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PRIZM PERSPECTIVE

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Should We Worry about the Deficit?

A federal deficit occurs when the government's expenditures for the year exceed its income. The government then pays for those excess expenditures by borrowing money, adding to the national debt. With so much stimulus money being spent to prod the economy out of recession, the federal deficit will reach record levels this year. According to the Congressional

Budget Office, the federal deficit will quadruple in 2009, from \$459 billion last year to \$1.845 trillion for 2009 (Source: *The Economist*, June 10, 2009). While the president vows to slash the deficit in half within four years, the Congressional Budget Office estimates the deficit will still total more than \$1 trillion per year by 2019. Are these huge deficits cause for concern? It's tough to decide,

since opinions range from "deficits don't matter at all" to "deficits will ultimately result in federal bankruptcy." It might help to put the federal deficits in perspective.

In 1998, for the first time in 28 years, the federal government ran a budget surplus. Those surpluses lasted four years. During that time, concerns about the viability of the Social Security system seemed less urgent, and there was talk about what would happen to the bond market if the federal government paid off all its debt. These discussions were short lived. Following two tax cuts, the September 11 terrorist attacks, the Afghanistan and Iraq wars, and a recession, the federal deficits were back and have not gone away since.

Of course, a federal deficit results in an increase in the national debt.

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The Basics of Income Taxes

The subject of income taxes is one that most people prefer to ignore. However, since income taxes are a significant expense for most taxpayers, you should come to grips with some basics about taxes:

- **Realize you can exert some degree of control over how much you pay in income taxes.** While you do have to file and pay taxes every year, how much you pay depends on the tax strategies used. Discuss your tax situation with a tax professional, reviewing ways to help reduce your income tax bill.
- **Understand basic tax concepts.** You don't have to become a tax expert, but you should have a basic understanding of the tax laws so you recognize when you need assistance. Before any major financial transaction, review the tax ramifications.
- **Don't make decisions solely for tax reasons.** While you want to minimize the payment of income taxes, that is only one factor in most decisions. You should first make sure the transaction is economically beneficial and then decide how to minimize the tax effects. For instance, perhaps you are considering selling a stock with gains. If you hold the stock for another month, the gain will be subject to capital gains tax rates. However, during that time, the stock's value may go down.
- **Keep good tax records.** During the year, file any records with possible tax ramifications. That way, when it comes time to file your income tax return, all your tax records will be located in one place and you won't forget a deduction. ○○○



Should We Worry?

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Currently, the gross national debt is approximately \$11 trillion. A significant portion of that debt is owed to the Federal Reserve and other government accounts. But the public holds \$6.8 trillion, or 62%, of the total debt (Source: *Region Focus*, Winter 2009). China and Japan are the largest foreign holders of this publicly held debt.

While the dollar amounts of the deficits and national debt are enormous, these numbers are often presented as a percentage of gross domestic product (GDP) to compare to past deficits and debt levels. The 2009 deficit of \$1.8 trillion is 13.1% of GDP, twice the post-World War II record of 6% set in 1983 (Source: *Fortune*, June 22, 2009). The Congressional Budget Office's estimate of a \$1.2 trillion deficit for 2019 would represent 5.7% of GDP, an extremely high number for a healthy economy.

In 2008, federal borrowing totaled 42% of GDP, about average for post-war years. By 2019, it could reach 82% of GDP, close to double the current level. At that point, one out of every six dollars the government spends will go to interest payments (Source: *Fortune*, June 22, 2009).

The general consensus is that the government needs to spend money now to stimulate the economy out of the current downturn. Without



Check Your Property Tax Assessment

Given the drastic declines in housing values over the past couple of years, it may be time for you to take a second look at your home's assessed value. It's possible that the value isn't accurate, which might entitle you to a reduction in property taxes. To get that reduction, you'll have to officially challenge the assessor's valuation of your home, following these steps:

- **Initiate your challenge right away.** You'll have a better chance of winning your appeal if you start it in the same year that you notice the discrepancy between your assessment and your property's market value.
- **Start your research in the assessor's office.** Check the records of your assessment and those of about half a dozen homes you believe are comparable. Your chances of a successful appeal are typically greater when you cite several relevant examples. If your community allows you to informally discuss this with the assessor, ask him/her to explain the value he/she currently has on your home in light of market conditions and other

assessments you've looked at.

