GUIDE FOR INDIVIDUALS

A financial guide for every stage of your life.

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FOREWORD

Life is good. The definition of a good life is different for every person and every phase of our lives brings new opportunities and challenges. You are one of your most important assets and it is up to you to protect your asset through hard work, continuous learning, upgrading of skills and knowledge, career choices and sound financial decisions.

Your financial needs are different depending upon your current circumstances. Financial success involves maintaining good control over your cash flow, protecting your assets, investing wisely, managing your taxes, saving for retirement, and leaving a legacy. The accompanying pages are meant to provide you with the information that you need to navigate financial decisions at every stage of your life.

Your AVL advisory team is here to assist you with all of your financial needs and we are pleased to be able to provide you with this financial tool.

"It is good to have an end to journey toward; but it is the journey that matters, in the end." -Ursula K. Le Guin

Table of Contents

CASH MANAGEMENT

Establish a Budget

A budget is a tool that allows you to manage and reach your spending and savings goals. A budget can help you prepare for life changes (a new home, children's education, retirement, etc.) as well as provide peace of mind by ensuring that you are in control of your future. Good foresight into costs provides the best chance of having the funds necessary to get through life changes smoothly. The most important ingredient of a successful personal budget is commitment.

A good budget requires an honest financial assessment. In order to establish a budget, you need to identify your income sources (i.e., net take home pay) and your current expenditures since these will be the foundation of your baseline budget. After you have established your baseline budget, you will be able to analyze your expenditures to determine which expenses need to be changed to allow you to meet your financial goals and dreams.

Expenses can be grouped into two broad categories. Fixed expenses represent those expenses that you can expect to pay every month such as mortgage, car payments, insurance, utilities, groceries, and medicines. Discretionary expenses are the extras that you could live without if you had to, such as dining out, hobbies, travel, and manicures/pedicures.

The good news is that a budget does not have to mean deprivation. Rather, it is important that you budget for the things that make life enjoyable such as vacations, dining out, entertainment, and hobbies.

The following table is an example of a budget. There are financial software and apps in the marketplace that can assist you with the budgeting process.

CASH MANAGEMENT (Continued)

EXAMPLE MONTHLY BUDGET			
REVENUES	**Budgeted**	**Actual**	**Difference**
Net monthly pay	$ -	$ -	$ -
Other income sources	-	-	-
Total Revenues	-	-	-
EXPENSES			
Fixed Expenses			
Mortgage/ Rent	-	-	-
Home equity loan	-	-	-
Car loan(s)	-	-	-
Student loan(s)	-	-	-
Utilities	-	-	-
Telephone	-	-	-
Insurance	-	-	-
Groceries	-	-	-
Total fixed expenses	-	-	-
Savings and Investments			
Emergency fund	-	-	-
College savings	-	-	-
Retirement (IRA)	-	-	-
Total savings and investments	-	-	-
Other Expenses			
Gas (Automobile)	-	-	-
Child care	-	-	-
Total other expenses	-	-	-
Discretionary Expenses			
Charitable contributions	-	-	-
Gifts	-	-	-
Vacation	-	-	-
Entertainment (Hobbies; Movies; Dining Out, etc.)	-	-	-
Clothing	-	-	-
Total discretionary expenses	-	-	-
Total Expenses	-	-	-
EXCESS REVENUES OVER EXPENSES	$ -	$ -	$ -

CASH MANAGEMENT (Continued)

Good Credit

A good credit score is an important attribute for an individual to have. A credit score is a statistically derived numeric expression of a person's creditworthiness that is used by lenders to access the likelihood that a person will repay his or her debts. Credit scores range between 300-850 points (the higher the number, the more creditworthy a person is deemed to be). A good credit score paves the way for you to get what matters most to you in your life such as buying or renting a home, getting a good job, and being able to borrow money (at reasonable interest rates) when you need it. Lenders, employers, insurance agents, and cellphone providers, among others, may all run credit checks on you before working with you. Poor credit is often seen as a lack of responsibility, honesty, or financial management skills.

Building good credit starts with making wise financial decisions and developing healthy credit habits such as paying your bills on time, not maxing out your credit cards, working with lenders to avoid delinquency and collections issues, and not applying for multiple loans and credit cards at the same time.

The following are some tips to establish good credit:

- Apply for a credit card or small loan to get your credit history started. (Debit cards will not help you build credit.)
- Pay off charges in full at the end of the month whenever possible.
- Pay your bills on time. (Late payments reported to credit bureaus can damage your credit.)
- Pay student loans on time.
- Keep your total charges well within your credit limit.
- Regularly read your credit report for errors that could hurt your credit.
- Ask for credit line increases where available. (Raising your credit limit will keep your debt to credit limit ratio low.)

Federal law requires each of the three nationwide consumer credit reporting companies – Equifax, Experian and TransUnion to give you a free credit report every 12 months if you ask for it. You can monitor your credit score by taking advantage of the free annual credit score reports available through freecreditreport.com or other similar services. As an added benefit, monitoring your credit reports is the single best way to spot signs of identity theft, such as errors and suspicious activities and account or addresses that you do not recognize.

CASH MANAGEMENT (Continued)

Good Credit (Continued)

You have heard the saying “Bad things sometimes happen to good people.” If you do find yourself in financial distress, bankruptcy should always be considered a last resort since it can be very damaging to your credit. Before filing bankruptcy, get professional advice and review all of your options.

Credit Cards

As with anything in life, there are advantages and disadvantages to credit cards. As mentioned before, credit cards are often the first building block of good credit. Some of the other advantages of credit cards are:

- Immediate access to funds for unexpected or big ticket expenditures.
- Temporary solution to unexpected financial emergencies.
- Secure form of payment (safer alternative to using cash).
- Convenient. (Credit cards are accepted almost anywhere.)
- A vehicle for bill consolidation.
- Make record keeping easier.
- Offer cash back/miles rewards.

One of the risks associated with using credit cards is that they can tempt over-spending on items that you do not need or cannot afford. Other disadvantages are:

- Purchases made on credit cards can cost you interest and fees.
- If you do not pay your credit card bill in full each month, you will have to pay for your charges in the future which will mean less available cash in the future.
- Easy to lose control of spending.

Credit cards need to be used responsibly. A good rule of thumb is not to charge any discretionary spending to credit cards if you will not be able to pay off those charges in full at the end of each month. At the end of each month, your credit card charges should be itemized and compared to your budget to make sure that your spending is kept in check.

Debt

Obviously, we would all like to live our lives debt free. The reality is that few of us have the financial capacity to make large purchases, such as our home or our car, without incurring debt. However, it is important that you do not borrow for a lifestyle that you cannot afford.

CASH MANAGEMENT (Continued)

Debt (Continued)

In order to be able to obtain financing from banks and lending institutions, you must have an acceptable debt ratio and good credit. Your debt ratio is a comparison of our monthly debt divided by your monthly income. Monthly debt includes existing minimum payments on credit cards, mortgage payments, and other loan payments plus the payment on any loan/mortgage you might be applying for.

Banks and lending institutions establish debt ratio limits as part of the lending process. The debt ratio limits can vary by financial institution but generally range between 28% and 38% of your income. If your debt ratio does not fall within the established limits you will not be eligible for a loan. A good rule of thumb is to keep your debt ratio (excluding your mortgage) to no more than 20% which should allow you to plan for a down payment and obtain a mortgage if you do not already have one.

