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Hi Everyone,

I hope you enjoy this month's edition of my newsletter!

Dave

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# Financial Foresights

Practical Insights For Your Financial Goals

August 2009

## Social Security: What Does the Future Hold?

Each year, the Social Security and Medicare trustees issue a report on the financial health of these two programs. The news hasn't been good. According to this year's report, in 2016, Social Security will begin paying out more money than it takes in, and will be able to pay promised benefits only until 2037; afterwards, the trust fund reserves will be exhausted and payroll tax income will be enough to finance only 76% of scheduled benefits until 2083.



Social Security reform has been a political hot potato, but that may be about to change. The decline of the financial markets has led to renewed focus on the importance of Social Security income to retirees, and on the need to address the growing burden that Social Security is placing on the federal budget.

**You can find the annual trustees report on the Social Security Administration's website, [www.socialsecurity.gov](http://www.socialsecurity.gov).**

### Proposals to stabilize Social Security

Despite fears that Social Security will not be around for future generations, there have been no calls to eliminate Social Security, and the focus is on making the program sustainable. In fact, President Obama has repeatedly expressed his commitment to preserving Social Security. To help accomplish this, he favors a Social Security payroll tax on earnings above \$250,000 (currently no Social Security payroll tax is assessed on earnings above a certain maximum, \$106,800 in 2009). Many other potential solutions have also been suggested. For example, the Social Security Solvency Act of 2009, introduced in the Senate in February, proposes accelerating by five years the gradual increase in full retirement age to 67, and modifying the benefit calculation to reduce benefit growth. This year's trustees

report mentions immediately increasing the payroll tax or reducing benefits as additional options.

### The near future

The Congressional Budget Office (CBO) is projecting that for the first time since 1975, when cost-of-living adjustments (COLA) were first payable, Social Security beneficiaries will not receive an automatic increase next year (or for 2011), due to low inflation. According to the CBO, the absence of COLA will also affect the maximum earnings that are taxable for Social Security, because under the Social Security Act, the earnings maximum can only increase when COLA is payable. Therefore, the CBO is projecting that this year's earnings base of \$106,800 will remain the same for the next two years.

Medicare beneficiaries will be affected too. By law, for individuals who have their Medicare Part B premiums withheld from their Social Security checks, premiums cannot rise more than COLA increases for Social Security. Consequently, no annual COLA means that standard Medicare premiums will remain at their current level of \$96.40 per month for approximately 75% of Medicare beneficiaries. However, certain beneficiaries (those who do not have their premiums deducted directly from Social Security and those with higher incomes who pay higher income-related premiums) do not have this protection, and will see their premiums rise, perhaps substantially.

### Stay informed

Most Americans rely on Social Security for at least a portion of their retirement income, but to ensure that Social Security will be able to pay promised benefits for many years to come, it's clear that the program must change. It's a good idea to follow the news to learn about legislative developments and model various income scenarios when developing your own retirement plan.

## More Drops in the Higher Education Bucket



The world of higher education has received some attention in Washington this year. The American Recovery and Reinvestment Act of 2009 (ARRA)

was signed into law by President Obama in February. This legislation, along with President Obama's proposed budget for FY 2010, contains several provisions related to higher education.

### Hope credit

The Hope credit is a tax credit for college tuition and related expenses. ARRA changed the Hope credit significantly. For 2009 and 2010, the Hope credit is renamed the American Opportunity tax credit and can be worth \$2,500 per student per year, up from \$1,800. (President Obama's FY 2010 budget blueprint proposes making the credit permanent.) In addition, the credit now applies to the first four years of a student's post-secondary education, provided he or she attends at least half-time (previously, the credit applied only to the first two years of college). And the income limits for qualifying have been increased:

- A full credit is available to single filers with a modified adjusted gross income (MAGI) below \$80,000 (previously \$50,000) and joint filers with a MAGI below \$160,000 (previously \$100,000)
- A partial credit is available to single filers with a MAGI between \$80,000 and \$90,000 (previously \$50,000 and \$60,000) and joint filers with a MAGI between \$160,000 and \$180,000 (previously \$100,000 and \$120,000)

Other points to note about the new credit:

- The credit may be claimed against an individual's alternative minimum tax liability
- Up to 40% of an individual's allowable credit may be refundable
- For purposes of the credit, the definition of "qualified tuition and related expenses" is expanded to include course materials

By increasing both the amount of the credit and the income limits to qualify for it, and by expanding the availability of the credit to all four years of college, the federal government has put the focus on helping traditional college students pay for college. (Congress did

not increase the amount of the Lifetime Learning credit, which is geared more toward occasional courses taken by students who are enrolled in school less than full-time.)

