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Most people know they should have a reserve fund. Unfortunately they postpone establishing a fund for unexpected expenses.

Having a portion of your paycheck deposited directly into another account is one approach. Another approach is to have all your income deposited into one account. Then once a month a set amount should be transferred to another account.

If you do not see it, you will be less likely to spend it. Before taking money out of the reserve account, ask yourself if you need to spend it. If the expenditure is not a need, you should ask yourself if you really need it now and can you afford it. Do not overlook the need to save for your future financial goals. Those could include: a new car, college education, a vacation, special occasions, retirement, etc.

Your referrals are appreciated!

Joe

2012 October

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Food for Thought

On the Precipice: the "Fiscal Cliff"



The phrase "fiscal cliff" has been used to describe the unique combination of financial realities scheduled to take effect in 2013: expiring tax breaks; the imposition of new taxes on

high-income individuals; and automatic deficit-reduction spending cuts.

Expiring tax breaks

Lower federal income tax rates, part of the tax landscape for more than ten years, expire at the end of 2012. We'll go from six federal tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) to five (15%, 28%, 31%, 36%, and 39.6%). The maximum rate that applies to long-term capital gains will generally increase from 15% to 20%. And while the current lower long-term capital gain rates now apply to qualifying dividends, starting in 2013, dividends will be taxed as ordinary income. The temporary 2% reduction in the Social Security portion of the Federal Insurance Contributions Act (FICA) payroll tax, in place for the last two years, also expires at the end of 2012, as do temporary breaks relating to the federal estate and gift tax.

Several other significant breaks go away in 2013 as well. Itemized deductions and dependency exemptions will once again be phased out for individuals with high adjusted gross incomes (AGIs); the earned income tax credit, the child tax credit, and the American Opportunity (Hope) tax credit all revert to old, lower limits and less generous rules; and individuals will no longer be able to deduct student loan interest after the first 60 months of repayment. Lower alternative minimum tax (AMT) exemption amounts (the AMT-related provisions actually expired at the end of 2011) mean that there will be a dramatic increase in the number of individuals subject to AMT when they file their 2012 federal income tax returns in 2013.

New taxes

Beginning in 2013, the hospital insurance (HI) portion of the payroll tax--commonly referred to as the Medicare portion--increases by 0.9% for

individuals 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).

Also beginning in 2013, a new 3.8% Medicare contribution tax is imposed on the unearned income of high-income individuals. This 3.8% contribution tax applies to some or all of 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).

Mandatory spending cuts

The failure of the deficit reduction supercommittee to reach agreement in November 2011 automatically triggered \$1.2 trillion in broad-based spending cuts over a multiyear period beginning in 2013 (the official term for this is "automatic sequestration"). The automatic cuts are to be split evenly between defense spending and non-defense spending. Although Social Security, Medicaid, and Medicare benefits are exempt, and cuts to Medicare provider payments cannot be more than 2%, most discretionary programs including education, transportation, and energy programs will be subject to the automatic cuts.

Understanding the "cliff"

Many fear that the combination of tax increases and spending cuts will have severe negative economic consequences. According to a report issued by the nonpartisan Congressional Budget Office (*Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013, May 2012*), taken as a whole, the tax increases and spending reductions will reduce the federal budget deficit by 5.1% of gross domestic product (GDP) between calendar years 2012 and 2013. The Congressional Budget Office projects that under these fiscal conditions, the economy would contract during the first half of 2013 (i.e., we would likely experience a recession).

Ways Grandparents Can Help with College Costs



Under federal law, tuition payments made directly to a college aren't considered taxable gifts, no matter how large the payment. This rule is helpful considering that annual tuition at some private colleges is now surpassing the \$40,000 mark.

College is expensive. For some fortunate students, grandparents are stepping in to help. This trend is expected to accelerate as baby boomer grandparents start gifting what could be trillions of dollars over the next few decades. Helping to finance a grandchild's college education can bring great personal satisfaction and can be a way for grandparents to minimize potential gift and estate taxes. Here are some common strategies.

Outright cash gifts

One way to contribute is to make an outright gift of cash or securities to your grandchild or his or her parent. To minimize any potential gift tax implications, you'll want to keep your gift under the annual federal gift tax exclusion amount--\$13,000 for individual gifts or \$26,000 for joint gifts made by both grandparents. Otherwise, a larger gift may be subject to federal gift tax and, for a gift made to a grandchild, federal generation-skipping transfer tax, which is a tax on gifts made to a person who is more than one generation below you.

An outright cash gift to your grandchild or your grandchild's parent will be considered an asset for federal financial aid purposes. Under this aid formula, students must contribute 20% of their assets each year toward college costs and parents must contribute 5.6% of their assets.

