

January - February 2013

# Money Moxie®

Financial Solutions for Your Life

*Income Tax:  
100 Years Later  
(Many Times Greater)*



**SMEDLEY FINANCIAL SERVICES, INC.®**

[www.SmedleyFinancial.com](http://www.SmedleyFinancial.com)

## *Celebrating 100 Years of Taxes!*

Dear Valued Clients,

Motivating the citizens of the United States to pay their Federal Income Tax has always been a struggle. Various strategies have been implemented over the years to improve tax collection. Some meant to force tax payers and others to encourage them.

The first income tax in our nation was enacted by Congress in 1862 to help support the Civil War. (Blockades against the ports of the North limited supplies and cut off tariffs.) President Lincoln himself paid \$1,296 in 1864 for his income tax. In order to encourage ordinary citizens to pay the government made tax returns public. Americans were encouraged to turn in those they suspected of not paying their fair share.

This Civil War Era income tax was removed ten years after it began, only to be brought back in 1894 until the Supreme Court voted in 1895 that it was unconstitutional.

In 1913, Congress passed the 16<sup>th</sup> amendment of the U.S. Constitution. This new law created the first permanent income tax in our country. At that time, the highest rate was 7 percent. Five years later the top bracket was at 77 percent. (See the full history of the top brackets in the graphics on pages 3 and 4.)

By the time World War II came, the nation had a serious problem with deficits. Congress was not about to make tax returns public. Instead, the nation turned to Donald Duck who explained to Americans their duty to pay the government: "Taxes to bury the Axis."

Today, most of us might relate more to Arthur Godfrey who said, "As an American I am proud to pay my taxes. But I'd be just as proud for half as much." Nevertheless, our nation needs us and so, taxes are here to stay. I hope you enjoy this issue of the Money Moxie® as we "celebrate" the 100<sup>th</sup> anniversary of the U.S. Income Tax.

James R. Derrick  
SFS Chief Investment Strategist

Source: David Kestenbaum, "From Abe Lincoln to Donald Duck: History of the Income Tax," *NPR*, 3/22/2012.

### **Tax Tips**

**Alert! Make sure you have all your tax documents before filing your taxes.**

The IRS will begin processing 2012 income tax returns on January 30, 2013. However, you may not have all the required documents by that date. Filing your taxes early, without the proper documents, may result in additional paperwork and fees. This can be easily avoided by taking an inventory of your investment tax documents.

The investment custodians providing your tax documents have until February 15, 2013 to put them in the mail. If you have investment accounts you should watch for the following tax documentation:  
IRA and Roth IRA – Form 5498 and Form 1099R (If you have taken a distribution)  
Individual, Joint, Trust, Corporate, and other non-qualified accounts – Form 1099 Tax statement

If you have an account with National Financial Services (NFS) you can download your tax documents directly into Turbo Tax.

If you have any questions regarding your 2012 tax documents please contact our office at (800) 748-4788. We will gladly review your accounts and verify that you have everything required.  
Happy Filing!



# 100 Taxing Years Later

*(Many Times Greater)*

By Sharla J. Jessop, CFP®

In 1913, the 16th Amendment to the Constitution, in an effort to fund a war, made the income tax a permanent fixture in the U.S. tax system. The amendment gave Congress legal authority to tax income and resulted in a revenue law that taxed incomes of both individuals and corporations.

Over the last one hundred years the tax code has become much more complicated. The number of words in the first tax law was 9,337. In 2010, the number was 3,800,000. Our leaders have obviously been busy!

To further complicate a complex system, the Senate waited until January 1, 2013 to pass a tax law that affects every American in some way. Here's a recap of what to expect.

### Affecting the majority of working Americans.

The elimination of the temporary payroll tax cut means you will take home a smaller paycheck. The payroll tax cut reduced the employee portion of the Social Security tax to 4.2 percent in 2011 and 2012. This year the employee portion reverts back to 6.2 percent. A worker earning \$50,000 can expect to take home \$1,000 less in 2013.

