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Dear Clients:

Summer is finally here and we hope you will have the chance to enjoy the nice weather with your friends and family.

Although this is the time of year for rest and relaxation, at Axial we never take a vacation from working to help protect and grow your investments or assisting you with other Wealth Management needs. Mid-year is a good time to make sure your 401K is allocated properly; to check that you have contributed to your IRA or Roth IRA for 2011; or simply to make sure all the different insurance products you have are meeting your current needs.

We would be pleased to help you with any and all of these issues. Simply give us a call or send us an email and we will do our best to assist you in any way we are able. We look forward to talking to you or seeing you soon.

Axial Financial

July 2011

Mid-Year Tax Considerations

Though it may seem as if the ink has barely dried on your 2010 federal income tax return, the end of 2011 is now visible on the horizon. Here are some things to consider as you take stock of your current tax situation.

The 2% difference

If you're an employee, 6.2% of your wages (up to the taxable wage base--$106,800 in 2011) would normally be withheld for your portion of the Social Security retirement component of FICA employment tax. But legislation passed in December 2010 included a temporary one-year 2% reduction in this tax. That means for 2011, you're paying the tax at a rate of 4.2%. If you're self-employed, the 12.4% you would normally pay for the Social Security portion of your self-employment tax is reduced to 10.4%.

Have you earmarked the resulting extra dollars in your paycheck efficiently by, for example, paying down high-interest debt or saving for retirement? If you haven't, consider making up for it by contributing an extra 4% of your income to your 401(k) or an IRA for the remainder of the year. By applying the extra money toward a long-term goal, the potential benefit of the temporary tax reduction can extend beyond 2011.

Tax rates

The same federal income tax rates that applied in 2010 continue to apply in 2011 and 2012 (depending on your taxable income, you'll fall into either the 10%, 15%, 25%, 28%, 33%, or 35% rate bracket). And, as in 2010, long-term capital gains and qualifying dividends in 2011 and 2012 continue to be taxed at a maximum rate of 15%; if you're in the 10% or 15% marginal income tax brackets, a special 0% rate will generally apply. So, unlike this time last year, you don't have to contend with the uncertainty of not knowing what next year's tax rates will be.

That consistency, however, does not apply to the alternative minimum tax (AMT)--essentially a parallel federal income tax system, with its own rates and rules. While the December legislation extended regular income tax rates through 2012, it only extended AMT relief (in the form of increased AMT exemption amounts) through 2011. You can probably expect another AMT fix in legislation later this year, since without it there would be a dramatic increase in the number of individuals subject to AMT in 2012. But that leaves a fair degree of uncertainty today, however, as you consider your overall tax situation.

Also worth noting

Small business stock: Generally, individuals may exclude 50% of any capital gain from the sale or exchange of qualified small business stock provided they meet certain requirements, including a five-year holding period. For qualified small business stock issued and acquired after September 27, 2010, and before January 1, 2012, however, 100% of any capital gain may be excluded from income if the stock is held for at least five years and all other requirements are met.

IRA qualified charitable distributions: Absent additional legislation, 2011 will be the last year that you'll be able to make qualified charitable distributions (QCDs) of up to $100,000 from an IRA directly to a qualified charity if you're age 70½ or older. Such distributions may be excluded from income and count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to receive from your IRA in 2011.

Depreciation and IRC Section 179 expensing: If you're a business owner or self-employed individual, you're allowed a first-year depreciation deduction of 100% of the cost of qualifying property acquired and placed in service during 2011 (the "bonus" first-year additional depreciation deduction will drop to 50% for property acquired and placed in service during 2012). For 2011, the maximum amount that can be expensed under IRC Section 179 is $500,000, but in 2012 the limit will drop to $125,000.

Of the total new benefits awarded by Social Security in 2009, 16% was paid to survivors of deceased workers. Source: Social Security Administration

Social Security Survivor's Benefits

You might think Social Security is a program that only provides you with a monthly income after you retire. But what you might not realize is that Social Security may also provide monthly payments in the form of survivor's benefits, based on your work record, to certain members of your family after your death.

Earning survivor's benefits

In order to be able to provide Social Security survivor's benefits to your family, you have to earn those benefits. Generally, to be eligible for survivor's benefits, you must pay Social Security taxes and you have to work long enough to earn sufficient credits to be fully insured. The length of time you need to work and pay Social Security taxes depends on your age--the younger you are, the fewer years you need to work. But in any case, if you've worked at least 10 years (the equivalent of 40 credits) you'll be fully insured for any Social Security benefits, including survivor's benefits.

