Farmington Observer

Business

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Tax planning aids couple's saving goals

Family Finances

a profile

By Alan Ferrara
and Dan Boyce
special writers

Local financial planning experts reviewed the data of the family profiled here and made general recommendations based on the participant's resources and goals. The information is for educational purposes only; references are not intended as discrimination or endorsements by Observer & Eccentric Newspapers or the advisers interviewed. To receive a free financial planning brochure or obtain a questionnaire to have your finances reviewed in this column, contact the Center for Financial Planning, Dept. 100, 877 S. Adams, Suite 202, Birmingham 48011 or call 642-4000.

"The only certainties in life are death and taxes" was never so true as it seems today. Our family profile this month centers on David and Irene T. of Plymouth who are concerned about how the new tax law will effect their situation this year.

"We are unsure what our tax bill will be and what actions we should be taking. We're expecting the worst, but hoping for the best," they write.

A childless two-income couple, David and Irene are comfortable in their current lifestyle. David, 43, is a computer programmer with a utility company, and Irene, 41, is a nurse in a local hospital. Their salaries are $31,000 and $27,000 respectively.

They "have not been savers" in the past, but they are trying to make amends for past extravagance. Through careful planning, they have reduced their charge card balances by half over the last two years, and David is now putting 5 percent of his income into a company-sponsored 401(k) retirement plan.

Still they believe they are not getting ahead as fast as they would like. They have always felt that taxes were a major problem, and they are worried that the 1986 Tax Reform Act is going to make things worse.

Our advisers note some positive factors in their situation: two steady incomes; good auto and homeowners coverage along with excellent life, health and disability packages at work; and an adequate estate plan of simple wills and durable powers of attorney, which provide control of their assets in the case of death or incompetence.

Though they now are more careful in their spending habits, they are still unsure where their money goes. Some fixed outlays include a house payment of $520 per month; two auto payments of $240 each with one almost paid off; immediate payment of all new credit card purchases, plus $250 per month on the outstanding balance.

Had they been putting 10 percent of their incomes into company-sponsored retirement plans all year, they would have saved more than $1,400 on their federal tax bill.

THE IMMEDIATE goals of David and Irene include paying off the remainder of their credit cards and beginning to build their assets for long-term financial security. They do not have a great deal of time to spend on evaluating investment alternatives, but they realize that they should not put all of their long-term money into a savings account.

"How and where are the best places to save for our retirement?" they ask.

Certified financial planner Dan Boyce in Birmingham recommends considering liquidating the relatively weak company stock that David owns. The proceeds can be used to pay off the remainder of the credit card debt and add to their emergency reserve.

"Without the $250-a-month credit card repayments, they now have the ability to save greater amounts toward retirement. The best place for retirement savings is the plans their employers offer.

"David should increase his 401(k) contribution to the 10-percent level, and Irene should start contributing to a tax-sheltered annuity offered through her employer. Both programs will result in immediate tax savings as well as tax-deferral on all earnings. "They should have an ultimate goal of saving at least 10 percent of both incomes for retirement."

When one car payment stops soon, they should allocate that money toward building their cash reserves. Rather than a passbook savings, Boyce suggests a money market account or fund. "It offers a somewhat higher interest rate with immediate access to the money if needed. The goal should be to accumulate three months' disposable income, or $7,000 to $8,000 in the account."

ATTORNEY ALAN Ferrara assesses the impact of the 1986 Tax Reform Act and strategies for the couple's use. An estimate of their federal tax due in 1987 is $9,200.

Ferrara agrees with the recommendation to increase contributions to their employer-sponsored retirement plans.

"Had they been putting 10 percent of their incomes into them all year, they would have saved more than $1,400 on their federal tax bill. Since they are not eligible for deductible IRAs (David is eligible for a pension plan, and their adjusted gross income is more than $50,000), the 401(k) and the tax-sheltered annuity are the most effective retirement savings plans for them."

Ferrara points out other items in the new tax law which affect them:

- The repeal of the two wage-earner deduction, which previously had given two-income families a tax break of up to $3,000.
- Only 65 percent of consumer interest (credit card and auto loan interest) is deductible in 1987, and this percentage decreases in future years, eventually to zero.
- Repeal of the itemized deduction for state and local sales taxes.
- Miscellaneous itemized deductions are deductible only to the extent that they exceed 2 percent of adjusted gross income.