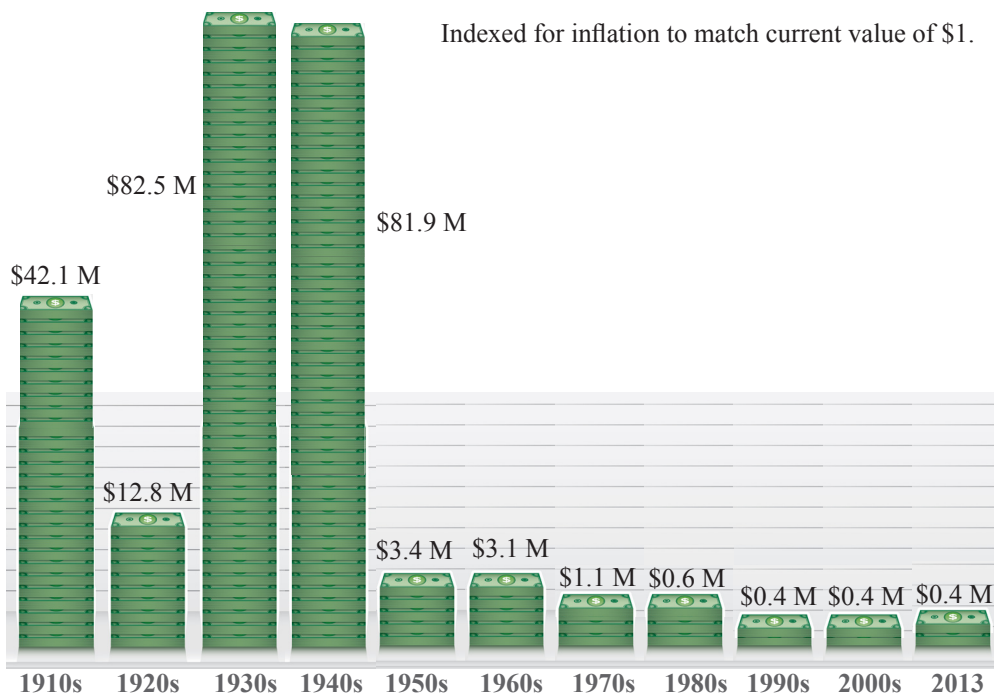
**38,172%** ↑

Percent increase in words in U.S. tax code.

### Affecting the wealthy.

If you are fortunate enough to have a taxable income greater than \$450,000 (or single filers above \$400,000) you can expect a higher marginal income-tax rate. The top marginal income-tax bracket has increased to 39.6 percent. Previously the highest bracket was 35 percent. These same filers will also pay more in capital gains taxes. The top capital gains rate has increased to 23.8 percent. This is up from last year's 15 percent.

## How much income to reach the top tax bracket?



(source: Tax Foundation)

The wealthy are hit again on deductions. Those making more than \$300,000 (\$250,000 for single filers) will see their deductions and personal exemptions phased out. On a positive note, the Alternative Minimum Tax (AMT) threshold will now be adjusted for inflation.

The Alternative Minimum Tax was originally designed to make sure wealthy Americans were not using loopholes to avoid paying taxes. AMT knocks out a lot of exemptions, deductions, and credits forcing those

affected to pay a minimum amount of tax. Previously the law was not automatically updated for inflation and every year more and more Americans were being hit by this limiting tax.

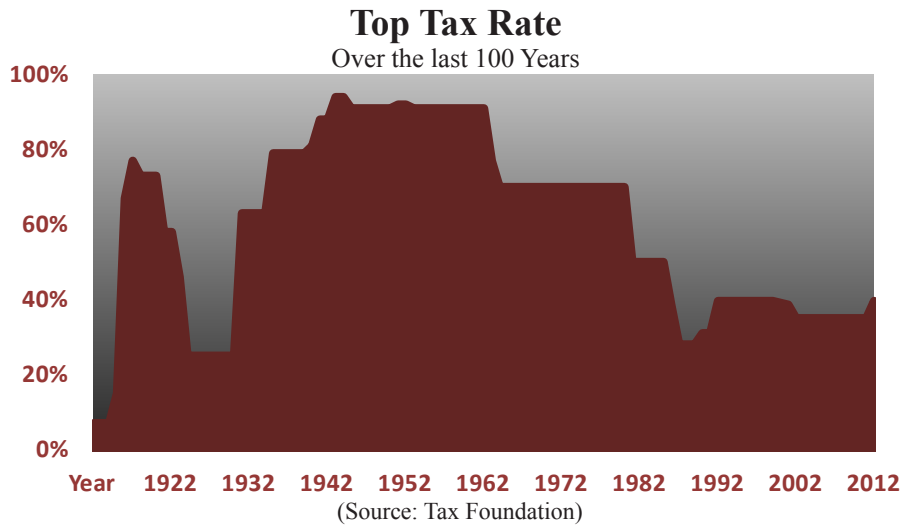
Estates over \$5 million can expect to pay 40 percent in estate taxes. Last year the estate tax rate was 35 percent. This is of course after the \$5 million Estate Tax Exemption.

