Current Financial Topics

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For anyone interested, we can provide market summaries. Please let us know if you are interested and if you would like to receive them; annually, quarterly or monthly.

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If you know of any one interested in receiving our newsletter, let us know.

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"Insanity: doing the same thing over and over again and expecting different rules"

Albert Einstein

In this issue:

A Mid-Year Financial Review: More Time to Plan

Mid-year is an ideal time to take a look at your finances, because the demands on your time may be fewer, and the planning opportunities greater, than if you wait until the end of the year. Here are a few tips to get you started.

Identifying your needs

Financial plans often need to be modified when personal circumstances change. Answering these questions can help you identify the financial issues you want to address within the next few months.

- Are any life-changing events coming up soon, such as marriage, the birth of a child, retirement, or a career change?
- Will your income or expenses substantially increase or decrease this year?
- Are you concerned about the performance of your investment portfolio?
- Do you have any needs or concerns that you would like to address?

Tax planning

Completing a mid-year estimate of your income tax liability can reveal tax-planning opportunities. You can use last year's tax return as a basis, then make any anticipated adjustments to your income and deductions for this year. Check your withholding, especially if you owed taxes when you filed your most recent income tax return or if you received a large refund. Doing that now, rather than waiting until the end of the year, will help you avoid a big tax bill or having too much of your money tied up with Uncle Sam. If necessary, adjust the amount of federal or state income tax withheld from your paycheck by filing a new Form W-4 with your employer.

One of the easiest things you can do right now to help avoid missed tax-saving opportunities for the year is to set up a system for saving receipts and other tax-related documents. This can be as simple as dedicating a folder in your file cabinet to this year's tax return so that you can keep track of important paperwork.

Retirement planning

If you're working and you received a pay increase for this year, don't overlook the opportunity to increase your retirement plan contributions by asking your employer to apply a higher percentage of your salary. This year, you may be able to contribute up to $16,500 to your retirement plan at work ($22,000 if you're age 50 or older). If you have a traditional IRA, you may also want to weigh the benefits of converting it to a Roth IRA this year, when you may be able to take advantage of a special deferral rule that applies only to 2010 conversions. This deferral rule gives you the option of reporting half of any resulting taxable income that results on your 2011 tax return and half of the income on your 2012 return.

If you're already retired, take a new look at your retirement income needs and whether your current investments and distribution strategy will continue to provide enough income.

Investment planning

Have you recently reviewed your portfolio to make sure that your asset allocation is still in line with your financial goals, time horizon, and tolerance for risk? Though it's common to rebalance a portfolio at the end of the year, if the market is volatile, you may need to rebalance more frequently.

Insurance planning

Do you know exactly how much life and disability insurance coverage you have? Are you familiar with the terms of your homeowners, renters, or auto insurance policies? If not, it's time to add your insurance policies to your summer reading list. Insurance needs frequently change, and it's possible that your coverage hasn't kept pace with your income or family circumstances.

529 College Savings Plans vs. Roth IRAs

According to an article in *The Wall Street Journal* ("More Parents Are Becoming 529 Dropouts," November 11, 2009), after the 2008/09 market collapse, some investors--and financial advisors--have reduced their reliance on 529 plans. Some of this pullback can be attributed in part to a broader retreat from the stock market as a whole. But another part can be attributed to parents who have opted to trade the tax benefits of 529 plans for college savings vehicles that don't have a "must-be-used-for-college" restriction. And as parents seek to save for their own retirement too, one such vehicle is a Roth IRA. So, just how does a favorite of the college savings world, a 529 college savings plan, stack up to a favorite of the retirement savings world, a Roth IRA, as an education-funding vehicle?

Tax benefits

Both 529 college savings plans and Roth IRAs offer federal tax-free earnings if certain conditions are met (and most states follow this tax treatment), but only 529 plans offer the possibility of a state tax deduction too.

For 529 plans, earnings are tax free at the federal level if the distribution is used to pay the beneficiary's qualified education expenses--a broad term that includes tuition, fees, room and board, books, and computers--at any accredited college in the United States or abroad. If the distribution is used for any other purpose, earnings are subject to income tax and a 10% federal penalty tax.

For Roth IRAs, earnings are tax free at the federal level if the distribution is "qualified." A distribution is qualified if a five-year holding period requirement is met and one of the following conditions is met: (1) you are at least age 59½; or the distribution is made (2) due to a qualifying disability; (3) to pay certain first-time homebuyer expenses; or (4) by your beneficiary after your death.

