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Mid-Year Reality Check: Covering Your Bases in Uncertain Times

Ways Parents Can Help Their Boomerang Kids Of Taxes Past, Present, and Future

Is it true that Social Security beneficiaries are being required to receive their payments electronically?



Your Money Matters

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Mid-Year Reality Check: Covering Your Bases in Uncertain Times



Imagine playing a complicated game, but the rules of the game are changing, and the new rules have yet to be announced. That's what income tax planning is like this year. In fact, if there was ever a year to spend some quality time with your financial professional, this is it. Here are a few items to discuss.

How will higher rates next year affect you?

Federal income tax rates are scheduled to jump in 2013, with the bottom (10%) rate disappearing, and the top rate increasing from 35% to 39.6%. Starting in 2013, high wage earners--those with wages exceeding \$200,000 (\$250,000 for married couples filing jointly and \$125,000 for married individuals filing separately)--will also have to pay an additional 0.9% in the hospital insurance (HI) portion of their payroll tax, commonly referred to as the Medicare portion.

Could the current federal income tax rates be extended again? Of course, but it's far from a certain bet, and the odds are that any action would not take place until after the presidential election. That means any financial plan you put in place has to account for this uncertainty. And the uncertainty extends beyond just tax rates, because a number of popular tax breaks are also scheduled to expire at the end of the year, while others have already expired. So, any potential moves have to be considered in the context of several "what if" scenarios. For example, if you have the opportunity to defer compensation to next year, you have to really think about whether that makes sense, or if you would be better off paying tax on the income at this year's rates.

Potential investment moves

In addition to increased tax rates on earnings, the rates that apply to long-term capital gain and qualifying dividends are scheduled to increase in 2013. The maximum rate on long-term capital gain will jump from 15% to 20%. And while qualifying dividends currently benefit from being taxed at the rates that apply to long-term capital gain, in 2013 they'll be

taxed at ordinary income tax rates. Also beginning in 2013, a new 3.8% Medicare contribution tax will be imposed on the net investment income of individuals with modified adjusted gross income that exceeds \$200,000 (\$250,000 for married couples filing jointly and \$125,000 for married individuals filing separately). That means someone in the top tax bracket could potentially end up paying tax on some investment income at a total rate of 43.4%.

Potentially higher rates in 2013 could be a motivating factor in your investment strategy. For example, you might want to consider selling investments that have appreciated in value to recognize long-term capital gain in 2012, before the maximum rate is scheduled to increase. Alternatively, you might consider timing the sale of an investment to postpone the recognition of a capital loss until 2013, when it could be more valuable.

Roth conversions--is this the year?

If you've been on the fence about converting traditional IRA funds or pretax 401(k) contributions to a Roth account, you ought to give the matter one last hard look before the year ends. That's because when you convert a traditional IRA to a Roth IRA, or pretax dollars in a 401(k) plan to a Roth account, the converted funds are subject to federal income tax (to the extent the funds represent investment earnings, tax-deductible IRA contributions, or pretax 401(k) contributions) in the year that you make the conversion.

If tax rates go up next year, so will the effective cost of doing a Roth conversion. Additionally, qualified distributions from Roth IRAs and Roth 401(k)s are free from federal income tax. That could make a big difference in retirement if you're paying tax at a higher rate at the time. Whether a Roth conversion is right for you depends on a number of factors. If it makes sense for you, though, it might pay to think about acting now, rather than later.

Ways Parents Can Help Their Boomerang Kids



A financial strain

Parents naturally want to help their children during hard times, but in some cases, the financial strain of another adult (or two or three) in the house can be too much of a financial shock. If your adult child needs to move back home, discuss how long your child plans to stay and how he or she can contribute financially to the household.



It's been called the new retirement wild card. But it's not inflation, health-care costs, or taxes, though those things certainly matter. What is it that's causing so much uncertainty? It's boomerang kids, and the money their parents spend on them.

The trend

According to the U.S. Census Bureau, there were 6 million young adults ages 25 to 34 living at home in 2011--19% of all men (up from 14% in 2005) and 10% of all women (up from 8% in 2005). Not surprisingly, the percentages are higher for young adults in the 18 to 24 age bracket, with 59% of young men and 50% of young women living with their parents in 2011.

Sociologists have cited a number of reasons for this trend--the recession, college debt, the high cost of housing, delayed marriage, and a tendency toward prolonged adolescence. But whatever the reason, there's no doubt that boomerang children can be a mixed blessing for their parents, both emotionally and financially. Just when parents may be looking forward to being on their own and preparing for their retirement, their children are back in the nest and relying on their income. While the extra company might be welcome, you don't want to sacrifice your emotional and financial health to help your kids.

Set ground rules

If your adult children can't afford to live on their own, establish ground rules for moving back home, including general house rules, how long they plan to (or can) stay, and how they can contribute to the household in terms of rent and chores. As an adult, your child should be expected to contribute financially to the household overhead if he or she is working. Determine a reasonable amount your child can contribute toward rent, food, utilities, and car expenses. You can then choose to apply this money directly to household expenses or set it aside and give it to your child when he or she moves out, when it can be used for a security deposit on an apartment, a down payment on a car, or some other necessary expense.

