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Pathways

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As 2009 Dawns, Is There Hope on the Horizon?

There's little doubt that 2008 will be remembered as a tumultuous year. Turmoil in the credit and housing markets, inflation pressures, and the volatility of the stock market all contributed to economic pressures. But buried within the negative headlines was some good news you may have missed—here's a recap.

Financial help for homeowners

If you're a homeowner, you may benefit from a new income tax deduction. When you're filing your 2008 federal income tax return in 2009, you may be able to take a deduction for property taxes you've paid—even if you don't itemize. Taxpayers who claim the standard deduction may be able to claim an additional deduction of up to $1,000 if married or $500 if single.

If you're a first-time homebuyer, you may be able to take a refundable tax credit of 10% (up to a maximum of $7,500 or $3,750 for married persons filing separate returns) of the purchase price of a home you've purchased after April 8, 2008, and before July 1, 2009. However, this credit is phased out for individuals with adjusted gross incomes ranging from $75,000 to $95,000 ($150,000 to $170,000 if married filing jointly). And keep in mind that this tax credit functions more like a loan—you'll need to repay the credit over 15 years in equal installments on your annual tax return (possibly sooner if you sell your home or don't use it as your main residence).

New ways to manage college costs

Student loans staged a disappearing act in 2008, as the credit crisis drove some lenders out of the student loan market and forced others to become more selective. But the Higher Education Opportunity Act, which became law in August, contains several provisions that will help families and students better manage the high cost of college. These will be phased in during 2009 and in future years. Some highlights:

- Individuals who have worked for at least ten years in certain public service occupations (e.g., teachers, nurses, law enforcement officers, firefighters) may qualify to have their federal student loan debt forgiven (up to $10,000)
- Colleges will be encouraged to control price increases, and textbook publishers will be required to provide complete retail price information and sell unbundled versions of textbooks to help control costs
- The maximum Pell Grant will increase from $5,800 to $9,000 per academic year, and will be available year-round
- The federal student aid application (FAFSA) will be streamlined, making it easier to apply for financial aid

Expanded education benefits for the military

August 1, 2009, marks the debut of a new GI bill, which has been hailed as the first major expansion of education benefits for the military since World War II. Active duty service members (including members of the Guard and Reserve) may be eligible for the new program. Education benefits will be payable for up to 36 months, and will cover tuition costs and fees. Eligible veterans may also receive a monthly stipend for books and supplies, and a monthly housing allowance. In some cases, benefits may even be transferable to spouses and dependent children. You can find more information on the Department of Veterans Affair's website, www.gibill.va.gov.

New "green" vehicles

Gas-saving vehicles have been rolling off assembly lines for several years. Up until now, most have been passenger cars, and smaller SUVs and trucks. But these are now sharing the road with larger and sportier

About New Wealth Advisors.

New Wealth Advisors is an independent, fee-only, SEC-registered investment advisor, operating as a multi-family investment office. We work with newly wealthy individuals and families to protect, grow and manage assets.

models, including a hybrid version of an infamous gas guzzler—the Cadillac Escalade. Admittedly, the 2009 Escalade's estimated 20 mpg city isn't going to break any fuel conservation records, but its emergence is a sign that Detroit is focused on developing even more fuel efficient vehicles in 2009 and beyond, due to growing demand.

As in previous years, when you purchase a qualified hybrid or other alternative fuel vehicle, you may be entitled to claim a tax credit when you file your federal income tax return. This credit will reduce your tax bill dollar-for dollar. You can find a list of qualified vehicles on the IRS website, www.irs.gov.

The road to recovery is paved with good intentions—and probably new legislation

Will an economic recovery take place in the first half of 2009, the second half of the year, or even later? No one knows for sure. But economic woes will likely result in new initiatives and relief measures, so keep your eyes open for developments on the road ahead.

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Good news for Medicare beneficiaries

For the first time since 2000, the monthly standard premium for Medicare Part B won't be rising. In 2009, individuals enrolled in Medicare Part B will pay $96.40 per month—the same premium they paid in 2008.

Time to Consider Year-End Investment Moves

Taking time now to make some strategic saving and investing decisions before December 31 can affect not only your ability to meet your financial goals but also next April's tax bill.

Review and rebalance

A review of your portfolio can tell you whether it's time to rebalance. If one type of investment has done well, it might now represent a greater share of your assets than you originally intended. To rebalance, you could sell some of that asset class and use the proceeds to buy other types of investments that will bring your overall allocation back to an appropriate balance. Diversification and asset allocation don't guarantee a profit or protect against a possible loss, of course, but they're worth reviewing at least once a year. Your checkup also can help you decide whether it makes sense from a tax perspective to do that rebalancing before or after December 31.