Even if you haven't worked long enough to be fully insured, if you've worked at least 1½ years out of the 3 years immediately before your death, survivor's benefits will be available to your dependent children and to your spouse if he or she is caring for your children.

Who can receive survivor's benefits?

Your spouse is eligible to receive full survivor's benefits at your spouse's full retirement age. Full retirement age is 66 for people born between 1943 and 1954, and gradually increases until reaching age 67 for people born in 1960 or later. Your spouse can receive reduced survivor's benefits as early as age 60. If your spouse is disabled, he or she can begin receiving survivors benefits as early as age 50. And your spouse can receive survivor's benefits at any age if he or she is caring for your child who is receiving Social Security benefits and is under age 16 or disabled.

Your former spouse, if you've been divorced, may receive survivor's benefits if your marriage lasted at least 10 years, and your former spouse does not remarry before age 60 (remarriage after age 60 will not affect your former spouse's eligibility for benefits based on your work record). If your former spouse is caring for his or her child who is under age 16 or who is disabled and entitled to benefits based on your work record, your former spouse may receive benefits at any age. In that case, your former spouse need not meet either the age or length-of-marriage requirements.

Your unmarried children may receive survivor's benefits if they are younger than age 18 or age 19 if they're attending elementary or secondary school full-time. If your child was disabled before reaching age 22, and remains disabled, he or she is eligible for benefits at any age. Also, your stepchildren, grandchildren, stepgrandchildren, or adopted children may be eligible for benefits under certain conditions.

Your dependent parents can get survivor's benefits if they're at least age 62 and you provide at least one-half of their support.

How much will the benefits be?

The easiest way to find out how much your family may receive in survivor's benefits is by checking your Social Security statement, which is sent to you each year beginning at age 25. Generally, survivor's benefits are based on your basic benefit amount, which can be increased by delayed retirement credits, or reduced if you claimed retirement benefits before reaching full retirement age. The amount your survivors receive is based on a percentage of your basic benefit, and the percentage, in turn, is based on the survivor's age and relationship to you.

For example, at full retirement age, your surviving spouse can receive 100% of your retirement benefit. However, if your spouse claims survivor's benefits between age 60 and under full retirement age, then the benefit will be reduced to between 71% and 99%, depending on his or her age. An eligible child and a surviving spouse caring for a child under age 16 would receive 75% of your benefit amount. At your death, there is also a one-time death benefit of $255 paid to your surviving spouse or child under certain circumstances.

Limits on benefits

Depending on the circumstances, the total amount of monthly benefits your family can receive is capped at between 150% and 180% of your retirement benefit amount. Your survivor's benefits may be reduced if you're receiving a pension from an employer that didn't contribute to Social Security, like federal civil service, or if you're under your full retirement age but still working, and your earnings exceed certain limits.

Social Security survivor's benefits are an important means of providing for the continued support of your family members after your death. For more information, go to the Social Security website, www.ssa.gov.

Estate Tax Exemption Is Portable (for Now)

To use the exemption portability, the first spouse to die must elect to use portability on his or her estate tax return. An estate tax return must be filed by the first spouse to die to use portability even if the return is not otherwise required to be filed.

Many states have state estate tax exemptions that are less than the federal estate tax exemption. So, while your surviving spouse might not be subject to federal estate tax upon your passing, your surviving spouse may have to pay significant state estate tax if you rely solely on the federal exemption portability.

Recent legislation introduced a new, but perhaps temporary, estate planning concept--exemption "portability." In short, the estate of a deceased spouse can transfer to the surviving spouse any portion of the federal estate tax exemption that it does not use. The surviving spouse's estate can then add that amount to the exemption it is entitled to, increasing the total amount that can be passed on to heirs tax free. This new feature makes it easier for married couples to minimize the potential impact of estate taxes.

The federal estate tax exemption defined

The federal government imposes a tax on the value of your property when you pass it along to your descendants at your death. Any amount that is passed to a surviving spouse is generally fully deductible. The estate is also allowed to exclude a certain amount that passes on to nonspouse beneficiaries. That amount is called the "basic exclusion amount," which is $5 million in 2011.

