



# Bartholomew & Company

MANAGING WEALTH WITH WISDOM SINCE 1994

## Mid-Year Tax Considerations

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*A customer is the most important visitor on our premise; he is not dependent on us. We are dependent on him.*

*He is not an interruption in our work. He is the purpose of it.*

*He is not an outsider in our business. He is part of it.*

*We are not doing him a favor by serving him. He is doing us a favor by giving us an opportunity to do so.*

—Mohandas K. Gandhi

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Though it may seem as if the ink has barely dried on your 2010 federal income tax return, the end of 2011 is now visible on the horizon. Here are some things to consider as you take stock of your current tax situation.

### The 2% difference

If you're an employee, 6.2% of your wages (up to the taxable wage base--\$106,800 in 2011) would normally be withheld for your portion of the Social Security retirement component of FICA employment tax. But legislation passed in December 2010 included a temporary one-year 2% reduction in this tax. That means for 2011, you're paying the tax at a rate of 4.2%. If you're self-employed, the 12.4% you would normally pay for the Social Security portion of your self-employment tax is reduced to 10.4%.

Have you earmarked the resulting extra dollars in your paycheck efficiently by, for example, paying down high-interest debt or saving for retirement? If you haven't, consider making up for it by contributing an extra 4% of your income to your 401(k) or an IRA for the remainder of the year. By applying the extra money toward a long-term goal, the potential benefit of the temporary tax reduction can extend beyond 2011.

### Tax rates

The same federal income tax rates that applied in 2010 continue to apply in 2011 and 2012 (depending on your taxable income, you'll fall into either the 10%, 15%, 25%, 28%, 33%, or 35% rate bracket). And, as in 2010, long-term capital gains and qualifying dividends in 2011 and 2012 continue to be taxed at a maximum rate of 15%; if you're in the 10% or 15% marginal income tax brackets, a special 0% rate will generally apply. So, unlike this time last year, you don't have to contend with the uncertainty of not knowing what next year's tax rates will be.

That consistency, however, does not apply to the alternative minimum tax (AMT)--essentially a parallel federal income tax system, with its

own rates and rules. While the December legislation extended regular income tax rates through 2012, it only extended AMT relief (in the form of increased AMT exemption amounts) through 2011. You can probably expect another AMT fix in legislation later this year, since without it there would be a dramatic increase in the number of individuals subject to AMT in 2012. But that leaves a fair degree of uncertainty today, however, as you consider your overall tax situation.

### Also worth noting

**Small business stock:** Generally, individuals may exclude 50% of any capital gain from the sale or exchange of qualified small business stock provided they meet certain requirements, including a five-year holding period. For qualified small business stock issued and acquired after September 27, 2010, and before January 1, 2012, however, 100% of any capital gain may be excluded from income if the stock is held for at least five years and all other requirements are met.

**IRA qualified charitable distributions:** Absent additional legislation, 2011 will be the last year that you'll be able to make qualified charitable distributions (QCDs) of up to \$100,000 from an IRA directly to a qualified charity if you're age 70½ or older. Such distributions may be excluded from income and count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to receive from your IRA in 2011.

**Depreciation and IRC Section 179 expensing:** If you're a business owner or self-employed individual, you're allowed a first-year depreciation deduction of 100% of the cost of qualifying property acquired and placed in service during 2011 (the "bonus" first-year additional depreciation deduction will drop to 50% for property acquired and placed in service during 2012). For 2011, the maximum amount that can be expensed under IRC Section 179 is \$500,000, but in 2012 the limit will drop to \$125,000.





*Though past performance is no guarantee of future results, you should make sure your expectations (both financial and social) are realistic and in line with what you hope to achieve.*

## The New Face of Socially Responsible Investing

Feeling strongly about the societal benefit or harm your money might be supporting doesn't mean you have to forgo pursuing a return on your investments. Socially responsible investing allows you to further both your own economic interests and a greater good.

The concept of putting your money where your mouth is first gained widespread attention during the 1970s, when such highly charged political issues as the Vietnam War and apartheid in South Africa led some investors to try to make sure their money didn't support policies that were counter to their beliefs. Since then, a wide variety of investment products, such as socially conscious mutual funds, have been developed to help people invest in ways consistent with a personal philosophy. However, individuals aren't the only ones to adopt responsible investing principles; many colleges and universities, government pension and retirement funds, and religious groups do so as well.

There are many approaches to what may also be known as mission investing, double- or triple-bottom-line investing, ethical investing, socially conscious investing, green investing, sustainable investing, or impact investing.

### Screening potential investments

This is perhaps the best known aspect of socially responsible investing: evaluating investments based not only on their finances but on their social, environmental, and even corporate governance practices. The process may be negative, eliminating companies whose products or actions are deemed contrary to the public good. Examples of companies that are frequently excluded from socially responsible funds are those involved with alcohol, tobacco, gambling, defense, and those that contribute to environmental pollution or that have significant interests in countries considered to have repressive or racist governments.

