduction offers an immediate deduction against current year income vs the more typically required approach of depreciating over 5 years.

Included among eligible items for this special treatment is off-the-shelf computer software. •

expected family contribution (EFC) in the federal financial aid formula. A 529 account or Coverdell ESA is normally considered an asset of the account owner; however, 529 accounts or Coverdell ESAs which are owned by a dependent student are excluded from the Free Application for Federal Student Aid (FAFSA).

Under federal financial aid rules, college savings plans are counted as an asset of the parent (if the parent is the account owner) and assessed at a rate of 5.6 percent. This means that 5.6% of the funds are deemed available for college expenses in the year a student applies for aid. By contrast, 35 percent of assets owned by the student are used to calculate EFC. So removing student-owned accounts from the formula can have a big impact on the EFC.

Note that some private institutions

### Kiddie Tax Updates

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and signed into law in May 2006.

The regulation is intended to reduce the attractiveness for parents shifting investment income to young children in a lower tax bracket than would otherwise apply to the parents.

For 2006 if a child receives interest, dividends or other 'unearned income', the first such \$850 is typically tax free, with the next \$850 taxed at the child's lower rate. Income above the \$1700 is subject to the parents' top tax rate.

Previously the parental rate kicked in only for children under age 14. Thanks to the new TIFRA provisions it now affects kids under age 18. •



### UNIVERSITY

follow a different formula for calculating financial resources and financial aid, other than the applicable guidelines under the federal aid rules.

On a related note, prepaid tuition plans began receiving the same preferential treatment as 529 plans for financial aid purposes, effective July 1, 2006. Distributions (withdrawals) from college savings plans such as 529s or prepaid tuition plans are now excluded from being considered as income for either parent or student.

The good news is that college planning has become easier with the permanent status granted to 529s. However there's still a lot to know and consider when it comes to funding a college education. Call if we may assist you in sorting through the various choices, evaluating financial aid possibilities or projecting the funding amounts needed. •

### Medicare Part D

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compare out-of-pocket costs and benefits in your area.

Keep in mind that the coverage gap threshold, or 'doughnut hole', will increase to \$2400 for 2007, along with the out of pocket maximum to \$3850 before reaching the catastrophic threshold.

Also recall that some plans offer coverage through the doughnut hole, in return for a higher premium. However many such plans cover only generic drugs in the doughnut hole. Hence review each plan's benefit description carefully.

If you did not sign up for Part D earlier and have no other creditable coverage, do not overlook your opportunity now. Call if you need assistance in sorting through the various options and selecting the best plan for your needs. •

# Pension Protection Act of 2006

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requirements must be met to ensure that such advice remains free of conflicts of interest.

- flexibility for employers to automatically enroll employees in 401(k) and similar plans, with designated automatic investment options other than money market or stable value funds.
- offers employees the opportunity to opt out of automatic enrollment or to change the rate of contribution, the time periods for making elections and investment contributions.
- allows participants to divest that portion of their account balances invested in employer securities according to specified schedules.
- provides that taxpayers may direct the IRS to send tax refunds directly to their IRA accounts.

To be sure, many of the provisions are designed to strengthen pension plan solvency. Examples include:

- requiring that employers make specific progress toward eliminat-

ing underfunding for defined-benefit plans.

- imposing restrictions against an employer setting aside reserve funds for executive nonqualified deferred compensation plans at the expense of the majority of workers.
- specifying interest rate assumptions that must be used.
- requiring that participants in underfunded plans be informed of the plan's funding status.

Other provisions address future PBGC solvency, such as:

- imposing higher termination premiums and for longer periods for pension plans that dump pension liabilities on the PBGC and then emerge from bankruptcy, and
- limiting the PBGC guarantee for benefits arising from plant shutdowns and other unpredictable events.

In my view the ultimate effect of the PPA will be a reduction in the

number of remaining defined benefit plans, either by outright termination or shifting to cash balance plans; a reduction in future monthly or lump-sum pension payments for new retirees; and an increase in the number of underfunded plans caused by the changing interest rate funding standard.

A recent news brief has already alluded to this trend. Belo Corporation, a national media concern with a large presence in the North Texas area with WFAA-TV and *The Dallas Morning News*, has already stated that their Board of Directors is considering changing or terminating the current pension plan, due to PPA.

Belo cited the requirements for increased contributions and use of lower interest rates to calculate the return on fund investments as the primary reasons prompting the review.

These changes will impact not only pension plans of public companies, but also those of school, university and non-profit employers, as well as government workers at all levels.

PPA is by no means perfect legislation. It will take time to fully implement the various provisions. While PPA includes tougher funding requirements for employers — which may ultimately lead to fewer pensions plans left standing — perhaps Congress also recognized the need and provided the means by which employers can help educate the general workforce about the importance of saving toward their own retirement.

The clear message that PPA sends is that the future will be marked by a further shift away from traditional pensions to defined contribution plans such as 401(k) and 403(b)s. Thus, being informed, taking advantage of opportunities and taking responsibility for your own nest-egg accumulation will take on even greater importance. •

## By the Number\$ . . .

28 . . .

Percentage of taxpayers incorrectly reporting capital gains or losses on their tax returns due to confusion over how to calculate the numbers (GAO)

39 . . .

Percentage of adults who have enough money in cash-equivalent accounts to cover 3 months of living expenses (Bankrate.com)

42,000 . . .

Number of U.S. salaried workers affected by General Motors' deci-

sion to freeze its defined benefit pension plan (New York Times)

15 . . .

Percentage of total 401(k) assets invested in company stock at the end of 2004, vs 19 percent in 2001 (Employee Benefit Research Inst.)

43 . . .

Percentage of companies offering company stock as an investment option in 401(k) plans in 2005, vs 55 percent in 2001 (Hewitt Associates)