FINANCIAL SERVICES ADVISORY INCORPORATED

First Quarter 2010 www.fsainvest.com (800) 235-4567

Many Leaving Their Job Also Leave 401(k) Behind

If you're leaving your company because of a downsizing or a switch in jobs, you wouldn't think of going without cleaning out your office. But what about the assets in your 401(k) plan? All too often, departing employees leave behind their retirement plans without giving much thought to the consequences.

According to a recent survey by Charles Schwab, almost half of the money held in 401(k) plans by employees who left their jobs during the first quarter of 2008 had not been moved a year later. Though there's no penalty for keeping your funds in an ex-employer's plan, you can't continue contributing to the account. Also, you may have concerns about how the account will be administered after you've gone, and you could face obstacles in recovering the money if the company goes under.

But you don't have to let your assets languish in a former employer's plan. You have three other principal options: take a cash distribution, move the funds to a new employer's plan, or roll over the assets to an IRA.

Take a cash distribution. Frequently, an employee will elect to take a lump-sum distribution from a 401(k) plan when leaving a job, especially if money is tight. But that could result in a hefty tax bill. The amount representing pre-tax contributions and earnings in the 401(k) is taxed at ordinary income rates reaching as high as 35% on the federal level. If you're under age 59½, the IRS will generally tack on a 10% "early withdrawal" penalty. And don't forget about state and local taxes and state penalties.

Besides incurring tax liability now, this approach means forfeiting the future benefit of tax-deferred savings and putting a hole in your retirement plan. After 60 days have passed, you'll have lost the opportunity to transfer the funds to another tax-advantaged plan. And don't think you'll receive the full balance of assets in your account. The employer's 401(k) administrator will automatically withhold 20% of the payout, regardless of your personal circumstances. Unless you have a dire need for funds, you would do better choosing one of the other options.

Transfer assets to a new employer's plan. If you find another job, you often can move your 401(k) balance to another 401(k) or other tax-qualified retirement plan available through your new company. That way, your assets will continue to grow tax-deferred without interruption. This direct transfer is also exempt from the early withdrawal penalty, and there's no tax withholding as long as you arrange a trustee-to-trustee transfer from one plan to another. If you take the funds yourself, you have 60 days to complete the transfer, but 20% will be withheld,

(Continued on page 4)

Coming Soon: Paperless FSA Statements!

More and more folks are turning to the Web for information on everything from Lady Gaga to your bank or brokerage accounts. Along these lines, we're happy to announce a new service for FSA clients. You will soon be able to access your FSA account information online: daily account balances, transaction history, quarterly reports, and tax forms in an easy-to-share and secure format that can be emailed to your CPA, for example.

Of course, you will have the option to opt out of this new service if you prefer to receive your information through the mail. Stay tuned for more details in coming months.

We've focused this newsletter on a few "hot topics" that are buzzing around the financial world these days: unemployment, Roth IRA conversions, and 401(k) rollovers. Read about tips for those that are out of work, particularly what to do with a 401(k). And for those thinking about converting a traditional IRA into a Roth, it's often more complicated than simply flipping a switch; an article summarizes the process. And you might also enjoy reading about helping loved ones financially and the best way—for you and for them—to go about it.

As you read, keep in mind that if any of these articles raise questions, we are happy to help you find the right answer for your personal circumstances. Be sure to give us a call.

Jim Joseph, CFP®
Vice President

Financial Tips For Those Out Of Work

The numbers are scary. From December 2007 through October 2009, unemployment in the U.S. doubled from 7.6 million to 15.1 million. But the statistic that matters most is your own, and if you've been laid off or your company has gone under, you're competing with an army of others for the few available jobs. Still, manage your financial affairs carefully and you'll certainly survive the economic crisis. You might even emerge in better shape than you were before. These eight suggestions could help.

1. Don't panic. It's normal to be nervous if you've suddenly been sent packing after years of gainful employment. But now's the time to take stock of your situation as calmly as possible. Keeping your emotions under control will make it easier to find the way forward.

2. Reduce spending. Food and shelter are necessities, but other purchases are discretionary. Consider ways to trim your cable TV bill and think twice about dining out. Finding things you can do without may also help you overcome the feeling of powerlessness that often comes with unemployment.

3. Eliminate unnecessary debt. Cut up your credit cards? Maybe not, but charge only what you can afford to repay each month. Otherwise, a small debt could quickly spiral out of control.

4. Take advantage of benefits. These days, you can likely avoid those dispiriting visits to the unemployment office and apply for jobless benefits by mail or online. And if you need to continue your health insurance coverage under COBRA, a provision of the American Recovery and Reinvestment Act of 2009 will subsidize 65% of the cost for nine months.

5. Network, network, network. Applying for posted jobs pits you against a host of other applicants. You may do better reaching out to friends, family, and business associates. Be casual—you don't want to seem desperate—but be sure they know you're job hunting.

