



## The big question: Save for your children's education or your retirement?

In a perfect world, everyone could save enough to fund their children's higher education, as well as provide for their own retirement. But in the real world, many

people struggle to do both, to the point one often takes a back seat to the other. If this describes your situation, here are some ideas that might help.

Tax-advantaged saving for either college or retirement relies on the same basic principle – setting aside money that grows tax-free until you need it.

There is also some commonality in how the funds for college and retirement plans can be used. While those plans that are designed for education must be used for that purpose alone, it is possible to use some retirement accounts for education.

### ■ IRA funds

For instance, penalty-free withdrawals can be made from both traditional and Roth IRAs if the money is used for qualified educational expenses. With a traditional IRA, however, the full amount of the withdrawal remains subject to income tax. Early withdrawals from a Roth IRA that are used for college expenses are tax-free up to the amount contributed into the plan. Only the earnings portion of these withdrawals is subject to income tax.

So, does this make IRAs the perfect catch-all for both retirement and col-

lege saving? Not exactly. One big disadvantage is that you can only contribute \$4,000 per year (\$5,000 if age 50 or older) to an IRA. Depending on when you start, this might not be enough to accumulate significant funding for both college and retirement.

### ■ The best strategy

Be careful of falling into the deadline trap. It's likely your kids will attend college before you retire. Since the tuition deadline is closer, you might be tempted to reduce or eliminate retirement plan contributions in the early years of your savings plan in order to focus on education savings. But a typical retirement will generally last longer and cost more than your child's education. By putting college tuition first, you could end up with less than you need in your retirement nest egg.

What is the best strategy? If you cannot adequately fund both college savings and your retirement account, maximize your retirement saving first. There are far more options for financing college, such as grants, scholarships, student loans, and asking the student to pay a portion of his or her own schooling.

Whether it's college or retirement – or both – you need a plan to reach your financial goals. This is where we can help. Give our office a call today if you would like assistance in analyzing the options best suited to your circumstances. ♦



### JANUARY

**15** – Due date for the fourth installment of 2007 estimated tax.

**31** – Employers must furnish W-2 statements to employees. 1099 information statements must be furnished by banks, brokers, and other payers.

**31** – Employers must file 2007 federal unemployment tax returns and pay any tax due.

### FEBRUARY

**28** – Payers must file information returns (such as 1099s) with the IRS.\*

**29** – Employers must send W-2 copies to the Social Security Administration.\*

### MARCH

**3** – Farmers and fishermen who did not make 2007 estimated tax payments must file 2007 tax returns and pay taxes in full.

**17** – Deadline for calendar-year corporations to elect S status for 2008.

**17** – 2007 calendar-year corporation income tax returns are due. ♦

\*March 31 if filing electronically.

# Client UPDATE



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WINTER 2007

## Planning can trim taxes on your investments

Maximize your tax savings this year by reviewing your investment tax planning before year-end. Here are a few strategies that might reduce your 2007 taxes and

prepare you for what's coming in 2008.

■ **Maximize your dividends and capital gains.** Take advantage of the preferred tax treatment on both dividends and long-term (more than 12 months) capital gains. Review your current stock and other investment holdings in order to generate dividends and create long-term gains.

■ **Make the most of year-end stock sales.** If you have a few loser stocks in your portfolio, consider selling them now. You can sell enough losers to eliminate all your realized capital gains for the year, plus another \$3,000 in regular income. Be careful to avoid a wash sale (buying the same security within 30 days before or after you sell shares at a loss) since the tax rules disallow the loss. If you have realized losses over \$3,000, consider selling enough of your winners to get back to the \$3,000 amount. Taking those gains will add nothing to your tax bill.

■ **Time your mutual fund transactions.** A key fact to be aware of is that mutual funds are usually required to distribute their income annually to shareholders. If you purchase a mutual fund just before a distribution date,

you will receive the distribution and be required to include it in your taxable income. Since the price of the fund shares before and after a dividend distribution reflect the amount of the dividend, you are actually paying income tax on part of your own purchase. To avoid this outcome, call the fund and ask for the ex-dividend

date and the estimated payout and make your purchase after that date.

