



Family First Financial Planning

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Family First is proud to be collecting pajamas for The 2010 Pajama Jam Donation Drive organized by the Junior League. We will be collecting new children and youth pajamas, underwear, socks and bras of all sizes as well as cash donations to purchase these items for children from 2 years to teenagers. The collected items can provide small comfort to children in need and give them a sense of normalcy. The League will distribute them to foster children and other children in need. You can drop off your donated items at our office.

Don't forget to follow Family First on Twitter! To view our Tweets go to FamilyFirstFP for updates on financial issues, tips and advice. The newsletter only goes out once a month but we can tweet at any time we feel there is something important for our clients and friends to know.

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The First-Time Homebuyer Tax Credit



Recent changes to the first-time homebuyer tax credit mean you might be able to benefit from the credit, even if you're not actually a first-time homebuyer. To take advantage of the credit, however, you have to act by May 1. Here are the basics as they apply to home purchases in 2010.

Qualifying for an \$8,000 credit

If you, and your spouse if you're married, haven't owned a principal residence in 3 years, you may qualify for a credit worth 10% of the purchase price of a home, up to \$8,000 (\$4,000 if you're married and file a separate federal income tax return). The home has to be your principal residence, and must be purchased before May 1, 2010. If you enter into a written binding contract before May 1, 2010, you can still qualify for the credit if you close on the home before July 1, 2010.

Qualifying for a \$6,500 credit

If you, and your spouse if you're married, have maintained the same principal residence for at least 5 consecutive years in the previous 8 years, you may qualify for a credit if you purchase a new principal residence. While the credit remains 10% of the purchase price of the new home, it's capped at \$6,500 (\$3,250 if you're married and file a separate federal income tax return). As with the \$8,000 credit, the home must be purchased before May 1, 2010 (or you must close on the home by July 1, 2010, after entering into a written binding contract before May 1, 2010).

Limitations

There are several limitations that apply (the same limitations apply to both the \$8,000 credit and the \$6,500 credit):

- The credit is reduced if your modified

adjusted gross income (MAGI) exceeds \$125,000 and is completely eliminated if your MAGI reaches \$145,000. If you're married and file a joint return, the credit is reduced if your joint MAGI exceeds \$225,000 and is eliminated if your MAGI reaches \$245,000.

- You can't claim a credit if the purchase price of your principal residence exceeds \$800,000.
- You can't claim a credit if you're under age 18 at the time of purchase (unless you're married and your spouse is at least 18), or if you can be claimed by someone else as a dependent.
- You can't claim a credit if you purchase a principal residence from someone who is closely related to you or your spouse.
- You can't claim the credit if you're a non-resident alien.

Payback requirements

Generally, if you qualify for the credit as a result of a 2010 home purchase, you won't have to worry about repaying the credit. There's one important exception, however: if the home ceases to be your principal residence in the 36 months following the purchase, you'll have to pay the credit back. (If you're married at the time of purchase, the home must remain the principal residence of *either* you *or* your spouse for the 36-month period.) If you have to pay back the credit, you'll do so on the tax return for the year in which the home ceased being your principal residence.

Treating a 2010 purchase as made in 2009

If you purchase a qualifying principal residence in 2010, you can elect to treat the purchase as if it occurred on December 31, 2009, allowing you to claim the credit on your 2009 federal income tax return.



Got Stock? The Long and Short of Capital Gains

If you buy or sell shares of stock, you need to be familiar with the rules that govern the way capital gains are taxed. That's because the amount you owe in tax can depend on a number of factors, including the length of time you hold the shares and the federal income tax bracket you're in. Here are the basics.

Basis and holding period

"Basis" refers to your investment in the shares of stock you hold. Generally, your basis is the amount you paid for the stock, plus any commissions you paid to purchase the shares. (Note, however, that special rules apply if you received the stock as a gift or as part of an inheritance.) If you sell a share of stock and the sales price--less any commission--is more than your basis, you have a *gain*; if the amount you receive is less than your basis, you have a *loss*.

Your holding period is generally the length of time that you hold a share of stock before you sell or exchange it. If you hold a share of stock for a year or less before selling it, any gain you have is *short-term* capital gain. If you sell a share of stock after holding it for more than a year, any gain is *long-term* capital gain. Your holding period typically starts on the trade date the share is purchased, and ends on the trade date it's sold.

Short-term capital gain

Short-term capital gain is treated as ordinary income, just like interest on your savings account or wages from your employer. It's added in with all of your other income, and the amount of federal income tax you owe depends on the federal marginal income tax bracket you're in. For example, if you're in the top tax bracket in 2010, you'll pay tax on ordinary income at a maximum rate of 35%.