Pay tuition directly to the college

If you are considering making an outright cash gift, another option is to bypass your grandchild and pay the college directly. Under federal law, tuition payments made directly to a college aren't considered taxable gifts, no matter how large the payment. This rule is helpful considering that annual tuition at some private colleges is now surpassing the \$40,000 mark. Only tuition qualifies for this federal gift tax exemption--room and board, books, and fees aren't eligible.

Aside from the benefit of being able to make larger tax-free gifts, paying tuition directly to the college ensures that your money will be used for education purposes. However, a direct tuition payment might prompt a college to reduce any potential grant award in your grandchild's financial aid package, so make sure to ask the college about the financial aid impact of your gift.

529 college savings plan

A 529 college savings plan is a tax-advantaged savings vehicle that can be a smart way for grandparents to contribute to their grandchild's college education while paring down their own estate. Contributions to your account grow tax deferred and earnings are tax free if the money

is used to pay the beneficiary's qualified education expenses (states generally follow this tax treatment as well). Funds can be used at any accredited college in the United States or abroad.

You can open a 529 account yourself and name your grandchild as beneficiary, or you can contribute to an already existing 529 account (e.g., a parent-owned 529 account).

Tip: *Under current federal financial aid rules, grandparent-owned 529 plans are not counted as a parent or student asset (only parent-owned and student-owned 529 plans count as assets), but withdrawals from a grandparent-owned 529 plan are counted as student income, which can affect student aid eligibility in the following year (withdrawals from parent-owned and student-owned 529 plans are not counted as student income).*

If you have a large sum to gift, 529 plans offer a big advantage. Under special rules unique to 529 plans, you can make a lump-sum gift of up to \$65,000 (\$130,000 for joint gifts) and avoid federal gift tax by making a special election to treat the gift as if it were made in equal installments over a five-year period (provided you don't make any additional gifts to the same grandchild during the five-year period). And if you happen to be the 529 account owner, you retain control over these funds. For example, if you should have unexpected medical costs, you can withdraw part or all of your lump-sum contribution (however, you will owe income tax and a 10% penalty on the earnings portion of the withdrawal). In addition, your lump-sum gift is considered removed from your estate even though you retain control over the funds as account owner (but if you were to die during the five-year period, a prorated portion of the gift would be recaptured by your estate for estate tax purposes).

Of course, you can contribute smaller, regular amounts to your grandchild's 529 account as well. If you have more than one grandchild, you can open an account for each and limit your annual contributions to each account to \$13,000 or \$26,000 for joint gifts. Come college time, if one grandchild gets a scholarship, you can change the beneficiary of his or her 529 account to another grandchild or you can withdraw an amount equal to the amount of the scholarship, penalty free.

Note: *Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about specific 529 plans is available in each issuer's official statement, which should be read carefully before investing.*

For more information about your options and the benefit application process, contact the Social Security Administration at 800-772-1213 or visit www.socialsecurity.gov.



Every situation is unique, and these strategies may not be appropriate for all couples. When deciding when to apply for Social Security benefits, make sure to consider a number of scenarios that take into account factors such as both spouses' ages, estimated benefit entitlements, and life expectancies.

Two Social Security Strategies for Married Couples

Deciding when to begin receiving Social Security benefits is a major financial issue for anyone approaching retirement because the age at which you apply for benefits will affect the amount you'll receive. If you're married, deciding when to retire can be especially complicated because you and your spouse will need to plan together. Fortunately, there are a couple of strategies that are available to married couples that you can use to boost both your Social Security retirement income and income for your surviving spouse.

File and suspend

Generally, a husband or wife is entitled to receive the higher of his or her own Social Security retirement benefit (a worker's benefit) or as much as 50% of what his or her spouse is entitled to receive at full retirement age (a spousal benefit). But here's the catch--under Social Security rules, a husband or wife who is eligible to file for spousal benefits based on his or her spouse's record cannot do so until his or her spouse begins collecting retirement benefits. However, there is an exception--someone who has reached full retirement age but who doesn't want to begin collecting retirement benefits right away may choose to file an application for retirement benefits, then immediately request to have those benefits suspended, so that his or her eligible spouse can file for spousal benefits.

The file-and-suspend strategy is most commonly used when one spouse has much lower lifetime earnings, and thus will receive a higher retirement benefit based on his or her spouse's earnings record than on his or her own earnings record. Using this strategy can potentially boost retirement income in three ways: 1) the spouse with higher earnings who has suspended his or her benefits can accrue delayed retirement credits at a rate of 8% per year (the rate for anyone born in 1943 or later) up until age 70, thereby increasing his or her retirement benefit by as much as 32%; 2) the spouse with lower earnings can immediately claim a higher (spousal) benefit; and 3) any survivor's benefit available to the lower-earning spouse will also increase because a surviving spouse generally receives a benefit equal to 100% of the monthly retirement benefit the other spouse was receiving (or was entitled to receive) at the time of his or her death.

