

## **2010 Update for *The Case Approach to Financial Planning: Writing a Financial Plan***

The 2010 update includes a 2009 and 2010 version of the Financial Facilitator spreadsheet, a few errata, some 2009 and 2010 tax (and other) numbers, and a little new material (generally, strategies).

### **Financial Facilitator**

A copy of the 2010 Financial Facilitator spreadsheet is included (in addition to the 2008 and 2009 Financial Facilitator spreadsheet). Some of the cases and problems in the book have been worked and explained using the 2008 Financial Facilitator spreadsheet. The method of estimation remains the same, although the following items have been updated in the 2009 and 2010 Financial Facilitator Income Tax Estimator worksheet: income tax rate brackets, personal exemption and standard deduction amounts, and the social security wage base.

### **Errata**

Page 75, in the first formula, 0.09 – 1.03 should actually read 0.09 – 0.03.

Page 76, in the third paragraph, \$1,611,228.92 should actually read \$1,161,228.92.

Page 77, in the first formula,  $i + g$  should actually read  $1 + g$ .

Page 393, in the first paragraph under the Bedo case, use \$10,000 as the current annual (rather than per semester) cost of college.

## **2010 Update (Tax plus Medicare and new materials)**

### **Page 137**

Personal exemption: \$3,650 in 2009 and 2010

### **Page 138**

**Tax Rate Table for Single Taxpayer**

<b>2008 Taxable Income</b>	<b>2009 Taxable Income</b>	<b>2010 Taxable Income</b>	<b>Tax Rate</b>
\$8,025 or less	\$8,350 or less	\$8,375 or less	10%
\$8,025 to \$32,550	\$8,350 to \$33,950	\$8,375 to \$34,000	15%
\$32,550 to \$78,850	\$33,950 to \$82,250	\$34,000 to \$82,400	25%
\$78,850 to \$164,550	\$82,251 to \$171,550	\$82,400 to \$171,850	28%
\$164,550 to \$357,700	\$171,550 to \$372,950	\$171,850 to \$373,650	33%
Over \$337,700	Over \$372,950	Over \$373,650	35%

**Tax Rate Table for Married Filing Jointly**

2008 Taxable Income	2009 Taxable Income	2010 Taxable Income	Tax Rate
\$16,050 or less	\$16,700 or less	\$16,750 or less	10%
\$16,050 to \$65,100	\$16,700 to \$67,900	\$16,750 to \$68,000	15%
\$65,100 to \$131,450	\$67,900 to \$137,050	\$68,000 to \$137,300	25%
\$131,450 to \$200,300	\$137,050 to \$208,850	\$137,300 to \$209,250	28%
\$200,300 to \$357,700	\$208,850 to \$372,950	\$209,250 to \$373,650	33%
Over \$357,700	Over \$372,950	Over \$373,650	35%

**Standard Deduction Amounts**

Filing Status	2008	2009	2010
Dependent	\$900	\$950	\$950
Single	\$5,450	\$5,700	\$5,700
Married filing jointly	\$10,900	\$11,400	\$11,400
Married filing separately	\$5,450	\$5,700	\$5,700
Head of household	\$8,000	\$8,350	\$8,400

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Product Strategy 4: Compare 529 Plans, UGMAs and UTMA's to Save Taxes and Plan for College

There is a 0% long-term capital gain rate in 2009 and 2010.

**Page 146**

Hope Scholarship Credit for 2009 and 2010

100% of first \$2,000 in educational expenses, 25% of next \$2,000 in expenses  
Available for first 4 years (rather than 2) of postsecondary education.

**Page 147**

Special qualified dividend and capital gains rates of 0% and 15% in 2009 and 2010.

**Page 148 (new)**

**Procedural Strategy 11: Use Like-Kind Exchange Strategies Appropriately**

**Advantage:** IRC Section 1031 provides a provision for owners of certain investment property to exchange property without incurring immediate taxation. In order to be an effective tax-postponing strategy, a client must exchange his or her property for a similar kind or class of asset. For example, an investment property such as an apartment building may be exchanged for another investment property such as a rental house. Boot, defined as the receipt of non-like-kind property, may trigger taxation.

**Disadvantage:** Sometimes clients attempt to exchange investment stocks, bonds, or other securities or personal use property. IRC Section 1031 does not provide nonrecognition on exchanges of these types of property. Further, real estate may only be exchanged for real estate, which is defined as improved or unimproved land, buildings, warehouses, etc. Care must be taken whenever a like-kind exchange strategy is employed.