MANAGING YOUR TAXES

"In this world nothing can be said to be certain, except death and taxes." - *Benjamin Franklin*

Although paying taxes is certain, we often forget that we receive benefit from the taxes that we pay. Our tax dollars pay for our national defense and public safety, our highways and roads, the education of our children, and our health and social welfare. We pay taxes to be Americans and enjoy the benefits of the American society that offers crucial infrastructure and unlimited opportunities to its citizens.

The United States, through the Internal Revenue Service (IRS), has established a tax code (rules and regulations) that every taxpayer must follow. The rules and regulations are often complex and require interpretation. **AVL can assist you in understanding the rules and in taking advantage of all of the available tax strategies to ensure you are only paying for your share of the American dream.**

Filing Status

There are five filing statuses:

1. Single
2. Married filing jointly (MFJ)
3. Married filing separately (MFS)
4. Head of Household (HOH)
5. Qualifying widow(er) (QW)

A taxpayer is single if unmarried or separated from a spouse, either by divorce or a separate maintenance decree as of the last day of the tax year.

A taxpayer is MFJ if married (not legally separated or divorced) on the last day of the tax year. A surviving spouse can also file MFJ in the year of the deceased spouse's death.

A taxpayer is HOH if they are unmarried at the end of the tax year and provide half the cost of the principle residence of a qualifying dependent for more than half the year.

A taxpayer is a QW if the deceased spouse died during the tax year and provided half the cost of the principle residence of a qualifying dependent child for the entire year.

In most instances (but not all), MFS results in a tax liability greater than MFJ. However, MFS does remove joint liability for accuracy of the tax return(s). If filed jointly, each spouse is responsible for the accuracy of the return as well as the payment of the tax liability.

MANAGING YOUR TAXES (Continued)

Filing Status (Continued)

A "Marriage Penalty" sometimes occurs in the tax system when a husband and wife pay more income tax than they would have if they remained single. The penalty can occur because the couple's income is combined which causes them to be taxed at a higher tax rate than they would have been if they had filed separate tax returns as single taxpayers.

Tax Liability

Individuals are required to pay in social security and Medicare tax as well as federal and state income taxes on income received during the tax year (i.e., on a **cash basis**).

Employed individuals are subject to the "Pay-As-You-Go" system requiring that their income tax be deducted from each paycheck and sent to the IRS and State by the individual's employer.

If you are self-employed or have other taxable income sources in addition to your employment earnings, the IRS and the State(s) require you to estimate your income tax liability on those sources of income and to pay your income tax on a quarterly basis as follows:

First payment – April 15
Second payment – June 15
Third payment – September 15
Fourth payment – January 15

In order to avoid Federal income tax penalties, you must pay in at least 90% of your total income tax liability by the quarterly deadlines stated above.

MFJ taxpayers with wages and/or self-employment earnings equal to or greater than $250,000 and Single, HOH, and QW with wages and/or self-employment earnings equal to or greater than $200,000 are required to pay in an additional 0.9% Medicare tax on those earnings.

MFJ taxpayers with wages and/or self-employment earnings equal to or greater than $250,000 and Single, HOH, and QW with wages and/or self-employment earnings equal to or greater than $200,000 may be subject to an additional 3.8% tax if they have net investment income. The 3.8% net investment tax is applied to the lesser of the net investment income or the modified adjusted gross income (as defined by the IRS) over the income threshold. Net investment income includes interest, dividends, annuities from nonqualified plans, royalties, rental income, and gains on distribution of investment property.

MANAGING YOUR TAXES (Continued)

Tax Liability (Continued)

All taxpayers are subject to alternative minimum tax rules. The IRS established alternative minimum tax rules to ensure that high income taxpayers do not use loop holes and tax strategies to avoid paying income tax completely. AMT is a separate parallel calculation of taxable income which eliminates some deductions allowable for regular tax to determine if additional tax is due.

Tax Savings Strategy

Tax benefits are allowable deductions on a tax return that are intended to reduce a taxpayer's tax liability. A tax savings strategy is a plan for reducing the amount of income taxes owed by a taxpayer by maximizing the use of tax benefits. The first step to applying tax strategies is to determine whether you will be in a higher or lower tax bracket from one tax year to the next. In high tax bracket years, you want to maximize deductions and defer income. In low tax bracket years, you want to maximize income and defer deductions. The following are some common tax savings strategies.

- Defer income until retirement when your taxable income will be lower and taxed at a lower tax rate.
- Max out your employer sponsored tax deferred retirement plan (i.e., 401k).
- Max out your self-employed retirement plan. (See AVL's Guide for New Businesses for more information on retirement options available to self-employed individuals.)
- Contribute to an individual retirement account (IRA).
  Note: High income taxpayers who are eligible to participate in an employee sponsored retirement plan will not be able to receive a deduction for an IRA if the modified adjusted gross income exceeds the threshold established by the IRS.
- Manage trading activity in your investment portfolio. You are taxed on realized capital gains initiated by your investment advisor even if you do not withdraw the gain proceeds.
- Harvest capital losses on investments. (Capital losses are deductible to the extent of capital gains plus $3,000.)
- Defer capital gains on investments until after the end of the year if no capital losses are available to offset the gain. This strategy will allow you to defer the taxes for an additional year.
- Defer receipts of bonuses or other income until the next tax year if income is expected to be low in that year.
- Invest in treasury securities because their interest is exempt from state income tax.
- Gift income producing property up to the non-taxable threshold established by the IRS to recipients taxed at a low income tax rate.

Tax Savings Strategy (Continued)

- Donate appreciated property to charity allowing you to take a charitable deduction for the fair market value of the property without having to pay tax on the appreciated gain.
- Keep track of mileage driven for business, medical, or charitable purposes. (You must keep detailed daily mileage logs to substantiate your deduction.)
- If one spouse has high medical expenses or other deductions that are limited by adjusted gross income, it may be beneficial to file separately in order to maximize the available deduction.
- Take larger retirement distributions in years where your tax bracket is the lowest.
- Complete Roth IRA conversions in years where your tax bracket is the lowest.
- Delay payment of itemized deductions to bunch the expenses into one tax year in order to maximize your deduction. (This strategy would be beneficial if deductions are limited by AGI or the taxpayer does not have enough deductions in one year to itemize.)

Charitable Giving

Deductible contributions include money or property given to religious and nonprofit organizations (excluding social clubs, civic clubs, labor unions, and chambers of commerce). In addition, charitable travel such as transportation, meals, and lodging are also deductible if there is not a significant element of personal pleasure, recreation or vacation in the travel.

Monetary charitable deductions are only allowed when the taxpayer has either bank records or a written acknowledgement from the charity documenting the contribution amount and date.

Non-cash charitable deductions must be substantiated including the name of the charitable organization, the date and location of the contribution, reasonably detailed description of the contributed property, original cost of the property, the fair value of the property at the date of donation, and the method of determining fair value. A written appraisal is required for non-cash charitable contributions with a value of $5,000 or more.

A taxpayer cannot claim any deduction above $500 for a donated vehicle unless the recipient charity provides the taxpayer with a form 1098-C substantiating the fair value of the donation.

Total charitable deductions cannot exceed 50% of adjusted gross income. Contributions that exceed the limitation can be carried forward to future tax years up to five years.

