PARTNERS
WEALTH MANAGEMENT

Third Quarter 2013 (630) 778-8088/info@partnerswealth.com

The Best States To Move To For Tax Purposes

Federal income taxes can take a big bite out of your income, but they aren't your only tax concern, particularly if you're about to retire. Don't forget to take state and local income taxes into account. For instance, if you'll be relying less on Social Security and more on investment income during retirement, you might move to a state that doesn't have an income tax or that has relatively low tax rates. Conversely, if you expect to depend heavily on Social Security, consider moving to a state that doesn't tax these benefits. Here are a few key areas to ponder.

State income tax rates: Currently, seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—don't tax income of individuals at all. Two other states—New Hampshire and Tennessee—impose income tax only on dividends and interest. Those favorable taxation rules have made several of these states very popular with retirees.

In addition, some states have a relatively low income tax rate across all income levels. For example, the highest marginal income tax rates for Arizona, New Mexico, Kansas and North Dakota are below 5%. Other states charge a relatively low flat rate regardless of how much you make. These include Pennsylvania (3.07%), Indiana (3.4%), and North Dakota (3.99%). On the other hand, retirees may shy away from notoriously high-tax states such as California (10.55%) and New York (8.97%).

State income tax on retirement income: In the 41 states that do tax income, as well as the District of Columbia, the tax treatment of retirement benefits varies widely. For example, some states don't tax any income from qualified plans such as 401(k)s or Social Security, some states provide a partial exemption, and finally some states tax all retirement income. The two states that currently exempt retirement plan income from taxation are Mississippi and Pennsylvania.

Of course, all of these rules are subject to legislative changes, as revenue-hungry states look for new ways to fill their coffers.

State income tax on Social Security benefits: According to tax publisher CCH, more than one quarter of all states (14) impose income tax on Social Security benefits. The states are Colorado, Connecticut, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, New Mexico, North Dakota, Rhode Island, Utah, Vermont, and West Virginia. These states either tax Social Security income in the same way the federal government does or they provide breaks, usually for taxpayers at lower income thresholds.

State and local sales taxes: 45 states and the District of Columbia impose a state sales-and-use tax. Only Alaska, Delaware, Montana, New Hampshire, and Oregon do not. You may want to consider combined state and local sales taxes when figuring out where to retire. For instance, CCH says

(Continued on page 4)

Client Service Is Our Top Priority

Client satisfaction is our commitment to you. As such, Partners Wealth Management would like to announce that our team has expanded.

Joining us is Rick Bindler. Rick is an Accredited Investment Fiduciary (AIF) and has over 20 years of retirement plan experience. He will be serving as our Director of Retirement Plan Solutions. Michelle LeBlanc has also joined us in the capacity of Client Services Manager. Michelle, who earned a B.A. in Accounting, brings 10 plus years of client service expertise. As we continue to grow, service to our clients remains our top priority.

Also, in our ongoing fiduciary role, we are committed to the relentless pursuit of optimal solutions for you, our clients. Dimensional Fund Advisors is a platform of mutual funds that is not available to investors directly, but is available to us through our strategic alliance with NFP. We have introduced this to clients where we see a potential fit and they have enjoyed the result. If this is something that you would like to hear more about, please let us know. Meanwhile, we will continue our work on your behalf and wish you all the best as we venture into the last half of 2013.

John

NING Trusts: Better Than They Sound

A tax-planning vehicle with an unsightly name—a NING trust, short for Nevada Incomplete gift Non-Grantor trust—is more attractive now, thanks to a private letter ruling from the IRS. With a NING trust, you may lighten the heavy state income tax load that burdens investors in California, New York, and other high-tax states.

Paying high state taxes is particularly unappealing now that the American Taxpayer Relief Act of 2012(ATRA) has raised federal tax rates for those who earn more than $450,000 for couples filing jointly or $400,000 for single filers. Those taxpayers are now subject to a top income tax rate of 39.6% and a maximum 20% tax on capital gains and qualified dividends. Moreover, also beginning in 2013, there's a new 3.8% Medicare surtax on certain investment income. Add state income taxes on top of the federal tax bill, and about half of annual investment income could end up going to pay taxes.

One way to minimize state taxes in high-tax states is to establish a "self-settled" trust in one of the handful of states that don't have state income taxes. Such trusts are structured so that the person who creates the trust and its beneficiary are one and the same. So an investor in, say, New York, might create a trust in Delaware, transfer assets to the trust, and take distributions from the trust—but without having that distribution income subject to New York state taxes. As with most trusts, however, the devil is in the details, and if a self-settled trust is set up incorrectly, it could be tagged as a "grantor" trust. In that case, trust income is taxed to the grantor—who in this example would be subject to New York state taxes—rather than to the trust, which isn't taxed because it's in Delaware. Another tightrope: relinquishing enough control over trust assets to avoid grantor trust status without giving up so much that the transfer to the trust is considered a completed gift, which would be subject to gift tax.

Rules in some states offer another benefit: shielding assets in self-settled trusts from creditors. However, an IRS ruling issued in 2012 clouded the issue and suggested a drawback to using such a trust in Delaware, perhaps the most popular state for incomplete non-grantor trusts. In certain situations, according to the ruling, some assets transferred to a Delaware trust would be considered a completed gift.

