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Hello-

We hope everyone is enjoying the beginning of summer and looking forward to the July 4th holiday! Our office will be closed on July 5th in recognition of the holiday.

Now is a great time to review your portfolio to ensure that your financial plan is aligned with your life plans. Call us today to schedule a review.

Visit our website to check out the newest section: *Money Manager Commentary*. While you are there sign up to receive the newsletter electronically.

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# INVESTING PERSPECTIVES

3rd Quarter 2010

## A Mid-Year Financial Review: More Time to Plan

Mid-year is an ideal time to take a look at your finances, because the demands on your time may be fewer, and the planning opportunities greater, than if you wait until the end of the year.

Here are a few tips to get you started.



### **Identifying your needs**

Financial plans often need to be modified when personal circumstances change. Answering these questions can help you identify the financial issues you want to address within the next few months.

- Are any life-changing events coming up soon, such as marriage, the birth of a child, retirement, or a career change?
- Will your income or expenses substantially increase or decrease this year?
- Are you concerned about the performance of your investment portfolio?
- Do you have any needs or concerns that you would like to address?

### **Tax planning**

Completing a mid-year estimate of your income tax liability can reveal tax-planning opportunities. You can use last year's tax return as a basis, then make any anticipated adjustments to your income and deductions for this year. Check your withholding, especially if you owed taxes when you filed your most recent income tax return or if you received a large refund. Doing that now, rather than waiting until the end of the year, will help you avoid a big tax bill or having too much of your money tied up with Uncle Sam. If necessary, adjust the amount of federal or state income tax withheld from your paycheck by filing a new Form W-4 with your employer.

One of the easiest things you can do right now to help avoid missed tax-saving opportunities for the year is to set up a system for saving receipts and other tax-related documents. This

can be as simple as dedicating a folder in your file cabinet to this year's tax return so that you can keep track of important paperwork.

### **Retirement planning**

If you're working and you received a pay increase for this year, don't overlook the opportunity to increase your retirement plan contributions by asking your employer to apply a higher percentage of your salary. This year, you may be able to contribute up to \$16,500 to your retirement plan at work (\$22,000 if you're age 50 or older). If you have a traditional IRA, you may also want to weigh the benefits of converting it to a Roth IRA this year, when you may be able to take advantage of a special deferral rule that applies only to 2010 conversions. This deferral rule gives you the option of reporting half of any resulting taxable income that results on your 2011 tax return and half of the income on your 2012 return.

If you're already retired, take a new look at your retirement income needs and whether your current investments and distribution strategy will continue to provide enough income.

### **Investment planning**

Have you recently reviewed your portfolio to make sure that your asset allocation is still in line with your financial goals, time horizon, and tolerance for risk? Though it's common to rebalance a portfolio at the end of the year, if the market is volatile, you may need to rebalance more frequently.

### **Insurance planning**

Do you know exactly how much life and disability insurance coverage you have? Are you familiar with the terms of your homeowners, renters, or auto insurance policies? If not, it's time to add your insurance policies to your summer reading list. Insurance needs frequently change, and it's possible that your coverage hasn't kept pace with your income or family circumstances.

## Social Security: File-and-Suspend for Higher Benefits

If you're married and looking for opportunities to increase retirement income, you may want to look closely at your Social Security benefits. One opportunity for maximizing Social Security income, called "file-and-suspend," may enable a married couple to boost both their retirement and survivor's benefits.

### What is file-and-suspend?

Generally, a husband or wife is entitled to receive a Social Security retirement benefit based either on his or her own earnings record (a worker's benefit), or on his or her spouse's earnings record (a spousal benefit), whichever is higher. But under Social Security rules, a husband or wife who is eligible to file for retirement benefits based on his or her spouse's record cannot do so until his or her spouse begins receiving benefits. However, there is one exception--someone who has reached full retirement age may choose to file for retirement benefits, then immediately request to have those benefits suspended, so that his or her eligible spouse can file for spousal benefits.

