



# Harris Financial Services

Big City Solutions - Small Town Service

February 2010

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As you are preparing your taxes, don't forget to ask your tax preparer if you can benefit from converting some or all of your traditional IRAs or 401(k)s into Roth IRAs. Even if you are making more than \$100,000 per year, it may be advisable to make this conversion. Call me at 810-629-4900 to further discuss your IRA options.

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## How to Double the Power of Your Tax Refund

Filing your taxes may be a dreaded chore, but receiving your refund is a wonderful reward. What you do with a refund is up to you, but here are some ideas that may make your tax refund twice as valuable.

### Double your savings

Perhaps you'd like to use your tax refund to start an education fund for your children or grandchildren, contribute to a retirement savings account for yourself, or save for a rainy day. A financial concept known as the rule of 72 can give you a rough estimate of how long it might take to double what you initially save. Simply divide 72 by the annual rate you hope that your money will earn. For example, if you expect an average annual rate of return of 6%, your invested tax refund may double in approximately 12 years. Of course, this is a hypothetical estimate, and doesn't account for taxes, inflation, or the actual return you may receive.



### Split your refund in two

If you like to think of your tax refund as a well-deserved bonus, you may be less than enthusiastic about saving it or using it for something practical. If stashing it away in a savings account or using it to pay off bills sounds like no fun, go ahead and splurge on something for yourself. But remember, you don't necessarily have to spend it all. Instead, why not make the most of your tax refund by putting half of it toward something practical and spending the other half on something more fun?

The IRS has even made it easy for you to do this. When you file your income taxes and choose direct deposit for your refund, the IRS allows you to have it deposited among two or even three accounts. Qualified accounts include savings and checking accounts, and other accounts such as IRAs, Coverdell edu-

cation savings accounts, health savings accounts, Archer MSAs, and TreasuryDirect online accounts. To split your refund, you'll need to fill out IRS Form 8888, *Direct Deposit of Refund to More Than One Account*, when you file your federal return.

### Be twice as nice to others

Giving to charity has its own rewards, but Uncle Sam may reward you too by allowing you to deduct contributions made to a qualified charity from your taxes if you itemize. You can also help your favorite charity or nonprofit reap double rewards from your gift by finding out if it benefits from any matching gift programs. With a matching gift program, individuals, corporations, foundations, and employers offer to match gifts the charitable organization receives, usually dollar-for-dollar. Terms and conditions apply, so check with the charitable organization or with your employer's human resources department to find out more about available matching gift programs.

### Make your refund do double duty

A great way to increase the value of this year's tax refund is to spend it on something that might offset your overall tax bill and potentially increase your tax refund next year. For example, this year you might want to consider spending your refund on improvements that will increase your home's energy efficiency because you may be eligible for a tax credit worth up to 30% of what you spend (capped at \$1,500 for certain improvements). Qualifying improvements include certain high-efficiency heating and cooling systems, and water heaters, windows, doors, and insulation that meet strict energy-efficiency standards. You can find out more about this tax credit and other credits and deductions you may be entitled to by consulting IRS Publication 17, *Your Federal Income Tax*.



*The trend of not saving enough makes families heavily dependent on borrowing to fund college. ...The result is a new paradigm for millions of young adults--a crushing amount of student loan debt that stretches from early to middle adulthood and can affect all major life decisions.*



## College Debt: How Much Is Too Much?

According to a recent survey by the nonprofit College Savings Foundation, the confidence of parents in their ability to save for college dropped significantly over the past year (go to [www.collegesavingsfoundation.org](http://www.collegesavingsfoundation.org) to read the survey). That's not entirely surprising, considering the economic climate. But what is surprising is that, of parents surveyed, a whopping 41% reported having saved nothing at all, and 28% reported having saved less than \$5,000 per child.

### The loan factor

The trend of not saving enough makes families heavily dependent on borrowing to fund college. In the survey above, 47% of parents said they expected to utilize student loans to pay for college. And parents seem inclined to borrow whatever it takes: 76% don't expect to narrow their children's college choices.

### The cost factor

Loans matter when you consider the cost of college. According to the College Board's *Trends in College Pricing 2009* report, even though the Consumer Price Index declined 2.1% between July 2008 and July 2009, college costs rose across the board--a disturbing but familiar pattern (to read the report, go to [www.trends-collegeboard.com](http://www.trends-collegeboard.com)).

For the 2009/10 school year, the average cost of a public college increased 5.9% to \$19,388, while the average cost of a private college increased 4.3% to \$39,028, with elite private colleges topping out at over \$50,000 per year.