STRATEGIC PLANNING AND GOAL SETTING

Strategic planning and goal setting ensures that you get the highest possible return on the investment of yourself in everything that you do. Strategic planning is a systematic process of envisioning a desired future and translating this vision into broadly defined goals or objectives and a sequence of steps to achieve them. Goal setting is the process of defining the steps that you must take to achieve your desired future.

You should set **"SMART"** goals *(source: www.mindtools.com)*:

- **S**pecific
- **M**easurable
- **A**ctionable
- **R**ealistic
- **T**ime-bound

Strategic planning and goal setting can be achieved as follows:

- **Step 1** - Create your "big picture" of what you want to achieve in your lifetime by identifying large scale goals and dreams that you want to achieve. Your goals should be specific.
- **Step 2** - Break your larger goals down into smaller tasks that you must achieve to reach your lifetime goals.
- **Step 3** - Prioritize your goals into smaller tasks and set completion deadlines for those tasks.
- **Step 4** - Start executing your small tasks one task at a time until you reach your goals.

"How do you eat an elephant? One small bite at a time." - ***Anonymous***

Financial goals will be a necessary part of achieving your desired future and can generally be grouped into short term (0-5 years) and long term (5+ years) goals.

Short-term savings goals may include:

- Gifts
- Vacation
- Car purchase
- Home purchase
- Appliance
- Others

STRATEGIC PLANNING AND GOAL SETTING (Continued)

Long- term savings goals may include:

- Retirement savings
- College savings
- Dream vacation
- 2nd home purchase

AVL WealthCare, LLC can advise you on how to achieve your financial goals. AVL Wealthcare, LLC helps clients identify their financial goals and develop solutions to achieve those goals. We are a full service wealth management firm that provides estate and financial planning along with investment management. We guide investment behavior and educate clients on an evidence based strategy that is tax effective and low cost.

SAVINGS AND INVESTMENT (Non-retirement)

Emergency Savings

No one likes to think about the possibility that they will lose their job, become disabled, or be faced with another financial crisis. The reality is that these things happen to people all of the time. That is why it is important to create an emergency savings fund to cover both large and small emergencies that may arise. Three months' worth of your household expenses is the recommended emergency savings amount which will give you the peace of mind that you need to work through and resolve the emergency without the additional stress of financial burden.

Personal Residence

Owning your own home can be a lifestyle investment as well as a financial investment. If you can comfortably afford the mortgage payments and if owning your own home improves the quality of your life, then it is a lifestyle investment. It is a financial investment because you are investing the money that you would spend on renting into something that you will own one day. You will be able to sell the home at a gain if the home appreciates during the time frame that you own it and the mortgage interest is a tax deductible item. However, real estate values do not increase overnight so your short term and long term strategic plan as well as the current economic standing of the real estate market should be considered when you are making a decision to purchase a home.

According to Forbes' magazine, "Renting provides increased flexibility, a lower liquidity hit, and lower upfront costs, while buying a home can increase housing security, provide some inflation protected asset, tax benefits, and research continues to show that those who buy a home are more likely to increase their wealth. Purchasing a home can also work as a forced savings vehicle, which is very beneficial to many Americans that struggle to regularly save money." Real estate values can increase 2% to 3% per year when the economy is strong.

The benefit of owning a home versus renting a home will vary based on your specific situation. If you do decide to purchase a home, lender guidelines generally require that your total debt payment be no more than 36% of your gross income.

Interest incurred on acquisition debt (up to $750,000 joint and $375,000 separate) secured by the home is a deductible tax expense. The interest on first and second homes is deductible up to the debt thresholds previously mentioned.

SAVINGS AND INVESTMENT (Non-retirement) (Continued)

Vacation Homes and Rentals

Caution should be taken when making a decision to buy a second vacation/rental home. Keeping a primary residence is a big financial decision. Taking on a second home results in the same expenses as the primary residence but without the same write-offs allowed by the IRS and being a landlord comes with its own new set of responsibilities. Just like with your personal residence, you will need to consider your short term and long term strategic plan as well as the current economic standing of the real estate market when you are making a decision to purchase a vacation/rental home.

Some of the benefits to owning a second vacation/rental home are:

- You can generate income by renting the house when you are not using it.
- If you rent the home for less than 15 days in a calendar year, the rental income is not taxable.
- If all rentals are to family and friends at below market value, then those days are considered personal use days which will may allow you to deduct a portion of the interest as an itemized deduction without limitation.
- The market value of the home could increase between the time you purchase the home the time that you sell the home resulting in a gain on your investment.
- If you make your second home your personal residence for 2 of the 5 years before you sell the home, the income will be tax free up to the exclusion provided by the IRS.

Some of the disadvantages to owning a second vacation/rental home are:

- Changing work and financial responsibilities can keep second-home owners away from their vacation homes for extended periods of time negating the benefit of owning the home.
- Second homes need maintenance and costs associated with the home increase over time.
- If your expenses exceed your rental income from the home, the loss will only be deductible to the extent that you have other passive income (interest, dividends, etc.) to offset the loss against. *(Note: If you have the capital to purchase the second home outright without financing, then you will probably avoid suspended non-deductible passive losses resulting from interest expense.)* Suspended losses can be carried forward and will be fully deductible in the year that the property is sold. *(Note: If your AGI is below $100,000, you will be able to deduct up to $25,000 of the annual loss.).*
- The market value of the home could decrease between the time you purchase the home and the time that you sell the home resulting in a loss on your investment.

SAVINGS AND INVESTMENT (Non-retirement) (Continued)

Automobile Purchase vs. Lease

When deciding whether to purchase or lease a new vehicle you will need to consider the following:

- Reasons to buy

  1. You intend to keep the vehicle for more than a typical lease term.
  2. You expect to put more miles on the vehicle than will be allowed by the lease contract's mileage limit which could result in large penalty payments at the end of the lease.
  3. You have cash for the purchase or a down payment.
  4. If the vehicle is used for business you can choose the standard mileage method in the first year and then switch to the actual expense method in later years if it becomes favorable. *(Note: If you choose the standard mileage method for a leased vehicle, you have to use the method for the entire term of the lease.)*

- Reasons to lease

  1. Your monthly payments will likely be lower and require little or no money down.
  2. Leasing is suited to new taxpayers who desire a new vehicle every few years and who would borrow to pay for a new car.
  3. When it is time for a new car, there is no issue with disposing of the old car.
  4. Lease payment or standard mileage method is deductible if the vehicle is used for business.

SAVING FOR CHILD'S EDUCATION

One of the most important goals in any individual's financial plan is to provide a college education to your children. Beginning a college savings plan early is key to a successful result. There are numerous ways to save money for college in tax advantaged accounts prior to the student enrollment. The following plans can be used to save for your child's education and each of these plans have advantages and disadvantages.

Tax Free College Savings Plan

Commonly called a Section 529 Plan, this is the most popular tax advantaged savings account. Money that is contributed to the plan grows tax free and the distributions from the plan are non-taxable as long as they are used for qualified education expenses. Qualified education expenses for 529 plans include tuition, fees, books, supplies, equipment, and room and board. The appreciated earnings portions of the distributions not used for qualifying expenses are subject to income taxes on the beneficiary's income tax return. There is also a 10% penalty assessed on distributions not used for qualified education expenses.

