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Hi Everyone!

I hope you shared a joyous holiday season with your family and friends.

This issue shares a brief update on important estate planning legislation passed by Congress late last year. Yes, the area remains a changing landscape. Yet it's important to consider how the new laws may affect your existing plans and whether updates may be needed.

Some tax information is included as well, as you begin working on taxes for 2010 and planning for the current year.

Warm regards,

Deidra

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1040 Tax Tips



You don't want to pay more in tax than you have to. That means taking advantage of every deduction and credit that you're entitled to. You also need to recognize potential opportunities to save. So here are a few things to keep in mind this filing season.

There's still time to contribute to an IRA

You generally have until the due date of your federal income tax return (April 18 this year) to make contributions to either a Roth IRA or a traditional IRA for the 2010 tax year. That means there's still time to set aside up to \$5,000 (\$6,000 if you're age 50 or older) in one of these retirement savings vehicles. It's worth considering, in part because contributing to an IRA can have an immediate tax benefit. That benefit comes in the form of a potential tax deduction--with a traditional IRA, if you're not covered by a 401(k) or another employer-sponsored retirement plan, you can generally deduct the full amount of your contribution. (If you're covered by an employer-sponsored retirement plan, whether or not you can deduct some or all of your traditional IRA contribution depends on your filing status and income.)

It's a little different with a Roth IRA; if you qualify to make contributions to a Roth IRA (whether you can contribute depends on your filing status and income), the contributions you make aren't deductible, so there's no effect on your 2010 taxes. Nevertheless, a Roth IRA may be worth considering because qualified Roth distributions are completely free from federal income tax.

Individuals with lower incomes may also be able to qualify for a tax credit of up to \$1,000 when they contribute to a traditional or Roth IRA.

Decision time on 2010 Roth conversions

If you converted funds from a traditional IRA or an employer plan like a 401(k) to a Roth in 2010, you can report half the income that

results from the conversion on your 2011 federal income tax return, and half on your 2012 federal income tax return. Good deal, right? Sure. But in some cases, you might be better off making an election to claim the entire amount on your 2010 return instead. This could be true if, for example, your 2010 taxable income is significantly lower than you think it will be in 2011 and 2012, or if you've got unusually high deductions for 2010.

Other considerations for 2010 returns

- For the first time in many years, itemized deductions and dependency exemptions will not be reduced for high-income individuals.
- If you claim a large number of dependency exemptions, deductible medical expenses, state and local taxes, or miscellaneous itemized deductions, you're more likely to be subject to the alternative minimum tax (AMT), essentially a parallel federal income tax system with its own rates and rules.
- If you purchased a new home in the first half of 2010, check to see if you meet the timing, purchase price, and income requirements to qualify for the first-time homebuyer tax credit, worth up to \$8,000. Even if you weren't a first-time homebuyer, it's still possible to qualify for a tax credit of up to \$6,500 if you maintained the same principal residence for five out of the eight years preceding the purchase, and meet all other requirements.
- If you made energy-efficient improvements to your home in 2010 (e.g., new windows, a new furnace), you might be entitled to a 30% tax credit, up to \$1,500. Check the requirements closely, though, and note that if you claimed the full \$1,500 credit in 2009 you can't claim the credit for 2010.

Legislation in late December extended a host of expiring tax credits, deductions, and provisions, so it could pay to take a little extra time to carefully review IRS instructions this year. And as always, if you have questions, discuss your situation with a tax professional.





Estate Tax Update

Once again, Congress waited until the eleventh hour to extend, patch, and reinstate old tax laws, and once again, they made most changes temporary (generally, for two years). The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Act), signed into law on December 17, 2010, dramatically changes the federal transfer tax landscape. The biggest news: the estate and generation-skipping transfer (GST) taxes have been reinstated for 2010. And, to the delight of some and great disappointment of others, for 2010 through 2012, the estate tax exemption equivalent amount is increased to \$5 million (indexed for inflation in 2012), and the top estate tax rate is set at 35%. Here is a brief summary of all the changes.

For 2010

For 2010, the federal gift tax is unchanged by the 2010 Tax Act. The gift tax remains in force with an exemption equivalent amount (called the "applicable exclusion amount") of \$1 million and a top tax rate of 35% (also, remember that if you file as single, you can exclude gifts of up to \$13,000 per recipient, or if you're married and file jointly, you can exclude gifts of up to \$26,000 per recipient).

The estate tax has been reinstated for 2010, with a "basic" exclusion amount (the name has been changed from the "applicable" exclusion amount) of \$5 million. That translates into a tax credit of \$1,730,800. The top estate tax rate is 35%.

The 2010 Tax Act gives estates of decedents dying after December 31, 2009, and before January 1, 2011, the option to elect to apply (1) the reinstated estate tax with a step-up (or step-down) in basis, or (2) no estate tax with a modified carryover basis. The modified carryover basis allows an increase in basis of \$1.3 million, plus an additional \$3 million for property that passes to a surviving spouse.

