



Helping Employees Make the Most of Their 401(k)/403(b) Plans

Seven Things You Need to Know about Tax Laws and Sunset Provisions Part 1

Sunsets are often described as romantic, majestic, and awe-inspiring. It's a good bet, however, that investors will have a less-than-glowing reaction to sunset provisions in tax laws.

The current sunset provisions in various tax laws are the result of legislative compromises over tax-relief measures. As currently written, they will cause some popular tax breaks to disappear in just four to six years. Retirement accounts, college savings plans, grandparent bequests, and estate plans may all be affected. Making matters even more complicated, some tax treatments actually are scheduled to change a number of times, creating increasingly favorable opportunities until they're erased at the end of the day on December 31, 2010, the sunset date for many of these popular tax breaks.

In this confusing tax environment, it may be tempting to stick your head in the sand and hope that Congress intervenes to eliminate or modify some or all of the sunset provisions. That may well happen, but, then again, it may not. During these uncertain times, you can help protect your family's future by building flexibility into your financial plans. As you do so, consider these seven tips.

1. Save aggressively for retirement

Among a number of retirement-related rules slated to end at the end of 2010, one of the most significant is the so-called catch-up provision, which permits those age 50 and older to contribute more to various tax-advantaged retirement accounts than younger investors can. This year, the maximum catch-up amount is \$4,000 for 401(k) plans and \$500 for traditional and Roth IRAs. In 2006, those amounts will rise to \$5,000 and \$1,000, respectively. This creates a great saving opportunity — for now. Keep in mind, investing involves risk. The value of your investment will fluctuate over time, and you may gain or lose money.

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2. Keep an eye on 529 college savings plans

After-tax contributions to 529 plan accounts grow on a tax-deferred basis. Currently, there are no federal income taxes on distributions used to pay for qualified educational expenses. That tax break, however, is scheduled to disappear at the end of 2010, when distributions for qualified educational expenses will be taxable to the distributee. Under both current law and after the sunset date, distributions of earnings for nonqualified expenses are subject to a 10% penalty, in addition to any applicable income taxes. Unless legislation is passed that extends the current tax treatment of 529 plan accounts, the benefits of these accounts won't be as great as they are now, but they may still be worth having since funds grow tax deferred until they're used.

3. Be realistic about federal estate-tax changes

Between now and 2009, the individual applicable federal estate tax exclusion amount (the "exemption") will increase from \$1.5 million to \$3.5 million, while the top federal estate tax rate will drop from 47% to 45%. Then, in 2010, the federal estate tax will disappear, but just for a single year. Since you don't know when you are going to die, you should prepare for all the various scenarios through 2011, the first year after these favorable estate tax laws sunset. In 2011, the applicable exclusion amount will go back down to \$1 million and the top tax rate will rise to 55%, experts expect these rules to change again, although there are no guarantees.

Look for part two next week.

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