Financial Alternatives

Integrated Wealth Management

Jim Freeman, CFP® / Chris Jaccard, CFP®, CFA

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New Reports On Investment Tax Basis

A recent tax law change should end years of frustration for investors. No longer do you have to tear your hair out at tax return time trying to compute gains or losses from sales of stocks, mutual funds, and other investment products. Your brokerage firm will do most of the work for you by supplying the "tax basis" of your investments.

Still, this tax headache isn't gone just yet. The basis reporting changes are being phased in gradually and don't apply at all to the investments you already own—the beginning date for the new rules was January 1, 2011.

To understand how the rule change will help, first consider the fundamentals of how investment taxes are calculated. When you sell securities, your gain or loss is equal to the difference between the sale price and your basis in the shares. For this purpose, your basis is normally what you paid for the investment, including brokerage commissions and fees. Also, your basis must be adjusted to reflect stock splits, mergers, and similar events.

Under current law, brokerage firms and other financial institutions must report the amount of proceeds an investor receives in a securities sale to both the investor and the IRS. So the tax agency will know that a stock sale netted you, say, $50,000. But financial firms don't have to report the basis of the shares that were sold, and for years, the IRS has complained that with taxpayers free to compute their own basis, some have inflated it on their tax returns to reduce taxable gains or increase deductible losses. The real motivation for the new rules is to make it more difficult to cheat, rather than to make you life easier. But you'll benefit, too.

Suppose you acquired a stock for $1,000 and sell it for $1,500, paying a combined total of $100 in transaction fees. In this case, your adjusted basis is $1,100 and your taxable gain is $400 ($1,500 minus $1,100).

When you fill out your federal income tax return, you must "net" your capital gains and losses for the year, and it's often possible to balance the two so that you come out more or less even. If you end up with a net long-term gain for 2011, the maximum tax rate is 15% (0% for individuals in the10% and 15% income brackets). That top capital gains rate is scheduled to increase to 20% in 2013 (10% for the lower-bracket taxpayers). If you show a net loss, you can use it to offset up to $3,000 of ordinary income and you can carry over unlimited excess losses to later years.

You're probably familiar with these basic rules. And it's usually not hard to figure out your adjusted basis if you bought one block of shares of an investment and then sell all of those shares at the same time. But things

(Continued on page 4)

What Will The Greek Crisis Mean In Five Years?

The markets spent summer 2011 dreaming of Greece—or, more to the point, suffering nightmares about the prospect that the country would default on its $300 billion debt and perhaps take the rest of Europe down with it. For months, fear drove fair-weather traders out of every asset class even remotely connected to Greece or Europe.

Although things still look a little scary now, it's likely that within a few years, investors will barely remember even the worst-case scenario. In fact, you've probably forgotten the time five years ago when markets were also worried about the euro.

Rewind to June 2005. The financial media were full of talk about how the European Union was "faltering," the euro was plunging to multi-month lows, and the fate of U.S. exporters dangled in the balance. At the time, France was the offender. Its crime? Voting against a new European constitution.

Today, few remember that failed constitutional vote or how ominous it looked at the time.

You can make a similar case for the Russian default of 1998, the Hong Kong currency flu of 1997, the Mexican crisis of 1994, or any other potentially apocalyptic market event. Well-diversified investors with a long-term view rolled with the headlines, stuck to their plans and weathered the storm.

All the best,
Jim & Chris

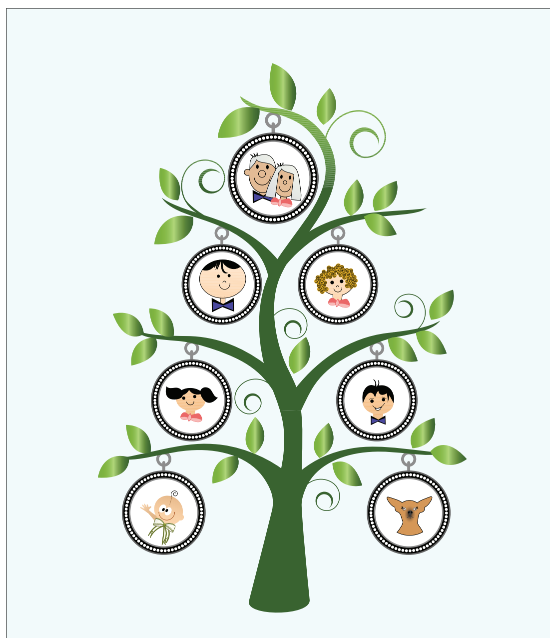
What Do You Want Your Legacy To Be?

