



# Parker Financial Services, LLC

Helping Biz Owners & Professionals Retire On Time

November 2007

## Parker Financial Services, LLC

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## 2007 Year-End Tax Planning Considerations

For the most part, the window of opportunity for 2007 tax year planning closes on December 31. Here are a few points to consider as you contemplate any 2007 year-end tax moves, and look forward to the 2008 tax year.

### New zero percent tax rate

Currently, the maximum federal income tax rate for most long-term capital gains and qualifying dividend income is 15%. Individuals in the lowest two tax brackets receive the benefit of an even lower 5% maximum rate. Beginning January 1, 2008, however (and continuing through 2010), the maximum rate drops all the way to zero for individuals in the lowest two tax brackets.

This presents an important planning opportunity. Make year-end gifts (up to \$12,000 per individual gift tax free) of appreciated assets to family members currently in the lowest two tax brackets, who would then be able to sell the assets after January 1, 2008 without any resulting federal income tax. There's one big catch, though: the new "kiddie tax" rules.

### New "kiddie tax" rules

Generally, the kiddie tax rules apply when a child has unearned annual income (e.g., interest, investment earnings, taxable gain resulting from the sale of an asset) exceeding \$1,700 (2007 figure).

In 2007, the kiddie tax rules apply to children under the age of 18. Beginning in 2008, however, the kiddie tax rules apply to children who are under age 19, and to full-time students under age 24. (There's an exception for any child who earns more than one-half of his or her own support.)

So, if you want to take advantage of the zero tax bracket in 2008 by transferring appreciated assets to a low-tax-bracket family member, make sure the kiddie tax rules won't apply. Otherwise, the resulting income--at least the portion that exceeds \$1,700--will be taxed

at your (presumably higher) tax rate, eliminating most or all of any potential tax savings. For the remainder of 2007, though, the old rules apply--a child who will reach age 18 by year end is able to sell appreciated assets and potentially pay tax on any resulting income at the (still low) 5% rate.

### AMT uncertainty

Legislation signed into law in early 2006 brought the most recent in a long series of temporary "fixes" for the alternative minimum tax (AMT), which continues to reach further into the ranks of middle-income families. This temporary fix, in the form of increased AMT exemption amounts, expired at the end of 2006. If Congress doesn't act, the number of taxpayers subject to AMT is projected to increase from 4.24 million in 2006 to 23.19 million in 2007 (Source: Joint Committee on Taxation, March 5, 2007). Some action regarding the AMT is likely, but the form it will take is uncertain, making it important to stay up to date on any new developments.

### Other important considerations

- Unless there is additional legislative action, 2007 is the last year that a taxpayer age 70½ or older is able to make charitable contributions of up to \$100,000 directly from an IRA to a qualified charity.
- 2007 is also the last year for other deductions, including the option to deduct state and local general sales tax (instead of state and local income tax) and the above-the-line deduction for qualified higher education expenses.
- For small businesses, legislation this year increased the Section 179 expensing limits.

### Talk to a professional

A financial professional can explain how these issues, and others, might affect your 2007 tax situation.



## The Power of Dividends in a Portfolio

It wasn't so long ago that many investors regarded dividends as roughly the financial equivalent of a record turntable at a gathering of MP3 users--a throwback to an earlier era, irrelevant to the real action.

But fast-forward a few years, and things look a little different. Since 2003, when the top federal income tax rate on qualified dividends was reduced to 15% from a maximum of 38.6%, dividends have acquired renewed respect. Favorable tax treatment isn't the only reason, either; the ability of dividends to provide income and potentially help mitigate market volatility also is attractive to investors. As baby boomers approach retirement and begin to focus on income-producing investments, the demand for high-quality, reliable dividends is likely to increase.

### Why consider dividends?

Dividend income has represented roughly one-third of the monthly total return on the Standard and Poor's 500 since 1926. According to S&P, the portion of total return attributable to dividends has ranged from a high of 53% during the 1940s--in other words, more than half that decade's return resulted from dividends--to a low of 14% during the 1990s, when investors tended to focus on growth.