The contribution limit is set by each plan and can vary by state. In Mississippi, the total contribution is $235,000. Once this amount is reached no additional contributions are allowed. The gift tax limits do apply to the contributions; however, there is an option to contribute 5 years of annual exclusion in one year. One attractive feature of Section 529 plans is anyone can make contributions to the plan which makes it an excellent estate planning tool for higher net worth individuals. (For example, grandparents can make contributions on behalf of their grandchildren.)

Each state and most investment firms have a Section 529 plan so there are many investment options. Generally speaking, Section 529 plans are composed of investment portfolios that contain one or more mutual funds, certificates of deposit, money market funds, etc.

Contributions to a 529 plan are not deductible for Federal income tax purposes. However, the State of Mississippi allows a state income tax deduction for contributions to each Mississippi 529 plan (MACS or MPACT) account up to $10,000 for a single filer ($20,000 joint returns) annually.

SAVING FOR CHILD'S EDUCATION (Continued)

Prepaid College Tuition Plans

Prepaid college tuition plans are a type of Section 529 Plan. These plans are offered by each State and provide guaranteed tuition at today's rate (as of the contribution date) for public universities. Mississippi's program is called MPACT. These plans protect against the future rise in college tuition and are guaranteed by the State.

Payments are made to the plan for the beneficiary and tuition is paid directly to the public community college or university. If the student decides to attend a private or out of state college, MPACT will pay the selected college using the same rates per credit hour paid to Mississippi institutions.

If the student obtains a scholarship that pays tuition and fees, MPACT will refund to the purchaser an amount equal to the tuition of the school attended. If the student decides not to attend college the refund is an average of the tuition and fees at all Mississippi colleges.

Contributions to a Section 529 plan are not deductible for Federal income tax purposes.

Uniform Gifts to Minor Accounts and the "Kiddie Tax"

Parents can establish investment accounts under the Uniform Transfers to Minors Act (UTMA, which is the successor legislation to the Uniform Gifts to Minors Act or UGMA). These accounts are established to transfer assets to a minor child. The parent or guardian controls the account making all investment and spending decisions for the benefit of the minor child. Transfers to these accounts are subject to gift tax; however, parents can make gifts up to the annual gift tax exclusion (currently $14,000). Gifts can exceed this amount without gift tax if the parent elects to use some of his lifetime estate and gift tax exemption (lifetime exemption is currently $5,430,000).

The benefit of these accounts is the income is taxed at the child's rates subject to the "Kiddie Tax "rules which can result in lower income tax on the investment income if the income does not exceed the Kiddie Tax limit. Income in excess of the Kiddie Tax limit is taxed at the parent's rate.

SAVING FOR CHILD'S EDUCATION (Continued)

The Kiddie tax applies to the following children:

1. Children under 18
2. Children 18 and their earned income is less than 50% of their support
3. Children 19-23, a full time student, and earned income is less than 50% of support

The first $1,050 of investment income is tax free. Income from $1,050 to $2,100 is taxed at 10%. The income above that amount is taxed at the parent's rate which varies based on the parent's income. Long-term capital gains are taxed at the child's rate, which is typically 0%.

One disadvantage to these UTMA accounts for minors attending college and applying for financial aid is available financial aid is reduced by 20% - 25% of the account.

When the child reaches the age of majority (usually 18 or 21, depending on the state), control of the account transfers to the child.

Education Credits

Tuition and fees paid by the parents **not** using tax advantaged accounts discussed above may be eligible for two very favorable tax credits.

American Opportunity Credit

The American Opportunity Credit is available for the first 4 years of undergraduate education. The credit is 100% of the first $2,000 of eligible expenses and 25% of the second $2,000 of eligible expenses for a maximum credit of $2,500. $1,000 (or 40%) of the credit is refundable which means it is added to your refund even if you owe no federal income tax. Eligible expenses include tuition, fees, books, supplies and equipment that are required for enrollment. The student must be at least a half-time student. The credit is subject to a phase out based on income beginning at $80,000 for single returns ($160,000 for joint filers).

Lifetime Learning Credit

The Lifetime Learning Credit is available for undergraduate and graduate education. The credit is 20% of eligible expenses limited to $2,000. Eligible expenses include tuition, fees, books, supplies and equipment paid directly to the education institution. This is a non-refundable credit so it is more beneficial to take the American Opportunity Credit if eligible.

SAVING FOR CHILD’S EDUCATION (Continued)

Education Credits (Continued)

The lifetime learning credit is subject to a phase out based on income beginning at $55,000 for single returns ($110,000 for joint filers).

Child Employed by Parents

One strategy for accumulating funds for college for parents who own a small business is to employ their minor children in the business. The child’s wage income is taxed at the child’s rate which is 10% of the amount exceeding the standard deduction of $6,300. The wages will be deducted by the parents’ business reducing taxable income that would be taxed at the parent’s marginal rate which may be as high as 37% and reducing income that would otherwise be subject to self-employment taxes.

The employment must comply with child labor laws and the duties assigned must be appropriate for the age and abilities of the child. The child must actually perform the duties assigned. Time records should be kept to support the hours worked by the child. Typical duties might include office cleaning or filing for younger children. College children may be assigned computer or internet related tasks.

EMPLOYEE BENEFITS

Employers provide basic benefits required by law and they provide optional benefits to entice employees to work for them and to stay with them. Very often, you can purchase employee benefits through your employer offered plan(s) more economically than you can purchase them on your own.

Employers are required by law to provide employees with the following benefits:

- Time off to vote, serve on a jury, and perform military service.
- Comply with all workers' compensation requirements.
- Withhold FICA taxes from employees' paychecks and pay your own portion of FICA taxes, providing employees with retirement and disability benefits.
- Pay state and federal unemployment taxes.
- Comply with the Family and Medical Leave Act (FMLA).

Optional benefits generally provided by employers are as follows:

- Retirement plans (*See Retirement Plan Section*)
- Health insurance plans
- Dental and vision plans
- Life insurance plans
- Paid vacations, holidays, and sick leave.

Most employers offer health and other wellness benefits through a cafeteria plan (a written plan that meets the specific requirements established by the IRS) that allows employees to pay for their share of the premiums out of their gross income before taxes resulting in tax savings. The following benefits qualify to be included in the cafeteria plan:

- Accident and health insurance
- Dental and vision insurance
- Cancer insurance
- Adoption assistance
- Dependent care assistance
- Group–term life insurance coverage
- Flexible spending accounts
- Health savings accounts

EMPLOYEE BENEFITS (Continued)

Employers with more than 50 full-time employees (FTEs) (an FTE is an employee that works more than 30 hours per week) are required to offer healthcare to their employees that is affordable and provides minimum benefit coverages. Employers who do not comply with the rules will be subject to the Employer Shared Responsibility payment (penalty) established by the IRS.

<u>Health Savings Account</u>

In response to rising health insurance costs, many individuals/employers are turning toward high deductible insurance plans in an effort to keep premium costs to an affordable level. If you are covered <u>solely</u> under a high deductible plan and are not claimed as a dependent on another return, you can establish a Health Savings Account (HSA) and deduct annual contributions up to the limit established by the IRS against taxable income. Your employer may also elect to contribute to your HSA and the amount contributed is not taxable to you. Total annual contributions (employer and employee) to the plan cannot exceed the annual limit established by the IRS.