Imagine what would happen to your family if you died unexpectedly. Even if you have a will and an estate plan in place, your spouse and children may feel rudderless without your guidance. They won't be able to take advantage of what you might have taught them about financial matters or about life in general. And you'll never have the chance to pass along the stories and memories that helped make you the person you are.

A process known as legacy planning could help you avoid that sad result. This isn't about tangible items such as wills, trusts, and powers of attorney. Instead, legacy planning encompasses your personal values, hopes, and expectations. It also touches on practical issues you may not have addressed with your family.

The concept of a legacy plan isn't new. In fact, its roots can be traced back to the "ethical wills" used in biblical times. But legacy planning is often neglected today, to the detriment of family members who might benefit from your efforts. And while there's no precise blueprint for what to do, these four steps could get you started.

1. Organize and update documents. Create a spreadsheet listing where you keep important papers and other items. These locations may range from a safe deposit box in which you store trust documents to the hook in the garage where you hang spare car keys. Make sure the list includes the names and contact information of your professional advisors and other important people.



2. Share your personal values and history. Spell out in writing your preferences regarding culture, religion, education, and other traditions. Impart any personal messages and inspirations you would like to pass along to a younger generation. If you're especially diligent, you might even chronicle the main events of your life in a brief autobiography.

3. Document the details. Be as specific as you can be regarding your future wishes. For instance, you could leave detailed instructions regarding how to manage investments and other financial matters, funeral arrangements, and other related concerns. You might even include suggestions about how to care for a pet or run the household.

4. Live with a purpose. Going through this process will undoubtedly give you a new perspective, and may encourage you to find new ways to live your life to the fullest. For instance, you could create your own "bucket list" of things you'd like to accomplish during your lifetime and then start working your way through those experiences.

Keep in mind that a legacy plan is meant to complement—not replace—your existing estate plan, although the process of creating it might lead you to modify your will or other documents. We would be glad to help you coordinate these plans. ●

Children In College Need A Health Proxy

Have you just sent your child off to college for the first time? For your offspring, this marks a new, exciting chapter in life. But your child will also face new challenges and perils, and it makes sense to take precautions, such as obtaining a "health care proxy" (also known as a "health care power of attorney") for your son or daughter. This document will give you access to your child's medical history and enable you to make health care decisions in the case of a serious illness or injury.

Although health care proxies are frequently used for elderly relatives, the same basic premise applies to a child in college. Once your child turns age 18, he or she is treated as an adult for legal purposes. Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), your child is entitled to full confidentiality unless you have a health care proxy. Without a proxy, you might not even learn of a child's health problem at school or receive information about the child's health status.

The health care proxy is a legally binding document appointing someone—usually another family member such as a parent—to make health care decisions for an individual if he or she is temporarily or permanently incapable of making those decisions. It's a narrow power of attorney that gives authority to the designated party and allows you to take action on behalf of your child.

Of course, you can't execute a health care proxy unilaterally. Your son or daughter will need to sign the document, thus giving up his or her right to complete medical privacy. But you can reassure children that you'll have access to information about them only under very specific circumstances. A health care provider may discuss only the immediate

What Does The Downgrade Really Mean?

Sentimental observations about the United States falling from a 94-year state of grace aside, Standard & Poor's recent downgrade of the Treasury's credit rating has real implications for investors and the nation.

