

# STRATEGIC Planning

The Fee Based Financial, Investment, & Tax Report

**WestPoint** *Private client*  
G R O U P



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## Saving for Education with Coverdell ESAs

The average price tag for four years at a private college exceeds \$120,000, according to the College Board's *Trends in College Pricing 2006*. That's 35% higher than just five years ago. In fact, rising tuition costs are outpacing inflation; at the same time, federal grant aid is lagging behind inflation.

While funding four years of college can be a challenge, research also proves that higher education remains a valuable investment. According to the College Board's *Education Pays 2006*, in 2005, women with bachelor's degrees earned 70% more than women with only high school diplomas; college-educated men earned 63% more than men who graduated from high school but did not have college degrees.

## Highlights of the Tax Relief and Health Care Act of 2006

The Tax Relief and Health Care Act, signed into law on December 20, 2006, extends a variety of popular tax breaks. In addition, this measure also enhances favorable tax reform for Health Savings Accounts (HSAs) and provides a measure of relief for individuals hit by the alternative minimum tax (AMT) after exercising incentive stock options (ISOs).

There are a variety of savings vehicles and planning strategies that can help you overcome the financial challenges and reach your education goals. One tax-efficient vehicle is the **Coverdell Education Savings Account (ESA)**, which can be used to pay for college expenses, as well as for the cost of attending qualified K-12 schools.

With a Coverdell ESA, funds have the opportunity to grow tax deferred, and withdrawals used for qualified educational expenses, such as tuition, are tax free. A beneficiary can be anyone under the age of 18 (or older, if qualified as a special needs beneficiary). Any individual (including the beneficiary) may make contributions to a Coverdell ESA,

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## Deduction for State and Local Sales Taxes

The American Jobs Creation Act of 2004 made it possible for taxpayers who itemize their deductions to deduct state and local sales taxes instead of state and local income taxes, but this option expired on December 31, 2005. The new

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## Highlights of the Tax Relief and Health Care Act of 2006

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reform allows this deduction through 2007. This option holds the most benefit for residents in states with no income tax or for those living in states with low income tax rates but high sales tax rates, provided their earning and spending make the numbers work.

There are two ways to determine the amount of your deduction: 1) calculate the actual amount of sales tax you paid, which would require your having saved receipts to substantiate the amount of your deduction in the event of an audit, or 2) use a standard IRS table, which will figure an amount based on your adjusted gross income, dependents, filing status, and state of residence.

### Higher Education Tuition Deduction

Through 2007, an above-the-line deduction is available to individuals paying qualified higher education expenses. Single filers with an adjusted gross income (AGI) no more than \$65,000 and joint filers with AGIs of no more than \$130,000 are eligible to deduct qualified expenses up to a maximum of \$4,000. Single filers with AGIs under \$80,000 and joint filers with AGIs between \$130,000 and \$160,000 can deduct up to \$2,000 of qualified expenses. If you claim either the Hope Credit or the Lifetime Learning Credit, you may not take this deduction.

### Teacher's Classroom Expense Deduction

Teachers, counselors, principals, and classroom aides may be eligible for a \$250 above-the-line deduction for out-of-pocket classroom expenses through 2007. Qualified supplies include books, paper, pens, art supplies, computer equipment, software, and athletic equipment.

### Energy Efficiency Incentives

Extending certain provisions of the Energy Policy Act of 2005, this new measure renews some tax incentives through 2008, including the deduction for energy-efficient commercial building property and the business credit for energy-efficient new homes.

This energy reform does not, however, extend or enhance tax breaks for hybrid cars, and some models are no longer eligible for the maximum tax credit. Toyota, having sold more than 60,000 fuel-efficient vehicles, has exceeded the limit set by the Energy Policy Act of 2005. The tax credit for Toyota models will eventually phase out, as will the credit for hybrids produced by other manufacturers once they sell 60,000 fuel-efficient vehicles.

### Health Savings Accounts

In a nod to health care reform, the new legislation

permanently enhances tax incentives for Health Savings Accounts (HSAs). Employees who have a health Flexible Spending Arrangement (FSA) or a Health Reimbursement Arrangement (HRA) can make a one-time, direct transfer to an HSA through December 31, 2011. Furthermore, beginning in 2007, employees can make a one-time transfer from an Individual Retirement Account (IRA) to an HSA. The amount is limited to the maximum HSA contribution limitation for the year.

In addition, contributions to an HSA are no longer limited to the annual deductible of the HDHP. As a result, in 2007, the maximum contribution is \$2,850 for self-only coverage and \$5,650 for family coverage.

### Alternative Minimum Tax Reform

Many unsuspecting taxpayers who exercised incentive stock options (ISOs) have been hit by the alternative minimum tax (AMT). Through December 31, 2012, taxpayers with AMT income from stock options may claim a refundable credit worth up to 20% of their unused, long-term AMT credits. The credit phases out for higher-income taxpayers.

### Business Incentives

Delivering good news to business owners, this

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## Saving for Education with Coverdell ESAs

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as long as his or her modified adjusted gross income for the year is less than \$110,000 (\$220,000 for married couples filing joint tax returns). Other features include the following:

- Contribution limits are \$2,000, per beneficiary, per year.
- Individuals may contribute to both a Coverdell ESA and a 529 plan for the same beneficiary, without incurring any tax penalties.
- Corporations and non-profit groups are eligible to contribute to ESAs. Unlike individual contributors, corporations or nonprofit organizations are not subject to earning restrictions.
- Contributions can be made up to the April tax-filing deadline.
- It is permissible to claim either the **Hope Credit** or the **Lifetime Learning Credit** in the same year that you take a tax-free distribution from an ESA, provided

the ESA distribution is not used for the same expenses for which the credit is claimed.

