THE PERSONAL PLANNER

Personal Financial Planning Tips for Today and the Rest of Your Life

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I'm writing this early again, partly because vacation plans will have me away from the office at month-end. So here it is, the 21st of the month... the summer solstice is gone but summer is definitely here. Europe is still a mess and the markets are still hanging on the news and gyrating daily in response. Things aren't in the tank yet, thankfully.

On the bright side, festival season in Milwaukee has started and the lakefront fireworks are upon us. So relax, enjoy the summer, and leave the financial driving to me.

Have a great July!

Bruce Heling

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HELING ASSOCIATES
Bringing the Personal to Financial Planning

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.

How to Raise a Saver

Earmarking savings

To help your child learn how to manage money, encourage a 50-25-25 rule (or some variation) that earmarks 50% for immediate spending needs, 25% for the purchase of big-ticket items, and 25% for long-term savings.

As parents, we naturally want what's best for our kids. We want them to be polite, respectful, healthy, curious, and smart. And we hope that someday, they will grow into successful adults with independent, fulfilling lives. How best to accomplish this? Well, along with teaching the ABCs, 123s, and right from wrong, teaching your child the basics of financial literacy can help you raise a saver and lay the foundation for your child's bright financial future.

The early years, 3 to 7

Children this age may think that money magically appears from special machines whenever Mom or Dad pushes a few buttons, but there is one money concept they can understand. They know people need money to buy things--chances are they've tagged along with you to the grocery store a few times and watched you fill up your cart. Young children often model the behavior of their parents, so on these shopping trips, when you think your child is receptive, you might say things like "I can't buy this right now, I have to save more money and buy it next time" or "That's great these apples are a really good price today--I can buy more." These types of comments sink in and hopefully will get your child thinking about money and spending.

Once children can identify coins and dollar bills, give them a piggy bank or clear plastic jar to keep any money they earn or receive as gifts. Tell them they can buy something they want once they save a certain amount (make sure the item/price is appropriate and within short-term financial reach). Taping a picture of the item on the bank can provide a visual goal. Of course, children need a way to earn some money. Consider giving your child a weekly allowance and/or payment for small jobs around the house. Some parents tie an allowance to chores; others expect chores as part of everyday family life, but pay extra for "super" chores. The overall goal is to get your child excited about seeing the coins and dollar bills pile up.

The middle years, 8 to 12

These years are the sweet spot to lay a solid financial foundation. Children this age are more financially and materially aware--they have a general idea of what things cost (at least the things they want), they see (and covet) the possessions their friends have, they're bombarded by advertising, they get asked what they'd like for their birthday, and they often have a say in the new clothes and school supplies they get every year. And they aren't shy about pointing out the other items they want--electronics, sports equipment, room decor. It's enough to make any parent shudder.

The first thing to do? Explain the difference between "needs" and "wants." Continue to give your child an allowance, and encourage a 50-25-25 rule (or some variation) that earmarks 50% for immediate spending needs, 25% for the purchase of big-ticket items, and 25% for long-term savings. Consider matching a portion of that last 25% so your child is more motivated to save. Open a bank savings account for your child's long-term savings, and explain how interest and compounding works.

Help your child set financial goals, both short-term (a skateboard or sweatshirt) and long-term (a laptop). When it comes to spending, explain--and model--the concepts of delayed gratification, prioritizing purchases, and making tradeoffs. Help your child learn to get the most value for his or her money by selecting quality merchandise, comparison shopping, waiting for sales, and discouraging impulse buying. Let your child see that you, too, can't buy everything you want all the time.

Introduce the concept of budgeting by explaining how your family's budget works. Without going into detailed numbers, explain how income you receive from your job must be used to pay for needs like food, housing, utilities, and clothing, and how any money left over is set aside for emergency savings, long-term savings, and for "wants" like trips to the movies, restaurants, and new toys and gadgets.

The teen years

Children this age often seem to be ever-growing financial sinkholes--$10 here, $20 there, a laptop, sports equipment, an instrument, school trips, gas for the car, not to mention looming college expenses. Build on the saving, goal-setting, and budgeting lessons from earlier years. Be more specific about what things cost in your family's budget, and explain that in addition to paying day-to-day expenses and saving for college, you're saving for your own retirement.

When your child is old enough, encourage him or her to get a job to help pay for some typical high-school expenses and to start building a nest egg. Teach your child how to use an ATM/debit card, balance a checkbook, and wisely manage credit--skills they'll need in college. Finally, you can introduce your child to more advanced financial concepts, such as stocks, bonds, IRAs, and diversifying investments, by looking at teen-oriented investing books and financial websites.

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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.