Consider harvesting losses

It's also a good time to consider the tax consequences of any capital gains or losses you've experienced this year. Though tax considerations shouldn't be the primary driver of your investing decisions, you can take steps before the end of the year to help manage your taxes.

If you have realized capital gains and you have no tax losses carried forward from previous years, you can sell losing positions—known as harvesting losses—to offset some or all of those gains. Any losses over and above the amount of your gains generally can be used to offset up to $3,000 of ordinary income ($1,500 for a married person filing separately) or carried forward to offset future gains.

Before selling an investment, consider how long you've owned it. Assets held a year or less generate short-term capital gains and are taxed as ordinary income. That tax rate could be as high as 35%, not including state taxes. Long-term capital gains on the sale of assets held for more than a year generally are taxed at lower rates: 15% for most investors, 0% to the extent investors are in the 10% and 15% tax brackets (through 2010).

Time trades carefully

If you're selling to harvest losses and intend to repurchase the same security, make sure you wait at least 31 days before buying it again. Otherwise, the trade is considered a "wash sale," and the tax loss will be disallowed. The wash sale rule also applies if you buy an option, sell a stock short, or buy it through your spouse within 30 days before or after a sale of the same security.

If you're considering purchasing a mutual fund outside of a tax-advantaged account, find out when the fund will distribute dividends or capital gains. Consider postponing action until after that date, which is often near year end. If you buy just before the distribution, you'll face potential taxes on that money, even if your own shares haven't appreciated. If you plan to sell a fund, you may be able to minimize taxes by doing so before the distribution date.

Think about your cost basis

If you own a stock, fund, or ETF and decide to unload some shares, you may be able to maximize your tax advantage. There are several ways to figure your cost basis; for example, you can use the average cost per share for a mutual fund. Or you could request that specific shares be sold—for example, those bought at a certain price. Which shares you choose depends on whether you want to book capital losses to offset gains, or keep gains to a minimum to reduce your tax bite. (This applies only to shares held in a taxable account.)

Taking a moment out of the holiday rush to plan ahead could be a big help in the spring.

The ABCs of 1031 Like-Kind Exchanges

A like-kind exchange, sometimes called a 1031 exchange after the section of the Internal Revenue Code that governs these transactions, is the exchange of one business or investment property for another. Provided the property you receive is of a "like kind" to the property you transfer, and all other requirements are met, no gain or loss is recognized on the income deferred as a result of the exchange. This has made like-kind exchanges a popular technique for investors looking to defer the payment of taxes on capital gains. When it comes to like-kind exchanges, though, even the most straightforward transaction is complicated.

Simultaneous swaps

If there is a "basic" like-kind exchange, it takes the form of a simultaneous exchange. You transfer business or investment property to another party in return for similar property. For example, let's say you own a piece of land that has a basis of $200,000 (your cost) and a fair market value of $400,000. If you were to sell the property, you would recognize $200,000 in gain. Instead of selling the land, however, you exchange it for a rental property owned by another individual. If all the conditions of IRC Section 1031 are met, you do not recognize any gain as a result of the exchange (recognition of any gain is deferred until you sell the rental property). If you receive cash in addition to the rental property, gain is recognized to the extent of the cash received.

Deferred exchanges

With a deferred exchange, you give up your original property before receiving the replacement property. During the time that you're looking for a replacement property, you can't touch the proceeds from your original property (taking control of cash or proceeds before the entire like-kind exchange is complete can disqualify the transaction). For this reason, deferred like-kind exchanges generally involve executing a written exchange agreement with a qualified intermediary or other exchange facilitator, such as a bank, trust company, or attorney, that you pay to handle the transaction. The intermediary, who may assist you in locating a replacement property, is responsible for keeping the proceeds from your original property separate in an escrow account until the exchange is complete.

In a deferred exchange, you have 45 days from the date that you relinquish your original property to identify, in writing, potential replacement properties. You must then receive the replacement property and close the exchange within 180 days from the date you relinquish your original property, or by the due date of your tax return (including extensions) for the tax year in which you relinquished your original property, whichever is earlier.

Tenancy-in-common (TIC) exchanges

With a TIC exchange, you exchange real property, and as replacement property, you receive a partial ownership interest (you're a co-owner, specifically a tenant-in-common) in commercial real estate. For example, you might exchange a piece of land with a fair market value of $400,000 for a 10% TIC ownership interest in a $4 million commercial property. TIC interest offerings include partial ownership interests in manufacturing facilities, office buildings, and malls.