### Qualified expenses and 529 plans

ARRA has expanded the definition of "qualified higher education expenses" for 529 plans to include expenses paid or incurred in 2009 or 2010 for computer technology, equipment, and Internet access, provided they are used by the 529 plan beneficiary and the beneficiary's family during any of the years the beneficiary is enrolled at an eligible educational institution. This means you can take a tax-free withdrawal from your 529 plan to pay for these items. (Previously, a computer had to be required by the college in order to be considered a qualified education expense.)

This carve out for computer-related expenses is similar to the existing provision for K-12 computer expenses currently allowed by Coverdell education savings accounts.

### Pell Grants

ARRA increased the maximum Pell Grant to \$5,350 for 2009/2010 and to \$5,550 for 2010/2011. President Obama's FY 2010 budget proposes making the Pell Grant program a mandatory spending program with automatic increases tied to the Consumer Price Index.

### Federal Family Education Loan program

President Obama's 2010 proposed budget seeks to eliminate the Federal Family Education Loan program in 2010. If it passes, all student loans would be made through the federal government's Direct Loan program.

### Financial aid

According to [www.whitehouse.gov](http://www.whitehouse.gov), President Obama wants to simplify the federal financial aid application process by eliminating the current FAFSA application and allowing families to apply by simply checking a box on their tax form, authorizing their tax information to be used. Stay tuned to see whether this major time-saving objective will happen in 2010.



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## Getting to Yes Despite Investing Differences

In a perfect world, both halves of a couple share the same investment goals and agree on the best way to try to reach them. It doesn't always work that way, though. One spouse may be risk-averse, while the other may be comfortable investing more aggressively. How can you bridge that gap?

### First, define your goals

Making good investment decisions is difficult if you don't know what you're investing for. Making sure you're on the same page--or at least reading from the same book--when it comes to financial goal-setting is the first step toward dealing jointly with investments.

### Make sure the game plan is clear

Making sure both spouses know how and (equally important) *why* their savings are invested in a certain way can help minimize marital blowback if investment choices don't work out as anticipated. Second-guessing rarely improves any relationship; making sure both partners understand from the beginning why an investment was chosen, as well as its risks and potential rewards, may help moderate the impulse to say "I told you so" later.

### If you're the more aggressive investor ...

Listen respectfully to your spouse's concerns. You may need to provide additional information to increase his or her comfort level, but you won't know what to supply if you automatically dismiss any objections.



If you're enthusiastic about an investment, concealing potential pitfalls could make future joint decisions more difficult if your credibility suffers because of a loss. A more cautious spouse may help you remember to assess the risks involved.

Remember that you can make changes in your portfolio gradually; you don't have to become more aggressive all at once. And if you're an impulsive investor, try not to act until you can consult your partner--or be prepared to face the consequences.

### If you're the more conservative investor ...

If you're unfamiliar with a specific investment, research it. Though past performance is no guarantee of future returns, understanding

how an investment typically has behaved in the past or how it compares to other investment possibilities could give you a better perspective on why your spouse is interested in it.



Consider whether there are investments that are less aggressive than what your spouse is proposing but that still push you out of your comfort zone and might represent a compromise position. For example, if you don't want to invest a large amount in a single stock, a mutual fund that invests in that sector might be a way to compromise. (Before investing in a mutual fund, carefully consider its investment objective, risks, charges, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing.)

### What if you still can't agree?

You could consider investing a certain percentage of your combined resources aggressively, an equal percentage conservatively, and a third percentage in a middle-ground choice. This would give each partner equal input and control of the decision-making process, even if one has a larger balance in his or her individual account.

Another approach is to use separate asset allocations to balance competing interests. If both spouses have workplace retirement plans, the risk-taker could invest the largest portion of his or her plan in an aggressive choice and put a smaller portion in an option with which a spouse is comfortable. The conservative partner would invest the bulk of his or her money in a relatively conservative choice and put a smaller piece in a more aggressive selection on which you both agree.