**Procedural Strategy 12: Understand the Implications Related to Realized and Unrealized Gains**

**Advantage:** A realized gain (loss) is calculated by subtracting the adjusted basis in property from the sale price of the property. Realized gains (losses) are reported on a client's Form 1040. Sometimes a gain (loss) is not immediately recognized (i.e., reported on Form 1040). In these situations, the gain (loss) is unrecognized. Examples of situations that might result in an unrealized gain (or loss) include a Section 1031 like-kind exchange, the sale of personal use assets for a loss, and some gains on the sale of a personal residence (e.g., \$250,000 gain for a single taxpayer). Understanding when a gain or loss must be reported can be an effective tool to help clients maximize cash flow by managing and minimizing tax liabilities.

**Disadvantage:** Misinterpretation of gain and loss rules may result in tax penalties. For example, selling personal property for a loss does not result in a tax deduction or an offset against gain. However, selling personal property (e.g., sales at a garage sale) for a gain is taxable.

**Procedural Strategy 13: Calculate the Exclusion Ratio to Reduce the Tax on Annuity Distributions**

**Advantage:** Careful attention should be paid in situations where a client is taking distributions from an annuity, IRA, or qualified plan. If any contribution was made using after-tax dollars, or if any of the contribution was taxed previously, a portion of the total distribution may be considered a tax-free distribution.

Calculating the exclusion ratio for an annuity can reduce the probability that a client will pay unnecessary taxes. The general exclusion ratio formula for an annuity is as follows:

$$\text{Total After-Tax Contributions} \div \text{Total Expected Distributions}$$

Where Total Expected Distributions is calculated by multiplying the monthly distribution by the number of expected distribution years times 12 (i.e., months per year).

Different exclusion rules apply to IRAs and qualified plans.

**Disadvantage:** It is possible that distributions will last longer than the expected duration used in the annuity exclusion ratio formula. In these situations, all of the after-tax contributions will be accounted for. This will result in all future distributions being fully taxable. Clients who fail to track cumulative distributions may incur tax penalties at some point in the future.

**Procedural Strategy 14: Apply Provisions of the 2009 Stimulus Plan Appropriately**

**Advantage:** The 2009 stimulus plan (ARRA 2009) altered the tax planning situation for many clients. The following measures were enacted that might impact clients:

- The Making Work Pay Credit allows eligible workers to receive a credit for the lesser of 6.2% of earned income or \$800 for a joint return (\$400 for others) in 2009 and 2010.

- First-time homebuyers are allowed a tax credit for 10% of the purchase price, up to \$8,000, for homes purchased between January and November 31, 2009. This credit is available only to those who have not purchased a home in the past three years. The credit has been extended through April 2010 and certain long-time homeowners can qualify for a credit of up to \$6,500.
- The AMT exemption has been raised to \$70,950 for married clients (\$46,200 for singles) for 2009.
- Unemployed clients (due to a lost job) may receive \$2,400 in unemployment compensation tax free in 2009.
- Those who purchase a new car may deduct the sales tax paid as an above-the-line expense on cars costing up to \$49,500.
- For certain terminated employees, up to nine months of COBRA coverage will be provided through a 65% reduction in group health policy premiums paid by the employee.
- The Hope Scholarship Credit has been increased to \$2,500 (partially refundable) for four years of college for 2009 and 2010.
- Distributions in 2009 and 2010 from 529 plans to pay for computers and computer technology can be made tax free.

**Disadvantage:** The Making Work Pay Credit phases out for clients with AGI between \$75,000 and \$95,000 (\$150,000 and \$190,000 for a joint return). For those who do qualify, the maximum benefit may be equivalent to an extra \$12 to \$20 per pay period. The first-time homebuyers credit phases out for clients with AGI between \$75,000 and \$95,000 (\$150,000 and \$170,000 for a joint return). The new car tax deduction stops after 2009; further, the deduction phases out for clients with AGI between \$125,000 and \$135,000 (\$250,000 and \$260,000 for a joint return). To qualify for reduced cost COBRA coverage, a client must have been laid off between September 1, 2008 and December 31, 2009; certain income phase-out restrictions also apply. The Hope Scholarship Credit enhancement disappears after 2010.

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The standard Medicare Part B monthly premium is \$96.40 in 2009 and 2010 (\$110.50 for a new beneficiary in 2010). In 2009 and 2010, a small number of beneficiaries with higher incomes (individuals with income exceeding 85,000 and married couples with income exceeding \$170,000) will pay a higher premium with the premium pro-rated on the basis of income, with the highest premium at \$308.30 in 2009 and \$353.60 in 2010.

