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Taxes and your Social Security…

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There are strategies we can implement to offset your income to help alleviate taxation on Social Security benefits:

Change investments: To lower a tax bill, you may want to consider altering your investment strategies.

Gauge gains: You should be careful about recognizing capital gains. The actual tax can be much greater than 15% if the capital gain causes Social Security to be taxed. Harvesting capital losses can help hold down taxable capital gains.

Fund retirement accounts: Some tax-deductible contributions can keep combined income in check. Earned income up to $14,000 can be fully sheltered from taxes this year with a retirement account/plan.

Tax Planning is one of the many services offered by Bates Financial Advisors, Inc.

BATES Briefings

Spring 2012

from George's Desk

The beginning of a new year is always a challenge for me. I reflect on the past year and think, “How is this new year going to differ?”

This New Year, I believe, will be one of the most important years in our country’s history. For one, both politics and financial subjects are at a critical stage. However, before I go further, I wish to add a disclaimer: I am constantly reminded when I write this column, of a response I received from a reader years ago; he wanted financial advice and information from Bates, not “political opinions”.

My response to that is:
1) Fortunately or unfortunately, politics greatly influences financial consequences; 2) I blame both parties for the financial problems we face – both parties are guilty of excessive spending and expansion of government, and therein lies some of our most urgent challenges, in my opinion.

Let me elaborate. Though most retired people could not survive financially without Social Security and Medicare, those two entitlements have contributed to approximately $50 trillion of unfunded promises that future generations are going to have to pay, unless there are major changes in the benefits or unacceptable levels of taxation. You can check the government websites for those two programs if you want more proof.

In addition, the expansion of government, through enormous new departments, e.g., the Departments of Education and Energy, and new laws, is choking the development and survival of businesses throughout our country. I will cite one example: last August I received a 500 page document of rule changes and policy changes, which my companies had to incorporate largely due to the new law commonly referred to as the Dodd-Frank financial regulation bill. That new law is reported to establish 253 new rules and regulations on financial institutions. It also required the U.S. Securities and Exchange Commission to conduct 59 studies and report back to congress on what additional new legislation should be done.
I have recently learned that the highest in-demand position for new jobs is compliance officers, for financial services companies.

Now to what I really wanted to address: I am generally optimistic that 2012 will be better in some ways than 2011. The economy will continue to recover, progress will be made by the European Union to solve the financial problems several of its members face,

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From George's Desk…
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unemployment will continue to decline (though not nearly as much as it needs to), and corporate profits will continue to grow.

My outlook for the financial markets is that interest rates will stay relatively low, the stock markets will do OK the first half of the year (then the election process will cause the financial markets to "shift into neutral"), the real estate prices will bottom out and in some areas begin to improve slowly, the bond market will earn its premium (the interest that it yields), commodities will be influenced by both weather and world demand for improving diets, energy prices will be about the same, and precious metals will be flat to negative. That is my outlook, subject to change at any time.

A couple of final thoughts…I just read in the editorial of Investment News about New Year's resolutions and their request was that the President and Congress "resolve to get serious about reducing government spending, balancing the federal deficit and begin paying down the country's enormous debt." That publication pointed out that our current debt to GDP (gross domestic product) ratio is 100%. To put that in context, Italy's is 118% and Greece is 144%. Four years ago that ratio for the U.S. was 62% and ten years ago it was 33%.

The turmoil in the financial markets has caused many people to focus on short-term results regarding their financial well-being. I understand, and going forward will put more emphasis on having cash reserves to meet living expenses for at least a couple of years. However, with people living longer and the prospects of much higher inflation rates in the future, I think one must be careful not to get too fixed on short-term results.

As my friend, Joe Hargrove from Fort Worth, Texas, regularly says in his newsletter, "That's my opinion; I'd like to hear yours".
P.S. – It has been a few weeks since I first wrote this column, and I am already wrong on the energy prices.

WHAT IS THE TRUTH?

