



Financial Foresights

Practical Insights For Your Financial Goals

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Hi Everyone!

Here is the January edition of my newsletter. I hope that you enjoy it!

Sincerely,

Dave

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Look at What's New for 2007

Every new year offers some surprises, and 2007 is no exception. Here's a look at some of the changes--big and small--that may affect your finances this year.

Medicare Part B premiums tied to income

Beginning in 2007, Medicare Part B premiums will be higher for beneficiaries with higher incomes. You'll pay an income-related premium if your modified adjusted gross income exceeds \$80,000 if you're single, or \$160,000 if you're married and file your taxes jointly. If you're already receiving Medicare and are among those affected, you should have already been notified by the Social Security Administration. If you enroll in Medicare Part B this year, you can expect to be notified shortly after enrolling in the program.



Tax refunds can be split up

If you expect a federal income tax refund this year, here's a bit of good news. Taxpayers will now be able to split a direct deposit tax refund into as many as three different accounts with three different financial institutions, making it easier to put a tax refund to work toward several financial goals. Regular passbook savings accounts, individual retirement arrangements (IRAs), health savings accounts (HSAs), and Coverdell education savings accounts are among the potential savings options. Of course, you'll need to check with your financial institution first to make sure it accepts direct deposit refunds--not all will. And to make sure your refund is properly split, you'll need to follow carefully the instructions from the IRS and your financial institution.

Refunds due for telephone excise tax paid

More than a century after it was introduced as a luxury tax on wealthier individuals, the federal excise tax on long-distance telephone service has been discontinued. The IRS will refund a portion of tax paid by individuals,

nonprofits, and businesses when they file their 2006 income tax returns.

Although this refund won't make you wealthy--you'll be able to claim a refund only for excise tax paid on long-distance service billed after February 28, 2003, and before August 1, 2006--it will put a few extra dollars in your pocket. If you don't want to pour over old phone records to determine the exact amount of tax you've paid, you can claim a standard refund amount ranging from \$30 to \$60, depending on how many exemptions you claim on your 2006 federal income tax return. Nonprofits and businesses can either claim refunds of the actual amount of excise tax paid or estimate their refunds using a formula.

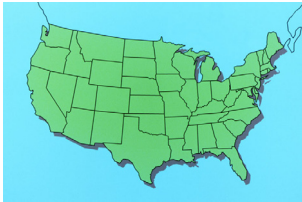
Charitable contributions from IRAs allowed

If you're over 70½ and need to take required minimum distributions from your IRA, you may benefit from a new rule that allows you to contribute as much as \$100,000 to a qualified charity directly from your IRA. These IRA distributions are tax free and satisfy minimum distribution requirements. But if you want to make a charitable contribution from IRA funds, don't wait--this option is available only until the end of 2007.

Charitable deductions need more documentation

If you give cash to your favorite charity in 2007, ask for a receipt. The IRS now requires that you have a receipt or other written confirmation for all cash contributions for which you are claiming a deduction, not just for those exceeding \$250. Bank records, such as cancelled checks, bank statements, or credit card statements showing the transaction, can also be used as support. Supporting documents must show the name of the charity as well as the date and amount of your contribution.

According to the U.S. Census Bureau, a net 1.4 million Americans moved from states with income tax to states with no income tax between April 1, 2000, and June 30, 2004.



To find out how your state's tax burden ranks, go to www.census.gov or www.taxfoundation.org.

The Most (and Least) Tax-Friendly States for Individuals

Your state of residence means little when it comes to federal income tax, but makes all the difference when it comes to the state and local taxes you pay. If your state is reaching too deeply into your pockets, you can always move to greener pastures. Before you pack your bags and call a mover, however, here are a few factors to consider.

Comparing states can be taxing

There are as many state tax systems as there are ... well, states. The 50 states and the District of Columbia raise revenue through a variety of taxes, including income tax, sales tax, personal property taxes on real estate and intangibles (e.g., stocks, bonds, notes, and loans), inheritance and estate taxes, and excise taxes on gas and cigarettes, among others. A state may impose all or some of these taxes. Often, a state that doesn't impose one type of tax will make up revenue by imposing higher rates in other types. For an accurate comparison among the states, then, you need to know their total tax burdens.

Fortunately, you don't have to gather and analyze this information yourself; the U.S. Census Bureau and the Tax Foundation, a nonpartisan tax research group, have done it for you.