You should also discuss your child's long-term plan for independence. Does your child have a job or is he or she making sincere efforts to look for work? Does your child need or want to go back to school? Is your child working and saving money for rent, a down payment on a home, or graduate school? Make sure your child's plans are realistic and that he or she is taking steps to meet those goals.

It's a balancing act, and there isn't a road map or any right answers. It's common for parents to

wonder if they're making a mistake by cushioning their child's transition to adulthood too long or feel anxious if their child isn't making sufficient progress toward independence.

Turn off the free-flowing money spigot

It can be tempting for parents to pay all of their adult children's expenses--big and small--in an effort to help them get on their feet, but doing so is unlikely to teach them self-sufficiency. Instead, it will probably make them further dependent on you.

If you can afford it, consider giving your child a lump sum for him or her to budget rather than just paying your child's ongoing expenses or paying off his or her debt, and make it clear that is all the financial assistance you plan to provide. Or, instead of giving your child money outright, consider loaning your child money at a low interest rate. If you can't afford to hand over a sum of cash or prefer not to, consider helping with a few critical expenses.

Evaluate what your money is being spent on. A car payment? Credit card debt? Health insurance? A fancy cell phone? Student loans? General spending money? Your child is going to have to cut the frills and live with the basics. If your child is under age 26, consider adding him or her to your family health plan; otherwise, consider helping him or her pay for health insurance. Think twice about co-signing a new car loan or agreeing to expensive lease payments. Have your child buy a cheaper used car and raise the deductible on his or her car insurance policy to lower premiums. Help your child research the best repayment plan for student loans, but don't pay the bills unless absolutely necessary. Same goes for credit card balances. Have your child choose a less expensive cell phone plan, or consolidate phones under a family plan and have your child pay his or her share. Bottom line--it's important for your child to live within his or her financial means, not yours.

Solidify your own retirement plan

Even if your child contributes financially to the household, you may still find yourself paying for items he or she can't afford, like student loans or medical bills, or agreeing to pay for bigger ticket items like graduate school or a house down payment. But beware of jeopardizing your retirement to do this--make sure your retirement savings are on track. A financial professional can help you see whether your current rate of savings will provide you with enough income during retirement, and can also help you determine how much you can afford to spend on your adult child now.



Of Taxes Past, Present, and Future



Qualified charitable distributions

A popular provision allowing individuals age 70½ or older to make qualified charitable distributions of up to \$100,000 from an IRA directly to a qualified charity expired at the end of 2011. These charitable distributions were excluded from income, and counted towards satisfying any required minimum distributions that you would have had to take from your IRA for the year.

Return of the "marriage penalty"?

Tax changes that were originally made to address a perceived "marriage penalty" expire at the end of 2012. If you're married and file a joint return with your spouse, you'll see the effect in the form of a reduced 2013 standard deduction amount, as well as in lower 2013 tax bracket thresholds in the tax rate tables (i.e., couples move into higher rate brackets at lower levels of income).

With the 2011 tax filing season behind us, much attention is being paid to the expiring "Bush tax cuts"--the reduced federal income tax rates, and benefits, that will expire at the end of 2012 unless additional legislation is passed. In fact, though, several important federal income tax provisions already expired at the end of 2011. Here's a quick rundown of where things stand today.

What's already expired?

A series of temporary legislative "patches" over the last several years has prevented a dramatic increase in the number of individuals subject to the alternative minimum tax (AMT)--essentially a parallel federal income tax system with its own rates and rules. The last such patch expired at the end of 2011. Unless new legislation is passed, your odds of being caught in the AMT net greatly increase in 2012, because AMT exemption amounts will be significantly lower, and you won't be able to offset the AMT with most nonrefundable personal tax credits.

Other provisions that have already expired:

- **Bonus depreciation and IRC Section 179 expense limits**-- If you're a small business owner or self-employed individual, you were allowed a first-year depreciation deduction of 100% of the cost of qualifying property acquired and placed in service during 2011; this "bonus" depreciation drops to 50% for property acquired and placed in service during 2012, and disappears altogether in 2013. For 2011, the maximum amount that you could expense under IRC Section 179 was \$500,000; in 2012, the maximum is \$139,000; and in 2013, the maximum will be \$25,000.
- **State and local sales tax**-- If you itemize your deductions, 2011 was the last tax year for which you could elect to deduct state and local general sales tax in lieu of state and local income tax.
- **Education deductions**-- The above-the-line deduction (maximum \$4,000 deduction) for qualified higher education expenses, and the above-the-line deduction for up to \$250 of out-of-pocket classroom expenses paid by education professionals both expired at the end of 2011.

What's expiring at the end of 2012?

After December 31, 2012, we're scheduled to go from six federal tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) to five (15%, 28%, 31%, 36%, and 39.6%). The rates that apply to long-term capital gains and dividends will change as well. Currently, long-term capital

gains are generally taxed at a maximum rate of 15%. And, if you're in the 10% or 15% marginal income tax bracket, a special 0% rate generally applies. Starting in 2013, however, the maximum rate on long-term capital gains will generally increase to 20%, with a 10% rate applying to those in the lowest (15%) tax bracket (though slightly lower rates might apply to qualifying property held for five or more years). And while the current lower long-term capital gain rates now apply to qualifying dividends, starting in 2013, dividends will be taxed at ordinary income tax rates.