However, as socially responsible investing has evolved, the screening process has become increasingly positive, using screens to identify companies whose practices actively further a particular social good, such as protecting the environment. For example, green technology that can help address environmental problems has attracted the interest of many investors who see not only a social good but an opportunity for profit.

### Shareholder activism

Both individual and institutional shareholders have become increasingly willing to pressure corporations to adopt socially responsible practices. In many cases, having a good social

record can enhance business, making a company more attractive to investors. Shareholder advocacy can involve filing shareholder resolutions on such topics as corporate governance, climate change, political contributions, environmental impact, and labor practices. Such activism got a boost from the SEC when it adopted the so-called "say on pay" rule as part of the Dodd-Frank financial reforms. As of April 2011, companies over a certain size must allow shareholders a vote on executive pay at least once every three years. Though the vote is nonbinding, it could give institutional investors a stronger hand in advocating for other interests.

### Community investing

Still another approach involves directing investment capital to communities and projects that may have difficulty getting traditional financing. Investors provide money that is then used to make or guarantee loans to organizations that help traditionally underserved populations with challenges such as gaining access to affordable housing, finding jobs, and receiving health care.

### Impact investing

A recent development focuses not only on investment returns and social benefit, but on measuring and managing performance in both of those arenas. So-called "impact investing" aims not only to minimize negative impact and enhance social good, but to do so in a way that maximizes efficient use of the resources involved, using business-world methods such as benchmarking to compare returns and gauge how effectively an investment fulfills its goals. In fact, some have made a case for considering impact investing an emerging alternative asset class, since such investments may not be highly correlated with traditional assets such as stocks or bonds.

### Know your goals

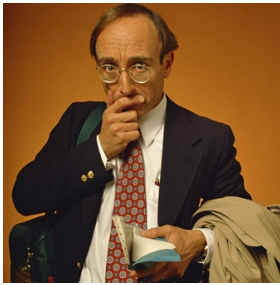
When investing for the greater good, make sure your expectations are clear and realistic. "The public good" may be defined differently by every investor. Also, many socially responsible funds achieve solid financial returns; others may not.

**Note:** Before investing in a mutual fund, carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the fund; read it carefully before investing.

## Deciphering Health Savings Vehicles



***Beginning January 1, 2011, for HSA, MSA, FSA, and HRA programs, a drug or medicine is considered a qualified medical expense only if it is obtained with a prescription, or is insulin.***



***Effective January 1, 2013, contributions to a flexible spending account will be limited to \$2,500 per year, increased annually by cost-of-living adjustments.***

Health savings accounts (HSAs), Archer medical savings accounts (MSAs), health reimbursement arrangements (HRAs), and flexible spending arrangements (FSAs) are all personal health accounts that may help you control your health-care costs. But trying to figure out what's what can be confusing. Here's a brief description of each type of account, including some of their major features and benefits.

### **MSAs/HSAs**

As of January 1, 2008, the MSA program expired and no new MSAs can be established, although if you already participate in an MSA, you can continue to receive contributions. HSAs have generally taken the place of MSAs because of their greater flexibility and options. In fact, in most instances you can roll over an existing MSA into an HSA. MSAs and HSAs are set up in a trust account with a financial entity. Contributions made through your employer are pretax dollars (or you can contribute to the account directly and deduct the contribution), no tax is due on funds in the account, or on any earnings until withdrawn, and if funds are used for qualified medical expenses, the withdrawals are not taxed. However, account withdrawals that aren't used for qualified medical expenses are subject to a tax penalty of 20%, in addition to regular income tax. Your account is portable, meaning if you change employers or leave the workforce, you can keep the account. To be eligible, you must be insured by a high deductible health plan (HDHP) that you maintain (if self-employed) or that's provided through your employer.

However, there are also differences between MSAs and HSAs. Generally, anyone with an HDHP can participate in an HSA. But to qualify for an MSA, you must have been either an employee of a company that employs 50 or fewer people, or be self-employed (or the spouse of such an employee or self-employed person). With an HSA, contributions can be made by you, your employer, or anyone else on your behalf within the same plan year. But MSA contributions can only be made by either your employer or yourself, but not both, in the same plan year. Contribution amounts also differ. In 2011, maximum HSA contributions are limited to \$3,050 for single HDHP coverage and \$6,150 for family HDHP coverage. MSA contributions can be up to 75% (65% if you participate in a self-only plan) of the annual deductible of your HDHP, but no more than your annual earnings from employment.

