Wi$e Up Teleconference Call
March 31, 2006
Understanding Taxes: Make the Most of Your Return
Speaker 2: Michael Schulman

Angela Rizzolo: Patricia?

Patricia Gaviria: Good afternoon. My name is Patricia, and I am the Program Specialist in New York for Region II. It is my pleasure to introduce our next guest.

Michael David Schulman, CPA/PFS is the third generation owner of Schulman, CPA, a full service tax, accounting, and auditing firm founded in 1952.

In 1999, the AICPA awarded him the Personal Financial Specialist designation and he formed Schulman CPA/PFS, P.C. to provide personal financial planning services.

In 2002, Michael formed Excelsior Senior Advisors LLC to provide PrimePlus/ElderCare services for those who are or about to become older adults.

Michael is a frequent speaker on tax and financial planning topics, has written numerous articles for newspapers and professional journals, and has appeared on television and radio.

Michael is a member of the American Institute of CPAs, the New York State Society of CPAs, and the California State Society of CPAs and is active on financial planning and elder care committees. He serves as a lecturer for the Foundation for Accounting Education, the education arm of the NYSSCPA.
In addition to his professional certification, Michael has an academic degree from MIT, U.C. Berkeley and Fordham University.

Welcome, Michael.

Michael Schulman: Thank you very much.

Good afternoon everybody, and for those of you who are on the West Coast, good morning everybody. And I wish I were out there enjoying the warm weather that you’re having out there.

What I want to talk about this morning is your tax return itself. For far too many people, April 15 marks the end of the financial process for the year. Their return is done. They might be getting a refund. They might have a balance a due. If you’re paying attention to Jeff, you’ll have enough money withheld just to cover your tax and the rest will be invested.

And that’s the end of it. The papers go back in the box. The tax return goes in the box. The box goes on the shelf. And you’re done for the year.

And what I want to suggest to you is that this is now the beginning. Now you should sit down. You’ve finally been forced to confront your financial realities. Look at your tax return. What are some of the things your tax return can teach you about taxes and about financial planning going forward?

So, if you can envision your tax return, the first important line on the tax return is your salaries and wages line.
For those of you who are on salary, take a look at your W-2 and look at that box number 14 and see if anything is in there. So that’s where your 401(k) deferrals go.

And those of you who are in 401(k) plans and if you’re not making contributions, you’re making a very, very big mistake. The 401(k) plan is one of the great tax institutions of the country, and you should take advantage of it as much as possible.

So there are those people who’ll say, “I can’t afford to put any more into the plan. I can’t afford to do the plan. I have taxes. I have school education to pay. I have a mortgage to pay.”

And I say to them, “If your mortgage went up a $100 a month would you be able to pay it?” And they go, “Sure, I can afford a $100 a month to pay something as important as my mortgage.” I say to them, “Fine. Your mortgage just went up $100 a month. But instead of paying the bank you’re going to pay yourself.”

Call your human resources person, get that $100 a month taken out for your 401(k) plan because once you do, you’re going to save $25 in taxes. That’s a remarkable return on your money. I can’t get you 33% on your money any place.

I strongly recommend the 401(k) plan for those of who are wage earners.

Next on your tax return, look at your dividend and interest line. If there’s nothing there, time to start saving buckos because that’s where your future revenue is going to come from when you’re old and gray.
Start putting money aside. In the beginning, it doesn’t matter where. It’s more important that you start saving than chasing rates of return. Don’t worry about the latest and greatest investment. I guarantee you you’re not going to find it because professionals can’t identify it. Don’t do that. Just start saving money: savings accounts, CDs, basic mutual funds. Get some money under your belt and start earning interest.

Those of you in higher income brackets, you want to look at that line and look at the distinction between your taxable and your municipal interest.

As Jeff pointed out before with tax avoidance and tax evasion, what I want to talk about is tax-deferred and tax-exempt.