**Some good news.** The child tax credit has been extended. This is a great benefit to families with children and can mean up to \$1,000 in tax credits.


Unemployed workers will continue to receive benefits.

**Contribution limits.** There are few ways for wage earners to reduce their tax liability. One way to help now and when it comes to retirement is making contributions into qualified

retirement plans. If you have a company sponsored retirement plan such as a 401(k) or 403(b) you can make a maximum contribution of \$17,500 in 2013. If you are 50 years or older, you can make an additional contribution of \$5,500.



Traditional IRA and Roth IRA contributions have also increased this year. You can make a maximum contribution of \$5,500. Those over 50 can make an additional contribution of \$500.

It took a great deal of political posturing and arguing for our elected officials to come to agreement on this recent tax law. Let's hope they are more open minded and courageous when it comes to what may be this country's greatest hurdle—reducing spending. This is only a short recap of the recent tax changes. Please contact our office for additional information or to discuss your individual situation. 

## Lynette S. Watts



Lynette has been serving our clients for over 10 years. Anyone who has had the opportunity to work with Lynette will agree that she is friendly, fun, and energetic.

Lynette has the ability to connect with our clients and understand their unique circumstances. Her many professional abilities are enhanced by her drive to get things done.

When not in the office, she loves spending time with her husband, Joseph, and two adorable daughters: Madelyn and Izabel.

The Watts family has a passion for traveling. They have visited 43 states and many countries. Lynette also enjoys reading and photography.



# Elections Over. Fiscal Cliff in Focus.

By James R. Derrick Jr., CFA

Stocks started 2012 with solid gains and then added to them during the year. Most major asset classes made money during the year.

Despite being three years into the current economic recovery, stocks and many other risky assets started 2013 with a bang. Small cap stocks, international stocks, and high yield bonds have been particularly good thus far. Resolution of the Fiscal Cliff was clearly the initial factor, but there are other fundamental

- The housing market is improving. Prices of existing homes rose over 4% (Case-Shiller 20 City Index) in the last year. Housing starts and permits are each up 20%.

- Even after the recovery began in 2009, state and local governments were reducing their work force. This placed a short-term drag on the economy by reducing consumer confidence and spending. Half a million workers lost their jobs. Now it appears that many of

## Major Markets Update

	2008	2009	2010	2011	2012
<b>Dow*</b>	<b>-33.84%</b>	<b>+18.82%</b>	<b>+11.02%</b>	<b>+5.53%</b>	<b>+ 7.26%</b>
<b>S&amp;P 500*</b>	<b>-38.49%</b>	<b>+23.45%</b>	<b>+12.78%</b>	<b>+0.00%</b>	<b>+13.41%</b>
<b>NASDAQ*</b>	<b>-40.54%</b>	<b>+43.89%</b>	<b>+16.91%</b>	<b>-1.80%</b>	<b>+15.91%</b>

contributors to current optimism as well. The following data points are available from the Federal Reserve Bank of St. Louis.

- Oil production continues to grow within the United States thanks to hydraulic fracturing or “fracking.” Natural gas production, which is growing from the same process, is also likely to continue at its elevated levels. This industry has provided jobs to approximately 50,000 workers in the last three years and is still increasing its employment numbers at a rate of 6.5 percent.
- The growth in the supply of natural gas and oil has also provided lower energy costs for consumers and manufacturing. After 10 straight years of job losses in manufacturing, this industry is now experiencing three years of employment growth around 2 percent.
- Consumers are in a better position to increase spending and saving. Household debt is 10.5% of disposable income, which is the best level since the early 1980s.

these governments have their fiscal house in order.

The hemorrhaging may have run its course. The negative factors may now turn positive.

- Inflation, measured by CPI, is just below 2 percent. This will provide the Federal Reserve the flexibility to continue to focus on stimulating the economy in order to create more jobs. The efforts of the Federal Reserve are certainly a large part of the current recovery and will likely continue to play a role in 2013.

Of course, all this opportunity for growth comes with a price. Investors don’t have to love risk, but they do have to live with it. It is a tool to be managed carefully in order to participate in the long-term benefits of investing.

Many of the positive factors that drove the market upward last year are still in place this year. Indeed, the current year started off with a similar jump as that in 2012. While history will not repeat itself exactly, hopefully it will rhyme. SFS

# Financial Marriage

By Rodney A. Walker, CFP®

Finances in a new marriage present unique opportunities and challenges no matter your age. Happy marriages are more likely to occur when each spouse shares similar opinions about what to do with money: earnings, savings, and spending.