6. Consider a career change. If your industry or profession seems unlikely to rebound, you might broaden your search to include related fields—from print media, say, to work on a website, in public relations, or in another job requiring writing and editing.

7. Start a new business. If you've always dreamed of turning a hobby or other passion into a profitable business, this might give you the push you need to go for it. If you can fill a niche with high-quality services or products while keeping startup costs low, you'll stand a good chance of success.

8. Stay positive. An extended job search may sap the energy you had when you were first laid off. But perseverance will pay off. And remember: If you're middle-aged or near retirement, your wealth of experience is an asset, not a liability.

Finally, in a pinch, you may need to tap your retirement plans. But money you pull out now will be difficult to recoup later on, so consider this option only for emergency purposes. ●

A Welcome Spike In Personal Savings

Are you looking for something good that may have come out of the recession? As a result of the economic downturn, Americans have generally been spending less and saving more. The savings rate in U.S. households in 2009 reached a high point of 6.9% of after-tax personal income in May. Even though the savings rate has slipped slightly since then, the watershed mark was the highest rate since 1992, when savings peaked at 7.7%.

While it's not an exact measure of fiscal health, the savings rate is the percentage of household disposable income that is put into savings rather than consumed. Mortgage payments are not considered savings, but retirement plan allocations (not capital gains) are. Although a sub-7% savings rate isn't much to brag about in most parts of the world—the annual percentage in other countries routinely hits double digits—it marks a dramatic shift in our personal financial habits. During recent years, the percentage of savings actually dipped below 1%, bottoming out at 0.4% in both 2006 and 2007. In 2008, the saving rate was still only 1.8%.

What's behind the trend towards more savings? During the preceding two decades, rising stock market values and home prices had enticed consumers into thinking they had money to burn, and they became less and less inclined to save for retirement and other needs. Even retirees were encouraged to spend like there was no tomorrow.

But the recent precipitous decline in household wealth ended the wild spending spree. Real estate values around the country have dropped by an estimated 35%, and during the past two years, U.S. household wealth has been reduced by a whopping 140% of annual disposable income. That's a total of $14 trillion.

Faced with daunting economic news, people have been forced to rein in spending, while increasing their efforts to prepare for a secure retirement. For

Help Loved Ones With Tax-Free Gifts

Today's severe economic crisis is taking its toll on virtually every segment of the population. Young newlyweds are finding it difficult to set aside funds for the down payment on a home, despite the now lower prices. Middle-aged parents are struggling to make ends meet and still squirrel away cash for their children's college costs. And older workers and retirees have seen their nest eggs eroded by the recent stock market downturn.

If you've been fortunate (and foresighted) enough to escape major damage to your own finances, you may want to consider helping family members overcome economic hurdles. Providing tax-free gifts could improve their situations while benefiting your own estate planning as well. If you stay within tax law boundaries, you don't have to pay gift tax on cash or property transferred to relatives or any other recipient. At the same time, the gifts will reduce the size of your taxable estate.

The value of the latter benefit depends on the future of the federal estate tax, which remains uncertain. The estate of an individual who dies in 2009 can shelter up to $3.5 million of assets from federal estate tax. That's an increase from a $2 million exemption in 2008, as stipulated by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which calls for the outright repeal of the estate tax in 2010. But that provision of the legislation expires at the end of 2010, and in 2011, pre-EGTRRA rules return. The estate tax exemption is scheduled to revert to just $1 million, and the estate tax rate will rebound to 55% from the current 45% unless Congress acts to change the law.

While a legislative compromise on the estate tax is likely, the tax will almost certainly continue in some form. And that likelihood only increases the appeal of making gifts now to help loved ones hurt by the recession. In 2009 and 2010, you can provide tax-free gifts of as much as $13,000—in any combination of cash and property—to as many recipients as you choose. (A periodic inflation adjustment resulted in an increase in this exclusion amount from $12,000 in 2008.) You don't even have to file any tax forms or otherwise inform the IRS about such gifts (if those are the only gifts made and unless gift splitting with a spouse is elected).

The chance to provide unlimited numbers of tax-free gifts could multiply the benefits not only for recipients but also to your estate plan. For instance, if you have two children and three grandchildren, giving each of them $13,000 in 2010 adds up to a total of $65,000. If your spouse also makes such gifts (or consents to a joint gift by filing a gift tax return), that exemption jumps to $26,000 per relative and a total of $130,000 for five, all without gift-tax consequences. Continue this gift-giving program for five years and you'll have cut the value of your estate by $650,000 while providing generous assistance at a time when it may be sorely needed.

If the recipient is in a lower tax bracket, gifting shares of stock, mutual funds, or other assets that have appreciated will save you from paying capital gains taxes. But if you have assets with unrealized losses that you want to donate, it's better to sell them first so that you can deduct the loss on your tax return and give your gift in cash.