The HSA can be used to fund eligible medical expenses not reimbursed by the insurance plan. Funds used for eligible medical expenses are not taxed. Unused contributions to the plan will earn interest and can be used as a second form of retirement. When you reach age 65, you can withdraw all HSA funds penalty free; however, the distributions will be taxed.

PLANNING FOR RETIREMENT

Retirement savings should be one of the top long-term goals for all individuals. The earlier that you start saving, the better chance you will have of retiring comfortably. A successful retirement plan continues throughout your working life.

The following retirement plan options are available to individuals.

401K

The most popular retirement plan today is an employer sponsored 401K plan. These plans allow an individual to contribute a percentage of their wages before income taxes to a retirement account. In most plans the employer will match the employee's contribution (also called a deferral). This employer match is tax free as well. A typical plan might have a 50% employer match up to 3% of employee compensation. Therefore, if the employee makes a 6% contribution, the employer will match another 3% for a total contribution of 9%. It is important to elect a sufficient contribution percentage to maximize the employer match.

The employer match is subject to a vesting schedule contingent upon length of employment, which means the employee will forfeit some of the employer match if employment is terminated before the employee is fully vested. Employee deferrals are limited to a threshold established by the Internal Revenue Service annually. Employee's over 50 are allowed additional catch-up deferrals up to the threshold established by the Internal Revenue Service.

The employee's 401K account is generally invested in mutual funds to allow for adequate diversification of investments. Typically the employer will provide pre-selected groups of mutual funds that provide different annual rates of return and have different levels of risk. It is up to each employee to select the group of mutual funds that meet their investment goals and risk tolerance.

Distributions from a 401K account are taxable in the year received. (*See Roth accounts discussed below for an exception.)* Distributions from a 401K account **must** begin the year the individual reaches the age of 70½. Generally, distributions made before the age of 59½ are also subject to a 10% penalty in addition to income tax.

PLANNING FOR RETIREMENT (Continued)

Profit Sharing Plan

An employer sponsored profit sharing plan is called a defined contribution retirement plan and can exist in conjunction with an employer sponsored 401K plan. The employer decides, based on the company's annual profits, to make a contribution to the plan for each employee. The contribution is made at the discretion of the employer. In years where there is a downturn in company profits, the company may elect not to make any contributions to the profit sharing plan. Contributions are limited to 25% of the employee's compensation. In most cases these contributions are subject to a vesting schedule that is contingent upon length of employment.

Each employee has an account established to accumulate the contributions and makes their own investment decisions based on their investment goals and risk tolerance.

Distributions from the profit sharing plan are subject to the same rules as 401K plans discussed above.

Some 401K plans may incorporate a profit sharing plan feature into the plan.

Pensions

Pensions are retirement plans established by an employer to provide defined retirement benefits to its employees. These plans are funded by the employer and the investments are managed by the employer. The retirement benefit is a percentage of the employee's earnings using a complex formula that includes age and years of service. These plans are subject to risks of underfunding if the employer experiences financial difficulty or the investment assumptions used to determine required contributions overestimate future market performance.

Pension plans are increasingly rare. They are offered primarily by very large companies or governmental bodies. Unions also negotiate pension plans with employers.

Individual Retirement Accounts

Individual retirement accounts (IRA) are used primarily by individuals that do not have an employer sponsored retirement plan or have income below certain limits. You must have earned income to contribute to an IRA. Contributions are tax deductible subject to limits based on income and participation in employer sponsored retirement plans. The annual contribution is limited to earned income or the annual threshold established by the Internal Revenue Service (IRS), whichever is less.

PLANNING FOR RETIREMENT (Continued)

Individual Retirement Accounts (Continued)

There is a special rule for unemployed spouses that have no earned income when the other spouse has earned income. The unemployed spouse can make the same deductible contribution as the employed spouse. The IRS also allows for a catch up contribution for individuals age 50 and over up to the current threshold established by the IRS. The earnings on IRAs are not subject to income taxes until they are withdrawn for retirement.

Contributions are fully deductible against taxable income if the individual and spouse are not covered by an employer retirement plan. If the taxpayer and/or spouse are covered by an employer retirement plan, the tax deduction begins to phase out at income levels established by the IRS. Contributions to an IRA must be made by the original due date of the individual's tax return. No extensions are allowed.

The individual makes all investment decisions. The investment options are virtually unlimited and include stocks, bonds and mutual funds.

Distributions from the IRA account are subject to the same rules as 401K distributions discussed above.

Roth Individual Retirement Accounts

Roth IRA accounts are fairly new and offer distinct advantages over traditional IRA accounts. Contributions to a Roth IRA are not tax deductible. However, the earnings on Roth accounts are not subject to income taxes when earned or when qualified retirement distributions are made. Qualified distributions (see below) from Roth IRA accounts are not included in taxable income which can result in significant tax advantages.

You must have earned income to contribute to a Roth IRA and annual contributions are subject to limits based on income and participation in employer sponsored retirement plans. The annual contribution is limited to earned income or the annual threshold established by the Internal Revenue Service (IRS), whichever is less.

There is a special rule for unemployed spouses that have no earned income when the other spouse has earned income. The unemployed spouse can make the same contribution as the employed spouse. The IRS also allows for a catch up contribution for individuals age 50 and over up to the current threshold established by the IRS. The earnings on traditional IRAs are not subject to income taxes until they are withdrawn for retirement.

PLANNING FOR RETIREMENT (Continued)

Roth Individual Retirement Accounts (Continued)

A significant advantage to a Roth IRA is that, unlike a traditional IRA, it is not subject to required distribution at 70½. Thus a Roth IRA can continue to grow tax free for longer periods. Traditional IRA accounts can be converted to Roth accounts. The individual will include the amount converted in taxable income in the year of conversion.

Qualified distributions must satisfy a five-year holding period and must be made after the individual reaches 59½ or is disabled. Distributions not meeting these requirements are subject to income taxes and a 10% penalty once all of the individual's contributions are paid (only the earnings of the nonqualified distributions are subject to income taxes and the 10% penalty).

One of the tax advantages to a Roth IRA is that qualified distributions are not included in adjusted gross income for Federal tax purposes. As a result, distributions from a Roth IRA will not result in income that could cause social security payments (benefits) to be taxable. Social Security payments are not included in income until modified adjusted gross income reaches $25,000 for single filers and $32,000 for joint returns. Since qualified Roth IRA distributions are not included in income, a single taxpayer with $20,000 in Social Security benefits and $50,000 in qualified Roth distributions would have zero taxable income. The same individual with traditional retirement distributions would have adjusted gross income of $68,100 and pay over $10,000 in federal income taxes.

Another tax advantage of a Roth IRA is that qualified distributions are not included in income for Federal tax purposes and, therefore, have no effect on the long-term capital gain tax rate. Long-term investment gains (capital gains) and qualified dividends are taxed at the long-term capital gain rate. The lower the taxpayer's ordinary income for tax purposes is, the lower the long-term capital gains tax rate is. Long term capital gains rates are 0%, 15% and 20% depending upon the taxpayer's ordinary income. Most mutual funds produce qualifying dividends and long-term capital gains. Since qualifying Roth IRA distributions are not included in income, the long-term capital gains and qualifying dividends are taxed at 0% percent in the right circumstances.