### **FSAs**

If you don't participate in an HDHP, you still can set money aside for uninsured medical expenses through an employer-established FSA. Unlike an HSA, you must be an employee of the employer providing the FSA in order to participate (self-employed persons are not eligible and certain limitations may apply if you are a highly compensated participant or key employee). Pretax contributions can be made by either you, your employer, or both of you (except employer contributions used to pay long-term care premiums must be included in income). You determine how much money you want deposited each year up to the plan's maximum dollar amount or percentage of compensation; funds in the account are not subject to tax; and distributions are tax free if used to pay for qualified, unreimbursed medical expenses you've incurred (no advance payments for anticipated expenses). Unlike HSAs, if you leave your employer, you can't keep the money in the account or take it with you to another employer (it's not portable). Also, what you don't spend on medical expenses by the end of the plan year is forfeited and not available the following year (i.e., you must use it or lose it).

### **HRAs**

Like FSAs, HRAs are only available to employees, not to self-employed individuals. And HRAs must be funded solely by an employer; you can't contribute directly to the account. The terms of the HRA are generally determined by the employer. For example, your employer's plan may or may not require you to have health insurance in order to participate. The plan sets the maximum amount of contributions, and determines whether a credit balance in the account can be rolled over from year to year, and if so, how much of the account can be rolled over. But contributions and reimbursements for qualified medical expenses are tax free. Reimbursements can be made to current and former employees, including spouses and dependents of employees and deceased employees. However, if the plan allows for any distribution to you or anyone else (e.g., spouse, dependent, estate at your death) for other than reimbursement for qualified medical expenses, then any distribution, whether for qualified medical expenses or not, is included in gross income.

## Ask the Experts

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### What is a funeral trust?

A funeral trust is a contract you enter into with a provider of funeral or burial services.

Often, the trust is entered into directly with the funeral home,

which may agree to "lock in" costs for future funeral or burial services at an agreed upon price. The funeral home sometimes serves as trustee (manager of trust assets), and you usually fund the trust with cash, bonds, or life insurance. A revocable funeral trust can be changed and revoked by you at any time. An irrevocable trust can't be changed or revoked, and you generally can't get your money out except to pay for funeral services.

Irrevocable funeral trusts may also help you qualify for long-term care benefits through Medicaid. These trusts may be funded with assets that would otherwise be countable resources for Medicaid. They are also often sold through insurance companies, in which case they are typically funded with single-premium whole life insurance. Trust assets, including life insurance death benefits, are not countable resources when trying to qualify for long-term care benefits through Medicaid. And you can fund the funeral trust

right before entering the nursing home--there's no "look-back" period for these transfers.

Another advantage of funding your trust with life insurance is that the trust will have no taxable income to report, since life insurance cash values grow tax deferred. Otherwise, income from trust assets may be taxed to you as the trustor (creator of the trust) unless the trustee elects to treat the trust as a qualified funeral trust by filing form 1041-QFT with the IRS, in which case trust income is taxed to the trust.

But what if you want to change funeral homes, or the facility you selected goes out of business? Does your irrevocable trust allow you to change beneficiaries (e.g., funeral homes)? Are trust funds protected from creditors of the funeral home? States have laws regulating prepaid funeral trusts that often require funeral homes to keep trust assets separate from their own business assets--keeping them safe from funeral home creditors. And most irrevocable trusts are transferable to another funeral home should the initial business fail or you change funeral homes.



### What is a pet trust?

A pet trust is a contract you use to provide for the care and financial support of your pet upon your disability or death.

As the trustor (creator) of the trust, you fund the trust with property or cash that can be used to provide for the care and protection of your pet based on the instructions you lay out in the trust.

Your pet trust should name a trustee, who will carry out your instructions for the care of your pet, including handling and disbursement of trust funds and turning your pet over to the person or entity you designate to serve as your pet's caregiver.

As with most trusts, you can create your pet trust while you're alive (an inter vivos or living trust) or at your death through your will (a testamentary trust). In either case, you can generally change the terms of your pet trust at any time during your lifetime to accommodate changing circumstances. If you create an inter vivos trust, you can fund it with cash or property either during your life or at your death through your will. A testamentary trust is only funded after you die.

Some of the instructions to consider for your pet trust include: provisions for food and diet, daily routines, toys, medical care and grooming, how the trustee or caregiver is to document expenditures for reimbursement, whether the trust will insure the caregiver for any injuries or claims caused by your pet, and the disposition of your pet's remains.

You may also want to name a person or organization to take your pet should your trust run out of funds. Also, consider naming a remainder beneficiary to receive any funds or property remaining in the trust after your pet dies.

A potential problem arises if your pet is expected to live for more than 21 years after your death. That's because the "rule against perpetuities" forbids a trust from lasting beyond a certain period of time, usually 21 years after the death of an identified person. However, almost every state has laws relating to pet trusts that address this issue in particular and allow for the continued maintenance of the trust even if its terms would otherwise violate the rule.