The yearly deductible for Medicare Part D should be no more than \$295 in 2009 and \$310 in 2010.

#### **Page 210**

##### **Health Savings Account (HSA) (2009)**

For an individual plan, the minimum deductible is \$1,150, and the stop-loss limit is \$5,800. For a family plan, the minimum deductible is \$2,300, and the stop-loss limit is \$11,600. Contribution limits are \$3,000 for an individual, and \$5,950 for a family. The catch-up contribution is \$1,000.

**Health Savings Account (HSA) (2010)**

For an individual plan, the minimum deductible is \$1,200, and the stop-loss limit is \$6,150. For a family plan, the minimum deductible is \$2,400, and the stop-loss limit is \$11,900. Contribution limits are \$3,050 for an individual, and \$5,950 for a family. The catch-up contribution is \$1,000.

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Figure 6.3. Starting June 2010, there will be new Medigap Plans M and N. But Medigap Plans E, H, I, and J will not be available to new buyers after May 2010; a person with such a plan before June 2010 can keep it. For a Plan F or Plan J high deductible option, the out-of-pocket is \$2,000 in 2009 and 2010.

The Plan K limit on annual out-of-pocket spending under Part A and B is \$4,620 in 2009 and 2010.

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The Plan L limit on annual out-of-pocket spending under Part A and B is \$2,310 in 2009 and 2010.

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For certain individuals involuntarily terminated after August 2008 and before 2010, the unemployed worker need only pay 35% (rather than 102%) of total premiums.

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**Maximum Deductibility of Long-Term Care Premiums (2009)**

Age	Max
40 or less	\$320
41 to 50	\$600
51 to 60	\$1,190
61 to 70	\$3,180
71 or over	\$3,980

**Maximum Deductibility of Long-Term Care Premiums (2010)**

Age	Max
40 or less	\$330
41 to 50	\$620
51 to 60	\$1,230
61 to 70	\$3,290
71 or over	\$4,110

**Page 270 (new)**

**Product Strategy 9: Use a Long-Term Care Partnership Program to Protect Client Assets**

**Advantage:** LTC partnership programs allow policy owners to protect a portion or all of their assets if they ever need to apply for and use Medicaid services. Typically, clients should be encouraged to purchase a three- to five-year LTC policy with a specific dollar amount of coverage. For example, \$250,000 in coverage over the term of the policy. Should a client need LTC coverage, the policy will pay benefits up to the maximum dollar amount of the policy. After depleting the coverage, the

client may qualify for Medicaid. These policies provide for a dollar-for-dollar protection of assets equal to the policy coverage limit (e.g., \$250,000). That is, each dollar that the policy pays out entitles the client to keep a dollar of assets sheltered from Medicaid.

**Disadvantage:** Each state is authorized to enact LTC partnership programs; not all states will have LTC partnership programs. In order to qualify for asset protection, partnership programs must be tax-qualified, contain certain consumer protection provisions, and provide inflation protection.

**Product Strategy 10: Purchase Annuity with Guaranteed Lifetime Withdrawal Benefit for LTC Costs**

**Advantage:** Several insurance companies have begun issuing both fixed and variable annuity products that provide a guaranteed lifetime withdrawal option that provides the benefits of an annuity with a LTC multiplier included in the policy. A portion of the annuity's return is used to pay for LTC benefit coverage. The amount of LTC benefit is calculated based on the amount of coverage selected when the policy is purchased. For example, a client who purchased a \$100,000 annuity with a LTC provision of 300% and a two year benefit factor would have access to \$200,000 to pay for LTC expenses after depleting the \$100,000. LTC payments would continue for up to six years, which is equivalent to a \$50,000 per year LTC payout. If the LTC coverage were not needed, the face value of the annuity would be paid out to a named beneficiary.

**Disadvantage:** Clients must be medically underwritten to qualify for these products. A client in poor health will not have access to these hybrid annuity products.