Many 401k plans have added a Roth feature that works the same as a Roth IRA account except the contribution limit is higher.

PLANNING FOR RETIREMENT (Continued)

Self-Employed Retirement Accounts

Self-employed individuals have numerous retirement plan options. See our New Business Guide for more information.

ASSET PROTECTION

Disaster or other unforeseen circumstances can strike at any moment. The impact of uninsured loss on you and your loved ones can be devastating. Purchasing insurance protects you and your future by minimizing financial risks associated with unexpected events.

The following types of insurance should be considered.

Umbrella Insurance

Umbrella insurance is extra liability insurance that is designed to help protect you from major claims and lawsuits by providing coverage above the limits of your homeowners, auto, and boat insurance policies.

Life Insurance

Life insurance is about taking care of loved ones. Life insurance is a tool that protects your spouse and children from the potentially devastating financial losses that can result if you die prematurely.

There are two types of life insurance:

- Permanent – covers your entire life.
- Term – lasts a limited number of years (i.e., 20 years)

If you purchase your life insurance premiums when you are young and healthy, you can usually lock in cheaper rates over the term of the policy. If you wait until you are older and have health issues, your rates will be higher and you may have a difficult time obtaining life insurance.

The following should be considered when determining how much life insurance you need:

- Outstanding debt including mortgage(s).
- Monthly spending requirements of the family and the income sources available. (How much income will your survivors need if you were not around?)
- Children's education.
- Savings and retirement stability of surviving spouse.

Ideally, you should purchase enough life insurance so that the surviving spouse can invest the life insurance proceeds and withdraw funds annually to replace the income void left by your death.

ASSET PROTECTION (Continued)

Disability Insurance

Illnesses or injuries can interfere with your ability to work resulting in loss of income. Loss of income can make managing household costs difficult and make a stressful time even more stressful. Disability insurance provides income coverage when you are disabled and cannot work. There are two types of disability insurance:

- Short Term Disability – kicks in after you run out of sick leave. (Usually pays between 9 and 52 weeks.)
- Long Term Disability – kicks in after you run out of short term disability and sick leave or after the waiting/elimination period as defined by the policy (i.e., 3-6 months). (Usually pays to retirement age or until you are no longer disabled.)

Disability insurance generally can pay up to 60% of your earnings while you are disabled. If the disability insurance premiums were paid with after tax earnings, then the disability benefits are generally not subject to income tax. If the disability premiums were paid with before tax dollars (i.e., through cafeteria plan deductions from your paycheck) then the disability benefits are subject to income tax.

Long-Term Care Insurance

Long-term care is defined as the help that people with chronic illnesses, disabilities or other conditions need on a daily basis over an extended period of time. Individual health insurance will not pay for daily, extended care services. Medicare will cover a short stay in a nursing home, or limited amount of at-home care, but only under strict conditions. Long-term care insurance helps provide for the cost of long-term care not covered by health insurance, Medicare, or Medicaid. Long-term care insurance policies reimburse policyholders a daily amount (up to a pre-selected limit) for services to assist them with activities of daily living such as bathing, dressing, or eating.

The following factors should be considered when determining whether to purchase long-term care insurance:

- Your age and health. (Policies cost less if purchased when you are young and in good health.)
- Can you afford to pay the premiums now and in the future allowing you to preserve the investment you have made in the premiums? (Premiums usually increase over time.)
- Your income level and assets. (Low income/asset levels may allow you to qualify for Medicaid and you would not need long term care.)
- Your support system. (Do you have family that can take care of you?)

ASSET PROTECTION (Continued)

Long-Term Care Insurance (Continued)

- Your savings and investments. (Have you saved enough to cover long-term care expenses?)
- Benefits received through long-term care policies are generally not taxed as income.
- Mississippi taxpayers are allowed a credit against income taxes in an amount equal to 25% of the long-term care premium costs paid during the taxable year up to $500 or the taxpayer's income tax liability. Unused credits can be carried forward.

LAST WILL AND TESTAMENT

Having a last will and testament is one of the most important things you can do for yourself and your family. A last will and testament is a legal document by which a person names one or more persons to manage his or her estate and provides for the distribution of his or her property and the care of his or her dependents at death.

The following are the top reasons that a person should have a will.

- To decide how your assets will be distributed.
- To determine who will care for your minor children.
- To avoid a lengthy probate process. (Probate is the general administering of a deceased person's will or the estate of a deceased person without a will.)
- To minimize estate taxes.
- To establish the person (executor) who will wind up the affairs of your estate after your death.
- To create a legacy by establishing gifts and donations that will continue after your death.

If a valid will is found after a person (decedent) dies, the decedent is said to have died testate and the will dictates how the decedent's property is distributed. If a will is not created, the decedent is said to have died intestate and the state of residence will dictate how the decedent's property is distributed. The state will also determine who will become the guardian for any minor children.

For a will to be legally enforceable, it must conform to the specific legal requirements of the state in which it is created. It is recommended that the person enlist the services of a competent attorney to prepare the will. This is important because a will can be contested after the decedent's death by potential heirs who believe that the will is not valid or does not represent the decedent's wishes.

Each state has requirements that must be met when executing a will. Generally, a will must be in writing, signed by the decedent, and witnessed.

Wills may be amended or revoked at any time. It is important that your will be considered for amendment when major life events occur such as the birth of a child or divorce. Your attorney can instruct you on how to amend or revoke your will.

The following types of wills can be considered:

Joint will – one document that functions as a will for two or more people (spouses, siblings, or close relatives). A joint will typically leaves all of one of the individual's assets to the other, while also giving direction as to what assets go to what parties after the death of the original parties.

LAST WILL AND TESTAMENT (Continued)

Mutual will – similar to a joint will except that each individual creates their own document. Since a mutual will obligates each party to distribute property a certain way, they are sometimes called contractual wills.

Reciprocal wills – used by couples to ensure that their assets will move from one to the other after death. Reciprocal wills are usually almost exact copies of one another and generally do not have additional provisions regarding what happens to the property after both parties die.

Living will (Advance Medical Directive) – allows an individual to give instructions about their healthcare including declining particular types of medical care such as those that serve the purpose of postponing the moment of death. Living wills supplement a Durable Power of Attorney for Health Care (DPOAHC). A DPOAHC appoints someone to make healthcare decisions for an individual should they become incapacitated. Creating both a DPOAHC and a living will allows an individual to choose the person they trust to direct their care and will protect the appointed person from having to make the decision on when to stop care. It is recommended that you have both a living will and a DPOAHC.

THE BENEFIT OF TRUSTS

A trust is defined as a separate legal entity created by a party (the Grantor) through which a second party (the Trustee) holds the right to manage the Grantor's assets or property for the benefit of a third party (the beneficiary). A trust is simply an arrangement whereby one person holds legal title to an asset and manages it for the benefit of another. A Trust has the ability to bridge the gap between life and death.

All trusts require you to arrange for a trustee to manage certain assets for a beneficiary. Banks and attorneys serve as Trustees for a fee. Assets are managed by the Trustee at the direction of the written trust document. The Trustee invests the trust's assets and makes payment to or on behalf of the beneficiaries according to the provisions outlined in the trust document. Trust agreements are very complex documents subject to State laws. A knowledgeable attorney should be consulted to draft the trust document to ensure the goals of the Grantor are achieved and to comply with all applicable State laws.

