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# Financial Briefs

JULY/AUGUST 2008

## Getting the Money Out

**T**raditional deductible and Roth IRAs have significantly different tax rules. With a traditional deductible IRA, current contributions are not taxed in the year the contributions are made, but you must pay income taxes on withdrawals. In contrast, with a Roth IRA, you do not get a current tax deduction for contributions, but withdrawals are taken income-tax free.

The tax laws regarding withdrawals from individual retirement accounts (IRAs) are complex. To avoid unnecessary penalties and to ensure you withdraw the funds efficiently, here are the basics:

### Before Age 59 1/2

In addition to any income taxes that may be due, withdrawals before the age of 59 1/2 are subject to a 10% federal income tax penalty. (Withdrawals of contributions from a Roth IRA are never subject to a 10% penalty tax. Contributions are deemed to be withdrawn first.) However, the 10% penalty will not be assessed in the following situations:

- Distributions are made to beneficiaries after the IRA owner's death.\*\*
- Distributions are made to the IRA owner due to his/her disability.\*\*
- Distributions equal medical expenses paid in excess of 7.5% of adjusted gross income.\*
- Distributions are made to certain unemployed IRA owners to pay health insurance premiums.\*
- Distributions are made for up to the \$10,000 lifetime limit for qualifying first-time homebuyer expenses.\*\*
- Distributions are made to pay qual-

ified higher-education expenses for the IRA owner, his/her spouse, children, or grandchildren.\*

- Distributions are made as a series of annual withdrawals in substantially equal amounts over the owner's life expectancy or the joint life expectancy of the owner and beneficiary.\*

\* *These types of Roth IRA withdrawals are subject to ordinary income taxes on any earnings, but distributions are ex-*

*empt from the 10% federal income tax penalty.*

\*\* *These Roth IRA withdrawals are penalty free and income-tax free.*

### Between Ages 59 1/2 and 70 1/2

Between these ages, you can withdraw as much or as little as you like from traditional and Roth IRAs. Both contributions and earnings withdrawn from a traditional deductible IRA and

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## Should You Contribute to a Roth 401(k)?

**A**lthough Roth 401(k) plans became effective on January 1, 2006, they are just now starting to gain momentum. Originally, Roth 401(k)s were scheduled to expire after 2010, so 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.

The Roth 401(k) is patterned after the Roth individual retirement account (IRA) — contributions are made from after-tax earnings that grow tax free, and qualified distributions are withdrawn tax free. Here are the basics, including how Roth 401(k)s differ from Roth IRAs:

- **Eligibility** — 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 a Roth IRA, single

taxpayers with modified adjusted gross income (AGI) less than \$101,000 and married taxpayers filing jointly with modified AGI less than \$159,000 in 2008 can make contributions, regardless of their participation in a qualified retirement plan. Contributions are phased out for single taxpayers with modified AGI between \$101,000 and \$116,000 and for married taxpayers filing jointly with modified AGI between \$159,000 and \$169,000 in 2008.

- **Contributions** — The contribution limits for the Roth 401(k) are the same as for the regular 401(k) plan. In 2008, you can contribute a maximum of \$15,500 plus a \$5,000 catch-up contribution for those age 50 and over, if permitted by the plan. However, your employer may set lower limits to

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## Getting the Money Out

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earnings from a nondeductible IRA will be subject to ordinary income taxes. As long as the first contribution was made at least five years previously, Roth IRA distributions will not be subject to federal income taxes. Generally, you should postpone withdrawals as long as possible to continue tax-advantaged growth. However, in years when income is low, you may want to take distributions from a traditional IRA to take advantage of lower income tax rates. You may also want to convert all or part of a traditional IRA to a Roth IRA during low-income years. While you will have to pay income taxes on the conversion, future earnings will accumulate tax free as long as you make qualified distributions.

### After Age 70 1/2

You are not required to take distributions from a Roth IRA after age 70 1/2. You must, however, take required minimum distributions (RMDs) from your traditional IRAs every year, or you will be assessed a 50% penalty on amounts that should have been withdrawn. You can always take out more than the RMD. Your RMD is calculated by taking the account balance as of the preceding year divided by the life expectancy factor from a uniform table. The table is based on joint life expectancies and assumes your beneficiary is 10 years younger than you. If your spouse is your sole beneficiary and is more than 10 years younger, you can use either the uniform table or a table based on the actual joint life expectancy of you and your spouse.

Your first RMD must be made by the required beginning date (RBD), which is April 1 of the year after you turn 70 1/2. However, if you take the distribution in the following year, you will then take both your first and second distributions in the same year. Evaluate your tax situation before doing that. Two distributions may increase your income so you are in a higher tax bracket, lose tax deductions or credits, or Social Security benefits become taxable. In those situations, you may be better off taking your first RMD in the year you turn 70 1/2.

