Newsletter Volume XI No.10 Week of Mar 6th 2011

Carr Talks

TAXLOGIC

WEEKLY SUMMARY

The mantra this week was jobs and Libya. Libya caused the spike in crude oil as their oil fields and shipping ports were under attack, in what is becoming more a civil war that the markets are tipping could be protracted. While Libya is less than 2% of the worlds production, and Saudi Arabia has said they are willing to pump additional oil, the uncertainty is weighing on the market.

On the jobs front, this weeks' numbers would indicate that the low has been reached and that a slow, albeit very slow, recovery is underway. The concern is that at this rate, the number of jobs required to be created to get the unemployment rate back to 5% could take 10 years.

As predicted, Congress kicked the can down the road for two weeks to resolve the budget impasse. There will be spending cuts, but the amounts, and from where, are still to be resolved.

The states are finally waking up to the deep void of budget shortfalls, as far as the eye can see into the future. The public sector unions are mobilizing and so expect significant confrontation in this area in the next 18 months. The economic pain has not been shared equally at this point, but by the end of 2012 be assured that this will not be the case.

Finance and Taxes

The number of Americans opting to take Social Security at 62 – currently the youngest age allowed – is on the rise. In 2009, 42% of 62-year-olds claimed benefits, up from 38% in 2007, according to economists at the Brookings Institution in Washington, D.C. This is despite the fact that by delaying benefits individuals stand to boost their payments by 7% to 8% each year until age 70. One reason may be concern about the safety and security of the Social Security System. There is no question that benefits will be paid. The worst that could happen is that the system would be able to provide only 80% of the benefits under current law if no changes are made to the entitlement program.

The Social Security Administration has estimated that beginning in 2037 benefits could be reduced by 22% and could continue to decline, barring any changes to the system.

The average pre-retiree typically underestimates the impact of taking benefits early. For example, a top-earner retiring at 62 would get $1,803 a month. By waiting until 66, he'd increase that amount to $2,442, and delaying until 70 would bump the monthly payment to $3,256.

Another way to look at it: someone who delays taking Social Security until 66 rather 62 will collect more money over time if they live until at least age 77. So the break even is means you have to live 10+ years to beat the system.

In specific situations, the decision to claim does make sense, like if you're in poor health or unemployed. Otherwise, I recommend delaying retirement (and social security payments) in order to boost your retirement savings, which likely took a serious hit during in 2008.

There is another option, take the money early, save it and then give it back to Soc Sec and claim the higher payout – free of any penalties or interest.

A February report by the non-profit Employee Benefit Research Institute found that nearly half of the early boomers -- those 56 to 62 -- are at risk of not having enough retirement income for "basic" costs in retirement such as food, transportation and housing. And taking social security early won't help as much as it seems.

Income Tax inequality

Last week I wrote about the apparent inequality in the tax code that as a percentage of income, a janitor in New York paid almost twice the rate of tax as that of the residents of Leona Helmsley's building in New York did, I thought it would be interesting to see how you could pay an average tax rate of 16% (effective tax rate) on $1,100,000 of income.

So, here is the hypothetical scenario, a mid forties couple living in the north east with two children under the age of 13 with combined wages of $250,000. Qualified dividends of $150,000 from an investment portfolio with $250,000 of long term capital gains and carried interest from a hedge fund of $450,000. All adds up to $1,100,000 of taxable income. Now take state income taxes of $40,000, charitable donations of $20,000 and $50,000 interest on the million dollar mortgage, and the tax bill comes up to $176,000 – an effective 16% tax rate.

Now if the family had Sch C income of $1,100,000 they would owe $355,000 in tax – essentially a 33% average tax. Fair?

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	Last Week	End of Week	Next Week	12/31/2011
Gold	$1,389.40	$1,433.10	$1,450.00	$1,600.00
Oil	$86.15	$104.91	$100.00	$120.00
Dow Jones	12,391.25	12,169.88	12,200.00	12,250.00
Prime Rate	3.25 %	3.25 %	3.25 %	4.00 %
Unemployment	9.00 %	8.90 %	9.00 %	9.50 %

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Comments, suggestions, and feedback welcome at john@carrtalks.com