There are three main types of trusts:

- Testamentary Trust (established by a will which comes into effect when the Grantor dies).

- Inter vivos trust (created by the Grantor while he/she is alive). There are two types:
    1. Revocable (Grantor or Living) Trust (can be modified or terminated by the Grantor after its creation).
    2. Irrevocable Trust (cannot be modified or terminated by the Grantor after its creation).

Trusts serve several important objectives which include:

- Asset protection and preservation
- Transfer of wealth
- Beneficiary protection
- Avoidance or reduction in estate taxes if the estate is expected to be greater than the exclusion.
- Address disability and old age

Asset protection and preservation

Trusts can put your money and assets beyond the reach of creditors and claims resulting from malpractice, accident, or divorce (for both the Grantor and Beneficiary). Generally a trust not subject to the reach of creditors has to be an irrevocable trust in which the Grantor no longer controls the assets.

THE BENEFIT OF TRUSTS (Continued)

Revocable trusts are often used to avoid probate court at the time of the Grantor's death because assets are not subject to the probate period (transferred directly to the beneficiaries according to the trust agreement) or the expense associated with probate.

Transfer of wealth

Trusts are an excellent vehicle for transferring highly appreciating assets to children because the assets that are transferred to a trust appreciate without incurring additional estate and gift taxes. The initial transfer of assets to the Trust is treated/taxed as a gift (further explained in the Estate Planning Section of the Guide).

- *Life Insurance Trusts*

  Trusts are used to hold life insurance policies so that the death benefit is not taxable to the insured at death. The Trust is the policy owner. It should be noted that if an existing life insurance policy is transferred into a Trust then the "Three Year Look Back Rule" applies at the date of death. Policies transferred to the trust less than three years prior to death have to be included in the insured's estate. Policies purchased by the trust are not subject to the look back rule.

Beneficiary protection

Trust assets are managed in accordance with the trust agreement by the Trustee. Therefore, the trust's assets can be protected from misuse by a financially irresponsible beneficiary. Trust can also provide protection for disabled beneficiaries who do not have the capacity to manage the funds themselves by ensuring that financial resources are available for their care.

- *Long term care*

  Placing assets into an irrevocable trust is a strategy to protect assets from Medicaid eligibility. Medicaid requires that all personal assets be used for nursing home expenses before Medicaid payments begin. However, if assets are placed in an irrevocable trust at least five years before nursing care/Medicaid is required, then they are not subject to the Medicaid benefit rules. (When you apply for Medicaid, any gifts or transfers of assets made within five years of the date of application are subject to penalties.)

THE BENEFIT OF TRUSTS (Continued)

Taxation of trusts

An irrevocable trust is a separate taxable entity that files its own income tax return each year. If the Trust makes distributions to beneficiaries during the year, some or all of the taxable income is reported on the beneficiary's individual income tax return. If the trust does not make distributions, the taxable income is reported by the trust subject to the trust income tax rates which are significantly higher than individual rates.

A revocable (grantor) trust does not file a separate income tax return. The taxable income of a grantor trust is included on the Grantor's income tax return regardless of whether distributions are made.

ESTATE PLANNING

Estate planning is the act of preparing for the transfer of a person's wealth and assets after his or her death. An estate is comprised of everything a person owns such as their vehicle, home, other real estate, checking and savings accounts, investment, life insurance, furniture, and other personal possessions.

The first step to Estate Planning is developing a will which was discussed earlier.

Taxation

Estate:

Estate tax returns must be filed within nine months following death. The fair market values of all estate assets are determined as of the date of death. The fair market value is then reduced by the estate tax exemption (currently $11,200,000 for each individual). The exemption is indexed for inflation and increases each year. The fair value in excess of the exemption is taxed at the current applicable tax rate. If a married individual dies and does not use all of his/her available exemption then the unused amount can be transferred to the surviving spouse through the filing of the estate tax return.

Life insurance is not taxable to the beneficiary. However, the life insurance death benefit is included in the estate of the insured if the insured is the owner of the policy.

Gifts:

Transfers of property while living are subject to gift taxes if the fair market value of the property exceeds the annual exclusion which is currently $15,000 per unlimited individual recipients. One individual can gift $15,000 in assets without any gift tax considerations to another individual. This exclusion is an annual total for ALL gifts made in a year to one individual. Once the $15,000 exemption is exceeded per individual, a gift tax return is required. Married couples can elect to make joint gifts which increase the annual exemption to $30,000. If the annual exclusion is exceeded the donor is required to file a gift tax return reporting the fair market value of the gift. The donor can elect to use his lifetime estate tax exemption to avoid paying gift taxes, but a gift tax return is required.

ESTATE PLANNING (Continued)

Basis in inherited and gifted property

A beneficiary's basis in inherited property is the fair market value at the decedent's date of death. Accordingly, the beneficiary is only taxed on the increase in value subsequent to the decedent's death.

Property owned jointly with a spouse receives a step up in basis for one half of the property's value at the date of death. The surviving spouse's basis in the property is one half of the original basis and one half of the date of death value.

A recipient of a non-cash gift does not receive a step up in basis to the fair market value as of the date of the gift. The recipient is responsible for the tax on the appreciation of the property from the date that it was acquired by the donor until the date that it is sold by the recipient. This can be problematic if the gifted property was owned for a long period of time before the gift and records were not maintained to establish the donor's basis.

Lifetime Giving

High net worth individuals can reduce the potential of estate gift taxes by making annual gifts to children and grandchildren not exceeding $14,000. This gifting will reduce the estate's assets that would be subject to estate tax without triggering the requirement to file a gift tax return. All gifts including Christmas and birthday gifts must be considered when calculating the annual gifts given to an individual.

FINANCIAL ASPECTS OF DIVORCE AND SEPARATION

Divorce and separation can be difficult in the best of circumstances. The emotional and financial stress can cause havoc on your life and the lives of your children. The avoidance of litigation as part of the divorce process is the most economical way to approach a divorce. Unfortunately, couples have often reached a point in their relationship where they are no longer able to communicate or compromise on a fair equitable property distribution. Contested divorce proceedings can result in significant fees charged by attorneys, certified public accountants, and valuation experts.

The Prenuptial Agreement

A prenuptial agreement is a written agreement entered into by a couple before marriage that outlines how pre-marital assets will be distributed should the marriage fail. Prenuptial agreements are critical for high net worth individuals. A good prenuptial agreement will include the property settlement and alimony resulting from the dissolution of the marriage. Developing a prenuptial agreement can be an emotional process because the couple is planning for a failure of the marriage before it even begins. Clear and open communication channels can help to overcome the challenges.

Separation

A trial separation is the period of time that the couple lives apart in order to decide whether or not they want to pursue divorce. A trial separation has no real legal effect. Any property or debt acquired during a trial separation is still considered to be marital property.

A legal separation is a court order that mandates the rights and duties of the couple while they are still married, but not living together. There is no such thing as a legal separation in Mississippi. In Mississippi you are either married or you are not.

Divorce

Divorce is defined as a judicial declaration dissolving a marriage in whole or in part.

