



HWM ViewPoint

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Dear Clients and Friends of HWM:

Thinking about reducing stock allocations? Here's an important reason to reconsider: "Over the last 20 calendar years ('88-'07), the S&P 500 was up +9.3% compounded per year not counting the impact of dividends. If you missed the 20 best performance days in those 20 years, your average annual return was nearly cut in half to just +4.8% per yr. If you missed the best 1% of all days in those 20 years (i.e., 51 days), your annual return was negative" (BTN Research).

Recall my quote from last month's edition: "Investment allocations must be driven by long-term goals and not short-term speculation, pessimism, or headlines".

Please read Dan's excellent lead article, **What Keeps You Up at 2:00 AM?** It can't be the thought of the Patriots securing a perfect season and 4th Super Bowl. Steeler fans- thank the Giants!

In this issue:

What Keeps You Up at 2:00 A.M. ?

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Working in Retirement--What You Need to Know

Ask the Experts

What Keeps You Up at 2:00 A.M. ?

Mike and Megan are living the retirement dream. Their successful careers and focused savings patterns have given them a comfortable nest egg to generate more than enough income. Their three children have blessed them with eight grandchildren. In good health at age 70, their days are spent engaged in volunteer and church activities, exercise, dining out with friends, and traveling to see their children who live in other states. Oh, by the way, they are deeply in love with each other.

So what's wrong with this picture and why is Megan having difficulty sleeping at night?

A close friend of the couple, Megan's friend since elementary school, suffered a stroke a few years ago. The husband of the ill wife was forced to spend the bulk of their savings to pay for her long-term care. After the funeral, he was left nearly bankrupt, financially and emotionally.

Megan, normally a very calm and content individual, now is on a 2:00 a.m. wake up schedule. Here is the agenda of worries that start at that dark and quiet hour:

Do we have any idea what long-term care costs could be for us, and are we prepared? What if our kids have to sacrifice their own financial goals and future for our care? What should we do now while we still have time to plan?

In 2007 dollars, consider some of these potential costs according to the Congressional Budget Office, April, 2005:

- **Basic assisted living** - Bringing an aide into your home? a few times a week? help with dressing, bathing, meals, chores?. approximate costs at \$21,600/year.
- **Nursing home** -Private room??. approximate costs at \$70,000/year

To ensure that Megan and Mike are prepared to never leave the remaining, healthy survivor financially strapped and to never burden their children, they decide to consider a newer, hybrid insurance product that combines a universal life insurance policy and long-term care insurance into one package. Some of the important features include, but are not limited to:

- **Protection against the financial risk of long-term care, and the ability to preserve the value of the estate.**
- **Maintaining control over the assets, with the option to change their mind if circumstances change, plus a money back guarantee if they no longer need coverage for any reason.**
- **If they do not need the money for long-term care, they have the ability to pass it on to their loved ones.**
- **Tax benefits for either the long -term care or the death benefit.**

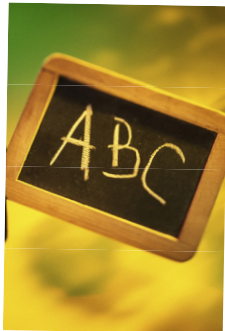
Although not the perfect solution for every person pacing their hallway at 2:00 a.m. this particular solution may help Mike and Megan to secure their joint remaining years, deliver needed long-term care to whomever needs it, protect the surviving spouse, keep the value of their estate intact and never place a financial burden on their children.

Mike and Megan have traded in an unknown future and more sleepless nights, for a known annual premium and secure living and death benefits. Sleep tight!



Why UTMA/UGMA Custodial Accounts Aren't Making the Grade

UGMA/UTMA custodial accounts let children hold assets like stocks, bonds, and mutual funds in their own names--under the watchful eye of a designated custodian--that they legally wouldn't be able to hold outright in their own names. Earnings, interest, and capital gains generated from assets in the account are taxed every year to the child. At one time, custodial accounts were a favored way for parents to save for their children's college education due to the potential tax advantages of children being in a lower tax bracket than their parents. But in recent years, the tax savings associated with custodial accounts have steadily diminished as the kiddie tax rules have expanded.



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The kiddie tax

The kiddie tax refers to special rules that apply when a child has annual unearned income over a certain amount (\$1,800 in 2008). Unearned income is income other than wages or salary (for example, interest and investment earnings, and taxable gain resulting from the sale of an asset). Under the kiddie tax rules, a child's unearned income over \$1,800 is taxed at the parent's (presumably higher) marginal tax rate.