If you are younger than age 59½ and you have a taxable distribution, you will also pay a premature distribution tax (also called an early withdrawal penalty) equal to 10% of the earnings portion of the distribution. But there are exceptions to this penalty, and one is if the money withdrawn is used to pay your child's qualified higher education expenses.

Bottom line: if you withdraw money before age 59½ to pay your child's college expenses, you'll generally owe income tax on the earnings, but not an early withdrawal penalty. However, you may not end up owing income tax on the earnings, because Roth IRA distributions generally aren't taxed as earnings until the principal has been fully withdrawn. (By contrast, a distribution from a 529 plan is considered part principal and part earnings.)

Financial aid

There is an important difference here. Under federal financial aid rules, 529 plans are counted as a parent asset (if the parent is the account owner), and 5.6% of all parent assets are deemed available for college costs. By contrast, the federal aid methodology doesn't count retirement assets in determining aid eligibility. So a Roth IRA won't impact the amount of federal aid your child may be eligible for. However, although Uncle Sam doesn't count retirement assets, colleges typically do when awarding their own institutional aid.

Investment choices

Roth IRAs have the edge here--you can choose from a wide range of investments to fund your Roth IRA, and you can buy and sell investments whenever you like. But with a 529 plan, you are limited to the investment options offered by the plan. If you're unhappy with the investment performance of the options you've chosen, most plans let you change the investment options for your future contributions at any time, but for existing contributions, you can only change investment options once per year (twice per year in 2009 only). In 2008 and 2009, this restriction proved costly for many 529 account owners: having reached their limit on investment changes for the year, they were unable to make further changes in response to deteriorating market conditions.

Lump-sum contributions and eligibility

If you have a lump sum to contribute, 529 plans allow individuals to gift up to $65,000 in 2010 ($130,000 for married couples) and avoid gift tax if certain conditions are met. By contrast, Roth IRAs have a contribution limit in 2010 of $5,000 ($6,000 for individuals age 50 or older). And your ability to contribute to a Roth IRA depends on your income level. But anyone can contribute to a 529 plan--there are no restrictions based on income.

Bottom line

Whether a Roth IRA or a 529 college savings plan is best for your college savings depends on your personal circumstances and the factors discussed here.

Note on 529 plans

Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about 529 plans is available in each issuer's official statement, which should be read carefully before investing. Also, before investing, consider whether your state offers a 529 plan that provides residents with favorable state tax benefits.

How Much Life Insurance Is Enough?

Your life insurance needs often depend on a number of factors, including whether you're married, the size of your family, the nature of your financial obligations, your career stage, and your goals.

There are a number of approaches you can use to figure out how much insurance you should have. One method, called the "family needs approach," focuses on the amount of life insurance it would take to allow your family to meet its various financial obligations and expenses in the event of your death.

Family needs approach

With the family needs approach, you divide your family's financial needs into three main categories:

- Immediate needs at death, such as cash needed for estate taxes and settlement costs, credit card and other debts including mortgages (unless you choose to include mortgage payments as part of ongoing family needs), an emergency fund for unexpected costs, and college education expenses.
- Ongoing income needs for expenses related to food, clothing, shelter, and transportation, among other things. These income needs will vary in amount and duration, depending on a number of factors, such as your spouse's age, your children's ages, your surviving spouse's capacity to earn income, your debt (including mortgages), and whether you'll provide funds for your surviving spouse's retirement.
- Special funding needs, such as college funding, charitable bequests, funding a buy/sell agreement, or business succession planning.

Once you determine the total amount of your family's financial needs, you subtract from this total the available assets that your family could use to defray some or all of their expenses. The difference, if any, represents an amount that life insurance proceeds, and the income from future investment of those proceeds, can cover.

Example: *John and his wife, Wendy, are estimating the appropriate amount of life insurance to buy on John's life. They first estimate their immediate needs as follows:*

- *Final medical expenses: $5,000*
- *Estate settlement costs including funeral and burial expenses: $37,500*
- *Debts, including credit cards and mortgages: $317,000*
- *Emergency fund: $100,000*

Subtotal: $459,500

Next, they estimate ongoing income needs, such as:

- *Providing for their dependent children's needs for a period of time: $500,000*
- *Wendy's income needs until her retirement: $450,000*
- *Wendy's retirement income needs: $380,000*

Subtotal: $1,330,000

Adding the sub totals together, John and Wendy estimate that, should John die, their family would need $1,789,500. They then determine that assets available to offset their needs include:

- *Bank savings: $40,000*
- *Investments: $220,000*
- *Retirement assets: $250,000*
- *Existing life insurance on John's life: $300,000*

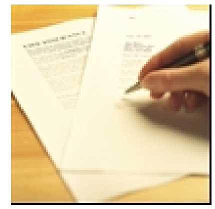
Subtotal: $810,000

The difference between their family needs ($1,789,500) and their available assets ($810,000) equals their life insurance need ($979,500).