In theory, a lower credit rating reflects a higher risk that an entity such as the Treasury will default on its debt or other financial obligations. To compensate lenders for the added risk, lower-rated borrowers generally need to offer higher interest rates. However, even though Standard & Poor's now considers U.S. debt no longer worthy of the top AAA rating, Treasury yields—the gauge of how much interest credit markets demand from the U.S. government—actually declined during the week following the downgrade. Although it may seem paradoxical, global investors still consider Treasury debt the safest place on earth to park their money in times of heightened risk, no matter what the rating agencies say. No foreign central bank is dumping our bonds; if anything, they're buying more.

In the longer run, if the Treasury fails to regain its AAA status, its reputation could eventually weaken, and U.S. interest rates may rise. On the eve of the downgrade, the two countries with AA+ ratings from S&P paid an average of 2.72% on their two-year bonds and 4.58% on their 10-year debt, compared with 1.12% and 2.65%, respectively, for the world's remaining AAA borrowers.

But averages can be deceiving. Switzerland, which S&P rates AAA, pays just 0.06% in annual interest on its two-year bonds, and the United Kingdom, also AAA rated, pays fully 10 times as much—still a very low rate. And then you get to Japan, which S&P rates two steps lower at AA—a full step below where the United States is now—and pays only 0.15% on its two-year debt. That's right: this lowly AA-rated country pays less than a quarter of what AAA-rated Britain offers, while interest rates for most other AAA nations are nine times as high as what investors are happy to get from Tokyo.

Incidentally, the worst-case scenario S&P currently sees for the United States would prompt one more downgrade during the next two years, which would put the Treasury at exactly the same level where Tokyo is now.

Any upward trend in U.S. interest rates would also have to overcome the Federal Reserve and its new policy of setting the low end of the yield curve effectively at zero through mid-2013. As we have seen several times during the past last few years, the Fed has almost endless funds at its disposal to buy Treasury debt and keep the government's borrowing costs artificially low.

Of course, other U.S. borrowers lack the infinite resources of the Federal Reserve. In the S&P system, the new U.S. rating means most U.S. companies, state and local governments and other bond-issuing entities are now also subject to a maximum rating of AA+, and that has led to downgrades of many formerly AAA-rated borrowers. However, S&P has made numerous exceptions to its normal operating rules, leaving the AAA ratings on some states, cities, and corporations intact.

In explaining why it didn't downgrade all municipal issuers, S&P noted that "the institutional framework for U.S. public finance is among the most stable and predictable in the world." Meanwhile, the behemoths of American industry—including Johnson & Johnson, ExxonMobil, and Microsoft—are also considered unassailably reliable, and their AAA ratings are safe as well. And though the entities whose debt was downgraded may suffer over the short term, the pain need not be permanent.

Standard & Poor's won't speculate on when or how the United States might get its AAA rating back, but other nations—Germany, Sweden, and Canada, among others—have rebounded from downgrades. It's often a slow process, taking as long as a decade, but if Congress can find the will to work out a sustainable budget that satisfies the ratings analysts, it can happen.

And that prospect in itself may be the silver lining in this situation. While Standard & Poor's has been criticized by the President, Warren Buffett, and others for publicly challenging the will of one of the greatest economies on earth to pay its debts, the challenge may be an opportunity in disguise. Any nation that owes 74% of its annual gross domestic product could stand to look seriously at its budget. If nothing happens to change the way the government spends, Standard & Poor's calculates that we would owe 101% of GDP by 2021, which would put us roughly where Italy is now.

This was a wake-up call. Now we can prove to the world how we became the greatest economy on earth in the first place. ●

medical condition, and only when prompt attention is needed for someone who is incapacitated. Very likely your kids will see the wisdom of having a health care proxy and may even be surprised to learn that otherwise you would have no say about their care even in life-threatening situations.

Once the proxy has been signed and notarized, you'll need to make sure that everyone who might be involved in a child's care knows that it exists. Give a copy to your child's college health service as well as to physicians and hospitals in your town from whom your son or daughter might receive care. If your child has a car, you could put a copy of the proxy in the glove compartment, and you might want to give copies to close friends or roommates.