- **Know your municipality's appeal procedures.** What are the deadlines for an appeal? What forms do you need to fill out? How much does the local government charge for an appeal, and when is it due? You don't want your case thrown out over a technicality.
- **Look for errors in the assessor's report.** Many assessments are conducted on a "drive by" basis, with the assessor never leaving his/her car and referring to existing records, which may be inaccurate or out of date. Check the figures used for such details as square footage and the number and types of rooms. Does the report accurately indicate such improvements as a finished basement or attic? Have you made any alterations that could have reduced the home's value, like taking down a deck or removing a swimming pool?
- **Secure an independent appraisal from a respected professional.** The closer the appraisal is to the date of your appeal hearing, the more effective it will be in supporting your case. ○○○

running deficits, the recession is likely to last longer and become more severe. When recessions cause a rise in unemployment rates, people spend less, which causes more people to lose their jobs, precipitating a downward spiral in the economy. Using short-term deficits to stimulate the economy helps reverse this cycle.

The problem is that even if the short-term deficits lift the economy out of recession, projected increases in Social Security, Medicare, and Medicaid expenditures make it difficult to envision a scenario where the government can operate without deficits. Spending is growing astronomically, while revenues as a percentage of GDP are basically flat.

Spending is primarily driven by entitlements such as Social Security, which are projected to grow enormously as the population ages. Revenues, on the other hand, are based heavily on the individual income tax, which typically rises and falls with GDP.

What impact will these huge deficits have on the economy if they continue? No one knows for sure. But perhaps the federal government should pay special heed to what got us into the current recession in the first place — consumers living beyond their means, incurring debt to support a lifestyle they couldn't afford. Will the government be next? ○○○

Should You Pay Off Your Mortgage by Retirement?

A recent study found that 41% of homeowners between the ages of 60 and 69 still have a mortgage on their home. Of those, 51% had sufficient assets to repay their mortgage (Source: Center for Retirement Research, July 2009). The study found that most households would be better off paying their mortgage off. But is that good advice for your situation? Before making this decision, be sure to consider these factors:

- **Compare your mortgage interest rate to the rate you are earning on your investments.** If you retain your mortgage because you believe you will earn more on your investment assets, make sure that is really happening. When paying off a mortgage, you are effectively earning a pretax return equal to your mortgage interest rate, which is a guaranteed return with no risk.
- **Consider the tax benefits of the mortgage interest.** Interest paid on mortgages with balances of up to \$1,000,000 and on home-equity loans up to \$100,000 is deductible on your federal tax return, provided you itemize deductions. You only benefit if your total itemized deductions exceed the standard deduction amount,

which in 2009 and 2010 is \$11,400 for married couples filing jointly and \$5,700 for single taxpayers. Even if you do itemize deductions, you are paying most of the interest.

- **Pay off consumer debt first.** Consumer debt typically carries higher interest rates than mortgage rates, and interest payments are not typically tax deductible, unless it's a home-equity loan.
- **Consider which funds you would use to pay off the mortgage.** If you are planning to use tax-deferred monies, such as those in a traditional IRA or 401(k) plan,

to pay off your mortgage, those withdrawals could be subject to income taxes, which will impact your decision to pay off the mortgage. Financially, it is typically better to use taxable accounts to pay off your mortgage.

- **Retain some savings.** You don't want to use so much of your investment assets to pay off your mortgage that you have difficulty paying for unexpected expenditures.