Tax-deferred income is income that will ultimately be taxable even though it’s not taxable now -- your money in your IRA, your money in your 401(k), your money in your annuity. These are growing, but you’re not going to pay tax on them for many, many years.

Tax-exempt is you’re never going to pay tax on them. And there’s a big difference. So if you have municipal bonds – city and state bonds – and you’re getting interest on those, that interest will never be taxable to you.

And those of you in a high tax bracket really want to take advantage of that because the taxability of your ordinary dividends and ordinary income really brings down your rate of return.
You want to look at that, the distinction between your taxable and tax-free interest and dividends. Again, you also want to make sure you’re getting somewhat of a decent return. If you’re investing in something and getting far too low a return, now’s the time to think about maybe switching your investment.

Looking farther down your tax return, there is what’s called a Schedule C for business owners.

If you own your own business, what are the things that are available to you as a business owner? Well, right away, self-employed pension plans, health insurance plans. There are many, many things that you can take advantage of. Speak to a professional and look for all the different things that you as a sole proprietor can take advantage of.

And look for the pitfalls of being a sole proprietor. You have to pay double Social Security tax, double Medicare tax, and sometimes that comes to be a very, very big surprise to people who own their own business.

If you’re collecting pensions and annuity, make sure you only pay tax on the taxable portion. If you have an annuity stream coming in to you that you have paid into, a piece of every check that you get from the annuity company is not taxable. So don’t pay tax on everything. Make sure you calculated it the right way; otherwise, all that return that you build up in the contract is going to be wasted. You want to be very careful.

Annuities as tax-deferred investments, in the appropriate circumstance, are wonderful ways of deferring your taxable income. But on the
other side, when it’s time to draw down, you want to draw down with caution.

There’s a line on your tax return called *retirement plan contribution* that is at the bottom of the first page. And again, as you – as every professional will tell you: your IRA, your 401(k), be sure to make your contributions into those.

And be sure to look into alternative ways of putting in as much money as you can. There are many, many different plans for self-employed people in terms of putting away your money. There are profit-sharing plans. There’s what’s called defined benefit plan. There are age-weighted plans. There are plans where you can sock away a lot of money, and now is the time to do it.

For every dollar you put in, you’re going to get a tax deduction which for most of you will be equivalent to an immediate 33% return on your money, and you can’t get that anywhere else. So you look at the bottom of Page 1 of your return and see if something is there.

If you are paying interest on student loans, and there’s a line on Page 1 [for student loan interest] - maybe it’s time to pay those student loans off. Maybe it’s time to start getting rid of some of that debt.

It’s true that the loans are deductible, and because the loan - the interest on the loans is deductible, the effective rate comes down. But how old do you want to be when you’re paying student loans? Do you want to keep paying student loans when your children are paying student loans? Maybe it’s time to start doing something like getting rid of some of that debt so down the road you can take that money and start accumulating it for yourself.
Itemized deductions are another place to look in terms of tax and financial planning. Medical expenses. There is a line for long-term care insurance premiums. If you are 50 years or older, I guarantee you you will need long-term care insurance.

And if you don’t have an entry on that line for deductible long-term care premiums, get yourself down to a financial services professional and talk about this. Because so many people wind up in nursing homes or need in-home care. It’s not nursing home for life; even nursing home for a year or two. What if you’re 75 and break your hip?

Do you think perhaps your parents have enough money to account for their retirement? If not, maybe you and your siblings or you alone could pay for a long-term care health policy for your parents. Believe me, that is money well spent.

If you can make certain today with a flow of money that will cover uncertain medical costs years in the future, I submit that for many of you, that’s a wonderful deal.

Long-term care insurance, I think, is extremely important. As you get to be 50, 55, it’s much more important than life insurance because by 50 or 55, the need for life insurance tends to dissipate. You probably have your mortgage down to a reasonable amount. Your kids’ education is somewhat cared for. And what you should be looking for now are longer term things, and long-term care is one of those. I wouldn’t cancel a life insurance policy, but you really ought to consider long-term care.
Do you have health insurance? What’s more important in financial planning than your health? Forget about the health of the money, how about the health of you? Make sure you have health insurance. Far too many people don’t have health insurance. Or if you do, are you shopping around for the best policy?