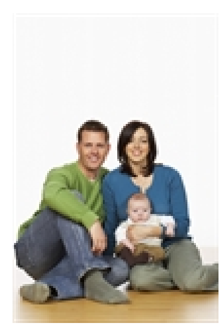
Review your coverage

Trying to figure out how much life insurance is enough isn't always easy, and that amount will likely change with your changing circumstances. By examining your family's anticipated expenses during various periods after your death, you get a more realistic estimate of your life insurance needs.

Unfortunately, many people underestimate their insurance needs and are underinsured. Often, the purchase of life insurance is based on cost instead of what's needed. By the same token, it's possible to have more insurance than you need. You may have purchased a large policy during a particular point in your life, and then didn't adjust your coverage when your insurance need was reduced. Both of these circumstances are reasons to review your insurance coverage periodically with your financial professional. Doing so can reveal opportunities to change your levels of coverage to match your current and projected life insurance needs.



An insurance coverage review is a periodic reassessment of your insurance needs. The main objectives are to confirm that the level of insurance coverage you have is still adequate, to alert you to shortages in coverage that can occur due to changes in your life, and to ensure that any cash value policies are performing as expected.



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Ask the Experts

I started a business that lost money this year. Do I have a net operating loss (NOL)?

If you're a sole proprietor and your business expenses exceed your business income, you have a reportable loss for income tax purposes. You're generally able to apply this loss against any wage income or other business income that you have (wages are considered business income) and any nonbusiness income (e.g., interest) that remains after taking your allowable nonbusiness deductions. If you still have a business loss remaining after offsetting all your income, you have a "net operating loss" for the year. The net operating loss (NOL) calculation is very complicated, though. For example, certain items, like personal exemption deductions and other nonbusiness deductions, aren't allowed in calculating an NOL.

The general rule is that you get to carry back an NOL for 2 years. This means that you can apply the NOL as a credit against income that was earned in--and reported on the tax returns for--the 2 years preceding the year in which you have the net operating loss. Any remaining loss is carried forward for up to 20 years after the year in which you have the NOL. You can, however, choose not to carry back the NOL to the prior 2 years and simply carry forward the entire NOL.

While NOLs are generally allowed to be carried back 2 years, special rules apply to NOLs incurred in 2008 and 2009 that allow NOLs to be carried back for up to 5 years. There are also exceptions to the general 2-year carryback rule, and alternative minimum tax (AMT) implications. Even in the most straightforward cases, NOLs are complicated.

If you have an NOL, you'll want to read IRS Publication 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts*, and the instructions for IRS Form 1045, *Application for Tentative Refund*. You should also consider discussing your situation with a tax professional.

Is it too late to take advantage of the special 2009 net operating loss (NOL) rules?

The Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA) included a provision that allows almost all taxpayers with business losses to make an irrevocable election to carry back losses incurred in *either* 2008 *or* 2009 for up to 5 years (the election can only be made for 1 year, however). Specifically, you're able to elect to extend the general 2-year NOL carryback period to 3, 4, or 5 years; NOLs carried back 5 years can offset up to 50% of the taxable income from the fifth year, and 100% of the taxable income from the other carryback years.

Even if you took advantage of a similar provision in earlier legislation to carry back a 2008 NOL, you're still able to elect to carry back a 2009 NOL under the provisions of the WHBAA. Certain taxpayers are specifically excluded from making the election, however. For example, any business in which the federal government acquired an equity interest pursuant to the Emergency Economic Stabilization Act of 2008 (i.e., a "TARP" recipient) is not eligible. Special rules apply to insurance companies.

If you're a calendar-year filer, you have to make the WHBAA election by the due date of your 2009 federal income tax return, including extensions. This deadline applies regardless of whether you're making the election for a 2008 NOL or a 2009 NOL. If you filed your 2009 federal income tax return by April 15, 2010, without making an election, you have until October 15, 2010, to do so.

You can make the election in one of two ways. You can attach an election statement to the federal income tax return or amended return for the tax year in which the loss is incurred. Or, you can attach the election statement to the carryback form itself (1040 filers would use Form 1045 or Form 1040X). Your election statement must contain specific language. You can find more information by checking the IRS website (www.irs.gov) or by talking to a tax professional.