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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.

Don't Let a Natural Disaster Demolish Your Finances

Protect your credit and your identity

- *Maintain effective debt management by communicating your circumstances to your creditors*
- *If you need to negotiate with creditors, consider seeking assistance from a consumer credit counseling service*
- *Only give out your Social Security number to verified agencies*
- *Monitor your bank account and credit report for unauthorized activity*

It seems as though there's always a hurricane, tornado, earthquake, flood, fire, ice storm, or mudslide happening somewhere in the United States. While a storm or other natural disaster could destroy your home, business, or workplace and put you in financial straits, there are things you can do both before and after the event to help you recover quickly.

Pre-Disaster

Create a financial emergency kit

Put together a kit that contains some cash and checks, a list of important contacts (e.g., your insurance agent), and copies of important documents, including identification cards, birth and marriage certificates, insurance policies and inventories, wills, trusts, and deeds. Make sure your kit is stored in a safe, secure place in your home, is easy to reach and carry, and is water and fire proof. You'll want to stash enough cash (or a credit card) to pay for immediate expenses such as gas, food, and lodging.

Tip: *While you're at it, you might also keep your most precious items in the kit, such as your photo albums and family heirlooms.*

Protect your assets

Take some commonsense precautions to safeguard your home, business, car, boat, and similar assets against damage from wind, water, fire, or other damage. For example, install an emergency generator and paperless drywall, keep loose objects (e.g., grills and patio furniture) secure, cut down overhanging tree limbs, park your car in the garage, and invest in storm windows, doors, and shutters.

Take inventory

Create and maintain an inventory of your valuables, including appliances, electronics, furniture, clothing, jewelry, and artwork. Record models and serial numbers, and take pictures or a video of the items. This will help when it comes time to file insurance claims and purchase replacements.

Check your insurance

Make sure your insurance policies (e.g., homeowners, auto) include all the coverage you need, and understand that damage caused by natural disasters may not be covered under these general types of policies. You may need to consider buying separate coverage for hurricanes, floods, earthquakes, or other disasters. Consult your insurance agent to determine whether you have adequate coverage given the likelihood of such events occurring in your area.

Post-Disaster

File insurance claims immediately

Contact your insurance agent and file claims as soon as possible. The quicker you do so, the sooner you can get back on your feet.

Protect your income

If you end up out of work, take advantage of any employee assistance programs that your employer may offer. Seek unemployment compensation from your state and ask about special job considerations for disaster victims. Find out if special unemployment benefits are available through the Department of Labor.

Get help from emergency sources ...

If you need immediate financial help, disaster relief funds and special programs (for example, housing assistance) may be available through the Federal Emergency Management Agency (FEMA) or your state and local governments, as well as the American Red Cross, United Way, Salvation Army, social services, and local churches.

… and from the federal government ...

Tax law allows taxpayers to deduct certain unreimbursed casualty losses in the year in which they are incurred, subject to certain limitations. In certain Presidentially declared disaster areas, individuals can claim the loss (again, subject to certain limitations) in the prior tax year by filing an amended return. Moreover, special relief (for example, bonus depreciation for business property) has been granted in the case of specific disaster events. Be sure to consult your tax professional about any tax relief that may be available to you.

… and get legal help, if necessary

If you experience legal difficulties, you may want to consider hiring an attorney who specializes in the complex area of natural disaster law.

Ten Gifting Traps You Should Avoid

Lifetime gifting can be a powerful estate planning tool. Transferring property during your life, instead of at your death, has many advantages. Making lifetime gifts can be desirable for personal reasons (e.g., to help your children or other family members) or for financial reasons (e.g., saving taxes). No matter what your reasons for starting a gifting program, there are a few gifting traps you should be aware of.

1. The kiddie tax rules

Beware of the kiddie tax rules when transferring income-producing property to your children. Investment income over $1,800 (for 2008) will be taxed at your marginal income tax rate, not your child's.

The kiddie tax rules apply to children who are: (1) under age 18, (2) age 18 with earned income that doesn't exceed one-half of their support, and (3) ages 19 to 23 who are full-time students with earned income that doesn't exceed one-half of their support.

2. Gifts of retained interests or powers

Be careful when making gifts of property in which you retain some financial interest (e.g., a life estate, right of reversion, or right of revocation) or powers (e.g., the power of appointment). This property may be includible in your estate for estate tax purposes.

For example, say you transfer ownership of your home to your son on the condition that you're allowed to continue living in the home for the rest of your life. You have retained a financial interest in the home, and this interest may be includible in your estate for estate tax purposes.

3. Income taxation of gifts made to a trust

Some types of trusts are taxpaying entities, which are taxed at more compressed income tax rates than individual taxpayers. If you'll be using such a trust, be sure to consider the consequences of paying income tax on trust income at higher income tax rates.

