Financing Your Retirement Future

November 2008

2008 Year-End Tax Planning Tips

Despite passing three major pieces of tax legislation in the past year, Congress is still considering a host of expired and expiring provisions. While it's likely that several of these provisions will be renewed for the 2008 tax year, the uncertainty creates a challenging planning environment. With the window of opportunity for many tax-saving moves closing on December 31, it makes sense to focus on the basics, while staying ready to take advantage of any late-breaking legislative developments.

Timing is everything

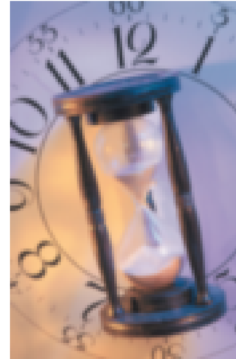
Year-end tax planning is as much about the 2009 tax year as it is about the 2008 tax year. There's a real opportunity for tax savings when you can predict that you'll be paying taxes at a lower rate (for example, if your income will be significantly different) in one year than in the other. If that's the case, some simple year-end moves can pay off in a big way.

For example, you may be able to defer a year-end bonus, or delay the collection of business debts, rents, and payments for services. Similarly, you may be able to accelerate deductions into 2008 by paying some deductible expenses in December rather than in January.

Alternative minimum tax (AMT) facts

If you're subject to the AMT, traditional year-end maneuvers, like deferring income and accelerating deductions, can actually hurt you. The AMT--essentially a separate federal income tax system with its own rates and rules--effectively disallows a number of itemized deductions, making it a significant consideration when it comes to year-end moves. For example, if you're subject to the AMT in 2008, prepaying 2009 state and local taxes won't help your 2008 tax situation, but could hurt your 2009 bottom line.

Legislation signed into law in December 2007 brought the most recent in a long series of temporary "fixes" for the AMT, but this temporary fix (in the form of increased AMT exemption amounts) expired at the end of 2007. If Congress doesn't act, the number of taxpayers subject to AMT could reach 25.7 million in 2008 (Source: Joint Committee on Taxation, JCX-38-07, June 25, 2007). Congress is likely to take some action, but the specifics are uncertain, making it important to stay up-to-date on any new developments.



Don't overlook IRA and retirement plan opportunities

Traditional IRAs (assuming you qualify to make deductible contributions) and employer-sponsored retirement plans, such as 401(k) plans, allow you to contribute funds pretax, reducing your 2008 income. Contributions you make to a Roth IRA or Roth 401(k) aren't deductible, so there's no benefit for 2008, but qualified Roth distributions are completely free from federal income tax--making these retirement savings vehicles very appealing.

For 2008, the maximum amount you can contribute to an IRA has increased to $5,000, and you can contribute up to $15,500 to a 401(k) plan. If you're age 50 or older, you can contribute up to $6,000 to an IRA, and up to $20,500 to a 401(k). The window to make 2008 contributions to your 401(k) closes at the end of the year, while you can generally make 2008 contributions to your IRA until April 15, 2009.

If you qualify, consider whether it makes sense to convert some or all of your traditional IRA assets to a Roth IRA. Funds that you convert, to the extent the funds represent investment earnings and deductible contributions, are considered taxable income. Nevertheless, the potential future tax benefit could outweigh the current tax bill.

Expired provisions likely to be renewed

In addition to AMT relief, watch for action on other provisions that expired at the end of 2007, but are likely to be renewed, including:

- Election to take an itemized deduction for state and local sales tax in lieu of state and local income tax
- Above-the-line deduction for qualified tuition and related expenses
- Above-the-line deduction for certain expenses of elementary and secondary school teachers
- Tax-free distributions from IRAs for charitable purposes of up to $100,000 per person, per year

It's always difficult, at best, to anticipate what Congress will do. In an election year, it's even more unpredictable. If the last few years are any indication, though, it's not unreasonable to assume that we might see some legislation late in the year, so stay alert.

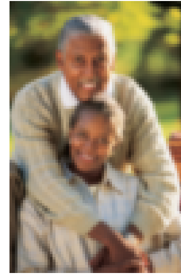
Reapplying for Social Security

What if you decide to apply for early Social Security benefits, but a few years into retirement, realize that a higher Social Security benefit would help you increase, and sustain, your standard of living? Fortunately, you're not necessarily locked into your decision to take your retirement benefit early. The Social Security Administration (SSA) allows you to withdraw your benefit application and reapply later if that would be to your advantage.

Why reapply?