Here's a hypothetical example. Leslie is about to reach her full retirement age of 66, but she wants to postpone filing for Social Security benefits so that she can increase her monthly retirement benefit from \$2,000 at full retirement age to \$2,640 at age 70 (32% more). However,

her husband Lou (who has had substantially lower lifetime earnings) wants to retire in a few months at his full retirement age (also 66). He will be eligible for a higher monthly spousal benefit based on Leslie's work record than on his own--\$1,000 vs. \$700. So that Lou can receive the higher spousal benefit as soon as he retires, Leslie files an application for benefits, but immediately suspends it. Leslie can then earn delayed retirement credits, resulting in a higher retirement benefit for her at age 70 and a higher widower's benefit for Lou in the event of her death.

File for one benefit, then the other

Another strategy that can be used to increase household income for retirees is to have one spouse file for spousal benefits first, then switch to his or her own higher retirement benefit later.

Once a spouse reaches full retirement age and is eligible for a spousal benefit based on his or her spouse's earnings record and a retirement benefit based on his or her own earnings record, he or she can choose to file a restricted application for spousal benefits, then delay applying for retirement benefits on his or her own earnings record (up until age 70) in order to earn delayed retirement credits. This may help to maximize survivor's income as well as retirement income, because the surviving spouse will be eligible for the greater of his or her own benefit or 100% of the spouse's benefit.

This strategy can be used in a variety of scenarios, but here's one hypothetical example that illustrates how it might be used when both spouses have substantial earnings but don't want to postpone applying for benefits altogether. Liz files for her Social Security retirement benefit of \$2,400 per month at age 66 (based on her own earnings record), but her husband Tim wants to wait until age 70 to file. At age 66 (his full retirement age) Tim applies for spousal benefits based on Liz's earnings record (Liz has already filed for benefits) and receives 50% of Liz's benefit amount (\$1,200 per month). He then delays applying for benefits based on his own earnings record (\$2,100 per month at full retirement age) so that he can earn delayed retirement credits. At age 70, Tim switches from collecting a spousal benefit to his own larger worker's retirement benefit of \$2,772 per month (32% higher than at age 66). This not only increases Liz and Tim's household income but also enables Liz to receive a larger survivor's benefit in the event of Tim's death.

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As a business owner, what should I know about using temporary workers?

Generally, temporary work is any work that is not intended to be permanent or long term. Temporary work can be full- or

part-time.

Use of temporary workers (sometimes referred to as temps) may provide you with some flexibility to handle employee absences due to illness, vacation, or maternity leave. They may also help you handle special projects, busy times, or seasonal work.

In a slow economy, temporary workers might be used until permanent needs become more certain. The temporary employee can be more easily let go if need be.

Temporary workers can be hired directly or through a temporary employment agency. Temporary workers you hire directly, even if part-time, are generally treated the same as full-time workers and may be entitled to employee benefits through you. For example, a worker who completes 1,000 hours of service in a year may be eligible to participate in your retirement plan.



As a business owner, what should I know about using remote employees?

Interest in the use of remote employees has greatly increased along with growth in the number of service jobs and

developments in technology that enable some workers to work almost anywhere. A remote employee is someone who works away from the office, often at home, part or all of the time. You might be able to use a remote employee in your business if the employee does not need to be at a specific location in order to do the work required.

You may be able to increase the talent pool available to your business by hiring an employee who is not local and permitting the employee to stay where he or she is and work remotely. Even local employees may see an advantage to working remotely at least part of the time.

Remote employment can be incorporated as part of flexible scheduling. An employee might come into the office one or two days a week, and work remotely the remainder of the week. Remote employment can be especially

On the other hand, a temporary employee hired through a temporary employment agency works for the employment agency, not for you. The employment agency is generally responsible for the temporary employee's benefits, if any. The hourly wage rate you pay to the agency may be higher as a result.

The temporary employment agency can save you time and effort by finding and screening potential employees so that you don't have to. They may have a pool of temporary employees available at any time and at a moment's notice.

However, you may need to break in or train a temporary employee each time you get one from the employment agency. To minimize this, you may request that the employment agency send a temporary employee who has already worked for you before.

Sometimes a temporary employee may become a permanent employee. If an employee was hired through a temporary employment agency, depending on the contract with the employment agency, you may need to pay a fee to the agency if you permanently hire the temporary employee.

advantageous where the employee would otherwise face a long commute to work, or the employee has to balance work with the occasional care or transport of young children or elderly parents.

If you hire an employee who works remotely in another state, remember that there are tax consequences. If the employee works almost entirely in the other state, the employee will usually pay income tax in the other state. If the employee splits time between the two states (for example, works one day a week in state A, and the other four days in state B), the employee may pay income taxes in both states.

As the employer, you will usually need to create an account with the state, and possibly local, taxing authorities in the other state, and withhold income taxes from the remote employee's wages and pay them to such tax agencies. As the employer, you may also need to pay unemployment insurance to the other state. A payroll service, accountant, or attorney can help you determine what your obligations are and how to meet them.