Or you could divide responsibility for specific goals. The more conservative half could be responsible for the money that's being saved for a house down payment in five years. The other partner could take charge of longer-term goals that may benefit from taking greater risk in pursuit of potentially higher returns. You also could consider setting a predetermined limit on how much the risk-taker can put into riskier investments.

Finally, a neutral third party with some expertise and a dispassionate view of the situation may be able to help work through differences.

### *It takes two*

*Aside from attempting to minimize marital strife, there's another good reason to make sure both spouses understand how their money is invested and why. If only one person makes all decisions--even if that person is the more experienced investor--what if something were to happen to that individual? The other spouse might have to make decisions at a very vulnerable time--decisions that could have long-term consequences.*

### *Affection through diversification*

*Investing doesn't have to be either/or. A diversified portfolio should have a place for both conservative and more aggressive investments. Though diversification can't guarantee a profit or ensure against a loss, it's one way to manage the type and level of risk you face--including the risks involved in bickering with your spouse.*



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## Ask the Experts



### Can creditors reach my 401(k) plan account?

The extent to which your 401(k) plan account is protected from the claims of your creditors depends on two things: (1) whether your plan is covered by the Employee Retirement Income Security Act of 1974 (ERISA), and (2) the type of claim (in bankruptcy or outside of bankruptcy).

Most 401(k) plans are covered by ERISA. ERISA contains an "anti-assignment" rule that provides broad protection from creditors' claims. This anti-assignment rule applies whether you've declared bankruptcy or not--no bankruptcy or judgment creditor can reach your 401(k) plan account, if the plan is governed by ERISA. (There are several important exceptions to ERISA's anti-assignment rule. For example, the IRS may be able to levy against your 401(k) plan account for failure to pay your taxes. And a court can issue a qualified domestic relations order (QDRO) that will require the plan to pay all or part of your plan benefit to your former spouse.)

But again, this broad protection applies only if your 401(k) plan is governed by ERISA. Some plans are not. For example, a plan that covers only a business owner, or the owner and his or her spouse (i.e., an "individual 401(k)" plan), isn't covered by ERISA. Plans sponsored by governmental entities and certain churches aren't governed by ERISA either.

If you participate in one of these plans, you won't be able to rely on ERISA at all for protection from your creditors. What happens then? Your 401(k) plan account will still be fully protected from your creditors if you declare bankruptcy, as a matter of federal law. But whether you'll be protected from creditor claims outside of bankruptcy will depend on the laws of your particular state. While most states provide at least some protection for retirement accounts, some do not. You'll need to consult a qualified attorney to determine how the laws of your state apply to your particular situation.

### Can creditors reach my IRA assets?

Traditional and Roth IRAs generally aren't subject to ERISA (we'll discuss SEPs and SIMPLE IRAs later). Therefore, they don't qualify for the broad protection from creditors that ERISA typically provides. However, even though ERISA doesn't apply, federal law still provides protection for up to \$1,095,000 (in 2009) of your aggregate traditional and Roth IRA assets if you declare bankruptcy.

If you've rolled any funds over from a 401(k) or 403(b) plan (or another qualified plan) to your IRA, then those assets, and any earnings on them, aren't subject to the \$1,095,000 cap, and are fully protected. (You may want to consider setting up a separate IRA to hold roll-over funds so that you can more easily identify the amount eligible for full protection if you declare bankruptcy.)

But, with IRAs, federal law governs only bankruptcy claims. Whether you'll have protection from your creditors outside of bankruptcy will depend on the laws of your particular state.

Different rules apply to SEP IRA and SIMPLE IRA plans. SEP and SIMPLE IRAs are fully

protected from your bankruptcy creditors under federal law--the \$1,095,000 limit doesn't apply. But whether or not your SEP/SIMPLE IRA has protection from your creditors outside of bankruptcy may depend on whether your plan is governed by ERISA (because it covers one or more common law employees).

If your SEP/SIMPLE IRA plan isn't subject to ERISA, whether you'll have protection from your creditors outside of bankruptcy will likely depend on the laws of your particular state.

But if your SEP/SIMPLE IRA is governed by ERISA, whether you'll have protection under state law from creditors outside of bankruptcy is not clear. These plans are not covered by the part of ERISA that protects assets from creditors generally. But they *are* subject to the part of ERISA that preempts state laws. So state laws that may have provided protection for your SEP or SIMPLE IRA account from nonbankruptcy creditors may not be available.

These rules are obviously quite complicated. Be sure to consult a qualified attorney if creditor protection is important to you.