

How tax planning can put more \$ in your pocket

Judging from some of the tax returns we see, many people seem to be of the opinion that it's a good idea to give the government an interest-free loan every year. They withhold more from their wages than they need to, then get a big refund in April.

No law requires wage-earners to withhold more taxes from their pay than what they owe. Yet many people do just that because of poor planning or by design, thinking that getting a big refund is a kind of forced saving.

Managing tax withholding affects not only what you owe (or receive as a refund), but it affects your cash flow, too. By managing your income-tax withholding, you can put more money into your pocket every pay day.

The key is to have enough withheld for federal income tax purposes to avoid interest and penalties. As long as you meet the following federal thresholds,

no interest or penalty will apply, no matter what you owe:

For taxpayers whose adjusted gross income is \$150,000 or less:

- 100% of the prior year's tax liability;
- 90% of the current year's liability; or
- Tax owed of \$1,000 or less.

For taxpayers whose adjusted gross income is more than \$150,000:

- 110% of the prior year's liability;
- 90% of the current year's liability; or
- Tax owed of \$1,000 or less.

Illinois taxpayers may owe interest and penalties if their tax exceeds their withholding by \$500 or more, and they did not make estimated payments when required.

By doing a thorough analysis of a client's tax situation, we can determine with a high degree of accuracy their

withholding and their liability for the year. Clients who are in solid control of their finances should withhold and make estimated

payments equal to the threshold amounts. They should have liquid funds available to pay any additional tax when due.

Some circumstances that may make planning more of a challenge early in the year are when a client has irregular self-employment income; investment income that is difficult to predict; income from trusts or pass-through entities; or large bonuses from employment. When any of these circumstances apply, estimated-tax payments may be made by Jan. 15 of the following year.



Do you know about the EFTPS?

The Electronic Federal Tax Payment System (EFTPS), created by the U.S. Treasury, provides an easy way for individuals and businesses to make virtually all federal tax payments. EFTPS accepts tax payments for any IRS tax form, online or by phone, 24 hours a day and 7 days a week. Tax payments are debited from your bank account on the date(s) you choose, and the tax data is reported to the IRS to update your tax records.



EFTPS offers taxpayers the option of scheduling tax payments in advance of the due date(s). Individuals and businesses may schedule payments up to 365 days and 120 days, respectively, in advance of the due date(s). For example, you can schedule your quarterly estimated tax payments for the entire year, eliminating the hassle of having to write a check for each quarterly payment and the risk of forgetting to do so.

For more information, visit www.eftps.com.

Time to order free credit reports?

A federal law allows you to receive a free copy of your credit report every 12 months from the three nationwide consumer reporting agencies (Equifax, Experian, and Trans Union). If you haven't ordered credit reports in the past year, consider doing so now. It's important to review your credit report regularly to make sure that all of the information is correct.

A clearinghouse at www.annualcreditreport.com allows you to conveniently order credit reports from all three agencies. (you cannot order them through the individual agency websites). This is the only authentic website for doing so; other websites require you to sign up for credit monitoring or other costly services.

Ordering all three credit reports at the same time allows for easier comparison of all three, while ordering one every few months allows you to keep tabs on your credit files more frequently.

What type of life insurance is right for you?

Our May newsletter covered the topic of determining how much life insurance you need. Once that is determined, what type of life insurance is right for you?

“Term” and “permanent” are the most common types of life insurance. A term policy provides pure life insurance coverage and nothing else. The death benefit is available for a specific period of time, typically for up to 30 years. If the insured dies during the coverage period, the beneficiary receives a death benefit equal to the policy's face amount.

Permanent policies combine life insurance coverage and an investment component. As the value of the investments grows, it may be borrowed against by the policy owner, and the policy does not expire at any specific point in time.

The most common types of permanent policies include:

- *Whole Life* – Premium payments are generally fixed, with the death benefit and cash value predetermined and guaranteed. The insurer chooses the investments.
- *Universal Life* – Premiums may be paid at any time and in any amounts (within limits), as long as the policy's expenses and insurance cost are met. The death benefit and cash value are not guaranteed, and the insurer chooses the investments.
- *Variable Life* – Premiums are level, and the policy owner selects the investments. While a minimum death benefit might be guaranteed, its value depends largely on how the investments perform.
- *Variable Universal Life* – Premiums may be paid at any time and in any amount (within limits) while the policy owner chooses the investments. These policies generally do not guarantee a death benefit or cash value.

We usually recommend term life for our clients because permanent policies typically have high fees, commissions, and other costs that may reduce their returns by 3% or more each year. It is usually preferable to separate your insurance needs from your investments rather than combine both in a permanent life insurance policy.

We are not saying that term is better than permanent life insurance in all cases. For example, permanent policies might be suitable for certain estate planning purposes. The bottom line is that the decision on what type of life insurance to buy should be carefully determined.

College plan is new and improved

If you haven't considered the Illinois Bright Directions college savings plan, now is a good time to take a look.

Bright Directions, a so-called “529” plan, is a big improvement over Illinois' Bright Start program – it has more and better investment options and lower expenses.

Parents, grandparents and others can open an account and receive a state tax deduction of up to \$20,000 (married filing jointly) for contributions, which grow tax-deferred until withdrawal. Withdrawals in excess of basis are tax-free if used for qualified higher-education expenses, under current law.

Another important benefit: 529-plan assets belong to the account holder, not the beneficiary. This may result in a higher level of financial aid for the student.

Clients of Mentor Capital Management Inc. are eligible to participate in Bright Directions without sales or service charges. Call us for more information.

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JOKE OF THE MONTH

Joe loved golf, but his eyesight had gotten so bad, he couldn't find his ball once he'd hit it. He consulted with his wife, and she recommended that Joe bring along her uncle Ted.

Joe said, "But Ted is 80 years old and half senile!"

His wife replied, "Yes, but his eyesight is incredible."

Joe finally agreed and took Ted along. He teed off and asked Ted, "Do you see it?"

Ted nodded his head and said, "Boy, that was a beautiful shot!"

Joe excitedly asked, "Well, where did it land?!"

Ted said, "Hmmm. I forget."


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