Other provisions expiring at the end of the year:

- **2% payroll tax reduction**-- The recently extended 2% reduction in the Social Security portion of the Federal Insurance Contributions Act (FICA) payroll tax expires at the end of 2012.
- **Itemized deductions and personal exemptions**-- Beginning in 2013, itemized deductions and personal and dependency exemptions will once again be phased out for individuals with high adjusted gross incomes (AGIs).
- **Tax credits and deductions**-- The earned income tax credit, the child tax credit, and the American Opportunity (Hope) tax credit revert to old, lower limits and (less generous) rules of application. Also gone in 2013 is the ability to deduct interest on student loans after the first 60 months of repayment.

New Medicare taxes in 2013

New Medicare taxes created by the health-care reform legislation passed in 2010 take effect in just a few short months. Beginning in 2013, the hospital insurance (HI) portion of the payroll tax--commonly referred to as the Medicare portion--increases by 0.9% for high-wage individuals. Also beginning in 2013, a new 3.8% Medicare contribution tax is imposed on the unearned income of high-income individuals.

Who is affected? The 0.9% payroll tax increase affects those with wages exceeding \$200,000 (\$250,000 for married couples filing a joint federal income tax return, and \$125,000 for married individuals filing separately). The 3.8% contribution tax on unearned income generally applies to the net investment income of individuals with modified adjusted gross income that exceeds \$200,000 (\$250,000 for married couples filing a joint federal income tax return, and \$125,000 for married individuals filing separately).



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Is it true that Social Security beneficiaries are being required to receive their payments electronically?

That's correct. On March 1, 2013, the U.S. Treasury Department will stop mailing paper benefit checks. After that date, all Social Security beneficiaries (as well as anyone receiving another type of federal benefit, such as Supplemental Security Income benefits, Railroad Board annuity payments, federal retirement benefits, or veterans benefits) will be required to receive their benefits electronically. The federal government estimates that switching to electronic payments will save taxpayers \$1 billion over 10 years, and cut down on the risk of lost and stolen checks.

Most Social Security beneficiaries are already receiving benefits electronically, and if you're among them, you don't need to do anything--you'll continue to receive your benefits via the method you've chosen. But if you're receiving a paper check, you need to choose one of two electronic payment options as soon as possible.

The first payment option is to have your benefit directly deposited to a bank or credit union account. The second option is to have your benefit put on a Direct Express® Debit

MasterCard® prepaid card that can be used to pay bills, make retail purchases, or withdraw benefit funds from an ATM or a financial institution. Most transactions are free, although fees do apply to certain services. The Treasury Department recommends the direct deposit option for anyone with access to an account at a financial institution. The Direct Express® card is most appropriate for individuals who need the benefits of direct deposit but who don't have an account at a financial institution. If you haven't chosen an option as of March 1, 2013, you'll be automatically enrolled in the Direct Express® card option. If you're applying for Social Security benefits for the first time, you'll be asked to choose your payment option at that time.

To sign up for electronic payments, you need to visit the government website, www.GoDirect.org, or call the U.S. Treasury Electronic Payment Solution Center at (800) 333-1795. You can also sign up for the direct deposit option at your bank or credit union, or for the Direct Express® card at www.usdirectexpress.com.



Is the Social Security Administration mailing out annual Social Security Statements?

In 1995, the Social Security Administration (SSA) began mailing out annual Social Security Statements to everyone age 25 and older. These statements were designed to help Americans plan for the future by providing a detailed record of their earnings and estimates of Social Security benefits. Last year, the SSA suspended mailing these statements because of budgetary concerns, but in March 2012, the SSA resumed mailing annual statements to workers age 60 and older. If you're age 60 or older, you should receive your statement every year, about three months before your birthday. The SSA is also resuming the mailing of one-time statements to workers who are age 25 to introduce them to Social Security programs and benefits.

The SSA has also unveiled an online version of the Social Security Statement, available at the SSA website, www.socialsecurity.gov. You'll have immediate access to your statement once you've signed up for a "My Social Security" account. Statement information includes a projection of your retirement benefits at age 62, at full retirement age, and at age 70; projections

of disability and survivor's benefits; a detailed record of your earnings; and other information about the Social Security program. Individuals who are receiving paper statements in the mail will have the option to sign up for online statements instead. While workers are encouraged to use the online statement option, in some cases, the SSA will mail statements upon request to individuals under age 60, including domestic violence or identity theft victims who have blocked online access to their personal information.

There's also another way to estimate the amount of Social Security retirement benefits you will be eligible to receive in the future under current law. You can use the SSA's Retirement Estimator, which is also available at the SSA website. To use this calculator, you must have enough credits to qualify for benefits, and you must not already be receiving benefits or waiting for a decision on your benefit application. You can create various scenarios that will illustrate how different earnings amounts and retirement ages will affect your future retirement benefit.