Long-term capital gain

If you sell shares of stock that you've held for more than a year, any gain is long-term capital gain, and special maximum tax rates apply. If you're in the 10% or the 15% marginal income tax bracket in 2010, you'll pay no federal income tax on long-term capital gains (a "0% tax rate" applies). So, for single individuals with taxable income of \$34,000 or less (\$68,000 for married individuals filing jointly), long-term capital gains are federal income tax-free in 2010.

For those who aren't in the lowest two federal income tax brackets (i.e., those in the 25%,

28%, 33%, and 35% brackets), a 15% maximum tax rate generally applies to long-term capital gains. There are limited cases, however, when individuals in the higher tax brackets can still benefit from the 0% tax rate.

For example, a retired couple with taxable income of \$60,000 would be in the 15% marginal income tax bracket in 2010 if they file jointly (the bracket covers married couples with taxable income less than or equal to \$68,000). The couple sells stock, resulting in a long-term capital gain of \$40,000. This increases their taxable income to \$100,000, placing them in the 25% marginal income tax bracket. In this situation, they would pay no federal tax on the first \$8,000 of long-term capital gain, and the maximum 15% rate would apply to the remaining \$32,000 in gain.

Offsetting gains with losses

Any capital losses that you may have realized during the year can offset some or all of your capital gain. If your losses offset all capital gains, any excess capital loss can be applied against up to \$3,000 of ordinary income (\$1,500 for married individuals who file separately), and any unused capital loss can be carried forward to future years.

Big exception: retirement plans, IRAs

All of this assumes your stock is not being held in a tax-advantaged retirement account like a 401(k) plan or IRA. Special tax rules apply to investments, including stock, held within these plans. If you sell shares of stock within one of these plans, there's no immediate tax consequence. Instead, you'll generally pay federal income tax when you take withdrawals from the plan, and any income will be considered ordinary income--even if the earnings are attributable to capital gains. (Certain Roth retirement plans and Roth IRAs provide for tax-free treatment of qualified withdrawals.)

Uncertainty in 2011

The special federal income tax rates that currently apply to long-term capital gains expire at the end of 2010. Absent new legislation, in 2011, individuals in the 15% tax bracket (under current law the 10% bracket disappears in 2011) will pay tax on long-term capital gain at a rate of 10%. For everyone else, a 20% rate will generally apply. Special rules (and slightly lower rates) will apply for qualifying property held five years or more.



Small business stock

Special rules apply to qualified small business stock. Generally, a portion of any gain realized upon the sale of qualified small business stock held for more than 5 years can be excluded from income. The portion of the gain that is not excluded from income is generally taxed at a maximum rate of 28%. For additional information, see IRS Publication 550.

10 Financial Terms Everyone Should Know

Understanding financial matters can be difficult because of the jargon used. Becoming familiar with these ten financial terms may help make your financial picture clearer.

1. Time value of money

The time value of money is the concept that money on hand today is worth more than the same amount of money in the future because the money today can be invested to earn interest. *Why is it important?* Understanding that money today is worth more than the same amount in the future can help you evaluate and compare investments that offer returns at different times.

2. Market volatility

Market volatility measures the rate at which the price of a security moves up and down. If the price of a security historically changes rapidly over a short period of time, its volatility is high. Conversely, if the price of a security rarely changes, its volatility is low. *Why is it important?* Understanding volatility can help you evaluate whether a particular investment is suited to your investing style and risk tolerance.

3. Inflation

Inflation reflects any overall upward movement in the price of goods and services in the economy. *Why is it important?* Because inflation generally pushes the cost of goods and services higher, any estimate of how much you'll need in the future—for example, how much you'll need to save for retirement—should take into account the potential impact of inflation.

4. Asset allocation

This strategy means spreading investments over a variety of asset categories, such as equities, cash, bonds, etc. *Why is it important?* How you allocate your assets depends on a number of factors, including your risk tolerance and your desired return. Diversifying your investments over asset classes can potentially help you manage risk and volatility.

5. Net worth

Net worth is what your total holdings are worth after subtracting all of your financial obligations. *Why is it important?* Your net worth will probably fund most of your retirement years. Therefore, the faster and bigger your net worth grows, the earlier and more comfortably

you will be able to retire. Once retired, preserving your net worth to last through your retirement years is your goal.