■ **Cut capital gains taxes to zero.** Beginning in 2008, the tax rate on long-term gains will drop to zero for taxpayers in the lowest two regular tax brackets. If you're a single filer with income less than about \$32,000 or married with income less than about \$64,000, the new zero long-term capital gain rate could apply to you. In that case, you may want to postpone planned sales until 2008.

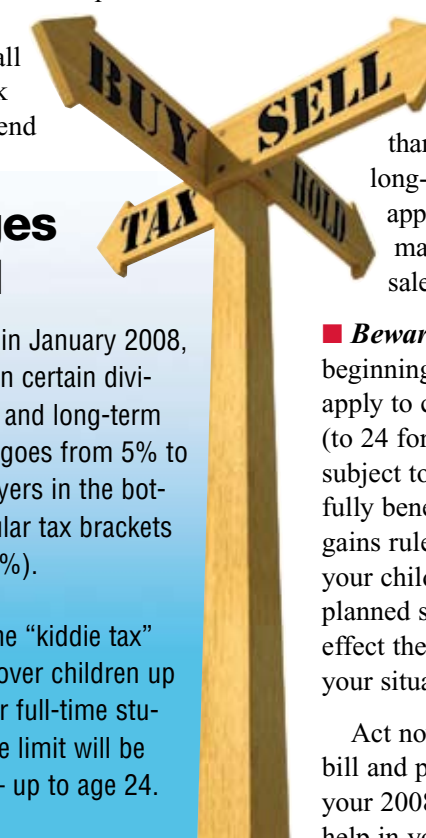
■ **Beware the kiddie tax.** Also beginning in 2008, the kiddie tax rules apply to children up to 19 years of age (to 24 for full-time students). Children subject to the kiddie tax rules will not fully benefit from the new zero capital gains rules. Now is the time to review your child's stock portfolio and time planned sales to avoid any adverse effect the new rules could have on your situation.

Act now to minimize your 2007 tax bill and position yourself to reduce your 2008 taxes. Give us a call for help in your planning. ♦

### Changes Ahead

■ Beginning in January 2008, the tax rate on certain dividend income and long-term capital gains goes from 5% to 0% for taxpayers in the bottom two regular tax brackets (10% and 15%).

■ In 2008, the "kiddie tax" expands to cover children up to age 19. For full-time students, the age limit will be even higher – up to age 24.





## Retirement funds: What you need to know about required withdrawals

**D**o you own a traditional IRA, SEP-IRA, SIMPLE IRA, Keogh plan, 401(k) plan, or 403(b) plan? If so, you'll have to start taking distributions when you reach age 70½. If you don't, you'll forfeit 50% of the amount you should have taken but did not.

For example, if your required minimum distribution (RMD) in 2007 was \$10,000, but you only withdrew \$4,000, your penalty would be 50% of the \$6,000 you did not withdraw, or \$3,000.

The RMD rules apply to the plans mentioned above, but not to Roth IRAs.

### Here are the requirements.

- You may take your first distribution any time before April 1 of the year following the year in which you reached age 70½. However, a first distribution taken after the year you turned 70½ still will be credited to the year you actually reached the required age. You'll then have to take another distribution by December 31 of the current year, forcing you to pay income tax on two distributions in the same year.
- You must take each subsequent distribution by December 31 of the applicable year. To avoid the 50% penalty, give your plan administrator enough time to process the distribution and get it to you by year-end.
- The amount of your RMD is computed using Uniform Lifetime Tables issued by the IRS. These tables provide percentages that are applied to the value of your retirement account

as of December 31 of the year preceding your distribution. Beginning at age 70½, for example, most people must withdraw at least 3.6% of the value of their accounts. At age 75, the percentage increases to 4.4%. If your spouse is ten or more years younger than you, different rates will apply.

- If you're still employed at age 70½, you may be able to delay withdrawing from your current employer's plan until you actually retire.
- You and your spouse may not take distributions from one another's accounts to make up your RMDs. However, if you individually own more than one IRA, you may compute a combined RMD and withdraw it from one or any combination of the accounts. RMDs from non-IRA plans, such as Keogh or 401(k) plans, must be computed for and withdrawn from each separate account.
- You may take distributions in monthly, quarterly, semi-annual, annual, or irregular increments, as long as you reach your required total each year.