There are several tax strategies for David and Irene to consider:

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Financial Position

INVESTED ASSETS	
Passbook savings	$3,100
U.S. Savings Bonds	$500
Company Stock	$4,400
IRAs	$6,700
401(k)	$4,100
Total	$18,800

USE ASSETS	
Residence	$90,000
Automobiles	$16,000
Boat	$10,000
Personal items	$10,000
Total	$126,000
Total Assets	$144,800

LIABILITIES	
Home mortgage	$50,000
Auto loans	$9,200
Bank loan (boat)	$3,400
Charge accounts	$3,100
Total Liabilities	$65,700
Net Worth	$79,100

Bottom line

Financial strengths

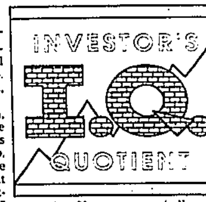
- Own their own home with $40,000 in equity.
- Both have steady employment income.
- Excellent insurance coverage at work.
- Up-to-date wills.
- Systematic 401(k) savings.

Financial weaknesses

- Lack of tax planning information.
- Excessive credit card debt.
- Irregular retirement planning.
- Lack of spending controls in past.
- Inadequate cash emergency reserve.

'Amateur' wins stock contest

By Marilyn Fitchett
staff writer



A 23-year-old former Farmington Hills man has won the National Association of Investor's Corp. stock contest, Investor's Quotient, on a stock he chose at random.

James Arrison of Falls Church, Va., selected Activision from the NASDAQ exchange to comprise his entire $1,000 fictional portfolio. The stock sold at 75 cents at the start of the contest and finished at 2⅝, boosting the wealth of his portfolio to $3,173.33 for a gain of 217 percent. Activision develops software for the home video game market.

Michael W. Lynn of West Bloomfield was second. His stock, Viratek, sold at 11 at the start of the contest and finished at 30¾. He raised the value of his portfolio to $2,722.50, a gain of 172 percent.

West Bloomfield's Robert Russette was third with Telesphere, which went from 2⅞ to 6¾. He closed with $2,342.25 in his portfolio. Frank A. Held of Farmington Hills was fourth. His Machine Vision International finished at 3 3/16 up from $1.60. He closed with $1,992.19.

Fifth place went to Cindy Stevens of Plymouth. She placed her money in two stocks, Activision and Maverick Restaurants. Maverick initially sold for ⅞ and rose to ¾. Her portfolio was worth $1,784.38.

ARRISON MOVED to Falls Church after entering the contest, put on in cooperation with Observer & Eccentric Newspapers, in June. He recently earned his master's degree in industrial engineering from Stanford and works as a consultant in Washington, D.C. Arrison calls himself "not much of an investor" although he did take finance courses in college.

"My brother (Tom) pointed out the contest, and when he wasn't going to enter, I said, 'I could do this.' I thought the only way to do it was to find a penny stock and put all the money in it. I thought with any luck, it'll win."

Arrison "went through the NASDAQ" index, looking for a stock with "a big beta." Beta is a measure of market risk.

After entering, he forgot about the contest.

"I didn't monitor it until I found out I was leading," he said. "Then I followed mine and the one that was in second place."

At the end of August, Arrison led the contest, followed by Lynn.

And although his stock has won him a weekend for two in New York City, including airfare, accommodations and a tour of the New York stock exchange, Arrison said the win has not prompted him to try his hand in a real investment strategy.

"I'd probably rather not invest my own money in a penny stock," he said. "It's too risky. You can get lucky in a contest but probably not in reality."

NAIC AND OBSERVER & Eccentric Newspapers challenged readers to select a fictional portfolio of up to five stocks for a total worth of $1,000. The winning entry was determined by growth exclusive of dividends from the date of the entry to the end of the contest on Sept. 25. June 28 was the last day to enter. The contest drew 879 entrants.

Contest winners will be announced today as part of the NAIC's annual convention at the Westin Hotel in the Renaissance Center. The convention runs through Saturday and includes NAIC's 37th annual Investors Gallery, which gives individual investors a chance to speak with corporate officers or investment relations directors from 75 publicly traded companies. Hours for the gallery, which is open free to the public, are 2-6 p.m. today, noon to 6 p.m. Friday and 10 a.m. to 4 p.m. Saturday.

