



The Hein Wealth Report

April 2010 Hein Wealth Report

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We should be having our open office party in about 6 weeks. We will send out a save the date shortly.

This month's newsletter explains 1) key economic indicators 2) changes to the capital gains rules 3) a fascinating tax advantaged structure called land conservation easements and 4) how to get exposure to gold and silver in your IRA's and some 2010 Roth IRA conversion Q&A.

We look forward to seeing you soon.

Regards,

Steve

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Key Economic Indicators and What They Mean

Late last year, members of the Federal Reserve Board's Open Markets Committee (FOMC) outlined some of the indicators they're watching to help determine when the economy might be stable enough to handle higher interest rates. Here's a primer on some of those indicators and why they're important.



Gross Domestic Product (GDP) indicates whether the economy is growing, shrinking, or stagnant. It represents the value of all goods and services produced in the United States, minus the value of all imports. This is the broadest measure of economic health.

Inflation represents increases in the cost of goods and services. The *Consumer Price Index (CPI)* represents increased costs for everyday expenditures such as housing, transportation, food, energy, and clothing. In addition to serving as an inflation gauge, CPI affects any payments tied to the cost of living, such as Social Security benefits.

A related measure, so-called core CPI, excludes food and energy prices because they can vary dramatically from month to month. Core CPI is closely watched by the Fed in determining whether and when to raise or lower its target interest rate, which in turn affects bond prices and other interest rates.

Still another inflation yardstick is the *Producer Price Index (PPI)*, which reflects prices at the wholesale level. If prices are rising for items used to manufacture a product, manufacturers and wholesalers may pass increased costs on to retailers and/or consumers. As a result, increases in the PPI can be an indicator of potential future inflation at the consumer level.

Unemployment and payroll statistics may seem similar, but they indicate slightly different things. The unemployment percentage usually

quoted in news headlines is based on a Bureau of Labor Statistics (BLS) survey of households. However, it doesn't include people who are working part-time involuntarily, or so-called "discouraged workers" who haven't been able to find a job and have given up looking. The BLS payroll figure uses corporate job records to show whether employers are creating or shedding jobs.

The unemployment rate is traditionally considered a lagging economic indicator, because an increase in jobs typically shows up only after other economic indicators, such as business inventories and unused manufacturing capacity, have begun to show signs of health. However, some economists argue that because the economy has relied heavily for many years on consumer spending, unemployment may now be more of a leading indicator than in the past.

Personal incomes as measured by the Commerce Department reflect not only paychecks but corporate and government benefits, pension checks, rental income, dividends, and interest payments; the data can give hints about future spending. *Personal consumption expenditures (PCE)* data show actual consumer spending on goods and services. As with core CPI, the Fed relies on PCE when setting its target interest rate.

Industrial production figures indicate whether factories are producing as much as they're capable of. When resource utilization is low, it suggests that factories are unlikely to experience near-term inventory shortages that could spark inflation. Somewhat related are *durable goods orders*, an indicator of inventory level and business investment in equipment. Also of interest are housing starts, new building permits (which hint at future construction), and new and existing home sales and prices.

These are only some of the data points to watch as guideposts in the months ahead.

Got Stock? The Long and Short of Capital Gains

If you buy or sell shares of stock, you need to be familiar with the rules that govern the way capital gains are taxed. That's because the amount you owe in tax can depend on a number of factors, including the length of time you hold the shares and the federal income tax bracket you're in. Here are the basics.



Basis and holding period

"Basis" refers to your investment in the shares of stock you hold. Generally, your basis is the amount you paid for the stock, plus any commissions you paid to purchase the shares. (Note, however, that special rules apply if you received the stock as a gift or as part of an inheritance.) If you sell a share of stock and the sales price--less any commission--is more than your basis, you have a *gain*; if the amount you receive is less than your basis, you have a *loss*.

Your holding period is generally the length of time that you hold a share of stock before you sell or exchange it. If you hold a share of stock for a year or less before selling it, any gain you have is *short-term* capital gain. If you sell a share of stock after holding it for more than a year, any gain is *long-term* capital gain. Your holding period typically starts on the trade date the share is purchased, and ends on the trade date it's sold.

Short-term capital gain

Short-term capital gain is treated as ordinary income, just like interest on your savings account or wages from your employer. It's added in with all of your other income, and the amount of federal income tax you owe depends on the federal marginal income tax bracket you're in. For example, if you're in the top tax bracket in 2010, you'll pay tax on ordinary income at a maximum rate of 35%.