### After Death

Heirs must generally start

## Spousal IRAs: Contributing Together

Perhaps you are a stay-at-home parent. Or your spouse is a professor on an unpaid sabbatical. Maybe your spouse decides to take time off to write a book. Even though you are not working, you still need to consider retirement plans. A spousal individual retirement account (IRA) allows a nonworking spouse to contribute to an IRA, even though the spouse has little or no earned income. Here are the basics:

- To be eligible to contribute, the couple must be legally married at tax year-end and file taxes jointly. The couple's combined earned income must equal or exceed the combined IRA contribution.
- Contributions can be made to traditional IRAs as long as the owner is under age 70 1/2, while there is no age limit for Roth IRAs.
- In 2008, the maximum contribution to an IRA is \$5,000 with an additional \$1,000 catch-up contribution for individuals age 50 and over.
- For traditional IRAs, if the working spouse is covered by a qualified retirement plan but the nonworking spouse is not, the

contribution for the nonworking spouse is phased out once adjusted gross income (AGI) is between \$159,000 and \$169,000 in 2008 and totally phased out once income exceeds \$169,000. If you both have earned income equal to at least the maximum IRA contribution amount and are both covered by a qualified retirement plan, your contribution is phased out at joint AGI between \$85,000 and \$105,000 in 2008. If neither of you is covered by a qualified plan, both of you can make a deductible contribution regardless of your AGI.

- For Roth IRAs, eligibility is phased out for AGI levels between \$159,000 and \$169,000 in 2008. It doesn't matter whether your spouse is covered by a qualified retirement plan at work.

Contributing to a spouse's IRA may be as beneficial to the working spouse as to the nonworking spouse, since the assets are likely to be shared during retirement. Please call if you'd like to review whether you or your spouse are eligible to contribute to a spousal IRA. ■■■

taking distributions by December 31 of the year after your death. Distributions by heirs are based on who your beneficiary is and whether you died before or after the RBD:

- If the account has a designated beneficiary, which includes individuals and certain trusts, the account balance can be withdrawn over the beneficiary's life expectancy, based on a single life expectancy table. This calculation is used whether you die before or after your RBD. Spouses who inherit traditional IRAs can delay distributions until attaining age 70 1/2, while spouses who inherit a Roth IRA do not have to make withdrawals during their lifetime.
- A spouse can treat an inherited IRA as his/her own, but the surviving

spouse has to be the sole beneficiary. However, if a spouse and other beneficiaries inherit an IRA, the account can be split so the spouse solely owns his/her portion.

- If the account does not have a designated beneficiary, which includes your estate, charitable organizations, and certain trusts, and you die after your RBD, the balance is paid out over your remaining life expectancy. If you die before your RBD, then the balance must be paid out within five years of your death.

The decisions you make regarding IRA withdrawals have important consequences for your retirement and for your beneficiaries. Please call if you'd like help making these decisions. ■■■

## Protect Your 401(k) Plan with an Annual Review

Reviewing your 401(k) plan on an annual basis helps you make sure your plan is on the proper course. Here are three steps to use when reviewing your 401(k) plan:

- **Consider your goals** — Keep your financial goals in mind as you review your 401(k) plan. Have you experienced life changes that affect your goals? Has your income or family situation changed? Do any of these changes require changes to your 401(k) plan?
- **Consider your contributions** — If your company offers matching

contributions, one of the biggest mistakes you can make is not to contribute enough to take advantage of the full matching amount. As part of your review process, create a detailed annual budget and actively look for ways to contribute more income to your 401(k) plan. Or resolve to put any pay increases directly into your 401(k) plan, before you find ways to spend the additional money.

- **Consider rebalancing** — Most 401(k) plans have a wide variety of investment options, so you

should be able to broadly diversify your holdings. Don't invest too much in your company stock. Take a look at all of the plan's investment options, reviewing their historical performance. Compare that to the investments you are invested in, and decide whether any changes are needed. There are no tax consequences to making investment changes within your 401(k) plan.

Please call if you'd like help reviewing your 401(k) plan. ■■■

### Roth 401(k)

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comply with nondiscrimination rules. Contributions can be split between a regular and Roth 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. In 2008, the contribution limits for a Roth IRA are \$5,000 plus an additional \$1,000 catch-up contribution for individuals age 50 and over. You can make contributions to both a Roth 401(k) and a Roth IRA, as long as you meet the income eligibility rules for the Roth IRA.

- **Required distributions** — With a Roth IRA, you are not required to take distributions during your lifetime. Thus, Roth IRAs are a good estate planning vehicle for individuals who want to leave tax-advantaged assets to beneficiaries, since beneficiaries can also withdraw qualified distributions without paying federal income taxes. With a Roth 401(k), annual distributions must be

taken after age 70 1/2, unless you are still working and are not a 5% or more owner in the company. However, funds in the Roth 401(k) can be rolled over to a Roth IRA, which would not require distributions.

- **Conversions** — Individuals under certain income levels can convert a regular IRA to a Roth IRA, as long as income taxes are paid on the amount that would have been taxable if withdrawn. Starting in 2010, all taxpayers, regardless of income level, can convert a regular IRA to a Roth IRA. There is no provision to convert a regular 401(k) to a Roth 401(k).