Among no-tax states, only Nevada has a statute that lets trusts avoid that problem. And now the private letter ruling (PLR 201310002) has effectively approved this technique for self-settled trusts in Nevada. That could make NING trusts more attractive than self-settled trusts in other no-tax states. Keep in mind, however, that NING trusts are sophisticated arrangements, and creating one that meets your needs will require expert legal and financial guidance. ●

Saving For Retirement At All Ages

Financial planners often are asked, "When should I start saving for retirement?" Although everyone's circumstances differ, the answer usually is a variation on this theme: As soon as possible. But that doesn't mean it's ever too late to begin, or that you'll have the same financial priorities at every age. When you're embarking on a career, you may not have much extra income to set aside, but you can work on establishing sound financial habits. Later, though you'll likely earn more, you'll also likely have greater obligations—supporting your family, paying a mortgage note, and, yes, saving for retirement. Still other factors may come into play as you approach your golden years.

Consider these basic approaches during different financial stages of your life.

In your 20s. Retirement may seem several lifetimes away. What's more, the salary you earn during your early working years likely won't provide much cushion for savings. But you may be surprised by how much you can accumulate if you're dedicated, thanks largely to the power of tax-deferred compounding. For instance, if you save $1,000 a month and earn 8% on your savings compounded annually for 40 years until retirement, you will amass a staggering $3,271,022.95. (These figures are hypothetical and not indicative of any particular investment.)

The easiest way for most people to sustain tax-deferred growth is through a 401(k) or another tax-advantaged retirement plan. If your employer provides matching contributions, try to contribute at least as much as you need to qualify for the maximum match.

In your 30s and 40s. These are prime earning years, but you also might incur substantial expenses raising the kids, buying and maintaining a home, and paying for

The 3.8% Surtax Requires A 10-Year Tax Plan

Barring any unforeseen circumstances, the 3.8% Medicare surtax is here to stay. This controversial tax provision, included in the 2010 health-care reform legislation upheld in 2012 by the U.S. Supreme Court, will affect investors for the 2013 tax year and beyond. Unless Congress repeals the surtax, it's the law of the land.

If you're an upper-income investor, you need to consider the potential impact of the 3.8% surtax. What's more, if you are nearing retirement, or if you've already retired, you should look closely at your tax future, taking this latest development into account. When you add the 3.8% surtax to the top federal income tax rate of 39.6% in 2013—up from 35%—you could end up paying an effective federal tax rate of 43.4% on a portion of your income.

First, let's review how the 3.8% surtax works. Unlike the separate 0.9% surtax on "earned income" such as wages—another provision of the health-care law—the 3.8% surtax applies only to income from investments and other sources. Yet earned, noninvestment income still can push you above the threshold that triggers the tax.

The 3.8% Medicare surtax applies to the lesser of (1) net investment income (NII) or (2) the amount by which your modified adjusted gross income (MAGI) exceeds a threshold amount. That threshold is $200,000 for single filers and $250,000 for joint filers. For example, if you're a joint filer with $50,000 of NII and MAGI of $225,000, you don't have to pay the 3.8% surtax because the joint MAGI does not exceed the $250,000 threshold. However, if your MAGI is $350,000, you owe the surtax on the lesser amount of the $50,000 NII (compared with your $100,000 in excess MAGI). That will result in an extra tax of $1,900 (3.8% of $50,000).

How the IRS defines net investment income is crucial to these calculations. Under the provisions of the health-care law and subsequent regulations, NII includes (but is not limited to) income from the following:

- Interest,
- Dividends,
- Annuity distributions,
- Rents,
- Royalties,
- Income from passive activities, and
- Capital gains from selling property.

Other kinds of income don't count as net investment income. Items excluded from the calculation include:

- Salaries, wages, or bonuses,
- Distributions from IRAs or "qualified" retirement plans such as 401(k)s,
- Any income that you count in calculating self-employment tax,
- Gains from sale of active interest in partnership or S corporation, and
- Items otherwise excluded from income tax such as interest from tax-exempt bonds, capital gains on selling a principal residence (up to the maximum allowed amount), and veterans benefits.

One way to reduce your chance of having to pay the 3.8% surtax is to avoid the kinds of income that are treated as NII. However, even some of the things that don't count as NII—such as distributions from an IRA or a qualified plan—will increase your MAGI and therefore still could cause surtax problems.

Another looming obstacle is that the threshold figures ($200,000 for single filers; $250,000 for joint filers) won't be adjusted annually for inflation. That means more investors will be hit by the 3.8% surtax in the future. If inflation picks up, you might find yourself affected by the tax within just a few years.

One practical way to prepare for that likelihood is to project what your overall tax picture may look like for an extended period. Keep in mind that the new top federal income tax rate of 39.6% will continue to be in effect, while the maximum tax rate on net long-term capital gains has increased from 15% to 20% for single filers with taxable income of more than $400,000 and joint filers making more than $450,000. If you expect to benefit from large investment gains and sizable qualified plan and IRA distributions during retirement, your combined tax rate for federal and state income could approach or even exceed the 50% mark.