The magic age for the kiddie tax used to be 14. Specifically, in the past, children under age 14 were subject to the kiddie tax rules, while children age 14 and older weren't. So parents saving for college with a custodial account had a limited window of opportunity--after their children turned 14--when they could sell assets in a custodial account and not be subject to the kiddie tax.

But in 2006, the Tax Increase Prevention and Reconciliation Act raised the applicable kiddie tax age from under age 14 to under age 18. The result was that children under age 18 would now be taxed on their unearned income over a certain amount at their parent's (presumably higher) marginal tax rate.

Then, in 2007, the Small Business and Work Opportunity Tax Act expanded the kiddie tax rules again, effective in 2008. Under these expanded rules, the kiddie tax now also applies to children who are under age 19, and to full-time students under age 24 (which covers traditional college students). There is an exception carved out for anyone in these two new categories who earns more than one-half of his or her own support.

The current kiddie tax rules are as follows:

If annual unearned income is in this range...	And child is (1) under 18, or (2) under 19 or a full-time student under 24 (and exception doesn't apply), then the income is...
\$0 - \$900	Tax free
\$901 - \$1,800	Taxed at child's rate
Over \$1,800	Taxed at parent's rate

Ramifications

The expanded kiddie tax rules significantly reduce the tax savings potential of custodial accounts, making them a less-than-stellar option for college savings. Now, if your child is a full-time student who does not earn more than one-half of his or her support, the kiddie tax rules will kick in if your child sells an investment asset (via the designated custodian) or has investment earnings before the year he or she reaches age 24.

Now what?

If you've been saving for your child's or grandchild's college education with an UGMA/UTMA custodial account, you may want to consider other options. One popular strategy that's emerged in recent years is to transfer the assets in a custodial account to a 529 college savings plan.

However, be aware that the typical restrictions that are the hallmark of a custodial account (for example, a beneficiary who can't be changed, gifts that can't be revoked, money that can't be withdrawn unless it's used for the beneficiary's benefit, and the requirement that all assets be handed over to the beneficiary when he or she reaches the age of majority, depending on state law) will be transferred onto the 529 plan. Your new account, referred to as a "custodial 529 plan" account, would be more restrictive than a 529 account you opened from scratch.

But keep in mind that you can only contribute cash to a 529 plan, so you'll have to sell assets in your UGMA/UTMA to complete the transfer. This may result in capital gains that will be taxed to the child, potentially at the parent's tax rate due to the kiddie tax.

Working in Retirement--What You Need to Know

Planning on working during retirement? If so, you're not alone. Recent studies have consistently shown that a majority of retirees plan to work at least some period of time during their retirement years. Here are some things you should consider.

Why work during retirement?

Obviously, if you work during retirement, you'll be earning money and relying less on your retirement savings--leaving more to grow for the future. You may also have access to affordable health care, as more and more employers begin offering this important benefit to part-time employees. But there are also non-economic reasons for working during retirement. Many retirees work for personal fulfillment--to stay mentally and physically active, to enjoy the social benefits of working, and to try their hand at something new.

How will working affect my Social Security benefit?

If you work after you start receiving Social Security retirement benefits, your earnings may affect the amount of your benefit check. Your monthly benefit is based on your lifetime earnings. When you become entitled to retirement benefits at age 62, the Social Security Administration calculates your primary insurance amount (PIA) upon which your retirement benefit will be based. Your PIA is recalculated annually if you have any new earnings that might increase your benefit. So if you continue to work after you start receiving retirement benefits, these earnings may increase your PIA and thus your future Social Security retirement benefit.

But working may also result in a reduction in your current benefit. If you've reached full retirement age (65 to 67, depending on when you were born), you don't need to worry about this--you can earn as much as you want without affecting your Social Security retirement benefit.

If you haven't yet reached full retirement age, \$1 in benefits will be withheld for every \$2 you earn over the annual earnings limit (\$13,560 in 2008). A higher earnings limit applies in the year you reach full retirement age. If you earn more than this higher limit (\$36,120 in 2008), \$1 in benefits will be withheld for every \$3 you earn over that amount, until the month you reach full retirement age--then you'll get your full benefit no matter how much you earn. Yet another special rule applies in your first year

of Social Security retirement--you'll get your full benefit for any month you earn less than one-twelfth of the annual earnings limit (\$1,130 in 2008), regardless of how much you earn during the rest of the year.

Not all income reduces your Social Security benefit. In general, Social Security only takes into account wages you've earned as an employee, net earnings from self-employment, and other types of work-related income, such as bonuses, commissions, and fees. Pensions, annuities, IRA payments, and investment income won't reduce your benefit.