Increasing your monthly Social Security retirement benefit is one of the main reasons you might want to withdraw your application and reapply. According to the SSA, most retirees file for Social Security benefits early, often at age 62. But the drawback to claiming benefits early is that your monthly benefit will be substantially less than it would be if you wait until full retirement age, or longer, to collect. For example, if your full retirement age is 66, your monthly benefit at age 62 will be approximately 25% less than it will be if you wait until your full retirement age of 66 to collect, and 43% less than if you wait until age 70. (Source: SSA chart, Effect of Early or Delayed Retirement on Retirement Benefits)

Once you have a clearer picture of your retirement income needs, you may decide to withdraw your initial application and reapply when you're older, so that you may receive a higher monthly Social Security benefit (adjusted annually for inflation) for the rest of your life. In addition, if you're married, your spouse will generally receive the greater of his or her own retirement benefit or your monthly benefit (including any cost-of-living increases) in the event of your death, so increasing your retirement benefit may translate into more survivor protection for your spouse.



You may also wish to withdraw your Social Security application if you decide to work and your income is enough to reduce or even eliminate your Social Security benefit, or if your Social Security income is increasing your tax liability.

How do you do it?

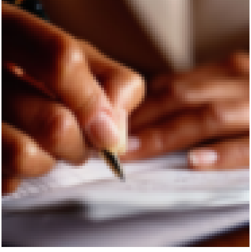
You can withdraw your initial benefit application by filing Form SSA-521, "Request for Withdrawal of Application" at your local Social Security office. However, there is a pretty big catch. If you withdraw your application after you begin receiving benefits, you're required to return--in a lump sum--all of the money that Social Security has paid you over the years. But any interest or investment earnings you've received as a result of saving or investing those benefits is yours to keep. If you paid taxes on the benefits you're now paying back, you may be eligible for an income tax credit or a deduction. You can find more information about the tax consequences in IRS Publication 915, Social Security and Equivalent Railroad Retirement Benefits.

There's so much to consider

Not everyone will come out ahead by withdrawing an application for retirement benefits, then reapplying--you'll need to consider your own financial circumstances. Obviously, the requirement to pay back benefits will limit the number of people who can take advantage of this opportunity. And even if you can afford to pay back your benefits, you must be willing to accept the risk that if you die, you or your spouse may not recoup the amount you've paid back. But reapplying for benefits may be worth considering if you need to maximize your lifetime income and provide higher survivor's benefits for your spouse.

Ask the Experts

Should my child apply to college early decision?



In the college early decision process, your child applies early to a particular college (typically in November of senior year), and hears back early (usually by December or January) as to whether he or she has been accepted.

For the student who has his or her heart set on a particular college that's also a good fit, applying for admission early decision can be a favorable way to get a leg up on the competition. It's also a good way to try to avoid the anxiety that typically comes with having to wait until spring for an acceptance letter. A student who gets accepted early may better enjoy his or her senior year, since there'll be more time for hobbies, courses, work, or activities that he or she might not otherwise have the time or inclination to pursue. However, there's a catch: an early decision application is a binding contract. If the college accepts your child (and offers an adequate financial aid package), your child must agree to attend that college. Consequently, a student can apply to only one college early decision.

There are two situations where applying early decision may not work in a student's favor. First, if a student needs senior year grades or extracurricular activities to boost his or her chances of admission, early decision will preclude consideration of these items. Second, if a student wants or needs to compare financial aid packages from several schools, early decision is not the route to go. Not only will the student have just one financial aid package to review, but the package may not be as generous as it would be for a traditional applicant. Why? Because the college knows that it's the student's first choice--in effect, the student has shown his or her cards.

Keep in mind that if your child does apply to one college early decision, he or she can still apply to other colleges through the regular admissions process as a backup--those applications are typically due by December or January.

What's the difference between early decision and early action?

If you and your child think the early decision process is too limiting, one alternative might be for your child to apply to college under an early action plan.

Early action plans are similar to early decision plans, but are less restrictive.

First, a student can apply to more than one college early action. Second, if a student is accepted under an early action application, he or she can either commit to the college immediately or wait until the spring to do so. Early action thus offers a huge advantage over early decision--your child gains the peace of mind that comes with early acceptance (and may even have several early acceptances by December or January), but can take a wait-and-see approach to making a commitment to any one school. This gives you and your child the opportunity to review the financial aid packages that come in from all the colleges your child has been accepted at, both under the early action process and the regular admissions process.

Not all colleges offer early action (or early decision) applications, however. In fact, in recent years, a handful of highly selective colleges have dropped their early action and/or early decision programs, believing that the process favors affluent students who are less likely to rely on financial aid. For a list of colleges that offer early action or early decision programs, visit www.collegeboard.com.

Considering the flexibility of early action plans, why would a student apply early decision? The answer is commitment--colleges likely consider the early decision applicant more committed, since he or she is bound to attend if accepted.

Students who apply either early action or early decision will need to have all applications and teacher recommendations completed by October or November of senior year.

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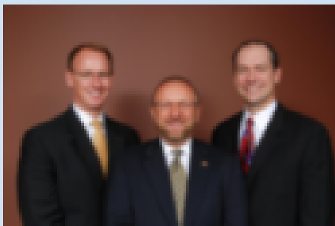

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