To get a form for the proxy, check online or with your physician or attorney. You can also file a HIPAA release form that gives you additional access to information about your child's health. ●

Student Loan Reform Buried In Health Law

What does 2010's landmark health care reform law have to do with student loans for your children about to enter college? Plenty. The Health Care Reconciliation and Education Act of 2010—signed in tandem with the massive Patient Protection and Affordable Care Act—overhauls the nation's student loan program. The new legislation could affect your family for years to come.

What's more, the changes aren't limited to low-income families, although bigger benefits will be available to some cash-strapped families. Many reforms apply to all students, whatever their families' financial situation.

The biggest change is in the way student loans are made and administered. Under the old rules, private banks did the lending, with loans guaranteed by the federal government. That meant you had to pick and choose among private lenders. Now, the government itself will originate student loans.

The loans will generally look the same to borrowers—with no differences in terms, fees, or interest rates—but the process should be simpler. Students can apply for loans by going directly to a college's financial aid office. Each school will work in conjunction with private companies approved by the government to disperse loan funds.

Even better, repayment terms for students will eventually improve. For loans obtained after July 1, 2014, monthly loan payments won't be allowed to exceed 10% of a borrower's monthly discretionary income. The current maximum is 15%. The U.S. predicts that more than 1.2 million borrowers will benefit from this change, which will mean a $110 payment reduction each month on a typical loan for a borrower who earns $30,000 a year and owes $20,000.

Moreover, remaining loan balances after 20 years will be forgiven, an improvement on the old rules' 25-year period. For students who are "public servants"—teachers, nurses, or member of the armed forces—the maximum repayment period is reduced to 10 years. But the new provisions aren't retroactive and don't apply to private bank loans.

Some changes under the new law are designed to alleviate economic hardship. For instance, the amount of financial aid available under the federal Pell grant program has been expanded. A student's eligibility for these grants, which aren't repaid, is determined by household income, and beginning in 2013, increases in the maximum Pell grant will be pegged to changes in the Consumer Price Index (CPI).

The new health care legislation, combined with education tax credits that are being expanded to a larger segment of the population, will provide much-needed relief to middle-income families facing the ever-increasing costs of higher education. ●

Reports On Investment

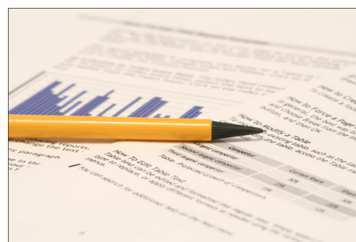
(Continued from page 1)

quickly get complicated if you bought or sold varying amounts of stock at different times. And you may not have kept the records needed to prove the initial cost of a security.

Under the Emergency Economic Stabilization Act of 2008, financial institutions are required to provide new "information returns" showing the basis of securities that have been sold and indicating whether a taxable gain or loss is short term or long term. But there's a three-year phase-in for the new rules, which apply to:

- Corporate stock shares and mutual fund shares acquired after 2010
- Stocks in a mutual fund or dividend reinvestment plan acquired after 2011
- Most other securities--including notes, bonds, and commodity contracts and options--acquired after 2012

So if you acquired shares in a mutual fund on, say, January 1, 2011, the fund will report your basis to both you and the IRS whenever you sell any of the shares. But if you sell a fund you bought a day earlier, on December 31, 2010, the fund won't be legally obligated to provide your basis when you sell (although it may do so). And you certainly can't count on financial firms supplying your basis for shares purchased years before the advent of the new rules.



The IRS recently issued proposed regulations for the scheduled changes. Under those rules, the basis for shares must be adjusted to reflect transactions within an account, but other transactions, including wash sales, may be ignored. Additional guidance is expected as the new rules begin to phase in.

The changes should eventually make it easier to compute your capital gains. Yet confusion may still reign regarding sales of shares you bought before the new rules took effect. We can help you sort through the intricacies. ●

Financial Alternatives, Inc. **7734 Herschel Ave., Suites L & M, La Jolla, CA 92037** **Phone: (858) 459-8289** **Fax: (858) 459-8258**
jim@financialalternatives.com **chris@financialalternatives.com**

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