The College Board also noted that about two-thirds of students receive grants, with the average private college student receiving \$14,400 in total grant aid and federal tax benefits for 2009/10, and the average public college student receiving \$5,400. But this still leaves approximately \$25,000 for private undergraduates and \$14,000 for public undergraduates to fund. Absent additional college merit aid and/or outside scholarships to make up the difference, parents and/or their children must fill the gap.

### How much borrowing is too much?

The gap is where families can get in over their heads. Is there such a thing as borrowing too much for college? In the iconic words of the Magic 8 Ball®, "signs point to yes."

The average student now leaves school with \$23,186 in federal student loans (Source:

*National Postsecondary Student Aid Study*). And this doesn't include private student loan debt, which has exploded in recent years due to the inability of federal loan borrowing limits to keep pace with skyrocketing college costs.

The result is a new paradigm for millions of young adults--a crushing amount of student loan debt that stretches from early to middle adulthood and can affect all major life decisions, from what career path to choose, to where to live, whether to go to graduate school, when to marry, have children, buy a home, begin saving for retirement, and so on.

And it doesn't end there. Parents who engage in "extreme borrowing"--routinely taking out large home equity loans, federal PLUS Loans, or other private loans to fully fund the gap without regard for the consequences--can hamper themselves financially for years.

How much is too much? Obviously, the answer is different for every family. But waiting until spring of your child's senior year--as you review individual financial aid awards--to think about college affordability can be a mistake. To avoid falling into the "I guess we'll just borrow whatever it takes" trap, families should start thinking about costs much earlier.

### Before filling out a college application...

- Get an idea of how much federal aid your family can expect by using the calculator at [www.fafsa4caster.ed.gov](http://www.fafsa4caster.ed.gov).
- For each college, research the total cost of attendance and the average merit aid award given to students with similar academic credentials as your child.
- Know what a particular loan amount *today* will end up costing *tomorrow* (e.g., \$40,000 in PLUS Loans at 8.5% with a 10-year repayment term will cost you \$496 per month; \$27,000 in Stafford Loans at 6.8% and a 10-year term equals \$311 each month for your child).
- Consider your child's career aspirations, earning potential, and job prospects after graduation. Will this school be a good return on your investment? Also, is graduate school likely?
- Talk to your child about how any debt taken on might impact your or your child's future goals and dreams.

## Hardship Withdrawals from 401(k) Plans

In these challenging economic times, you may be considering taking a hardship withdrawal from your 401(k) plan. Here are some points to think about before you pull the trigger.

### What is a hardship withdrawal?

When discussing 401(k) hardship withdrawals, we're generally talking about withdrawing your own elective contributions to the plan. This means your pretax contributions and your Roth contributions to the plan. A hardship withdrawal generally can't include any earnings on your contributions.

In order to qualify for a hardship withdrawal, you have to have an immediate and heavy financial need, and your withdrawal can't exceed the amount necessary to meet that financial need (including any taxes and penalties resulting from the hardship withdrawal itself). But there's an important restriction: you can't take a hardship withdrawal at all until you've taken all other non-hardship distributions and loans available to you from the 401(k) plan, and any other deferred compensation plans maintained by your employer.

Plans have a number of ways of administering the hardship withdrawal rules, but most rely on a "safe harbor" rule that automatically treats the following as constituting an immediate and heavy financial need:

- Medical care expenses for you, your spouse and dependents, and your plan beneficiary
- Costs directly related to the purchase of your principal residence (but not mortgage payments)
- Payment of tuition, fees, and room and board expenses for up to the next 12 months of post-secondary education for you, your spouse and dependents, and your plan beneficiary
- Payments necessary to prevent eviction from your principal residence or foreclosure of your mortgage
- Payments of burial and funeral expenses for your parents, spouse and dependents, and your plan beneficiary
- Expenses to repair casualty damages to your principal residence

### Why you should think twice ...

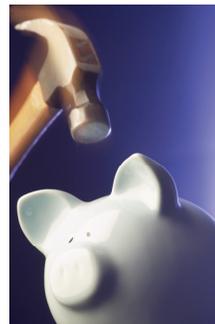
In general, you should take a hardship

withdrawal from your 401(k) plan only as a last resort, for the following reasons:

- Hardship distributions are includible in your gross income except to the extent they consist of your own after-tax (including Roth) contributions to the plan.
- The taxable portion of your withdrawal will be subject to a 10% early distribution penalty unless you're 59½ or another exception applies.
- If your plan uses the safe harbor rule described earlier, when you take a hardship withdrawal, you'll be suspended from participating in the plan (and any other elective plan maintained by your employer) for at least six months.
- Unlike plan loans, you generally can't pay a hardship withdrawal back to the plan. A hardship distribution permanently reduces your account balance, reducing the amount that can work for you on a tax-favored basis until you retire.
- You can't roll a hardship distribution over to an IRA or another employer plan.