Experienced divorce attorneys and mediators can assist in negotiating a divorce settlement. It is important that you consult with your attorney and tax advisor before entering into any divorce related agreements. If a settlement cannot be reached, then the couple will end up going to court where a decision on fair and equitable property distribution will be made by an arbitrator or a judge.

FINANCIAL ASPECTS OF DIVORCE OR SEPARATION (Continued)

Mississippi is known as an "equitable distribution" state. All property is first classified as marital property (acquired after marriage) and non-marital property (acquired prior to marriage). Marital property is divided up equally among the parties. Non-comingled non-marital property generally stays with the property owner. Commingled non-marital property or at least the appreciated value of the property subsequent to the marriage is divided equally among the parties.

Note: Comingling can occur by combining funds into a joint account/activity or through familial use. An example of familial use would be the use of a non-marital home after marriage. Your attorney can offer more advice on comingling of assets.

Equitable property division is based on fair value of the assets as of the separation date defined by the judicial system. In instances where an interest in a closely held business is owned by a spouse, only the fair value of the business assets is considered for property division, not the future earnings potential of the business (i.e., goodwill).

Uniform Chancery Court Rule 8.05 Financial Disclosure form can be used to inventory the fair value of marital assets and/or your CPA can assist you in preparing a personal financial statement and proposed property division as of the separation date.

Uniform Chancery Court Rule 8.05 Financial Disclosure also reports monthly income and expense to assist the court in determining the divorce settlement.

The division of property including appreciated property between spouses is considered to be a tax free transaction even if the division occurs after the divorce if the division is made incident to divorce. The spouse's basis in the property and holding period after the divorce is the same as the basis in the property before divorce.

It is important to consider the appreciated value, related tax basis, and type of marital assets at the time of property division because the spouse that ends up with appreciated assets will have to recognize a taxable gain when they convert the asset to cash (sell the asset). For this reason, property settlements should be based on net of tax values (fair value less income tax liability on realizable gain).

In addition to equitable property division, alimony, child support, and child custody and visitation are also determined as part of a divorce.

FINANCIAL ASPECTS OF DIVORCE OR SEPARATION (Continued)

Alimony

Alimony is not guaranteed in a divorce. The judge is more likely to award alimony if one spouse was not actively employed for an extended period of time for the purpose of supporting the working spouse. Alimony can be temporary and always ends when the recipient spouse re-marries or dies.

If possible, it may be beneficial for the paying spouse to negotiate alimony to be a percentage of the paying spouse's annual income rather than a fixed amount. This will protect the paying spouse in years where income decreases and benefit the receiving spouse in years where income increases.

Child Support

Child support is generally based on parental income, the number of children, and the visitation award. Child support is not taxable or a deductible income tax expense. In Mississippi, child support generally ends when the child reaches 21 years of age.

Tax Consequences

Retirement accounts

Retirement accounts typically comprise a substantial amount of a divorcing couples net worth. Qualified retirement plans (401K, pensions and profit sharing plans) and individual retirement accounts can be transferred between spouses without income taxes if done carefully. The most common and safest way to accomplish the transfer is direct trustee-to-trustee transfer.

Dependent children

Claiming dependency for the divorcing couple's children has tax consequences to both parties. The custodial parent claims dependency unless an election is made to release the dependency to the noncustodial parent discussed below. For tax purposes, the custodial parent is the parent who has physical custody the majority of the year. This is further defined by the parent who has the child the greater number of nights during the year.

The custodial parent claims the following tax benefits:

- Child and dependent care credit
- Child Tax Credit
- Earn income credit
- Head of household filing status

FINANCIAL ASPECTS OF DIVORCE OR SEPARATION (Continued)

Dependent children (Continued)

The custodial parent can release dependency to the noncustodial parent by signing Form 8332. The release can be limited to the current year or all future years. A copy of the form must be attached to the noncustodial parent's return. If the release is signed, the noncustodial parent claims the child tax credit. The child and dependent care credit, earned income credit and head of household filing status remain with the custodial parent. Careful analysis is required to determine if the release of dependency is beneficial.

PLANNING FOR THE ELDERLY

Americans are living longer than ever before and health care costs continue to rise. It is important to have a plan in place to take care of your loved ones or help them take care of themselves. It is best to start these conversations early with your parent or loved one while being sensitive to their need for independence and quality of life.

Family members may consider the following options when deciding the best way to take care of their loved ones.

1. Family members take care of their loved ones.
2. Hire part-time or full-time at home care givers.
3. Consider assisted living facilities.
4. Consider a nursing home.

Options 2-4 above require financial resources to be sustained. Financial resources include cash and investments, Medicare, or long-term care insurance.

Medicare will cover 100% of the cost of a nursing home stay for 20 days and only a portion of the 21-100 days if the stay is for the purpose of health care given when an individual needs skilled nursing or rehabilitation staff to manage, observe, and evaluate his/her care. After 100 days, the cost of a nursing home stay is the responsibility of the individual.

The Mississippi Medicaid program will pay for nursing home care for eligible individuals who cannot afford the nursing home care. Medicaid does require that the individuals assets be depleted (the individual must sell their home) before they can receive any benefits. Additionally, any assets transferred to others during the five years preceding the nursing home stay will be included as part of the individual's assets requiring payment up to the fair value of the transferred amount before Medicaid will pay benefits.

Caution should be exercised when deciding whether to use Medicaid as a nursing home option because nursing home care under Medicaid is not always equivalent to private pay nursing home care.

DEATH OF A SPOUSE

The death of a spouse can be a very difficult and emotional time for the surviving spouse under the best circumstances. The probate process can make the already difficult time more difficult. (Probate is the legal process that deals with the assets and debts left behind after someone dies. By default, probate court supervises the probate process.) Probate can be a time consuming expensive process. Fortunately, some strategies can be employed to avoid probate.

Joint Tenancy Property

Property held as joint tenants with rights of survivorship pass directly to the joint tenant without having to go through probate court. Assets that are typically owned as joint tenants include real estate and investment accounts.

Retirement Accounts

In almost all cases retirement accounts are transferred by naming a beneficiary with the retirement plan administrator. Retirement accounts transferred to a surviving spouse are subject to the same rules as the decedent. The surviving spouse can begin taking distributions at age 59½ without incurring a penalty and is required to take distributions at age 70½. The spouse also will name a beneficiary for the account.

Life Insurance

Life insurance is an important tool for couples to insure the financial stability of the household if a spouse dies. Life insurance with a death benefit of seven to ten times the annual income of the insured is needed to replace the income of a deceased spouse. Life insurance death benefits pass thought to the beneficiaries by naming the beneficiaries with the insurance company. Life insurance proceeds do not go through probate court unless the estate of the decedent is the named beneficiary. Life insurance proceeds are not taxable to the beneficiary when received.

Social Security

Social security benefits will be available to the surviving spouse and minor children if the decedent worked before his/her death. If the decedent has dependent children younger than 18, the children qualify for benefits. The surviving spouse will also qualify for benefits if the children are under 16.

DEATH OF A SPOUSE (Continued)

Social Security (Continued)

If the decedent is receiving social security benefits at his/her death, those benefits stop. However, if the surviving spouse was receiving social security benefits at the decedent's death then the surviving spouse will receive the greater of the decedent's monthly benefit or his/her own. A surviving spouse can be eligible for reduced social security benefits as early as age 60 (Age 50 if disabled no earlier than 7 years preceding the decedent's death).