Also, keep in mind that working may enable you to put off receiving your Social Security benefit until a later date. In general, the later you begin receiving benefit payments, the greater your benefit will be. Whether delaying the start of Social Security benefits is the right decision for you depends on your personal circumstances.

One last important point to consider. In general, your Social Security benefit won't be subject to income tax if that's the only income you receive during the year. But if you work during retirement (or you receive any other taxable income, or tax-exempt interest), a portion of your benefit may become taxable. IRS Publication 915 has a worksheet that can help you determine whether any part of your Social Security benefit is subject to income tax.

How will working affect my pension?

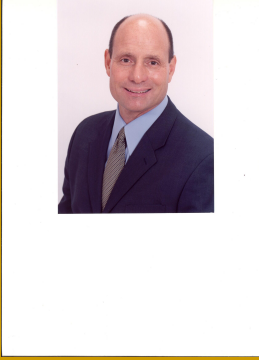
Some employers are adopting "phased retirement" programs that allow you to ease into retirement by working fewer hours, while also allowing you to access your retirement benefit. However, other plans require that you fully retire before you can receive your pension. And some plans even require that your pension benefit be suspended if you retire and then return to work for the same employer, even part-time. So check with your plan administrator before you make any decisions. Of course, if you work for someone other than your original employer, your pension benefit won't be affected at all--you can work, receive a salary from your new employer, and also receive your pension benefit from your original employer.

Working during retirement can significantly impact your retirement plan, so consider the implications before making a decision.

Recent studies have consistently shown that a majority of retirees plan to work at least some period of time during their retirement years.



Most people qualify for Medicare when they turn 65. Even if you plan on working past age 65, contact the Social Security Administration at 800-772-1213 about 3 months before your 65th birthday for help in deciding if you should sign up for Medicare.



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Ask the Experts



How do I figure the tax credit on my 2008 hybrid car?

The federal government sweetens the deal for buyers of hybrid motor vehicles with a tax credit. However, calculating the amount of

the credit can be confusing, as it's based on a complex formula determined by the type of vehicle, its weight and fuel economy, and emissions data.

The credit for light vehicles (8,500 pounds or less) contains two components: (1) the fuel economy credit, and (2) the conservation credit. The fuel economy credit amount (ranging from \$400 to \$2,400) depends on its fuel efficiency compared to 2002 standards. The conservation amount (ranging from \$250 to \$1,000) is based on the estimated lifetime fuel savings of the vehicle as compared to a comparable 2002 vehicle. Medium and heavy hybrid vehicles get a credit amount based on a certain percentage of the incremental cost of the hybrid over similar gas-powered vehicles.

Further, once 60,000 qualifying vehicles are sold by a particular manufacturer, the credit begins to be phased out. Fortunately for you, the burden is on the manufacturer and dealer to supply you with certification that indicates what the credit will be. (You must also meet certain other requirements to qualify.)

Here is a partial list of the credit amounts the IRS has announced for 2008 models:

- Chevrolet Malibu \$1,300
- Ford Escape 2WD \$3,000
- Ford Escape 4WD \$2,200
- Mazda Tribute 2WD \$3,000
- Mazda Tribute 4WD \$2,200
- Mercury Mariner 2WD \$3,000
- Mercury Mariner 4WD \$2,200
- Nissan Altima \$2,350

Many of my possessions were destroyed in a recent disaster. Can I get a break on my taxes?

If you experience a casualty loss, you can often claim a tax deduction. Deductible casualty losses can result from the destruction or damage to your property from any sudden, unexpected, and unusual event such as a flood, hurricane, tornado, fire, earthquake, or volcanic eruption.



For any personal-use property, you calculate your loss by starting with the property's adjusted tax basis immediately before the casualty or the property's decline in fair market value due to the casualty, whichever is lower. Subtract any insurance or other reimbursement you receive or expect to receive.

Generally, for personal-use property, you then reduce each casualty loss you've had during the year by \$100. Your total losses for the year must then be further reduced by 10% of your adjusted gross income.

Typically, casualty losses are deductible for federal income tax purposes only in the year in which the casualty occurs. But an exception exists for losses that occur in an area declared a federal disaster area by the President. In this case, you can choose to deduct your loss either in the tax year the disaster happened or in the year prior to the disaster by filing an amended return. By electing to deduct your loss in the prior year, you may be entitled to an immediate refund.

Casualty and theft losses are reported on IRS Forms 4684 and 1040, Schedule A. See IRS Publication 547, *Casualties, Disasters, and Thefts* for more information.



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