### And keep in mind ...

A 401(k) plan doesn't have to allow hardship withdrawals at all. And if it does, the plan may limit the reasons that qualify as a hardship, or may limit the amount you can withdraw. Some plans may not permit hardship withdrawals that are based on the need of your plan beneficiary. And in some cases, the plan may require that you prove you have no other resources available to meet your hardship need.



Your 401(k) plan may also permit withdrawals of other amounts in your account—for example, your employer's contributions to the plan—but these withdrawals may be subject to different rules.

You need to review your specific plan's terms to see what options are available to you. Your plan's withdrawal rules should be clearly described in the plan's summary plan description (SPD). If you don't have one, request it from your plan administrator, and discuss your options with your financial professional.

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## Ask the Experts



### What is a short sale?

A short sale occurs when a mortgage lender allows a borrower (the short seller) to accept a sale offer that is less than ("short") the balance due on the outstanding loan.

Lenders generally will consider this option only when (a) the market value of the home is less than the mortgage balances due, and (b) the borrower, having fallen behind on mortgage payments, has little hope of bringing the mortgage current even if it were modified. The lender expects the proceeds from the short sale will be greater than what could be expected in a foreclosure.

If the proceeds from the sale don't satisfy the total mortgage and/or lien balances due on the property, one or more deficiencies may occur. Short sellers should always find out (in writing) what will happen to any deficiencies. If a deficiency isn't forgiven, the lender may be able (depending on state law and how the mortgage note or lien is structured) to pursue the borrower for it.

Junior liens (e.g., second mortgages, home equity loans, or other liens) are not dissolved in short sales (as they are in foreclosures). As a result, either the short seller or the first lien holder may have to give some consideration (something as low as pennies on the dollar) to junior lien holders to satisfy their claims. The short seller should again get notification in writing of what will happen to any remaining deficiencies.

Forgiven deficiencies can have tax consequences; the IRS generally considers debt forgiven or cancelled by a lender to be taxable income. However, recent legislation allows (for calendar years 2007 through 2012) up to \$2 million of forgiven debt (\$1 million if married filing separately) to be excluded if the debt was incurred to purchase or improve a principal residence.

After completing a successful short sale, borrowers may be eligible to apply for a new mortgage on another home after two years; foreclosures require a five-year waiting period.

### What is a deed-in-lieu of foreclosure?

In a deed-in-lieu of foreclosure (often referred to as a DIL), a mortgage lender allows a borrower to sign the deed over to the lender in exchange for relief from the obligation to repay the mortgage.

DILs are usually issued only if the value of the property is less than the indebtedness against it and the borrower no longer has the ability to pay the mortgage. Prior to accepting a DIL, a lender usually must be convinced the property cannot be sold (even by short sale) within a reasonable amount of time.

Lenders will generally accept a DIL only if the property has no other liens against it. Department of Housing and Urban Development (HUD) borrowers may receive up to \$2,000 in compensation to discharge junior liens. (If none exist, the borrower may use the money for relocation expenses upon vacating the property.) And the Making Home Affordable program directs the U.S. Treasury to provide \$1 for every \$2 paid by a lender toward the release of junior liens, up to a maximum contribution of \$1,000.

HUD will accept DILs only on owner-occupied residences; the borrower must be one month or more delinquent on the mortgage. The DIL must be completed within six months of the date of default on the mortgage, or within 90 days of the failure of a special forbearance agreement or short sale attempt.

In most cases, a DIL agreement forgives a borrower of any obligation to repay a deficiency if all the conditions of the agreement have been met. Forgiven debt may be considered taxable income by the IRS. However, recent legislation allows (for calendar years 2007 through 2012) up to \$2 million of forgiven debt (\$1 million if married filing separately) to be excluded if the debt was incurred to purchase or improve a principal residence.

Homeowners who successfully complete a DIL are eligible to apply for a new mortgage four years after the execution of the DIL (two years if there are extenuating circumstances) and are required (for up to seven years) to provide a minimum 10% down payment. Foreclosures require a five-year waiting period.