4. Delays in making a gift of life insurance

Do not delay making a gift of a life insurance policy on your life. A transfer of an insurance policy by gift within three years of death results in the proceeds being includible in your estate for estate tax purposes.

5. Delays in planning your estate to meet percentage tests

Do not delay removing certain nonbusiness assets to help your estate meet the percentage tests to qualify for Section 303 (redemption of stock), Section 2032A (special use valuation), or Section 6166 (installment payout of taxes) tax treatment. This technique will work only if the gift is made more than three years prior to your death.

6. Payments for tuition or medical care made to the donee

Payments you make for tuition or medical care on behalf of another are exempt from federal gift tax. However, to qualify, you must make the gifts directly to the educational or medical institution--do not make such payments to the donee.

7. Overlooking gift splitting

For 2008, you can give $12,000 per donee federal gift tax free under the annual gift tax exclusion. There is also a gift-splitting privilege for spouses who qualify that can double the exclusion.

No matter what your reasons for starting a gifting program, there are a few gifting traps you should be aware of.

8. "Reverse" gifting if death is imminent

Reverse gifting is a technique where a healthy individual transfers low-basis assets to a dying individual. If the decedent lives for more than one year from the date of the transfer, the basis gets stepped up to fair market value. However, the basis will not get stepped up if the decedent dies within a year of receiving the gift, and should this happen, you may end up needlessly paying gift tax and/or using up your $1 million gift tax applicable exclusion amount.

9. Overlooking the benefit of taxable lifetime gifts

Don't assume that lifetime gifts and transfers made at death result in the same tax effect. Paying gift tax on taxable lifetime gifts can result in an overall tax savings because the tax you pay is also removed from your estate.

10. Selecting property that does not attain your tax-savings objectives

There are some types of property that you should avoid giving if you want to enjoy tax savings, such as property that has depreciated in value or is likely to depreciate.

Ask the Experts

I have a home office--can I still exclude gain when I sell my home?

You're generally eligible to exclude from income up to $250,000 ($500,000 if married filing jointly) of the capital gain that results from the sale of your home if:

- You have owned and lived in the home as your primary residence for at least two out of the five years preceding the sale (special rules apply to certain individuals, including members of the U.S. Armed Forces)
- You have not sold a principal residence and excluded some or all of the resulting gain in the prior two years

Even if you fail to meet these tests, you may be able to claim a partial exclusion if the primary reason for selling your house is a change in place of employment, health, or certain unforeseen circumstances.

The fact that you use a portion of your home for business purposes (in this case, your home office) adds a couple of wrinkles.

First, when you sell your home, any capital gain that's attributable to depreciation deductions allowed or allowable for the business use of your home after May 6, 1997, can't be excluded.

Second, if your home office is separate from the residential portion of your home (for example, a home office that's located in a converted, detached garage), any gain from the sale of the property typically has to be allocated between the business part of the property and the part used as a home. The gain that is allocated to the business portion (the separate office) can't be excluded. This can get complicated, though, so it's worth discussing your situation with a tax professional.

For more information, see IRS Publication 523, Selling Your Home.

Do I qualify for the first-time homebuyer tax credit?

If you purchase a principal residence after April 8, 2008, and before July 1, 2009, and you qualify as a first-time homebuyer, you may be eligible for a refundable tax credit of up to $7,500.

To qualify as a first-time homebuyer, you (and your spouse, if you are married) cannot have had an ownership interest in a principal residence in the United States for the 3-year period immediately preceding the purchase. In addition, you have to meet certain income requirements. If your modified adjusted gross income for the year in which you purchase the home is $95,000 ($170,000 for joint filers) or more, you don't qualify; if your modified adjusted gross income is between $75,000 and $95,000 ($150,000 and $170,000 for joint filers), the amount of credit that you're eligible for is reduced.

The credit is calculated as a percentage of the purchase price of the home. You're generally entitled to a credit of 10% of the purchase price, up to the $7,500 cap. If you're married and file a separate return, the maximum credit is $3,750. If you purchase the home in 2008, you'll claim the credit on your 2008 federal income tax return. If you purchase the home after December 31, 2008, and before July 1, 2009, you can claim the credit on your 2009 return, or you can elect to treat the purchase as if it took place on December 31, 2008 (allowing you to claim the credit on your 2008 return).

The twist with this credit, though, is that it has to be repaid in equal installments over 15 years, making the credit more like an interest-free loan from the government. If you claim the credit on your 2008 federal income tax return, the 15-year repayment period begins with your 2010 federal income tax return. If you claim the credit on your 2009 return, the first year of repayment is 2011.

There are several special rules that apply, including acceleration of repayments if you sell the home, or if the home ceases to be the principal residence of you or your spouse.

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