The U.S. Census Bureau ranks states by total tax collections per capita (collections divided by population), listing (in order for 2005) Vermont, Hawaii, and Wyoming with the highest tax burdens, and South Dakota, New Hampshire, and Texas with the lowest.

The Tax Foundation ranks states by collections as a percentage of total income. The highest are Maine (13.5%), New York (12.9%), and Ohio (12%); the lowest are Alaska (6.6%), New Hampshire (7.3%), and Delaware (8.4%).

Best (and worst) income tax states

That being said, state income tax still accounts for a large percentage of taxes paid. So, you may consider yourself lucky if you live in one of the seven no-income-tax states--Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming (New Hampshire and Tennessee impose income tax only on interest and dividends).

The "worst" income tax states are Vermont, with a maximum rate of 9.5%, and California, with a maximum rate of 9.3% (plus 1% for taxable income over \$1 million).

Best (and worst) sales tax states

Currently, all states except Alaska, Delaware, Montana, New Hampshire, and Oregon collect sales tax. Colorado has the lowest sales tax rate (2.9%), while California has the highest (7.25%). Note, though, that some states also have local sales taxes.

Best (and worst) real property tax states

According to the Tax Foundation, the state with the lowest property tax per capita (for 2005) is Alabama, followed by Arkansas. The state with the highest is New Jersey, followed by Connecticut. But be careful; property taxes are generally collected by local governments, and can vary substantially within an individual state.

The best states to retire in

If you're a retiree on a fixed income, you may be interested in states that provide special tax benefits to seniors. For example:

- Social Security income is completely exempted from income tax in 28 states
- Pension income is fully or partially exempt in 33 states
- Many states offer added exemptions, standard deductions, and credits based on age
- Some states offer property tax reductions

The worst states to transfer wealth in

If you're concerned about transfer taxes, here are the states to note:

- Connecticut, Louisiana, North Carolina, and Tennessee impose gift tax
- The District of Columbia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, Washington, and Wisconsin collect inheritance and/or estate tax
- Kansas, Massachusetts, Nebraska, New York, Vermont, Washington, and Wisconsin impose generation-skipping transfer tax

For more state-specific information, see your tax professional.

Successful Investors' Strategies and How You Can Apply Them

For golfers looking to improve their game, it can be useful to watch Tiger Woods. In the same way, investors can learn from acknowledged money masters. Though you may not have their experience or resources, understanding the philosophies they use can help you develop your own investing approach.

Think like an owner, not like a trader

This philosophy is as commonsense as the investor who is famous for following it: Warren Buffett. Any list of successful investors includes the chairman of Berkshire Hathaway, and he's typically at the top of the list. The Oracle of Omaha is well-known for his down-to-earth approach to sizing up investments.

Buffett invests in businesses, not stocks, and prefers those with consistent earning power and little or no debt. He also looks at whether a company has an outstanding management team. Buffett attaches little importance to the market's day-to-day fluctuations; he has been quoted as saying that he wouldn't care if the market shut down completely for several years. However, he does pay attention to what he pays for a stock; as a value investor, he may watch a company for years before deciding to buy. And when he buys, he plans to hang on to his investment for a long time.

Don't forget that markets can be irrational

Like Buffett, George Soros feels markets can be irrational. However, rather than dismissing their ups and downs, the founder of the legendary Quantum Fund made his reputation by exploiting macroeconomic movements. He once made more than \$1 billion overnight when his hedge fund speculated on the devaluation of the British pound (he no longer actively manages the fund).



Soros believes in capitalizing on investing bubbles that occur when investors feed off one another's emotions. He is known for making big bets on global investments, attempting to profit from both upward and downward market movements. Such a strategy can be tricky for an individual investor to follow. However, even a buy-and-hold investor should remember that market events may have as much to do with investor psychology as with fundamentals. Whether or not you apply Soros's philosophy in the same way he does, that can be a valuable lesson to remember.

Use what you know; know what you buy

During his 13-year tenure at Fidelity Investments' Magellan Fund, Peter Lynch was one of the most successful mutual fund portfolio managers in history. He subsequently wrote two best-selling books for individual investors.

If you want to follow Lynch's approach, stay on the alert for investing ideas drawn from your own experiences. His books contend that because of your job, your acquaintances, your shopping habits, your hobbies, or your geographic location, you may be able to spot up-and-coming companies before they attract attention from Wall Street. However, simply identifying a company you feel has great potential is only the first step. Lynch did thorough research into a company's fundamentals and markets to decide whether it was just a good idea or a good investment.

