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The Benefits of Roths

The Roth individual retirement account (IRA) has been an attractive retirement savings option since its inception in 1998. However, income eligibility restrictions have prevented many higher-income individuals from using this savings vehicle. Two recent developments are changing that — the removal of income limitations for Roth IRA conversions and tax laws making the Roth 401(k) permanent.

2010 Roth Conversions

Starting in 2010, all taxpayers, regardless of the amount of their adjusted gross income (AGI), can convert from a traditional IRA to a Roth IRA. Before 2010, your AGI cannot exceed $100,000 to convert, not including any income resulting from the conversion. Amounts converted must be included in income if taxable when withdrawn (i.e., contributions and earnings in deductible IRAs and earnings in nondeductible IRAs) but are exempt from the 10% early withdrawal penalty.

If you make a conversion in 2010, the tax can be paid in two installments in 2011 and 2012, with no tax due in 2010. However, if you prefer, you can elect to pay the tax in 2010, which may make sense if the current lower tax rates are not extended beyond 2010 or you expect much higher income in 2011 or 2012. Taxes on conversions made after 2010 must be paid in the year of conversion.

Permanent Roth 401(k)s

Originally, Roth 401(k)s were scheduled to expire in 2010, so many companies were not willing to start a plan that would expire after a few years. However, the Pension Protection Act of 2006 made Roth 401(k)s permanent, which should help spread their use.

The Roth 401(k) is patterned after the Roth IRA — contributions are made from after-tax earnings that grow tax free, and qualified distributions are withdrawn tax free. Employees eligible for their employer's 401(k) plan are also eligible for the Roth 401(k). There are no income limitations for contributions to a Roth 401(k), with contribution limits of $16,500 in 2009 plus a $5,500 catch-up contribution for those age 50 and over, if permitted by the plan. Contributions can be split between a regular and Roth

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Why You Need an IRA

Even if you have a 401(k) plan or defined-benefit plan, you may also want to contribute to an individual retirement account (IRA) for some or all of the following reasons:

✔ **You'll probably need the additional funds for retirement.** Even with Social Security and pension or 401(k) benefits, you'll probably need other savings to fund your retirement.

✔ **You'll lower your taxes.** You can lower your taxes currently by contributing to a traditional deductible IRA or in the future by contributing to a Roth IRA.

✔ **You're more likely to use the funds for retirement.** The government discourages the use of IRA funds for other purposes by assessing a 10% federal income-tax penalty when funds are withdrawn before age 59 1/2 (except in certain limited circumstances).

✔ **You have a wide variety of investing options.** With a 401(k) plan, you typically have a limited number of investment options. However, with an IRA, you can invest in a wide variety of investments. ❍❍❍

Back to the Drawing Board

When's the last time you looked at your retirement plans? Don't let the recent market declines cause you to just give up and ignore your plans. Sure, you'll probably need to make some changes. So go back to the basics and reconstruct those plans, following these key steps:

1. Determine how much income you'll need for retirement. First, decide how you'll spend your retirement years. Do you want to travel extensively, or are you content to stay at home pursuing inexpensive hobbies? Will you remain in your current home or move to a different city? Do you want to retire totally, or will you work part-time? Depending on your plans, you may need anywhere from 70% to over 100% of your current income (Source: *Money*, January 2009). If retirement is so far away that you're not sure what you want to do, use a range of retirement income assumptions, such as 70% at the low end, 90% in the middle range, and 110% at the high end.

2. Decide when you want to retire. Although many people want to retire early, supporting yourself for those additional years can make that difficult to achieve. You may want to work longer to save the amounts needed or consider part-time employment after retirement.

3. Estimate your current retirement benefits. Assess how much you're likely to receive from Social Security and company pension plans. Over the years, these benefits have been providing a smaller percentage of retirement income, so use conservative estimates.