How the exemption works for married couples

Prior to the new tax law, if a spouse died without having planned for his or her exemption, the deceased spouse's estate would have passed tax free to the surviving spouse under the unlimited marital deduction (assuming all assets passed to the surviving spouse), and the deceased spouse's exemption was lost or "wasted." The surviving spouse's estate could then only transfer an amount equal to his or her own exemption free from federal estate tax. To solve this dilemma, married couples typically set up what is commonly referred to as a credit shelter trust (aka "bypass" or family trust) that sheltered or preserved the exemption of the first spouse to die.

The following examples illustrate how portability can achieve a similar result without the use of a credit shelter trust.

Example: result without portability

Assume Henry and Wilma are married, have all of their assets jointly titled, and have a net worth of $10 million. Henry dies first, when the federal estate tax exemption is $5 million and there is no portability. Henry's estate passes to Wilma free from federal estate tax under the unlimited marital deduction and does not use any of his $5 million exemption. Assume that at the time of Wilma's death, the exemption is still $5 million, the federal estate tax rate is 35%, and Wilma's estate is still worth $10 million. With Henry's exemption completely wasted, Wilma can pass on only $5 million free from federal estate tax. Assuming no other variables, Wilma's estate will owe about $1,750,000 in federal estate tax: $10 million estate - $5 million exemption = $5 million taxable estate x 35% estate tax rate = $1,750,000.

Example: result with portability

Assume Henry and Wilma are married, have all of their assets jointly titled, and have a net worth of $10 million. Henry dies first, when the federal estate tax exemption is $5 million and there is portability. As above, Henry's estate passes to Wilma free from federal estate tax under the unlimited marital deduction and does not use any of his $5 million exemption. Even though Henry's estate owes no tax, Henry's executor files a timely return on which he elects to transfer Henry's unused exemption to Wilma. Assume that at the time of Wilma's subsequent death, the exemption is still $5 million, the federal estate tax rate is 35%, and Wilma's estate is still worth $10 million. Since Wilma has "inherited" Henry's unused exemption, she can pass on the entire $10 million estate free from federal estate tax. Portability of the estate tax exemption saves Henry and Wilma's heirs $1,750,000 in estate tax.

Portability does not eliminate the benefits of credit shelter trusts

Even with portability, there are still tax and nontax considerations that may lead you to use a credit shelter trust, such as:

- The portability feature is in effect for only two years and will expire after 2012, unless Congress enacts further legislation.
- The trust can help protect assets against creditors of the surviving spouse or future beneficiaries (typically children and grandchildren).
- The trust allows the first spouse to die to control the ultimate distribution of his or her assets. For example, in a second marriage situation, one spouse may wish to ensure that any assets remaining after his or her spouse's death pass to his or her children from a previous marriage.
- Appreciation of assets placed in the trust will escape estate taxation in the survivor's estate.
- The portability feature applies only to estate tax; it does not apply to the generation-skipping transfer (GST) tax. Without a trust, any unused GST tax exemption of the first spouse to die is lost.

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Ask the Experts

What health-care changes become effective in 2011?

The Patient Protection and Affordable Care Act (PPACA), signed into law in 2010, makes significant changes to our health-care delivery system. Here are some of the most important changes scheduled to take effect in 2011.

The cost of over-the-counter drugs not prescribed by a doctor can no longer be reimbursed through a health reimbursement account or a health flexible spending account, nor can these costs be reimbursed on a tax-free basis through a health savings account (HSA) or Archer medical savings account. Also, the tax on distributions from HSAs and Archer MSAs that are not used for qualified medical expenses increases to 20% (up from 10% and 15% for HSAs and Archer MSAs respectively).

Medicare Part D participants will receive a 50% discount on brand-name prescriptions filled in the coverage gap (i.e., the "donut hole") from pharmaceutical manufacturers, and federal subsidies for generic prescriptions filled in the coverage gap will start to be phased in.

Also, certain preventive services covered by Medicare are no longer subject to cost-sharing (co-payments), the deductible is waived for Medicare-covered colorectal cancer screening tests, and Medicare now covers personalized prevention plans including a comprehensive health risk assessment.

Medicare Advantage (MA) plans can no longer impose higher cost-sharing for some Medicare-covered benefits than would be imposed by traditional Medicare insurance. Also, MA plans cannot exceed a mandatory maximum out-of-pocket amount for most Medicare services. The maximum amount in 2011 is $6,700, but MA plans can voluntarily offer lower out-of-pocket amounts. Also, the annual enrollment period for MA plans is changed to October 15 through December 7.

The requirement that employers report the total value of employer-sponsored health benefits on employees' W-2s was to begin in 2011. However, the IRS has deferred this requirement until 2012.