Please call if you'd like help deciding whether you should pay off your mortgage before retirement. ○○○

Caring for an Aging Parent

If you are helping a parent financially, review the tax laws to determine whether you qualify for some tax relief. The key is to determine whether you can deduct your parent as a dependent, which entitles you to an additional personal exemption on your tax return, reducing your taxable income by \$3,650 in 2010. To do so, your parent's gross income can't exceed the exemption amount, and you must provide over half of your parent's support. For purposes of the gross income test, Social Security benefits typically aren't considered.

What happens if you share your parent's support with your siblings or other relatives? If the combined total equals more than half of your parent's support, and each person contributes at least 10% toward care, you can file a multiple support declaration. Even though more than one person contributed to the support, the parent can only be claimed as a dependent by one person. You can change the declaration on a year-to-year basis, so each person providing support

receives some tax relief.

If you claim your parent as a dependent, any medical expenses paid for your parent can be claimed as a medical deduction on your tax return. Your total medical expenses, including your parent's expenses, must still exceed 7.5% of your adjusted gross income before you can take the deduction. If you aren't able to claim your parent as a dependent due solely to the gross income test, you can still include your parent's medical expenses on your tax return. When calculating these expenses, be sure to include premiums for supplemental Medicare coverage and long-term-care insurance. If your parent lives with you and you must obtain outside care to go to work, you may be able to claim the dependent care credit. Also look into whether your employer offers a flexible spending account for elder care. This may allow you to set aside pretax dollars to pay up to \$5,000 of elder-care expenses for a dependent parent.

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Challenges to Your Retirement

We all know saving for retirement is becoming more and more challenging. Longer life expectancies, fewer traditional pensions, and decimated investment portfolios are the most obvious challenges. But there are other threats to your retirement:

- **Even if you have a traditional pension plan, those benefits can change.** Your employer can't take away benefits you've already earned, but benefits going forward can be reduced. Traditional pension plans have experienced large losses during the market decline, which will require additional contributions from companies. As an alternative, companies might reduce benefits. Keep an eye on your pension plan so you know if your employer makes changes.
- **Switching jobs can affect your retirement benefits.** If you have a traditional pension plan, don't change jobs without considering your pension benefits. The same applies to 401(k) plans with matching employer contributions. You may find staying at your job a while longer will significantly increase your benefits.
- **Don't forget about pension benefits at previous employers.** Many employees leave a company

without realizing they are entitled to pension benefits. Before changing jobs, check with your employer to find out what benefits you are entitled to. Then keep track of the company so you can claim benefits when you retire.

- **Early retirement can significantly reduce your retirement benefits.** Sure, it sounds great to retire before age 65 with company pension benefits. But don't just look at how much you'll receive when you retire early. Also consider what you would receive if you wait until normal retirement age. Retiring early can dramatically lower your monthly pension benefit for several reasons — you don't have as many years of service, salary increases you would have earned aren't considered, and those extra years of benefits cause a large actuarial deduction in benefit calculations.
- **You may not be able to count on health insurance benefits after retirement.** Due to rapidly increasing costs for health insurance, many companies are either phasing out health insurance benefits for retirees or increasing retirees' share of the costs. While Medicare is still available once you turn age 65, those benefits don't cover all medical costs. Whether or not you can count on

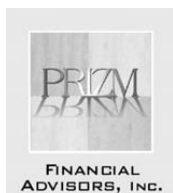
health insurance benefits is often a significant factor in deciding whether you can retire before age 65.

- **Social Security benefits are changing.** Normal retirement age is gradually increasing from age 65 to age 67, a change affecting anyone born in 1938 or later. You can still receive reduced benefits at age 62, but the permanent reduction in benefits is increasing from 20% to 30%, depending on your year of birth. These changes are meant to encourage you to retire at a later date.
- **Decide carefully before taking a lump-sum distribution.** Some traditional pension plans allow lump-sum distributions instead of monthly pension benefits. Use that option with care. While the amount of money might seem large, are you sure you can invest it and earn more than the monthly pension option?

There are many challenges to saving for retirement. If you'd like to discuss your retirement plans in more detail, please call. ○○○



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