- Since RMDs are taxable, consider making quarterly income tax estimates to cover your liability, or instruct your administrator to withhold taxes from each distribution. Call us to set up a time to develop further tax-saving strategies for handling your retirement funds. ♦



### New filing for tax-exempts

Thanks to a provision in the *Pension Protection Act of 2006*, tax-exempt organizations with annual gross receipts of \$25,000 or less will generally have to file a new annual report with the IRS. Form 990-N is to be filed electronically, and because it is short and easy, the IRS is calling it an e-Postcard. If an organization fails to file for three consecutive years, its tax-exempt status may be revoked.

### IRS reminds employers about tip credit changes

Employers are being reminded by the IRS about changes relating to the tip credit (known as the 45B credit). Even though the federal minimum wage is now \$5.85 an hour, employers are to compute the credit on the previous minimum wage of \$5.15.

Also, employers who claim the credit must reduce their social security and Medicare tax deduction accordingly. Employers may now use the credit to offset the alternative minimum tax; previously the credit could only offset the regular income tax. ♦

### CLIENT UPDATE

This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details and/or professional assistance.

## Give your business an annual checkup to keep it healthy and profitable



**B**usiness owners and managers spend most of their time monitoring operations and dealing with everyday problems. But just as an annual checkup from your

physician helps to monitor and manage your personal health, an annual checkup can do the same for your business. The benefits of such a review are holding your company accountable and evaluating current performance to better plan and execute future operations. Here are seven things that you should make time to do every year. These are important for your longer-term business health and personal success.

**1 Review your business insurance coverage.** Don't just automatically write a check to renew your insurance policies when they come due. Instead, you should sit down with your insurance agent every year. Review your business operations, focusing on any changes. Discuss types of risk that could arise. Ask about new developments in business insurance. Use your agent's expertise to identify risk areas and suggest suitable coverage.

**2 Review your business tax strategy.** Consider adjusting taxable earnings for the year, perhaps by accelerating expenses or delaying income at year-end. If you're a cash-basis taxpayer, you could boost 2007 deductions by declaring and paying bonuses in December rather than in early January. Also, you may be able to defer invoicing or make early purchases to reduce your 2007 tax bill.

Look into the "Section 179" rule that allows you to take an immediate tax deduction for most purchases of business furniture and equipment. By deducting the full cost immediately instead of depreciating it over several

years, you'll cut this year's tax bill. For 2007, you can deduct up to \$125,000 of qualifying purchases, subject to limits.

As your business grows, it's always good to make sure you're using the most appropriate form of business – whether it's sole proprietor, S or C corporation, LLC, or partnership.

Look for other tax breaks, such as specialized tax credits, that you might not be using to full advantage.

**3 Get a pulse on your customers.** An annual customer satisfaction survey is a great way to assess performance, obtain insight on potential new products or services, and to let your customers know how much you value their business.

**4 Check the effectiveness of your marketing.** Are your current methods and channels working well, or are you simply doing what you've always done?

**5 Update succession planning for your business.** Review your succession planning annually. You should have a specific plan for each key manager position, including yourself. Be prepared for a short-term absence or a permanent vacancy. Your plan might

mean promoting from within or recruiting externally. An up-to-date plan can be invaluable if you have an unexpected vacancy.

**6 Review your business banking relationships.** Annually, you should go over your cash balances and banking relationships with your controller or CFO. Then both of you should meet with your banker. Ask about new products or services that could help your company. Address any service concerns or problems you might have had. Look for ways to reduce idle cash, boost interest earned, and improve cash flows.

**7 Review and update your personal estate planning.** If you're a business owner, your company is likely to be a significant part of your estate. A good estate plan is essential if you hope to pass the business on to your heirs. Your company, your personal circumstances, and the tax laws are continually changing. You should take time each year to make sure your plans are current.

If you are serious about improving your business, consider a yearly assessment of your operation. For any assistance you need, give us a call. ♦