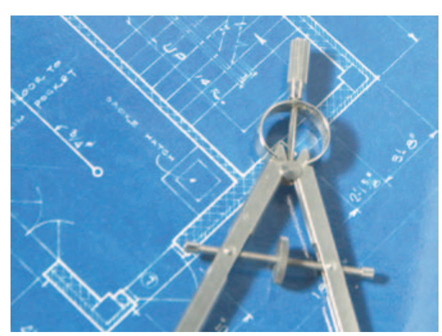
4. Total your current retirement savings. Prepare a net worth statement to help you determine how much you currently have saved for retirement. Also consider other financial needs that must be met, such as paying for a child's college education or providing nursing home care for an elderly parent. These needs can seriously reduce assets left for retirement.

5. Develop your retirement savings plan. Based on the above factors and your estimate of long-term inflation, you can make a reasonable estimate of your total capital needs at retirement. You can then calculate how much you need to save on a monthly, quarterly, or annual basis.

Don't give up if you can't afford to save the amount needed. You can start out saving what you can and increase your savings in subsequent years. You can also revise your retirement plans. Reducing your financial needs, delaying your retirement date, or working part-time after retirement can substantially change the amount needed for retirement.

6. Review your retirement plan annually. This allows you to assess your progress and make any needed changes.

Please call if you'd like help planning for your 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 decide 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 2009. To do so, your parent's gross income can't exceed the exemption amount, and you must provide over half 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 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. ❍❍❍

Benefits of Roths

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401(k), as long as total contributions do not exceed the maximum. Funds contributed to each type must be held in separate accounts. Any matching contributions made by the employer must be held in the regular 401(k) account, so they will be taxable when withdrawn.

Unlike a Roth IRA, annual distributions must be taken after age 70 1/2. However, funds in the Roth 401(k) can be rolled over to a Roth IRA, which would not require distributions during the owner's lifetime. There is no provision to convert a regular 401(k) to a Roth 401(k).

If you expect your income tax bracket to be similar or higher during retirement, a Roth 401(k) will typically result in more retirement funds than a regular 401(k).

Don't Forget about the Roth IRA

One advantage of the change in the Roth conversion rules is that it effectively removes the income limitations for contributions to a Roth IRA starting in 2010. In 2009, single taxpayers with modified AGI less than $105,000 and married taxpayers filing jointly with modified AGI less than $166,000 can make contributions, regardless of their participation in a qualified retirement plan. Contributions are phased out for single taxpayers with modified AGI between $105,000 and $120,000 and for married taxpayers filing jointly with modified AGI between $166,000 and $176,000 in 2009.

Starting in 2010, individuals with income over the limit can make contributions to a nondeductible traditional IRA and then immediately convert the balance to a Roth IRA. For 2009, you can contribute to a nondeductible IRA and convert the balance in 2010. In 2009, you can contribute a maximum of $5,000 with an additional $1,000 catch-up contribution if you are age 50 or older.

Since there are no required minimum distributions during your lifetime, the Roth IRA is a particularly effective way to transfer assets to family members. You can allow the Roth IRA to continue compounding on a tax-free basis during your life, with no withdrawals. If you leave the Roth IRA to your spouse after your death, he/she can roll the balance over to his/her own IRA, so no withdrawals would be required during his/her lifetime. When your spouse dies, his/her beneficiaries would then have to take distributions over their life expectancies, but qualified distributions would be taken free of federal income taxes. By using this strategy and only taking minimum distributions when required, the balance can continue to grow on a tax-free basis for years or even decades.

Please call to discuss Roth IRAs and 401(k)s in more detail, including how they can help address your retirement savings goals. ❍❍❍

Develop a Tax-Planning Mentality

Many people confuse tax planning with tax preparation and only think about the subject when preparing their annual tax return. However, if your goal is to reduce income taxes, you need to be aware of tax-planning opportunities throughout the year.

Take time early in the year to assess your tax situation, looking for ways to reduce your tax bill. It often helps to discuss these items with a professional who can review strategies you might not have considered. During the year, consider the tax consequences before making important financial decisions. Look at your tax situation again in the fall, which gives you plenty of time before year-end to implement any additional tax-planning strategies.

There are basically three strategies that can help reduce your income tax bill:

✔ **Reduce or eliminate taxes.** The objective is to receive income in a nontaxable form or to find additional tax deductions, exemptions, or credits. For instance, you might want to consider municipal bonds, whose interest income is generally not subject to federal, and sometimes state and local, income taxes. Some bonds may be subject to the Alternative Minimum Tax (AMT). Or investigate investments that can generate capital gains, such as growth stocks. If you have realized capital gains, you might want to offset those gains by selling investments with losses.