Long-term capital gain

If you sell shares of stock that you've held for more than a year, any gain is long-term capital gain, and special maximum tax rates apply. If you're in the 10% or the 15% marginal income tax bracket in 2010, you'll pay no federal income tax on long-term capital gains (a "0% tax rate" applies). So, for single individuals with taxable income of \$34,000 or less (\$68,000 for married individuals filing jointly), long-term capital gains are federal income tax-free in 2010.

For those who aren't in the lowest two federal income tax brackets (i.e., those in the 25%, 28%, 33%, and 35% brackets), a 15%

maximum tax rate generally applies to long-term capital gains. There are limited cases, however, when individuals in the higher tax brackets can still benefit from the 0% tax rate.

For example, a retired couple with taxable income of \$60,000 would be in the 15% marginal income tax bracket in 2010 if they file jointly (the bracket covers married couples with taxable income less than or equal to \$68,000). The couple sells stock, resulting in a long-term capital gain of \$40,000. This increases their taxable income to \$100,000, placing them in the 25% marginal income tax bracket. In this situation, they would pay no federal tax on the first \$8,000 of long-term capital gain, and the maximum 15% rate would apply to the remaining \$32,000 in gain.

Offsetting gains with losses

Any capital losses that you may have realized during the year can offset some or all of your capital gain. If your losses offset all capital gains, any excess capital loss can be applied against up to \$3,000 of ordinary income (\$1,500 for married individuals who file separately), and any unused capital loss can be carried forward to future years.

Big exception: retirement plans, IRAs

All of this assumes your stock is not being held in a tax-advantaged retirement account like a 401(k) plan or IRA. Special tax rules apply to investments, including stock, held within these plans. If you sell shares of stock within one of these plans, there's no immediate tax consequence. Instead, you'll generally pay federal income tax when you take withdrawals from the plan, and any income will be considered ordinary income--even if the earnings are attributable to capital gains. (Certain Roth retirement plans and Roth IRAs provide for tax-free treatment of qualified withdrawals.)

Uncertainty in 2011

The special federal income tax rates that currently apply to long-term capital gains expire at the end of 2010. Absent new legislation, in 2011, individuals in the 15% tax bracket (under current law the 10% bracket disappears in 2011) will pay tax on long-term capital gain at a rate of 10%. For everyone else, a 20% rate will generally apply. Special rules (and slightly lower rates) will apply for qualifying property held five years or more.

Small business stock

Special rules apply to qualified small business stock. Generally, a portion of any gain realized upon the sale of qualified small business stock held for more than 5 years can be excluded from income. The portion of the gain that is not excluded from income is generally taxed at a maximum rate of 28%. For additional information, see IRS Publication 550.

Tax Benefits of Conservation Easements

A conservation easement (also called a conservation covenant or restriction) is an encumbrance on privately held real estate that prohibits the development of that property in perpetuity. The landowner enters into an agreement with the easement holder--either a qualified charitable organization (referred to as a land trust) or a government agency (federal, state, or local). The agreement imposes specific restrictions on the use of the property, and it remains legally binding even when the property is subsequently passed on to heirs or sold to another private owner.

Property owners who grant conservation easements not only conserve their land for future generations, but they may also conserve their wealth for their heirs due to the many tax benefits that are available.

Federal income tax deduction

A gift of a conservation easement is considered a charitable donation that can be deducted on the donor's federal income tax return, if the easement meets all of the following IRS requirements:

- The easement is permanent
- It is donated to a qualified conservation organization
- It serves a valid conservation purpose (which can only be for outdoor recreation or education, habitat protection, historic preservation, or open space protection)

Generally, the value of the easement is the difference between the land's fair market value with and without the easement. For example, if land is valued at \$1 million without restrictions and \$750,000 with the easement, then the value of the easement is \$250,000. The value must be substantiated by a qualified appraisal.

For individual taxpayers, the deduction is generally limited to 30% of adjusted gross income in the year of the gift. Any excess can be carried forward over the next 5 years. Any deduction that is not used up in that 6-year period is lost.

Note: For donations made in 2006 through 2009, the limitations were 50% (100% for qualified farms and ranches) and 15 years, respectively. There is legislation in Congress that extends this provision, retroactive to January 1, 2010.