File-and-suspend is a strategy that may be used in a variety of situations, but is 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. (A husband or wife's spousal benefit may be as much as 50% of what his or her spouse is entitled to receive at full retirement age.) Using this strategy not only allows the eligible spouse with lower earnings to immediately claim a higher (spousal) retirement benefit, but can also increase the amount of available survivor protection. 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. Because a surviving spouse will generally receive a benefit equal to 100% of the retirement benefit the other spouse was receiving (or was entitled to receive) at the time of his or her death, suspending a benefit to accrue delayed retirement credits may substantially increase the survivor's benefit.

### Example

Let's look at one hypothetical example of how filing for, then suspending, Social Security benefits might help a married couple increase their retirement income and survivor's benefits.

Henry is about to reach his full retirement age of 66, but he wants to postpone filing for Social Security benefits. At full retirement age his monthly benefit will be \$2,000, but if he waits until age 70 to file, his benefit will be \$2,640 (32% more) due to delayed retirement credits. However, his wife Julia, who has had substantially lower lifetime earnings than Henry, wants to retire in a few months at her full retirement age (also 66). Based on her own earnings record, Julia will be eligible for a monthly benefit of \$700, but based on Henry's earnings record she will be eligible for a monthly spousal benefit of \$1,000 (50% of Henry's entitlement).

So that Julia can receive the higher spousal benefit as soon as she retires, Henry files an application for benefits, but immediately suspends it. That way, he can also continue to earn delayed retirement credits, which will result in a higher monthly retirement benefit for him later.

Using the file-and-suspend strategy not only increases Julia and Henry's retirement income, but it also offers increased survivor protection. Upon Henry's death, Julia will be entitled to receive 100% of what Henry was receiving (or was entitled to receive) at the time of his death. So by suspending his own retirement benefit in order to increase it through delayed retirement credits, Henry has ensured that Julia will receive a survivor's benefit that is up to 32% higher for the rest of her life should he die first. (Note, though, that this hypothetical example is for illustrative purposes only and does not account for cost-of-living adjustments or taxes.)

### Points to consider

- Deciding when to begin receiving Social Security benefits is a complicated decision. You'll need to consider a number of scenarios, and take into account factors such as both spouses' ages, estimated benefit entitlements, and life expectancies. A Social Security representative can help explain your options.
- Ask a tax professional to help you weigh the tax consequences of delaying Social Security income.
- Using the file-and-suspend strategy may not be advantageous when one spouse is in poor health or when Social Security income is needed as soon as possible.
- The spousal benefit will be reduced if the spouse claiming it is under full retirement age.

*Although many people think of Social Security as only a retirement program, Social Security also provides survivor's benefits that can provide substantial income to your spouse after your death.*



*For more information, contact the Social Security Administration at 800-772-1213 or visit [www.socialsecurity.gov](http://www.socialsecurity.gov).*

## How Much Life Insurance Is Enough?

Your life insurance needs often depend on a number of factors, including whether you're married, the size of your family, the nature of your financial obligations, your career stage, and your goals.

There are a number of approaches you can use to figure out how much insurance you should have. One method, called the "family needs approach," focuses on the amount of life insurance it would take to allow your family to meet its various financial obligations and expenses in the event of your death.

### Family needs approach

With the family needs approach, you divide your family's financial needs into three main categories:

- Immediate needs at death, such as cash needed for estate taxes and settlement costs, credit card and other debts including mortgages (unless you choose to include mortgage payments as part of ongoing family needs), an emergency fund for unexpected costs, and college education expenses.
- Ongoing income needs for expenses related to food, clothing, shelter, and transportation, among other things. These income needs will vary in amount and duration, depending on a number of factors, such as your spouse's age, your children's ages, your surviving spouse's capacity to earn income, your debt (including mortgages), and whether you'll provide funds for your surviving spouse's retirement.
- Special funding needs, such as college funding, charitable bequests, funding a buy/sell agreement, or business succession planning.

Once you determine the total amount of your family's financial needs, you subtract from this total the available assets that your family could use to defray some or all of their expenses. The difference, if any, represents an amount that life insurance proceeds, and the income from future investment of those proceeds, can cover.