If dividends are reinvested, their impact over time becomes even more dramatic. S&P

Dividends can be especially attractive if the market is producing relatively low or mediocre returns. If a stock's price rises 8% a year, even a 2.5% dividend yield can push its total return into the double-digit range; in some cases, dividends could also help turn a negative return positive. Also, many dividend-paying stocks represent large, established companies that may have significant resources to weather an economic downturn.

### The corporate incentive

Financial and utility companies have been traditional mainstays for investors interested in dividends, but other sectors of the market also are beginning to offer them. For example, investors are stepping up pressure on cash-rich technology companies to distribute some of their profits as dividends. In June 2007, the number of companies offering dividends was 3% higher than the year before, according to S&P, though increases in the amounts paid have been slowing in recent years.

Dividends are by no means guaranteed; a company's board of directors can decide to reduce or even eliminate them. However, a steady and increasing dividend is generally regarded as one sign of a company's ongoing health and stability. For that reason, most corporate boards are reluctant to send negative signals by cutting dividends.

### Look before you leap

Investing in dividend-paying stocks isn't as simple as just picking the highest yield. Some dividends, such as those paid by real estate investment trusts (REITs) and master limited partnerships, don't qualify for the 15% maximum tax rate, and a portion may be taxed as ordinary income. If you're investing for income, consider whether the company's cash flow can sustain its dividend. Also, the 15% rate is scheduled to expire at the end of 2010, and there is no guarantee dividends will continue to receive favorable tax treatment.

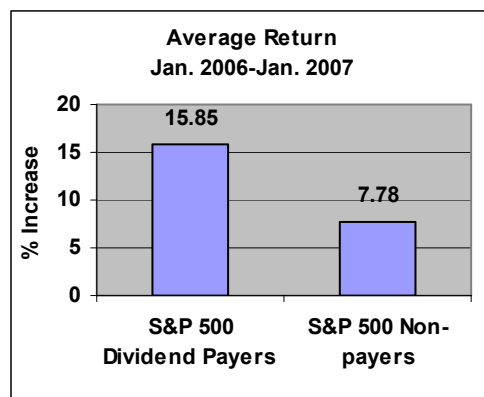
If you're interested in a dividend-focused investing style, look for terms such as "equity income," "dividend income," or "growth and income." Also, some exchange-traded funds (ETFs) track an index comprised of dividend-paying stocks, or that is based on dividend yield; be sure to check the prospectus for information about expenses, fees and potential risks, and consider them carefully before you invest. A financial professional can evaluate the role dividends might play in your portfolio.



### Dividends and interest: A bigger piece of the pie

In 2006, personal dividend income represented roughly \$696.3 billion--6.3% of the \$10.98 trillion in personal income in the U.S. that year. That was up from approximately 5.5% in 2004. Interest income represented about 10% of personal income in 2006, compared to 9.2% in 2004.

Source: U.S. Dept. of Commerce, Bureau of Economic Analysis



Source: Standard and Poor's

calculates that \$1 invested in the Standard and Poor's 500 in December 1929 would have grown to \$57 by September 2005. However, when coupled with reinvested dividends, that same \$1 investment would have resulted in \$1,353. (Bear in mind that past performance is no guarantee of future results, and taxes were not factored into the calculations.)

## Combining Term and Permanent Life Insurance

There are two basic types of life insurance: Term and permanent. Term life insurance provides temporary insurance coverage for a specific term. There is no cash value in the policy, and the policy's death benefit is paid only if you die during the term of the policy. Permanent (cash value) insurance is designed to provide lifetime protection, as long as you pay the premiums to keep the policy in force. At the outset, premium payments are usually higher than premiums for comparable term insurance. The increased premiums are used to provide a cash value that you can access if needed.

**Caution:** Any guarantees associated with payment of death benefits, income options, or rates of return are subject to the claims-paying ability of the insurer.

If you need a large amount of life insurance protection at an affordable price to cover short- or intermediate-term needs, term insurance may be the most appropriate option. On the other hand, if you will have an ongoing need for protection, or want the flexibility of building a cash reserve that you can borrow or withdraw from, permanent insurance may be the better choice. Term and permanent life insurance each have distinct advantages and disadvantages. So, it's probably not surprising that sometimes the best option is to consider buying both.