If your employer offers both a regular and Roth 401(k), which plan should you choose? Your decision will typically involve the same types of considerations as those made when deciding between a traditional deductible and Roth IRA. Two major factors include:

- **Your current income tax bracket versus your expected income tax bracket during retirement.** If you expect your income tax bracket to be higher during retirement, a Roth 401(k) will typically result in more retirement funds. Younger workers will often find themselves in this situation. On the other hand, if you

expect your tax rate to decline after retirement, you will typically want to use a regular 401(k) plan. Workers who are nearing retirement age may find themselves in this situation. If you expect your tax bracket to be the same, both alternatives will typically provide the same balance.

- **Whether you plan to leave assets to beneficiaries.** If you are using your 401(k) plan as a vehicle to provide tax-advantaged assets to beneficiaries, you should consider the Roth 401(k). Once you retire, you can roll the balance in your Roth 401(k) to a Roth IRA, without any tax consequences. You then do not have to take any withdrawals during your life. When your beneficiaries inherit the Roth IRA after your death, they will have to take distributions over their expected life expectancies, but those distributions will be federal-income-tax free as long as the distributions are qualified.

Keep in mind that this does not have to be an either/or decision. You can split your contributions between the Roth and regular 401(k) plans. Please call if you'd like to discuss the Roth 401(k) in more detail. ■■■

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## Business Data

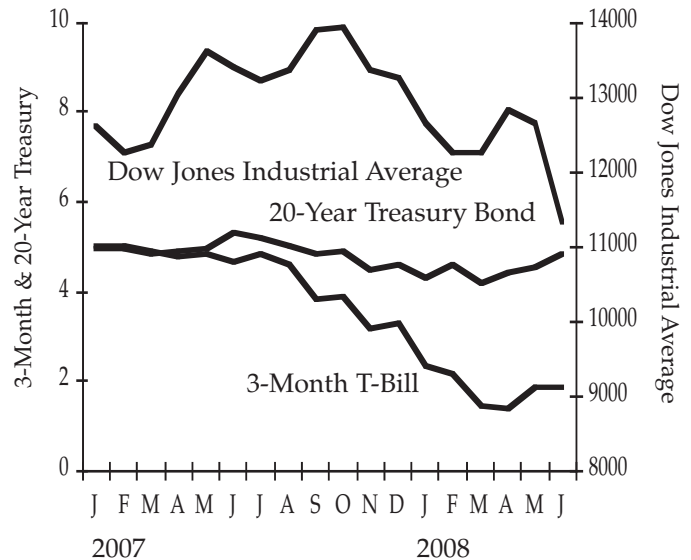


Indicator	Month-end				
	Apr-08	May-08	Jun-08	Dec-07	Jun-07
Prime rate	5.00	5.00	5.00	7.25	8.25
3-month T-bill yield	1.42	1.87	1.90	3.28	4.69
10-year T-note yield	3.67	3.84	4.20	4.12	5.14
20-year T-bond yield	4.44	4.56	4.81	4.58	5.33
Dow Jones Corp.	5.80	5.81	5.93	5.89	6.02
GDP (adj. annual rate)#	+4.90	+0.60	+1.00	+0.60	+0.60

Indicator	Month-end			% Change	
	Apr-08	May-08	Jun-08	YTD12-Mon.	
Dow Jones Industrials	12820.13	12638.32	11350.01	-14.4%	-15.4%
Standard & Poor's 500	1385.59	1400.38	1280.00	-12.8%	-14.9%
Nasdaq Composite	2412.80	2522.66	2292.98	-13.5%	-11.9%
Gold	871.00	885.75	930.25	11.6%	43.0%
Unemployment rate@	5.10	5.00	5.50	10.0%	22.2%
Consumer price index@	213.50	214.80	216.60	3.1%	3.9%
Index of leading ind.@	101.90	102.00	102.10	-24.9%	-25.7%

# — 3rd, 4th, 1st quarter @ — Mar, Apr, May  
Sources: Barron's, Wall Street Journal

## 18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield January 2007 to June 2008



## News and Announcements

### Does Someone You Know Need Help?

You and I have worked together to build an investment portfolio that has put you on the path toward your financial goals. By doing so, you realize the importance of professional financial advice when it comes to understanding different types of investments, asset allocation, and how the economic and political environment relates to your financial situation.

I enjoy helping guide you through this complex maze of financial information, and I value the faith and trust you have placed in me over the years. My goal is to ensure you are pleased with the work I do for you and to

continue our professional relationship.

I also hope you are satisfied with my work and that you will want your friends, colleagues, and relatives to benefit from my services in the same way as you have. So, if you have friends or relatives who you think may benefit from my services, please tell me about them. Please be assured I will treat your referrals with the same degree of confidentiality and respect to which you are accustomed. I value you as a client and thank you for giving me the opportunity to help others to pursue their financial goals.

*Rick*

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