Page 272 (new)

**Procedural Strategy 6: Use Tax-Advantaged Methods to Purchase LTC Coverage**

**Advantage:** A portion of LTC premiums paid may be eligible for a medical expense deduction for those clients who own their own business (this includes S corporation owners, LLC members, and partnership owners) and file Schedule A as part of Form 1040. The following deductible amounts are available regardless of a client's adjusted gross income:

Age of Client	Amount of Annual Premium Deductible	
	2009	2010
Up to 40	\$320	\$330
41 to 50	\$600	\$620
51 to 60	\$1,190	\$1,230
61 to 70	\$3,180	\$3,290
More than 70	\$3,980	\$4,110

Additionally, clients who purchase health insurance through a high deductible plan and a health savings account (HSA) may use distributions from the HSA to pay LTC insurance premiums. This results in a pre-tax purchase method for LTC insurance.

**Disadvantage:** The deductibility of LTC premiums that avoid the 7.5% of AGI limitation is available only to business owners. Individuals may only deduct premiums if all unreimbursed medical expenses, including LTC premiums up to the amounts in the table (based on age), exceed 7.5% of AGI. If a HSA is used to purchase LTC coverage, clients will lose the Schedule A deduction. Keep in mind that distributions from Section 125 plans and flexible spending accounts may not be used to pay LTC insurance premiums.

**Page 300 (new)**

**Procedural Strategy 6: Use Appropriate Business Structure to Help Clients Limit Liability**

**Advantage:** Clients who own a business as a sole proprietorship have unlimited personal liability. Although a sole proprietorship can be easy to manage, there are better alternatives to protect clients from liability.

**C-Corporation:** Limited liability for owners; relatively complex to manage.

**S-Corporation:** Limited liability for owners; income flows through from corporation to owners; may not have more than 100 shareholders.

**LLC:** Liability limited to member's contribution to firm; members rather than shareholders; less cumbersome than a corporation.

**LLP:** Liable for actions of all partners, but not liable for errors and omissions of partners.

**Partnership:** Liable for action of all partners.

The corporate structure can provide an effective way to provide tax-advantaged fringe benefit for employees and owner-shareholders.

**Disadvantage:** The costs, both financially and administratively, are higher for these arrangements than for sole-proprietorships. Also, changing from a corporate structure back to a sole-proprietorship can be expensive.

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\$65,000 (\$13,000 annual exclusion (in 2009 and 2010) × 5 years) may be contributed to a 529 Plan without triggering the federal gift tax.

**Page 398 (new)**

The amount of earnings required for a quarter of Social Security coverage in 2009 is \$1,090; \$1,120 in 2010.

***Comparison of Funding Characteristics of Defined Contribution Type Plans (2009 and 2010)***

<b>Plan</b>	<b>Maximum Contribution per Participant (Elective deferral)</b>	<b>Maximum Annual Addition per Participant (based on maximum compensation of \$245,000)</b>	<b>Are Yearly Employer Contributions Mandatory?</b>	<b>Is a CODA/ 401(k) Permitted?</b>	<b>Are Forfeitures Generally Required to be Redistributed?</b>	<b>Are In-Service Withdrawals Allowed?</b>	<b>Is 100% Immediate Vesting for Employer Contributions Mandatory?</b>
Money Purchase	After-Tax Allowed	< 100% or \$49,000	Yes	No	Yes	No	No
Target Benefit	Not Allowed	< 100% or \$49,000	Yes	No	Yes	No	No
Profit-Sharing	\$49,000	< 100% or \$49,000	No	Yes	Yes	Yes	No
Stock Bonus	\$49,000	< 100% or \$49,000	No	Yes	Yes	Yes	No
ESOP	\$49,000	< 100% or \$49,000	No	Yes	Yes	Yes	No
401(k)	\$16,500	< 100% or \$49,000	No	n/a	Yes	Yes	No
Thrift & Savings	Varies	< 100% or \$49,000	Generally Yes	No	Yes	Yes	No
403(b)	\$16,500	< 100% or \$49,000	No	No	No	Yes	Yes
457	\$16,500 or 100% of Compensation	\$16,500 or 100% of Compensation	Not Allowed	No	n/a	Yes; unforeseen emergency only	n/a
SEP	SAR-SEP 408(k) \$16,500	< effectively 25% or \$49,000	No	No	n/a	Yes; same as IRA	Yes
Keogh Money Purchase or Profit-Sharing	Employees May Not Contribute	< 100% or \$49,000 Maximum Contribution of \$49,000	Yes, for Money Purchase Plan;  No, for Profit-Sharing Plan	No, however, a profit-sharing Keogh may be established	No	Yes	No
SIMPLE IRA	\$11,500 \$14,000 age 50+	See Note	Yes	No	n/a	Yes; same as IRA	Yes
SIMPLE 401(k)	\$11,500 \$14,000 age 50+	\$18,850 \$21,350 age 50+	Yes	Yes	n/a	Yes; same as IRA	Yes