The GST tax (a separate tax on assets transferred to grandchildren and lower generations) has also been reinstated, but at a rate of zero percent.

Note: *The 2010 Tax Act provides an extension of sorts to pay estate taxes for decedents dying after December 31, 2009, and before the date of enactment of the 2010 Tax Act. The due date for filing an estate tax return, paying estate taxes, or disclaiming an interest in property passing to a beneficiary from a decedent's estate is nine months after the date of enactment of the 2010 Tax Act.*

Note: *IRS Form 8939 is necessary to allocate the \$1.3 million basis adjustment allowed for any heirs and the additional \$3 million basis adjustment allowed for surviving spouses of decedents who die in 2010. Originally, the form was due on the same date as the decedent's final income tax return (April 18, 2011). The 2010 Tax Act also extends this deadline to nine months after the Act becomes effective.*

For 2011 and 2012

For 2011 and 2012, the gift tax is reunited with the estate tax. There is a lifetime basic exclusion amount of \$5 million (which will be indexed for inflation in 2012). The top tax rate is 35% (for taxable gifts/estates in excess of \$500,000).

The basic exclusion amount is portable (new in 2011). That means a surviving spouse can use that portion of the exclusion that was left unused by a deceased spouse. This "deceased spousal unused exclusion amount" (DSUEA) is available only from the estate of a spouse who dies in 2011 or 2012. For gift tax purposes, the DSUEA is available for an unlimited number of deceased spouses. But there can be only one DSUEA at a time. For gift tax purposes, the DSUEA is determined on the last day of the year using the DSUEA of the last deceased spouse as of such date. For estate tax purposes, however, the DSUEA is available only from the last deceased spouse as of the date of death of the surviving spouse. Thus, the DSUEA can change if the surviving spouse remarries, and is then widowed for a second time.

Note: *An election is required on the estate of the first spouse to die in order to preserve the ability of the surviving spouse's estate to use the DSUEA.*

The GST tax rate for transfers made after 2010 is equal to the highest estate tax rate in effect for the year. The GST exemption for 2011 is \$5 million, which will be indexed for inflation for 2012.

Note: *The GST tax exemption is not portable.*

For 2013 and beyond

If there is no further legislation, the changes described above will sunset after 2012. The transfer tax rules that were in effect in 2000 will apply for 2013 and beyond. That means a gift and estate tax exemption equivalent amount of \$1 million and a top tax rate of 55%.

For 2010 through 2012, there is an estate tax exemption equivalent amount of \$5 million (indexed for inflation in 2012), and the top estate tax rate is 35%.

You can also make federal tax-free gifts by paying for someone else's medical expenses or college tuition. Payments must be made directly to the medical care provider or educational institution, and other requirements may apply.

Retirement Plan and IRA Limits for 2011

Many retirement plan and IRA limits are indexed for inflation each year. Some of the key numbers for 2011 are discussed below.

Elective deferrals

If you're lucky enough to be eligible to participate in a 401(k), 403(b), 457(b), or SAR-SEP plan, you can make elective deferrals of up to \$16,500 in 2011, unchanged from 2010. If you're age 50 or older, you also can make a catch-up contribution of up to \$5,500 to these plans in 2011 (also unchanged from 2010). (Special catch-up limits apply to certain participants in 403(b) and 457(b) plans.)

If your 401(k) or 403(b) plan allows Roth contributions, your total elective contributions, pretax and Roth, can't exceed \$16,500 (\$22,000 with catch-up contributions). You can split your contribution any way you wish. For example, you can make \$9,500 of Roth contributions and \$7,000 of pretax 401(k) contributions. It's up to you.

If you participate in a SIMPLE IRA or SIMPLE 401(k) plan, you can contribute up to \$11,500 in 2011 (unchanged from 2010). If you're age 50 or older, the maximum catch-up contribution to a SIMPLE IRA or SIMPLE 401(k) plan in 2011 is \$2,500 (unchanged from 2010).

IRA limits remain the same for 2011

The amount you can contribute to a traditional or Roth IRA remains at \$5,000 (or 100% of your earned income, if less) for 2011, and the maximum catch-up contribution for those age 50 or older remains at \$1,000. You can contribute to an IRA in addition to an employer-sponsored retirement plan. But if you (or your spouse) participate in an employer-sponsored plan, your ability to deduct

Contribution limits: 2011 tax year*		
Plan type	Annual dollar limit	Catch-up limit
401(k), 403(b), govt. 457(b) plans	\$16,500	\$5,500
SIMPLE plans	\$11,500	\$2,500
Traditional and Roth IRAs	\$5,000	\$1,000

*Contributions can't exceed 100% of your income. Special catch-up rules apply to 403(b) and governmental 457(b) plans.

traditional IRA contributions may be limited, depending on your income. Roth contributions are also subject to income limits.

Some other key numbers for 2011

For 2011, the maximum amount of compensation your employer can take into account when calculating contributions and benefits in qualified plans (and certain other plans) is \$245,000 (unchanged from 2010).