We can work with your tax advisor to help you develop a plan for the next 10 years, or even longer, that will take all of these tax factors into account. Such a plan might involve strategies for eliminating or reducing the 3.8% surtax—for example, by converting a traditional IRA to a Roth IRA, establishing a charitable remainder trust, or using life insurance, installment sales of property, or "leapfrog" annuities to defer income. You also might decide to increase your portfolio allocation to tax-exempt municipal bonds. ●

college. Nevertheless, you should do your best to stay disciplined and contribute as much as you can to your retirement plans. For 2013, you can defer up to $17,500 of salary to your 401(k). In addition, if you establish an IRA, the annual contribution limit is $5,500. Meanwhile, although contributions to a Roth IRA are never tax-deductible, future payouts may be tax-free. ï€†

In your 50s and 60s. This may be when you earn the highest salary of your career. If the kids are out of college and the mortgage is paid off, it's truly time to make hay while the sun shines. Although you might not have been as diligent at retirement saving in the past as you would have hoped to be, you can recover lost ground quickly by socking away more in your retirement plans at this point in your life. For 2013, you can contribute an extra $5,500 to a 401(k) and an additional $1,000 to an IRA, above the limits already discussed. And you can save still more in taxable accounts outside your retirement plans. ●

A Realistic Look At A Hot Topic: Dividend Stocks

Wall Street pundits are lining up to tout the prospects for dividend-paying stocks in 2013, but prudent investors need to understand the bigger picture before rushing into this hot area of the market.

It's true that dividend-paying stocks made a solid comeback in 2012 and offer good prospects for 2013, but it's important to keep this trend in perspective. The percentage of profits paid out by companies in the form of dividends remains far below historical averages, and an economic downturn could prompt U.S. firms to pull back on dividends again at any time.

As an investor, you also need to consider dividend stocks relative to other income-producing investments, in the context of a low-interest environment and your own portfolio. Because no one can say for sure which investments will outperform others, it's important to strike a prudent balance among possible choices.

A number of analysts believe dividend-paying stocks will produce solid returns this year for several reasons, starting with the fact that many large companies have built up huge cash reserves as they proceeded cautiously through the wreckage of the 2008 fiscal crisis. "While companies are paying out record dividends, these amounts are still significantly below historical payout rates," wrote Standard & Poor's analyst Howard Silverblatt in the firm's annual dividend report in January. "It's not a matter of companies being cheap. It's a matter of them being nervous about the economy and their resources, similar to most of us."

Companies in the S&P 500 index paid out a record $281.5 billion in dividends in 2012, 17% more than in 2011. Yet the payout ratio—the percentage of profits that companies devoted to dividends—was just 36%, far below the historical average of 52%.

That leaves companies with a lot of room to increase dividend payments, according to Silverblatt, who predicted another record for regular cash dividends in 2013. "The 2.8% overall equity yield remains relatively high, even at the higher dividend tax rate (now 20% for certain upper-income investors), when compared to competing income producers such as corporate bonds, Treasuries, or bank CDs," Silverblatt wrote in the report. "Given the range of yields within equities, from lower yielding growth issues to higher yielding income producers, this leaves investors with one of the few remaining areas of choice with measurable degrees of stability."

Still, the potential for the economy to turn downward dictates continued caution for investors. It doesn't take much of a decrease in stock prices to more than offset whatever income you derive from dividends. In any event, dividend-paying stocks may play a positive role as part of a well-balanced portfolio tailored to your individual goals. ●

Best States To Move To

(Continued from page 1)

that Tennessee (9.44%), Arizona (9.16%), Louisiana (8.87%), Washington (8.86%) and Oklahoma (8.67%) have the highest combined state and local sales tax rates. Among states with sales taxes, the lowest combined rates are in Alaska (1.11%), Hawaii (4.35%), Maine (5%), Virginia (5%), and Wyoming (5.17%).

State and local property taxes: While property values have declined over recent years in many areas, property taxes haven't necessarily gone down, too. According to the Tax Foundation, residents of New York, New Jersey, and Connecticut had the highest tax burdens in 2010. In those states, residents forked over more than 12% of income in state and local taxes.

Residents of Alaska, which has been the least-taxed state for more than a quarter of a century, paid the lowest percentage of income in 2010 at 7%, followed by South Dakota, Tennessee, and Louisiana.

State estate taxes: Estate taxes also may influence where you want to retire. The rules can differ widely from state to state and in several cases, state laws don't follow federal estate tax rules. As of January 1, 2013, 17 states and the District of Columbia collected estate tax and had varying exemption thresholds. (Some other states have inheritance taxes.) In several states, the threshold is $1 million or less. Only Delaware, Hawaii, and North Carolina use the current federal exclusion amount of $5 million (indexed to $5.25 million in 2013). Certain other states have neither an estate tax nor an inheritance tax. But these rules, too, are subject to change.

Remember that this is just a brief summary of state taxation rules. Of course, other factors also will come into play, but it pays to consider state and local tax consequences in choosing a location for your retirement years. ●