Couples should realize that to help facilitate financial success in your marriage, open discussions on finances must occur on a regular basis. Questions of full disclosure, joining assets, financial goals, prenuptials, and many others should be addressed prior to marriage.

## Full Disclosure

Take the time necessary to have an open conversation about assets, debts, and financial goals. While in discussion regarding debt, discuss student loans, credit cards, auto loans, home loans, parent loans, and any other debt one might have.

Remember, full disclosure includes all things that matter most. Never hide financial debt. Sooner or later it gets found. Many times it can break a marriage apart.

If you want a successful marriage, address your financial obligations early, communicate often about money, and be open about your financial concerns.

## Joining Assets

Couples must decide to combine assets or keep them separate. Discuss which is best for your marriage.

Joining of assets shows trust, which is necessary in a happy marriage. Keeping assets separate allows

for greater independence. In order for separate assets to function well couples should coordinate and communicate more. Each must do their part to meet financial obligations.

Couples can achieve financial success either way, but they must determine which way will function best financially and provide the framework for trust within the marriage.


## Goals

Couples need to make good financial decisions together. Bad financial choices may set you back years from reaching your goals.

Discovering your common financial goals and working together builds unity and prevents a wedge between your marriage. Goals for discussion can range from how much to contribute to retirement and how much to spend on major purchases: home, auto, school, and others.

## Prenuptials

Prenuptials in certain cases are necessary and can help avoid a financial nightmare when families fight over assets. A prenuptial helps bring clarity to spouses and children from previous marriages by outlining terms of assets that both parties are bringing into the relationship.

Marriage is about love and trust. Be honest with one another no matter how embarrassing or serious a financial situation is. This helps build a strong foundation for success. Have open and honest communication regarding the financial affairs of your marriage. 

## 2013 Tax Tables



Even with the averted fiscal cliff there were many changes to tax rates for 2013. View new updates to taxes as well as this year's contribution limits at [www.SmedleyFinancial.com](http://www.SmedleyFinancial.com). Scan this QR code with your smartphone to be directed to those tables on the website.

# IRA Charitable Distributions Are Back!



By Mikal B. Aune, CFP®

For those of you over age 70 ½, a very beneficial tax law is back in the books thanks to the agreement reached by Congress on January 1, 2013. The tax break allows you to donate IRA money directly to a charity and avoid paying any tax on the distribution. Even better, the distribution still counts toward your Required Minimum Distribution.


This tax break was off the books for all of 2012 and then retroactively added in January of 2013 (too little too late). Those who took advantage of it in 2011, or before, will be glad it is back. Officially it is called a Qualified Charitable Distribution or QCD.

So, what is the difference between making a QCD directly to a charity or taking the money and then donating it to the charity personally? Let's look at an example.

Let's say Henry decides to withdraw the money first and then donate to a charity. If his required minimum distribution was \$10,000, he would have to take the

distribution and withhold taxes. For this article, let's assume Henry must withhold 15% for federal tax and 5% for state tax, or \$2,000 in taxes. That means he would get a check for \$8,000. Henry would then deposit that check in his checking account and write out a personal check to his charity. Next year Henry would get to include the \$8,000 as a deduction on his taxes. However, the deduction only reduces his taxes a fraction of the \$8,000.

The other option is for Henry to donate the \$10,000 directly to a charity. He doesn't have to pay anything in taxes and his charity is benefited by the full \$10,000. The decision seems to be fairly easy.

If you plan to donate money to a charity and you have to take a Required Minimum Distribution this year, give us a call so we can help you take full advantage of this reinstated tax law. 

# Your SFS Team

Smedley Financial Services, Inc.<sup>®</sup> is an independent registered investment advisory firm. We work only for our clients. Our wealth managers have the flexibility to implement our financial plans, retirement plans, and income distribution plans using the investment strategies that work towards each client's needs, risk tolerance, and goals. We are never in a position where we are required to recommend a product we do not believe best serves the needs of our clients. We work with individuals, businesses, and family estates.

Some of the following products and services may be used to implement the plans we create.

## Investments

- Managed Accounts
- Mutual Funds
- Exchange Traded Funds (ETFs)
- Stocks
- Bonds
- Non-managed
- Alternative Investments

## Annuities

- Fixed
- Variable
- Indexed
- Immediate
- Deferred

## Life Insurance

- Term
- Whole Life
- Universal Life
- Variable Universal Life

## Long-term Care Insurance

- Traditional
- Hybrid

## Health Insurance

- Individual
- Medicare Supplement

## Social Security

Strategies & Options

## Disability Insurance

- Long-Term
- Short-Term



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