**Example:** John and his wife, Wendy, are estimating the appropriate amount of life insurance to buy on John's life. They first estimate their immediate needs as follows:

- Final medical expenses: \$5,000
- Estate settlement costs including funeral and burial expenses: \$37,500

- Debts, including credit cards and mortgages: \$317,000

- Emergency fund: \$100,000

Subtotal: \$459,500

Next, they estimate ongoing income needs, such as:

- Providing for their dependent children's needs for a period of time: \$500,000

- Wendy's income needs until her retirement: \$450,000

- Wendy's retirement income needs: \$380,000

Subtotal: \$1,330,000

Adding the sub totals together, John and Wendy estimate that, should John die, their family would need \$1,789,500. They then determine that assets available to offset their needs include:

- Bank savings: \$40,000

- Investments: \$220,000

- Retirement assets: \$250,000

- Existing life insurance on John's life: \$300,000

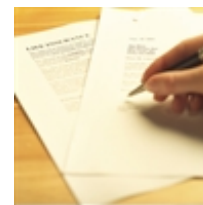
Subtotal: \$810,000

The difference between their family needs (\$1,789,500) and their available assets (\$810,000) equals their life insurance need (\$979,500).

### Review your coverage

Trying to figure out how much life insurance is enough isn't always easy, and that amount will likely change with your changing circumstances. By examining your family's anticipated expenses during various periods after your death, you get a more realistic estimate of your life insurance needs.

Unfortunately, many people underestimate their insurance needs and are underinsured. Often, the purchase of life insurance is based on cost instead of what's needed. By the same token, it's possible to have more insurance than you need. You may have purchased a large policy during a particular point in your life, and then didn't adjust your coverage when your insurance need was reduced. Both of these circumstances are reasons to review your insurance coverage periodically with your financial professional. Doing so can reveal opportunities to change your levels of coverage to match your current and projected life insurance needs.



**An insurance coverage review is a periodic reassessment of your insurance needs. The main objectives are to confirm that the level of insurance coverage you have is still adequate, to alert you to shortages in coverage that can occur due to changes in your life, and to ensure that any cash value policies are performing as expected.**





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## Ask the Experts



### My child got a scholarship for college. Is it taxable?

In certain situations, yes. If a scholarship is used to pay for college tuition, fees, books, or required equipment, it's not taxable.

But if the scholarship is used to cover room and board, travel costs, or optional equipment, or if it's awarded as payment for teaching, research, or some other required service, then it is taxable.

With most scholarships, the recipient can decide how to apply the money. Your first instinct may be to have your child apply it to tuition, fees, or books (making it tax free). But be aware that this may impact your ability to claim the Lifetime Learning or the American Opportunity (formerly the Hope) tax credits. That's because these credits are based on the amount of tuition and fees you pay, and any tuition and fees paid with a tax-free scholarship can't be counted when calculating your credit.

This rule has the most impact on your ability to claim the Lifetime Learning credit, worth up to \$2,000. Why? This credit is calculated as 20% of the first \$10,000 of tuition and fees, so a hefty scholarship applied to these expenses

may leave you with less than \$10,000 in eligible tuition and fees to count toward the credit. The American Opportunity credit, worth up to \$2,500, is calculated differently--100% of the first \$2,000 of tuition and fees, plus 25% of the next \$2,000 of such expenses. (You can only take one of these credits in a given year for the same student.)

If the scholarship has no restrictions on how it can be applied (and assuming you meet the income limits to take the credits--each credit has different income limits), consider running some numbers to determine your best option: (1) apply the scholarship to tuition and enjoy its tax-free status, but reduce the amount of eligible tuition that can be used to calculate the tax credits, or (2) apply the scholarship to room and board and pay income tax on the scholarship, but allow all tuition to be counted when calculating the credits. When running the numbers, keep in mind that generally a tax credit is more valuable than a tax deduction because it reduces your taxes dollar for dollar.

For more information, see IRS Publication 970, *Tax Benefits for Education*.