



What you need to know about Social Security

Open questions

If you are considering retiring in the foreseeable future, one of your important questions is when to begin drawing your Social Security benefits. That is the main topic of this issue of *QuarterNotes*.

Another open question concerns the tax law for next year, and what you should do this year if the law changes as currently scheduled. See page 3 for insights on this topic.

Finally, is the economy at risk of a double-dip recession? If so, how should investors respond? Please bring your investment concerns to us, and put our expertise to work for you.

Although Social Security benefits aren't likely to make up a sizable part of your retirement income, your planning wouldn't be complete without getting a good grasp on how much you'll be receiving and, if you plan to work part-time after retirement, the impact of your earnings on your benefits.

What is your full retirement age?

For those born in 1945, who are turning 65 in 2010, the full retirement age is 66, so they must wait until next year to begin drawing full benefits. Those born in 1944 reach their full retirement age this year. Those born in 1960 and later years have a full retirement age of 67.

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Receiving benefits early

You can begin receiving Social Security benefits as early as age 62. If you do begin receiving benefits early, they will be reduced permanently, based upon the number of months that you receive checks before you reach full retirement age. For example, if your full retirement age is 66, and you retire at age 62, there is about a 25% reduction in your benefits.

In an actuarial sense, early retirement gives people about the same total Social Security benefits over their lifetime as retirement at the normal age, but in smaller amounts so as to take into account the longer period during which they will receive them. In a personal sense, it all depends upon how long you live.

Starting benefits after full retirement age

Social Security benefits are increased if you choose to delay them beyond full

retirement age. These increases will be added in automatically from the time that you reach your full retirement age until you start taking your benefits, or until you reach age 70. The percentage is 8% per year for those who are 66 in 2010.

If you decide to delay your retirement, the Social Security Administration strongly urges you to sign up for Medicare at age 65.

Working while collecting

You may continue to work and still receive retirement benefits. Your earnings in or after the month that you reach your full retirement age will not affect your Social Security benefits. However, your benefits will be reduced if your earnings exceed certain limits for the months before you reach full retirement age.

Example: In 2010, if you're under full retirement age, \$1 in benefits will be deducted for each \$2 in earnings

that you have above the annual limit of \$14,160. In the year that you reach your full retirement age, your benefits will be reduced \$1 for every \$3 that you earn above \$37,680, until the month that you reach full retirement age. Then your earnings will no longer affect the amount of your monthly benefits, no matter how much you earn. The annual limits increase each year as average wages increase.

Taxation of benefits

Under legislation enacted in 1983, the Social Security Trust Funds receive income based on Federal income taxation of benefits. The funds receive taxes on up to 50% of benefits from single taxpayers with annual incomes over \$25,000 and from taxpayers filing jointly with incomes over \$32,000.

Legislation enacted in 1993 extended taxation of benefits. The legislation increased the limitation on the amount of benefits subject to taxation from 50% to 85% for single taxpayers with annual incomes over \$34,000 and for taxpayers filing jointly with incomes over \$44,000. All additional tax income resulting from the 1993 legislation is deposited in Medicare's Hospital Insurance Trust Fund.

Read your Statement

Each year—usually about three months before your birthday—you receive a Social Security Statement that provides a record of your earnings, estimates of your Social Security benefits for early retirement, full retirement and retirement at age 70. It also provides an estimate of the disability benefits that you could receive if you become severely disabled before you're eligible for full retirement, as well as estimates of the amount of benefits paid to your spouse and other eligible family members as a result of your retirement, disability or death. Visit www.ssa.gov to learn more.



How to boost your Social Security check

There is a little-known option for changing Social Security benefits, considered by some to be a “loophole,” that allows a retiree to effectively reverse a decision to receive early Social Security benefits. The strategy is sometimes recommended for those who have reached age 70, when the maximum additional benefit is available.

The retiree must file Social Security's Form 521 and repay the gross benefits received to date, including the premiums deducted for Medicare part B. However, there is no interest charge associated with the repayment. Benefits are then recalculated and paid for life as if the retiree had waited until the later age to begin drawing them.

Repayment of gross benefits could easily run to six figures, and not many retirees will have that much spendable cash for such an investment. In the right circumstances, however, such a move may pay off. *Forbes* magazine published an illustration suggesting that a monthly benefit check could be boosted by 73% through this technique. What's more, the larger benefit is available to a surviving spouse as well.

Consult with your tax and investment advisors about all your alternatives before making any such important decisions.