In addition, distributions from ESAs may be used to fund the following qualified education expenses:

- Tuition and fees incurred by the beneficiary at any eligible educational institution, including qualified elementary and secondary schools (K–12), as well as qualified post-secondary educational institutions.
- The cost of books, supplies, and equipment, including uniforms, computers, and related technology peripherals (if the computer-related equipment and services are to be used by the beneficiary during any of the years he or she attends school).
- Room and board, if the beneficiary is enrolled at least half-time in an eligible post-secondary educational institution. Room and board ex-

penses qualify only if the expense is not more than the greater of the following: The school's regular, posted room and board charges for students living on campus or the actual amount charged if the student is residing in housing owned or operated by the school. For qualified elementary and secondary schools, room and board qualifies only if it is required or provided by the school in connection with attendance or enrollment.

By expanding the definition of qualified educational expenses to include primary and secondary education expenses, as well as room and board, the Coverdell ESA is proving to be a welcome addition to the various tax-favored options for saving for educational expenses. \$

*Note: Nonqualified distributions may be subject to an additional 10% federal tax penalty on earnings.*

## Highlights of the Tax Relief and Health Care Act of 2006

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latest reform continues the Research and Experimentation (R&E) credit, which rewards companies for technological innovations and improvements. The R&E credit applies to qualified costs incurred in 2006 and 2007, and for tax year 2007, favorable modifications may apply.

Also getting a boost are the Welfare-to-Work (WtW) credit and the Work Opportunity Tax

Credit (WOTC), which provide tax incentives for businesses to hire poor workers. This reform renews both credits for 2006 and then consolidates the two credits into one for 2007. For most target groups, the credit equals 40% of qualified first year wages, which cannot exceed \$6,000.

This tax relief act also continues through 2007 the deductions for corpo-

rate charitable gifts of technology and computer equipment to schools and public libraries. For 2006 and 2007, equipment assembled by the donor qualifies.

The Tax Relief and Health Care Act of 2006 will cost an estimated \$45 billion over 10 years. For specific guidance, consult your tax professional. \$



## Advance Directives: Alternatives to Guardianship

**A**dvance directives are legal instructions that express a person's wishes regarding financial and health care decisions in the event he or she becomes unable to make them. However, if incapacity occurs and there are no advance directives, is **guardianship** a viable option?

Guardianship for an adult is far different from guardianship of a minor child. For minor children, guardianship essentially involves *parenting*. This is because minor children require adult care until they reach a certain age. Minor children do not *give up* any rights by virtue of guardianship.

By comparison, an adult, who is accustomed to making his or her own decisions, typically loses the right to vote, hold a driver's license, marry, and make a will (individual state laws may vary) when placed under guardianship. The guardian, appointed by the court, becomes a *decision-maker* for the incapacitated person, and he or she has the power to make some, or all, financial and care decisions for that person. Consequently, guardianship for an adult is considered a serious intervention.

Guardianship for an adult cannot be put into effect until *after* a clear need arises. At a minimum, most states require a court hearing and examination by a physician and/or psychologist to determine incompetence. The person for

whom guardianship has been petitioned (i.e., the **ward**) must be informed of his or her rights and notified that a court hearing has been scheduled. Proposed wards generally have the right to retain an attorney and to object to the petition for guardianship, even if incapacity prevents them from attending the hearing.

Confusion and eccentricity do not necessarily indicate incapacity. For example, an elderly parent may appear to be spending money frivolously, but that alone may not indicate an *inability* to manage his or her affairs. Also, consider what would happen if the court appoints a guardian for someone in a coma who later comes out of the comatose state. For these and other reasons, guardianship for an adult is generally considered a course of last resort in the absence of advance directives.

### Advance Directives

Advance directives can help you plan for a variety of situations. A **durable power of attorney** grants authority to another person to make legal and financial decisions on your behalf in the event of mental incapacity. The powers granted can be broad or limited in scope. Some areas a durable power of attorney can assist you with include your personal finances, insurance policies, government benefits, estate plans,

retirement plans, and business interests.

A **living will** generally allows you to *state your preferences* prior to incompetency regarding the giving or withholding of life-sustaining medical treatment. In most states, you must have a "terminal condition," be in a "persistent vegetative state," or be "permanently unconscious" before life-support can be withdrawn. The definition of these terms and the medical conditions covered may vary from state to state.

A **health care proxy** allows you to *appoint an agent* to make health care decisions on your behalf in the event of incapacity. These medical decisions are not limited to those regarding artificial life-support.

### Time Is of the Essence

Advance directives by durable power of attorney, living will, or health care proxy are generally inexpensive and easy to implement; they should be considered *essential* estate planning tools for all individuals, regardless of age. In the absence of such documents, court intervention to appoint a guardian may be necessary. This could involve a great deal of time, expense, and possibly stress to your family at precisely the moment when timeliness and ease of action are of the greatest importance. \$

The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any Federal tax penalties. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.