6. Five C's of credit

These are character, capacity, capital, collateral, and conditions. They're the primary elements lenders evaluate to determine whether to make you a loan. *Why is it important?* With a better understanding of how your banker is going to view and assess your creditworthiness, you will be better prepared to deliver appropriate information to obtain the loan you want or get a better interest rate.

7. Sustainable withdrawal rate

Sustainable withdrawal rate is the maximum percentage that you can withdraw from an investment portfolio each year to provide income that will last, with reasonable certainty, as long as you need it. *Why is it important?* Your retirement lifestyle will depend not only on your assets and investment choices, but also on how quickly you draw down your retirement portfolio.

8. Tax deferral

Tax deferral refers to the opportunity to pay income taxes in the future for investment interest and appreciation earned in the current year. *Why is it important?* Tax-deferred vehicles like IRAs and annuities produce earnings that are not taxed until withdrawn. This allows those earnings to compound, further adding to potential investment growth.

9. Risk/return trade-off

This concept holds that, in order to achieve a higher personal investment return, you must be willing to accept greater risk. *Why is it important?* When considering your investments, the goal is investing to get the greatest return for the level of risk you're willing to take, or to minimize the risk involved in trying for a given return.

10. Annuity

An annuity is a contract where you pay money to an insurance company in return for the insurer's promise to pay it back, with interest, in the future. *Why is it important?* You can supplement other retirement savings with tax-deferred annuity funds, and you can add to your retirement income with payments from your annuity for a fixed period of time or for the rest of your life.



Ten more terms to look up

- Equity
- Gross Domestic Product
- Working capital
- Recession
- Triple net lease
- Net income
- Roth IRA
- Earned income
- Debt/equity ratio
- P/E ratio





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Ask the Experts



How do I unwind my QPRT?

Given the state of the economy, it's not uncommon for real estate that has been transferred to a qualified personal residence trust

(QPRT) to have experienced less than anticipated appreciation or even depreciation. Consequently, one of the purposes of the QPRT--removing future appreciation from an estate--may go unachieved. Some grantors in this position may be inclined to "unwind" (undo) the QPRT. That, however, may not be the best option.

If you unwind the QPRT, you will have wasted any payment of federal gift tax or gift tax exemption that you may have used on the original transaction.

For example, say you transferred your primary residence valued at \$500,000 to a QPRT with a 20-year term when you were 40 years old and the Section 7520 rate was 4%. You made a gift of approximately \$205,000, and you either paid gift tax on that amount or you used

up \$205,000 of your \$1 million gift tax exemption. Either way, you will have squandered that amount because you won't get that back when you unwind the QPRT.

You may be better off keeping the QPRT. Even if there will be zero appreciation in the property, you might still enjoy some tax savings if you let the QPRT continue. That's because when the IRS values the gift, it assumes there will be no appreciation in the property; *plus*, it gives you a discount because there's a chance you may die during the trust term. So, if you outlive the trust term, you will still enjoy the benefit of that discount.

Not only that, but when the QPRT terminates, you will have to pay the remainder beneficiaries fair market rent. These payments will reduce your estate even further.

That said, if you still want to unwind the QPRT, your best option may be to invalidate the QPRT by ceasing to use your home as a primary residence (a requirement for a valid QPRT). How? Sell the home or rent it out.

My QPRT has terminated. What do I do now?



If the grantor outlives the term of a QPRT, the residence passes to the remainder beneficiaries. At this time, several things need to happen. Here's a quick checklist:

- Transfer title of residence: The trustee of the QPRT must transfer ownership of the residence from the name of the trust into the names of the remainder beneficiaries. This is done by recording a new deed in the registry where the property is located.
- Pay fair market rent: If you want to continue to live in the residence full-time, or if you want to use it periodically, such as for vacations, you'll have to pay fair market rent to the remainder beneficiaries. This will help to further reduce the value of your estate federal gift tax free, or without using any more of your \$1 million lifetime gift tax exemption, because the rent payments won't be considered gifts. Note that it's important to execute a written lease.
- Shift payment of expenses for the property to the remainder beneficiaries: During the term of the trust, the grantor typically continues to pay the expenses for upkeep of the home, such as maintenance, taxes, and repairs. When the QPRT terminates and ownership shifts to the remainder beneficiaries, so does the obligation to pay those expenses. Note that the income tax deduction for real estate taxes shifts as well.
- Do not repurchase the residence: An IRS ruling prohibits the grantor, the grantor's spouse, and any entity benefiting the grantor or the grantor's spouse from repurchasing the residence either during the trust term or afterwards.