- < means “the lesser of”
- Employers must make substantial and regular contributions to Profit-Sharing, Stock Bonus, and ESOPs.
- 25% deduction limit effectively limits contributions to Keogh Money Purchase or Profit-Sharing.
- Note: Employers must make either a dollar for dollar matching contribution up to 3% of an employee’s compensation (in the case of a SIMPLE IRA, an employer can elect a lower percentage in no more than 2 out of 5 years ending in the current year), or 2% of compensation for all eligible employees earning at least \$5,000 (regardless of elected salary reductions).
- SEP and KEOGH: the effective maximum contribution percentage is takes into account net earnings instead of total compensation.
- Employer deductible contributions limited to 25% of covered employee compensation.
- A targeted non-refundable tax credit for low- to moderate-income savers is available for 401(k), 403(b), 457(b), and IRA contributions
- Individuals age 50 or older are allowed to make annual catch-up contributions to salary deferral plans: \$5,500 for qualified plans and \$2,500 to SIMPLE IRAs or SIMPLE 401(k) plans in 2009 and 2010.
- The maximum permitted contribution for a SIMPLE 401(k) plan is the maximum elective deferral plus the 3% matching contribution.
- The maximum total contribution to a SIMPLE 401(k) plan for 2009 and 2010 is \$18,850 (salary deferral of \$11,500 + 3% contribution of maximum salary of \$245,000) + catch-up contributions).

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**IRA Contribution Limits (2009 and 2010):**

\$5,000 in 2009, plus \$1,000 for those 50 or older.

**Contribution Phaseout Limits (2009)**

Traditional IRA deductible contribution phaseout limits:

Single filer	\$55,000 to \$65,000
Joint filer	\$89,000 to \$109,000
Joint non-active participant	\$166,000 to \$176,000

Roth IRA contribution phaseout limits:

Single filer	\$105,000 to \$120,000
Joint filer	\$166,000 to \$176,000

**Contribution Phaseout Limits (2010)**

Traditional IRA deductible contribution phaseout limits:

Single filer	\$56,000 to \$66,000
Joint filer	\$89,000 to \$109,000
Joint non-active participant	\$167,000 to \$177,000

Roth IRA contribution phaseout limits:

Single filer	\$105,000 to \$120,000
Joint filer	\$167,000 to \$177,000

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\$110,000 of compensation in 2009 and 2010 makes a person highly compensated.

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Catch-up Contributions (2009 and 2010)

401(k), 403(b), 457	\$5,500
SIMPLE IRAs, SIMPLE 401(k) plans	\$2,500
Traditional and Roth IRA	\$1,000

**Page 431 (new)**

**Procedural Strategy 9: Understand Qualified Plan Coverage Rules**

**Advantage:** When designing a qualified retirement plan for an organization it is important to understand the coverage rules.

1. Defined benefit plans must benefit the lesser of 40% of eligible employees or 50 eligible employees.
  2. Qualified plans must provide a benefit to
    - a. 70% or more of Non-Highly Compensated Employees, or
    - b. A percentage of Non-Highly Compensated Employees to Highly Compensated Employees that is at least 70%;
- or
- c. The average benefit ratio for Non-Highly Compensated Employees to Highly Compensated Employees must be at least 70%, and
  - d. The plan must not be nondiscriminatory.

**Disadvantage:** Any plan that fails these coverage rules will be considered non-qualified for tax purposes, resulting in lost tax deductions for the organization and potential loss of tax deferral for employees.

**Procedural Strategy 10: Understand who may be excluded from a qualified retirement plan**

**Advantage:** Providing a qualified retirement plan can often be an expensive benefit for businesses. By understanding who may be excluded from plan participation, it may be possible to save an employee business owner client some plan expense. In general, anyone under the age of 21 or those who work less than 1,000 hours per year may be excluded. Any employee who has worked for 1,000 hours in a 12 month period and is at least 21 years of age is eligible for plan participation.

**Disadvantage:** Excluding certain employees from a qualified plan may result in reduced productivity, resulting in higher employee turnover.

**Page 448**

Gift tax annual exclusion: \$13,000 in 2009 and 2010  
Married couple using split gifts: \$26,000 ( $\$13,000 \times 2$ )

**Page 458**

529 Plan  
Married couple using split gifts and 5 years of contributions  
\$130,000 ( $2 \times 5 \times \$13,000$ )