### Planning for a young family

Let's say you and your spouse each plan to work for another 25 years. You determine that if either of you died, the survivor would need \$250,000 to replace the lost income of the deceased spouse. One option to consider might be the purchase of a \$100,000 permanent cash value life insurance policy and a \$150,000 25-year term insurance policy on each of your lives. Using this approach, you can potentially:

- Meet your need for income replacement now, largely with lower cost term insurance
- Address a need for more permanent insurance later by converting some or all of the term insurance to permanent insurance without the need for further underwriting or new medical exams, and
- Provide a foundation of permanent insurance that you will always have, and that will build cash values that you can use for

future expenses (e.g., college funding or your retirement).

### Planning for a child with special needs

If you're the parent of a child with special needs, you might find that purchasing both term and permanent insurance can help provide the broad protection your family needs. For example, if you were to die prematurely, your family would probably need funds to pay off immediate debts and obligations and to replace your lost income; term insurance might be the most affordable way to provide a lump sum to cover those needs.

However, your child will have other financial needs (e.g., specialized medical treatment, schooling, residential programs, caregiving services) that will probably exist even after your death, and the death of your spouse. An additional permanent insurance policy—in this case a second-to-die policy, which would pay a death benefit upon the death of the last surviving parent—might provide the funds to meet these additional needs. And, because a second-to-die policy only pays a death benefit upon the death of the last surviving spouse, it generally costs less than buying individual life insurance policies for you and your spouse.

### Business owners

Typically, life insurance plays a role in funding a business succession plan (e.g., funding a buy-sell agreement that prearranges the sale of a partner's interest upon death or disability). In this context, combining term and permanent insurance can be an efficient and economical solution. For example, individual term insurance policies can be purchased on the lives of each partner based on the current value of each partner's share of the business, with coverage until retirement age. Permanent policies can be purchased to provide additional funds with the expectation that the business' value will continue to grow. The permanent policies add flexibility, in terms of additional life insurance coverage, and cash value which can be accessed if needed (for example, to buy out a partner who retires before death).

### Talk to an insurance professional

The insurance policy or policies that are right for you depend upon your financial circumstances. A life insurance professional can help you evaluate your insurance needs and recommend appropriate insurance products.

### ***A balanced alternative***

*You may have a need for both temporary and lifetime insurance protection. One option is to buy a separate term policy and a separate permanent policy to cover both your short- and long-term life insurance needs.*

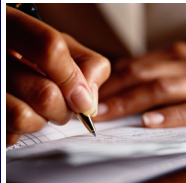


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## Ask the Experts



### Does Uncle Sam tax my child's college scholarship?

It depends. If a scholarship is used to pay for tuition, fees, books, or required equipment, then it's not taxed. But if it's used to

cover other expenses like room and board, travel, or optional equipment, or if it's awarded as payment for teaching or research, then it's taxable.

But keep this in mind: Scholarships used to cover tuition, fees, or books (making them nontaxable) may impact your ability to claim the Hope or Lifetime Learning credit. That's because these tax credits are based on the amount of tuition and fees you pay, and any tuition and fees paid with a tax-free scholarship can't be counted when calculating your credit.

This rule has the most impact on your ability to claim the Lifetime Learning credit, worth up to \$2,000. Because this credit is calculated as 20% of up to \$10,000 in tuition and fees, a hefty scholarship applied to these expenses may leave you with less than \$10,000 in

eligible tuition and fees to count toward the credit. By contrast, the maximum \$1,650 Hope credit is based on up to \$2,200 in tuition and fees, so even with a scholarship, you might not use up all your tuition and fee expense eligibility.

However, if your child's scholarship is taxable (for example, in cases where its terms specify that it can't be applied to tuition and related expenses), then the entire amount of tuition and fees you pay can be counted when calculating the Hope or Lifetime Learning credits.

For more information, see IRS Publication 970, *Tax Benefits for Education*.