If you are in - if you’re a business owner, do you have the best policy for your company and your employees? Have you shopped around? Have a professional come in now and then and look at those insurance policies. Are you getting the best deal that you can?

Then there is the insidious and disastrous alternative minimum tax on Page 2 of your tax return. I could spend hours talking about the AMT, and I won’t. But, briefly, the AMT is a tax instituted many years ago that was supposed to catch the wealthy taxpayer who wasn’t otherwise paying taxes.

And, basically, it’s a completely separate tax calculation where much of your regular deductions are voided out, the most common being state and local income taxes.

For taxpayers in high income tax states such as New York and California, more and more of us are finding ourselves grabbed by the alternative minimum tax. It’s an addition to the regular tax. In many instances it’s a substantial tax, and all the money you’ve been paying towards your state and local taxes effectively gives you no tax benefit whatsoever.

What would you do about this? What you do about this is in June, July and August is you sit down and you look at your financial situation for the year and you make a decision going forward as to how
to allocate your income and expenses to avoid the alternative minimum tax.

If you’re trapped in the alternative minimum tax situation, now is the time to possibly accelerate your income because you can take advantage of it that way as well. The rate of the AMT is lower than the rate of regular tax. [As noted in the MSN Money article Five Ways to Beat the AMT by Jeff Schnepper, the more ordinary income you have relative to your deductions, the less likely you will be in the AMT -- or, the less it will sting.]

So sometimes it pays to accelerate your income into a prior year. And you can see it by looking at your tax returns. All we’re doing now is looking at our return. And you can see that if there is an AMT number there, you want to do something about that.

For those of you with children in college, there are education tax credits that were spoken of before. If you have kids in college and you don’t have tax credits, sit down and find out why. Look into those credits. Find out how you can structure your savings to take advantage of those credits.

It’s never too late to open up a 529 plan, even if your child is already in college. If you have savings sitting at home for college education, think about dumping it into a 529 plan right away.

Check with your state. Each has their own plan. They are also - you can be in one state and get a plan from another state. But look into these things; 529 plans are wonderful ways of saving for college.
Jeff spoke before about - you don’t want to have too large a tax refund at the end of the year, and he’s absolutely right. If your refund is substantial, change that withholding. Wouldn’t you rather have the money in your pocket during the year? And you know what you do with it? Put it into a savings account. Put it into a mutual fund account. Put it into a variable life insurance policy. Start saving. Start saving, and the government will give you the money with which to save.

Now another thing you want to be careful about is you want to know the difference between when you can save and have Uncle Sam pick up a piece of the cost and when you can save and not. And that’s the difference between 401(k)s and IRAs that we spoke of before and other tax accumulation vehicles like annuities and life insurance.

In the 401(k) - in both of them, when you draw the money out towards the back, it will be taxable to you (except for the Roth IRA). When you draw money out of an annuity, it’s taxable. When you draw money out of an IRA, it’s taxable. But with IRAs and 401(k)s, you’re getting a tax reduction going in.

So by looking at your tax returns, there are ways of increasing your income just by strategizing around the information on your return. And now is the time because all the papers are in front of you. Everything is there, and now’s the time to sit down with a CPA, with a financial planner and get your questions answered.

And now’s the time in the year when you can start. You have nine months till the end of the year. Year is almost over. You have nine months now to sit down and look forward and make the best financial
decisions to you based on the documents that you have to prepare anyways.

And as long as we’re giving out Web sites, please, you’re free to jump on mine as well. It’s www.schulmancpa.com; tons of information as well.

And thank you for letting me participate today.

Cindy Henning: Well, thank you very much, Michael. We really appreciate all the information that you gave to us.