Federal gift or estate tax deduction

A landowner can claim a federal charitable gift tax deduction (if the easement is made during his/her life) or an estate tax deduction (if made after death) for the *full* fair market value of the easement. The easement must satisfy the same requirements as the federal income tax deduction, *except for the conservation purpose requirement.*

Federal estate tax exclusion

In addition to the federal deductions, up to 40% of the *after-easement value of the land* can be excluded from the landowner's estate for federal estate tax purposes, up to a maximum of \$500,000, if all of the following requirements are met:

- The donation is eligible for the federal income tax deduction
- The easement must prohibit more than a de minimis use of the property for a "commercial recreational activity"
- The easement must be donated by the decedent, his/her family member, the executor of his/her estate, or the trustee of the trust in which the land is held
- The land must have been owned by the decedent or his/her family member for the entire 3-year period preceding the decedent's date of death

To be eligible for the full 40% exclusion, the easement must reduce the value of the land by at least 30%. For every percentage that falls short of the 30% threshold, the exclusion is reduced by 2%.

Further, the tax basis of the land must be carried over from the decedent to the heirs, to the extent the value of the land is excluded from the decedent's estate.

State tax and property tax benefits

Some states offer an income tax deduction and/or tax credit, and many states offer property tax incentives to conservation easement donors.

Note: A conservation easement can also be sold, but a sale will not confer the same tax benefits as a donation.

For more information, see your financial professional.

"Property owners who grant conservation easements not only conserve their land for future generations, but they may also conserve their wealth for their heirs due to the many tax benefits that are available."



How popular are conservation easements?

According to the 2005 National Land Trust Census, the total acres conserved by local, state, and national land trusts doubled to 37 million acres in just the past five years. This is an area 16½ times the size of Yellowstone National Park.



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Ask the Experts



Can I buy gold and silver in my IRA?

Yes, but you'll need to establish a self-directed IRA with a trustee/custodian who has experience with precious metals and is able to take physical possession

of the assets. The company you purchase the metals from will generally have a relationship with a trustee/custodian who can set up a precious metals IRA for you.

Under IRS rules, holding certain collectibles, including metals, gems, or coins, in your IRA can result in a prohibited transaction. That doesn't mean you can't do it. But if you do, there can be serious tax consequences--the value of the collectible will be treated as a distribution to you, and will be subject to income tax and a 10% penalty (unless you're 59½ or another exception applies).

However, certain precious metals are specifically excluded from the definition of "collectible." The following are currently permitted as IRA investments:

- American Eagle gold, silver, and platinum bullion coins

- Coins issued by any state

Also allowed is any gold, silver, platinum, or palladium bullion, in coin form or otherwise, that meets certain purity requirements (for example, gold coins and bars must be at least 99.5% pure). Currently this includes:

- Canadian gold, silver, and platinum Maple Leaf coins

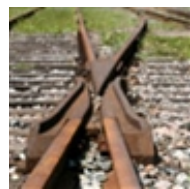
- Australian Philharmonic, Kangaroo/Nuggets, Kookaburras, and Koala coins

- Mexican Silver Libertads

- Isle of Man Noble platinum coins

- Gold, silver, platinum, and palladium bars and rounds of specific purity

Of course, you can also buy mining stocks, as well as gold and silver ETFs, in your IRA. For some, this is a more convenient way of adding this asset class to an IRA portfolio.



Frequently asked questions about 2010 Roth IRA conversions

1. How does the special deferral rule for 2010 conversions work? I've heard that I calculate the conversion tax in 2010, but can pay half in 2011 and half in 2012.

No, this is a common misconception. If you make a conversion in 2010, you will calculate the amount of taxable income in 2010. But then you have a choice: you can either report all of the taxable income on your 2010 tax return, or instead report half of the income on your 2011 return and half on your 2012 return. So, your tax liability will depend on your marginal tax rates in 2010, 2011, and 2012. (Note that tax rates will increase in 2011 if the Bush tax cuts are allowed to expire.)

2. Does the special deferral rule for 2010 apply to distributions I roll over from my 401(k) plan to a Roth IRA in 2010?

Yes. If you receive a distribution of non-Roth funds from your 401(k) plan in 2010 and roll

those funds into a Roth IRA, the taxation is similar to a conversion of a traditional IRA to a Roth IRA. You can report all of the resulting income on your 2010 tax return, or half on your 2011 return and half on your 2012 return.

3. Is it true that anyone can make annual contributions to a Roth IRA beginning in 2010, regardless of how much they earn?

No. You can contribute to a Roth IRA only if your income is within prescribed limits. These limits have not been repealed. What has been repealed are the income limits that used to apply to Roth conversions, beginning in 2010. But even if you can't contribute to a Roth IRA directly in 2010 because of the income limits, there's an easy workaround: you can make your annual contribution first to a traditional IRA (virtually anyone under age 70½ can make nondeductible contributions to a traditional IRA), and then convert that IRA to a Roth. Remember, though, that when you calculate the taxable amount due as a result of the conversion, you need to aggregate all of your traditional IRAs. See IRS Form 8606 for additional details.