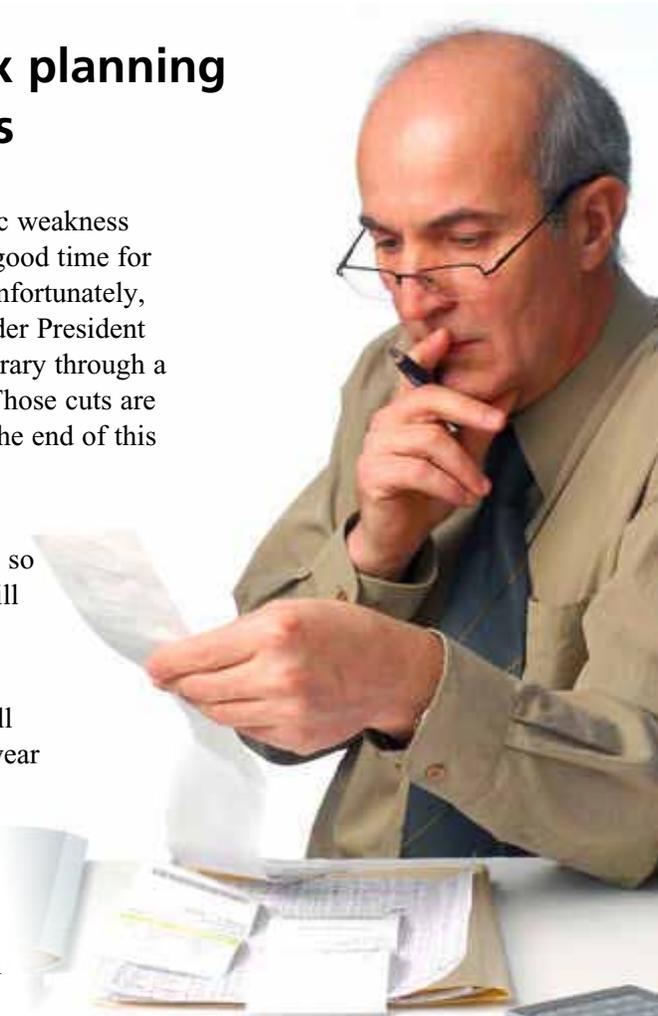
Year-end tax planning uncertainties

A period of economic weakness is generally not a good time for a major tax increase. Unfortunately, the tax cuts enacted under President Bush were made temporary through a political compromise. Those cuts are scheduled to expire at the end of this year, including:

- the 10% and 25% tax brackets will disappear, so middle-income folks will be covered by the 15% and 28% brackets;
- the top tax bracket will elevate from 35% this year to 39.6%;
- the lowest tax rate on capital gains will jump from 0% to 10%;
- the highest tax rate on capital gains goes from 15% to 20%;
- the preferential tax treatment for dividends will be lost, so the top tax rate will more than double, to 39.6% from this year's 15%;
- the marriage penalty tax returns;
- phaseouts for itemized deductions and personal exemptions will return.

Virtually all politicians advocate extending these tax cuts for 98% of Americans. The "price tag" in lost revenue on such a move, according to the Congressional Budget Office, is \$3.7 trillion. A political firefight has broken out over whether the top 2% of taxpayers should be included in the extension, which would boost the "cost" by an estimated \$700 billion. The outcome is uncertain as of this writing.

In percentage terms, lower- and middle-income families face the biggest increase, though the exact impact for any particular family is unpredictable.



A family with income of \$30,000 and projected federal income tax of \$400 in 2010 could see a jump of over 100%, to tax of \$878, because of the loss of the 10% tax bracket and marriage penalty relief. Family income of \$50,000? Expect a jump from \$2,763 tax this year to \$3,878 next year, roughly a one-third increase.

Higher-income families face higher dollar tax increases, though the percentage increase is less dramatic. A family with \$500,000 income and no itemized deductions (admittedly, an unusual situation) would see their tax liability grow from \$136,208 in 2010 to \$158,801 in 2011, about a 15% increase, according to one published estimate.

What should investors do?

Capital gains and losses. Long- and short-term capital gains may be netted against each other to reduce tax

exposure. Only \$3,000 in net capital losses may be written off against ordinary income. Tax considerations are secondary in investment decisions, but all things being equal, it may be wise to realize gains this year at a 15% tax toll instead of paying higher rates in the coming years. Keep in mind that if tax rates rise next year, the value of carried-forward capital losses also goes up.

Deductions. Bunching deductions allows taxpayers to take advantage of the standard deduction one year and larger itemized deductions the next. If tax rates go up, deductions become more valuable next year.

Retirement funding. Maximum contributions to IRAs and employer plans will be a sound idea regardless of what Congress does.

Roth IRA conversions. This year, for the first time, traditional IRAs may be converted to Roth IRAs regardless of the taxpayer's adjusted gross income. The conversion is subject to ordinary income tax. The benefit to the taxpayer is that future Roth IRA distributions may be fully tax free, avoiding the higher future rates. What's more, there are no required distributions, and the Roth IRA distributions won't affect the taxes on one's Social Security benefits, as IRA distributions do.

Let's say that you've decided on a conversion. The next question is when to pay the income tax due. You may choose to pay it all with this year's return, at this year's rates, or defer the pain by paying it in 2011 and 2012 at the rates that prevail in those tax years. No one expects rates to be lower in those years, and they may be significantly higher.

Check again in December. These important tax issues may not be resolved until a lame duck session of Congress, after the November elections. That's not a reason to delay your planning, but you may want to hold off on implementing your strategies until there is more certainty.

JUST ASK US

I'm thinking about converting my traditional IRA to a Roth. Do I have to do it this year?

No, there is no "sunset" provision for conversions to Roth IRAs. However, only 2010 conversions are eligible to have the required income tax payments deferred to 2011 and 2012.

What if I convert to a Roth IRA but then change my mind?

You have until you file your taxes for 2010, including extensions (normally allowed until October 15, 2011), to "recharacterize" the conversion back to a traditional IRA and avoid all income taxes.

What about direct transfers from my IRA to a charity? Is that still allowed?

Not at this writing. The provision allowing those over 70½ to transfer up to \$100,000 from their IRAs to charity without having to pay income tax on the distribution lapsed at the end of last year. Attempts to renew the provision this year have not succeeded thus far—but the year isn't over yet! Keep an eye on Congress for this one.

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