By George E. Bates

Recently I stopped at a service station to buy fuel for my truck on my way to Kentucky. On my return trip, I stopped at the same station. I was shocked that the price had jumped .20 cents per gallon from 9:00 a.m. to 9:30 p.m. When I said something to the cashier, he responded that it made him angry that prices could jump so much in a day.

During a brief conversation he mentioned that he was unhappy that people like Mitt Romney only paid 15% in income tax, while the working people like himself had to pay that much or more. I then asked him if he realized that someone with Romney's income could only be paying 15% because his income came from qualified dividends. However, the companies that he received those dividends from had to pay 35% of their profits in federal taxes and out of the remainder they paid the dividends which results in an effective tax rate of 45%.

He then said, "Well what about GE which earned $14 billion dollars and paid no U.S. Government taxes"? I then explained that a substantial part of those profits were earned overseas and were subject to the tax laws of those countries. The portion that was earned in the U.S. was not taxed because GE had substantial losses on their financial services division in 2008 and 2009 that allowed them to offset those profits in 2010. This fellow responded by asking "Why doesn't the news media in our country tell us that"? I responded to him that the news media does not always tell the whole truth and nothing but the truth.

Be on the lookout for our new website
www.batesfinancialgroup.com
Coming Soon!

TAXES AND YOUR SOCIAL SECURITY BENEFITS

Some people have to pay federal income taxes on their Social Security benefits. This usually happens if you have other substantial income (such as wages, self-employment, interest, dividends and other taxable income that must be reported on your tax return) in addition to your benefits.

Based on Internal Revenue Service (IRS) rules, if you:

- **File a federal tax return as an "individual"** and your ***combined income**** is
  - Between $25,000 and $34,000, you may have to pay income tax on up to 50% of your benefits.
  - More than $34,000, up to 85% of your benefits may be taxable.
- **File a joint return**, and you and your spouse have a ***combined income**** that is
  - Between $32,000 and $44,000, you may have to pay income tax on up to 50 percent of your benefits
  - More than $44,000, up to 85 percent of your benefits may be taxable.
- **Are married and file a separate tax return**, you will probably pay taxes on your benefits.

**Note:*

Your adjusted gross income
+ Nontaxable interest
+ 1/2 of your Social Security benefits

= Your "***combined income***"

If your combined income is less than $25,000 (or $32,000 on a joint return), Social Security benefits won't be taxed. If this is the case, you should call us because this means you may be able to withdraw money from an IRA or annuity without paying taxes.

The column to the right shows two illustrations demonstrating how taxation is calculated:

EXAMPLE 1

John and Jane Mapes have an adjusted gross income of $24,000 for 2011. John, who is retired, receives social security benefits of $7,200 per year. The couple also receives $6,000 a year from a mutual fund that invests solely in tax-exempt municipal bonds. On their joint return in 2011, the Mapes' would make the following computation to determine how much, if any, of John's social security benefits must be included in their gross income:

1	Adjusted gross income	$24,000
2	Plus: All tax-exempt interest	6,000
3	Modified adjusted gross income	30,000
4	Plus: One-half of social security benefits	3,600
5	Provisional income	33,600
6	Less: Base amount	32,000
7	Excess above base amount	1,600
8	One-half of excess above base amount	800
9	One-half of social security benefits	3,600
10	Amount includible in gross income (lesser of #8 or #9)	800

EXAMPLE 2

Assume the same facts as in Example 1 above, except that the Mapes' provisional income is increased from $33,600 to $53,600. The includable amount is determined as follows:

1	Provisional income	$53,600
2	Adjusted base amount	44,000
3	Excess of #1 over #2	9,600
4	85% of amount in #3	8,160
5	Amount otherwise includible (1/2 of benefits in the Mapes' case)	3,600
6	Base amount for joint filers	6,000
7	Lesser of #5 or #6	3,600
8	Sum of amounts in #4 and #7	11,760
9	85% of social security benefits	6,120
10	Amount includible in gross income (lesser of #8 or #9)	6,120

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