Lynch is a believer in finding unknown companies with the potential to become what he called "ten-baggers" (companies that grow to 10 times their original price), preferably businesses that are fairly easy to understand.

Make sure the reward is worth the risk

Perhaps the best-known bond fund manager in the country, PIMCO's Bill Gross makes sure that if he takes greater risk—for example, by buying longer-term or emerging-market bonds—the return he expects is high enough to justify that additional risk. If it isn't, he says, stick with lower returns from a more reliable investment. Because bonds have historically returned less than stocks and therefore suffer more from high inflation, he also focuses on maximizing real return (an investment's return after inflation is taken into account).

Choose a sound strategy and stick to it

Even though all these investors seem to have different approaches, in practice they're more similar than they might appear. Each of their investing decisions has specific, well-thought-out reasons behind it. They rely on their own strategic thinking rather than blindly following market trends. And they understand their chosen investing disciplines well enough to apply them through good times and bad.

Work with your financial professional to determine a strategy that matches your financial goals, time horizon, and investing style.



Key investing lessons

- *Minimize risk by understanding what you're buying*
- *Know why you're making a particular investment and what you want to accomplish with it*
- *Minimize your losses, but recognize that no investor is right 100% of the time; just make sure that you're comfortable with the risk you're taking and that the potential reward is worth it*



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Ask the Experts



Is it too late to make an IRA contribution for 2006?

You can make an IRA contribution for 2006 at any time up until the due date for filing your federal income tax return for the year. For most people, this will be April 16, 2007. This deadline isn't affected by any extension you may receive to file your return. So, if you obtain an automatic six-month extension, you'll have additional time to file your tax return, but you won't have any additional time to make an IRA contribution.

If you do make a contribution in 2007 for 2006, make sure you tell your IRA trustee (or custodian) that the contribution is being made for the prior year. Otherwise, the trustee may assume that the contribution is for 2007 (the year in which it's received) and report it as such.

Also, before you make a contribution, be sure you're eligible. Remember that if you're covered by an employer retirement plan, you may not be able to deduct your contributions to a

traditional IRA unless your income is within certain limits. And you can't contribute to a traditional IRA at all after you reach age 70½. You can contribute to a Roth IRA at any age, but again only if your income falls within certain limits.

If you are eligible to make a deductible contribution to a traditional IRA, keep in mind that you can file your 2006 tax return claiming the deduction before you actually make your contribution. Just be sure you meet the April 16 contribution deadline.

You can contribute up to \$4,000 to an IRA (traditional, Roth, or combination of the two) for 2006 (\$5,000 if you were age 50 or older by the end of 2006). You may also be able to contribute up to \$4,000 to an IRA for 2006 in your spouse's name (\$5,000 if your spouse is age 50 or older), even if he or she had little or no taxable compensation for the year.

If you haven't yet made your IRA contribution for 2006, why not do it now?

How do I undo my 2006 Roth IRA conversion?

So you converted your traditional IRA to a Roth IRA in 2006, and now you've determined that the conversion no longer makes good tax sense, or that you were ineligible to make the conversion in the first place. What do you do? You may be able to reverse ("recharacterize") your conversion. When you recharacterize a Roth conversion, it's as though the conversion never occurred, and the funds are treated as having never left your traditional IRA.

Generally, to undo a Roth IRA conversion, you'll need to take the following steps:

1. Identify the traditional IRA that will "take back" the recharacterized contribution (plus any earnings allocated to the contribution) in a trustee-to-trustee transfer. This can be the same traditional IRA you converted from, or a new IRA.
2. Notify the financial institution that you intend to recharacterize your contribution. Your financial institution should have a specific form for this that contains all the information required by the IRS. If more

than one financial institution is involved, you must notify both financial institutions--the one servicing your present Roth IRA and the one that will accept the recharacterized funds. You must provide the notice on or before the date the assets are transferred back to the traditional IRA.

3. Meet all applicable deadlines. The deadline for recharacterizing a Roth IRA conversion is the due date for your 2006 federal income tax return, *including* extensions. So, if you file for an automatic extension to October 15, 2007, you also have until then to recharacterize your 2006 conversion. (A special procedure applies if you file your tax return by April 16, and then later decide to recharacterize.)
4. Report the recharacterization by attaching Form 8606 to your 2006 tax return.

Failure to comply with all the technical requirements for a recharacterization can have serious tax consequences, so be sure to ask your financial professional for assistance.