✔ **Postpone the payment of income taxes until sometime in the future.** By postponing tax payment, your earnings compound on the entire balance, including the portion that will eventually be paid in taxes. You may also be in a lower tax bracket when taxes are paid. As an example, contribute as much as possible to retirement accounts, including employer plans and individual retirement accounts (IRAs).

✔ **Shift the tax burden to another individual.** The objective of this technique is to transfer assets to other individuals so that any income on those assets becomes taxable to those individuals. Typically, however, you have to give up control of the asset. For instance, annually you can give tax-free gifts, up to $13,000 in 2009 ($26,000 if the gift is split with your spouse), to any number of individuals. Any future income generated on those gifts then becomes taxable to those individuals. You may also want to use your lifetime gift tax exclusion of up to $1,000,000 to make larger gifts. ❍❍❍

An Update on 401(k) Plans

As employer-funded retirement plans have declined over the years, the importance of 401(k) plans has increased. Are workers making good choices with their 401(k) plans? An analysis by the Center for Retirement Research (March 2009) provides some interesting insights:

✔ In 2007, approximately 20% of eligible workers did not participate in their 401(k) plans, a marked improvement from 43% in 1988. Lower income and younger workers are much less likely to participate than higher-paid and older workers.

✔ Only 8% of all participants contributed the maximum amount to their 401(k) plan, but that percentage varied substantially depending on income. Less than 2% of those earning between $40,000 and $60,000 made the maximum contribution compared to 30% of those earning $100,000 or more.

✔ In terms of investment choices, approximately 14% of participants held no equity investments, 28% held all equity investments, and 58% held a mix of stocks and bonds.

✔ Overall, 11% of all assets in 401(k) plans were invested in company stock. However, it is primarily plans with 5,000 or more participants that offer company stock as an investment option. Of those plans, company stock accounted for 26% of total assets.

✔ Of those receiving a lump-sum distribution from their 401(k) plan, 40% did not roll the money over into another tax-deferred savings vehicle. However, most of these individuals were younger with smaller account balances, accounting for 16% of total assets.

✔ In 2007, 16% of 401(k) plan participants had taken a loan from their plan.

Please call if you'd like to review your choices for your 401(k) plan. ❍❍❍

Factors Influencing Asset Allocation

While you probably won't make frequent changes to your asset allocation strategy, changes in your personal situation may necessitate periodic alterations. That will typically occur when personal changes alter the major factors affecting your asset allocation:

Risk tolerance — Your risk tolerance is likely to change, either as you become more familiar with investing or as you age. Familiarity with investing typically makes you more risk tolerant, while aging may make you more or less risk averse.

Return needs — Your need to emphasize income or growth is likely to change over your life. Young investors typically want to emphasize growth, while retirees may want to emphasize income.

Investment time horizon — With a short time horizon, your liquidity needs may require avoiding more volatile investments. With a longer time horizon, you can wait out any fluctuations in volatile investments. Typically, young investors have longer time horizons than older investors, so they can invest more aggressively. ❍❍❍

Financial Thoughts

Approximately 32% of Americans have spent less money over the past few months and plan to continue to do so in the future (Source: Gallup Inc., May 2009).

Almost 66% of consumers feel that advertising agencies are partially responsible for the current economic crisis because they persuaded consumers to make purchases beyond their means (Source: Harris Interactive Inc., April 2009).

In a recent survey, the average 401(k) plan investor lost 28% of his/her balance in 2008. Approximately 63% said their confidence in their ability to retire had declined in the past year, and 15% said they were worried that they would never be able to retire. Participants believe the best way to recover losses is to save more or work longer (Source: Barclays Global Advisors, April 2009).

A recent study reveals that today's preretirees will need to postpone retirement by 4.2 years on average to make up for losses caused by the housing market and stock market. That is the first time in history that the retirement age has significantly increased in America (Source: Age Wave, 2009). ❍❍❍