Second-place prizes of a weekend (two nights' lodging) at the Westin will be awarded to Lynn, Russette and Held. There are five third-place prizes of one-year subscriptions to Better Investing magazine, an NAIC publication, and five fourth-place prizes of one-year subscriptions to Observer & Eccentric Newspapers.

Here is how the remaining 24 of the 29 top investors fared. Final portfolio worth is in parentheses: 6. Bob Nelson, Livonia, (1,775.); 7. Louis G. Basso Jr., West Bloomfield, (1,767.57); 8. Marc Zupmore, Southfield (1,746.75); 9. Len Iden, West Bloomfield (1,744.18); 10. Debby DiLalla, Livonia (1,726.63); 11. Wayne Forchand, Bloomfield Hills (1,665.63); 12. Michael West, Livonia (1,625); 13. Tim Hopkins, Detroit (1,593.75); 14. Brian O'Neill, Livonia (1,589).

15. Joseph Borysiak, Redford (1,578.25); 16. Kelly Bezuutch, Westland (1,562.45); 17. George W. Hess Jr., Birmingham (1,542.75), 18. Joseph Margevicius, Farmington Hills ($1,536.71); 19. Tanya Lewis, Birmingham (1,527.50); 20. Richard Nalepika, Plymouth, (1,511.88); 21.(tie) John Cherrette, Birmingham (1,500); Janet Willard, Troy, and John Harris, Canton; 24. Carl Bardel, Canton (1,488.81).

25. Stanley Baca, Detroit ($1,478); 26. Mike Shirilla, Ann Arbor (1,460.63); 27. Linda Turner, Canton (1,462.88); 28. Terrie Hutchinson, Westland (1,460.37); 29. Randall Falk, Bloomfield Hills ($1,455).

Economist paints new face on trade deficits

By Tim Richard
staff writer

So the United States has a foreign trade deficit. Hey, great!

The jubilant view of the economy came from Arthur B. Laffer, the supply-side economist, who told Michigan National Corp. bank officials last week: "The Japanese are protectionist. They're silly. Japan's wrong — we're right."

No longer a university teacher, Laffer runs his own economic consulting firm in southern California and sits on a panel of private economists advising President Reagan. Laffer loves Reagan.

But about that "trade deficit."

"OUR TRADE deficit is literally our foreign investment surplus. They are the same thing," said Laffer, concentrating on the dollars Japanese invest here rather than the autos and electronics Americans import.

Does a growth company lend or borrow money? It borrows. If you were a borrower, would you rather see investors lined up trying to get into your country? Or get out?

MNC officials nodded that they'd rather see investors coming in.

'Our trade deficit is literally our foreign investment surplus. They are the same thing.'
— Arthur Laffer

"We're the Bermuda of this planet — the biggest tax shelter in the world. We're pulling in capital. We're not a Mexico or a Brazil or an Argentina."

The reason the United States is attracting foreign investment is something Laffer had more than a little to do with. It's the low marginal tax rates in the new federal income tax code.

THE 45-YEAR-OLD Ohio-born economist is author of a graph called the "Laffer curve," which shows that revenue increases as high marginal tax rates drop, because so much productivity is stimulated. The Reagan-Kemp-Roth tax cut of 1981 was based on Laffer's reasoning.

"You can hang the ($160 billion federal budget) deficit on me," he laughed in an interview, "as long as you hang the unemployment rate on me and the inflation rate."

The jobs picture is a chief reason why Laffer insists the "trade deficit is not a problem. The American economy has created more jobs in the last seven years than the rest of the world combined — times three."

He fears protectionist legislation may come out of Congress, leading to the kinds of high prices that Japanese consumers suffer with.

"AN ABSOLUTELY spectacular 1988" is in store for both the American economy and federal budget, Laffer predicted. He cited three reasons:

- Smart taxpayers deferred much 1986-87 income to '88 to take advantage of the new, lower tax rates. "That makes '87 look slower than it really is." There will be "a huge bulge in growth and revenue" next year.
- Importers this year are doing much speculative buying to build up inventories, fearing protectionist legislation in Congress. That exaggerates the trade deficit.
- The new, lower tax rates will

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