These exchanges are extremely complicated. In fact, for a TIC interest to even qualify as potential replacement property in a like-kind exchange, there are extensive conditions that must be met. Most TIC interests are sold as securities, and are not available to the general public. TIC interests are generally available only to individuals who qualify as "accredited" investors (basically, those with a net worth greater than $1 million, or income of at least $200,000—$300,000 for a married couple—for the prior two years). TIC offerings are non conventional investments, and while they might provide ownership opportunity in a larger property than you might otherwise be able to afford, they are not suitable for all investors.

In addition to the significant fees and lack of liquidity generally associated with TIC exchanges, you'll typically have little or no day-to- day control over the TIC property.

Final thoughts

It can't be overemphasized: like-kind exchanges are complicated, and there's simply no way to cover all the rules here. So, before you even consider a like-kind exchange, you should familiarize yourself with the details, including all tax aspects of an exchange. Note as well that special rules apply to exchanges between related parties.

A like-kind exchange can be a powerful strategy for investors and business owners, so it's worth understanding. But, if you're interested, make sure that you contact a qualified professional who can help you navigate the intricate rules that apply.

Like-kind property is property of the same nature, character, or class. Quality or grade does not matter. Most real estate will be like-kind to other real estate. For example, real property that is improved with a residential rental house is like-kind to vacant land. One exception for real estate is that property within the United States is not like-kind to property outside of the United States. Also, improvements that are conveyed without land are not of like kind to land.

IRS Fact Sheet
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The like-kind exchange rules do not apply to:

- Stock in trade or other property held primarily for sale
- Stocks, bonds, or notes
- Other securities or evidences of indebtedness or interest
- Interest in a partnership
- Certificates of trust or beneficial interests
- "Choses in action" (rights to recover money or property in a court proceeding)

What is an expense ratio?

Every mutual fund must disclose certain costs associated with running the fund. Those costs, which are expressed as a percentage of the fund's assets, represent a fund's expense ratio, which can be found in its prospectus. For example, a fund that has $100 million in assets and annual expenses of $1 million would report a 1% expense ratio (1% of $100 million equals $1 million).

An expense ratio includes the following:

Management fees: Fees paid to the fund's investment manager or advisor, which manages the fund and makes investment decisions. These often represent the single largest portion of a typical fund's expense ratio.

Marketing costs: Also known as 12b-1 fees, named after the legal provision that permits them. These were originally designed to let funds recoup costs associated with distribution and advertising, on the theory that attracting new investors and additional assets would help make a fund more cost-effective for each investor. In recent years, there has been discussion of whether 12b-1 fees should be eliminated—especially for funds that are closed to new investors and therefore should have little need to market themselves—but they are still very common.

Administrative fees: Includes the cost of record keeping, custodianship, taxes, and legal, accounting, and auditing services.

A fund's expense ratio can help you gauge how efficiently it operates. You do not need to deduct a fund's expense ratio from the returns quoted in its prospectus; the figures that measure average annual and cumulative return have already taken them into account.

Before investing in a mutual fund, carefully consider its investment objectives and risks as well as its charges and expenses. This information is available in the prospectus, which can be obtained from the fund. Read it carefully before investing; a fund's expense ratio can affect your long-term net returns.

What are trading expenses and why do they matter?

Trading expenses represent the cost of buying or selling securities, and can have a substantial impact on your net return over time.

Brokerage commissions are the most obvious example of trading expenses, but there are others. For example, the bid/ask spread is the difference between the price sellers are asking for a security and the price buyers are willing to pay for it. Still another example of trading expenses is what's known as market impact effect costs, which occur when an institutional investor's purchases or sales of large quantities of a given security affect that security's price. If you use leverage—for example, if you buy on margin—you will likely pay interest, which also should be included in your estimate of trading costs.

For individual securities, it's relatively easy to know what your trading costs are. However, with a mutual fund understanding the impact of trading expenses can be more challenging. Funds also incur brokerage commissions and bid/ask spreads on their trades, but those costs aren't included in a fund's expense ratio. However, funds are required to report the per share cost of their annual commissions; this can be found in a fund's annual report or Statement of Additional Information.

Many investors use a fund's turnover ratio to help gauge the impact of its trading expenses. The turnover ratio indicates the value of a fund's trades as a percentage of its net asset value. Trading expenses for a fund with a high turnover ratio would typically be higher than for one that trades infrequently and therefore incurs fewer brokerage commissions.

Though not part of a fund's internal trading expenses, there are other potential trading costs of which you should be aware. A fund may charge a redemption fee if you sell your shares before a designated length of time. It also may impose a sales charge, either when you buy a fund (a front-end load) or sell it (a back-end load). Not all funds have a redemption fee or sales charge, but they should be considered when estimating your total trading costs.

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