The maximum annual benefit you can receive from a defined benefit pension plan is limited to \$195,000 in 2011 (unchanged from 2010).

And the maximum amount that can be allocated to your account in a defined contribution plan (for example, a 401(k) plan or profit-sharing plan) in 2011 is \$49,000 (also unchanged from 2010), plus age-50 catch-up contributions. (This includes both your contributions and your employer's contributions. Special rules apply if your employer sponsors more than one retirement plan.)



Income phaseout range for determining deductibility of traditional IRA contributions in 2011

1. Covered by an employer plan	
Single/head of household	\$56,000-\$66,000 (same for 2010)
Married filing jointly	\$90,000-\$110,000 (\$89,000-\$109,000 for 2010)
Married filing separately	\$0-\$10,000
2. Not covered by an employer plan, but filing joint return with a spouse who is covered	\$169,000-\$179,000 (\$167,000-\$177,000 for 2010)
Income phaseout range for determining ability to fund Roth IRA in 2011	
Single/head of household	\$107,000-\$122,000 (\$105,000-\$120,000 for 2010)
Married filing jointly	\$169,000-\$179,000 (\$167,000-\$177,000 for 2010)
Married filing separately	\$0-\$10,000

Many retirement plan and IRA limits are indexed for inflation each year. Most of the limits for 2011 are unchanged from 2010.



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This newsletter strives to provide factual and up-to-date information on the topics discussed, but it should not be regarded as a complete discussion of these issues. The reader is advised to engage the services of a competent professional before taking action on any subject matter discussed.

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Ask the Experts



Understanding the math of recovering from losses

Everyone knows the stock market has its ups and downs, but just what's involved in recovering from a serious downturn? If you lose 10% one year but your

portfolio returns 10% the next year, are you even again?

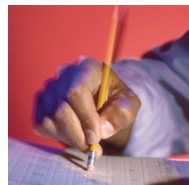
The short answer: no. The math of recovering from a loss isn't quite that symmetrical. You have to gain more than you lost to recoup all your losses. To understand why, let's look at a hypothetical example. Say you have a \$50,000 portfolio. In Year 1, you suffer a 10% loss and are down \$5,000. That leaves your portfolio worth only \$45,000.

In Year 2, the market rebounds and your portfolio rises by 10%. However, that 10% increase is based on a \$45,000 portfolio, not \$50,000. That means the 10% return adds only \$4,500 to your portfolio, not \$5,000, leaving you still \$500 down from where you started. You would actually have to earn a return of a little over 11% to get back to your original \$50,000.

The bigger the loss, the bigger that rebound needs to be to get you even. For example, if that \$50,000 portfolio had taken a 40% hit, as many did in 2008, you'd need almost a 67% increase to offset that \$20,000 loss and get back to the original \$50,000. That could take several years even if stocks perform well.

The challenge is compounded by investor psychology. Adjusting your asset allocation to aim for a higher return is one way to try to recoup losses faster. However, many investors find it difficult to take on additional risk after having watched their investments take a hit. And there's no guarantee that more risk will necessarily produce the desired result--at least not within the desired time frame.

The lopsided nature of recovery from market losses underscores why risk management is such a key component of successful portfolio management. Being realistic about the level of risk your portfolio involves and how much time you have to come back from potential downturns may help increase both your emotional and financial resilience.



Are you sabotaging your own portfolio?

Individual investors' returns typically fall short of those for the stock market as a whole. Why? Because their returns are affected by their own behavior. Many studies

have shown that individual investors tend to buy and sell at the wrong times. When the market goes down, they panic and sell. When the market rebounds, many gun-shy investors are reluctant to invest again and postpone getting back into the market. As they watch prices rise, they get increasingly anxious about missing out on those returns. However, by the time these investors are comfortable with buying again, prices often have risen to the point that they're almost ready to turn down again.

That kind of behavior can be costly over the long term. Dalbar's *Quantitative Analysis of Investor Behavior for 2010* compared the performance of the average mutual fund investor between 1990 and 2009 (as measured by fund inflows and outflows tracked by the Investment Company Institute) to that of the average index fund based on the S&P 500.*

The company found that returns for the average

investor trailed the S&P over that 20-year period by 5.6% because of investor behavior. Though there's no guarantee that the patterns of the past will continue in the future, previous studies also reached the same conclusion: that investors often earn less than a mutual fund's reported returns because of their own behavior.

How can you prevent self-inflicted portfolio sabotage? A disciplined approach to investing helps. Some techniques that can give you a framework for decisions that aren't based solely on emotion include establishing a target price based on fundamentals, dedicating specific pools of money to specific goals with defined time horizons, and rebalancing investments periodically. Also, understand your true risk tolerance. Knowing the type and level of risk involved in each of your investments and understanding how each has behaved relative to the overall market can help you stand firm despite losses.

*Based on the average return for all funds listed in Lipper's U.S. Diversified Equity fund category.