If you exceed the annual limit on tax-free gifts, you still won't necessarily owe money to the IRS. But larger gifts would count against your lifetime $1 million gift-tax exemption, which might be put to better use in funding trusts or for other estate planning purposes. Plus, you'll have to file a gift tax return—or potentially two gift tax returns if you're married.

Meanwhile, there are two special situations in which the normal giving limits don't apply. The first involves money you provide directly to an educational institution on behalf of a student. The second is for direct payments to health care providers.

The unlimited exemption for education payments means you won't owe gift tax if you cover college costs for children or grandchildren. Suppose your granddaughter is attending an Ivy League institution and the annual bill for tuition is $50,000. You can pay that amount directly to the university and still give her an additional $13,000 gift (or $26,000 with your spouse) that won't be subject to gift tax.

If children or grandchildren are still years away from college, an even better approach might be to fund a Section 529 college savings plan that names the child as beneficiary. Income earned by plan investments won't be taxed, and withdrawals to pay qualified educational expenses will also be tax-free. Plus, a special provision allows five years' gifts to be sent to a 529 plan in one fell swoop. That means you and your spouse could immediately provide $130,000 to jump-start a 529 plan without gift-tax consequences (provided you file a gift tax return to elect to front-load the gift). ●

instance, instead of buying goods with their checks from the economic stimulus package or taking advantage of other tax incentives, many people have chosen to hold on to the money. And it doesn't look as if things will change radically anytime soon.

How long will the latest trend last? Most economists predict a slow, steady climb back to better times rather than a quick return to another financial boom. But cutbacks in domestic consumption will also slow down the economic recovery. In the meantime, the savings rate is expected to rise gradually until it hits the 10% mark at some point during the next 10 years. Other financial experts believe the recovery period could last even longer.

Of course, an increased savings rate is to be applauded, especially after it had plummeted dangerously close to zero. Americans will have to adjust to a lower standard of living compared with the heyday of 2007. But if forgoing a few luxuries is the price you have to pay for protecting your financial future, that's probably a trade-off you'd be willing to make. ●

Build Up IRA Now For 2010 Roth Conversion

Thinking about converting a traditional IRA to a Roth IRA? Now in 2010, new rules permit anyone to make that move. But before you empty your traditional IRA, you might consider building it up, including using non-deductible contributions. The more money you convert, the more you'll be able to tap during retirement through tax-free Roth IRA distributions, but it's important to note that your Roth IRA conversion doesn't need to be an all-or-nothing event—you can do partial conversions. Just keep in mind that a little-known rule may affect the taxation of non-deductible contributions during a Roth conversion.

High-income taxpayers generally don't qualify for deductible contributions to a traditional IRA, but they can still contribute on an after-tax basis. The contribution limit for 2010 is $5,000 ($6,000 if you're age 50 or over). Distributions of deductible contributions and earnings are taxable at ordinary income rates.

A Roth IRA uses a different formula. Though contributions are never deductible, distributions from a Roth established at least five years ago are completely tax-free. Contribution limits are the same as they are for traditional IRAs. But here, too, high-income taxpayers may be shut out. For the 2009 tax year, Roth IRAs are off-limits to joint filers with an adjusted gross income above $176,000 ($120,000 for single filers), and to convert a traditional IRA to a Roth your AGI must be no more than $100,000 during the year of the conversion.

But starting in 2010, anyone, regardless of income, will be able to convert a traditional IRA to a Roth. And though you'll owe income tax on converted money that hasn't previously been taxed—in other words, all deductible contributions and earnings—if you make a conversion in 2010, you can pay the resulting taxes during 2011 and 2012.

Even without current year deductions, it could make sense to contribute to your IRA on a non-deductible basis before you convert. For example, you have until April 15, 2010 to make an IRA contribution of up to $5,000 for the 2009 tax year ($6,000 for older participants). When you then convert that traditional IRA to a Roth, the portion of the account attributable to those non-deductible contributions may be exempt from tax.

However, for purposes of a Roth conversion, the IRS looks at the overall split between deductible and non-deductible contributions in all of your retirement accounts to determine how much of a converted amount won't be taxed. Suppose you have one IRA with $10,000 in non-deductible contributions and another with $190,000 in deductible contributions and earnings. Because only 5% of your nest egg is represented by non-deductible contributions, if you convert the $10,000 IRA, you still must pay tax on 95% of the distribution, or $9,500. If you convert the entire $200,000, you'll be taxed on $190,000.

Astute planning can reduce the tax bite on Roth IRA conversions. For more information, please call our office. ●

Leaving 401(k) Behind

(Continued from page 1)

and you won't be able to recover that money until you file your tax return for the year of the transfer.

The main potential drawback to this option is that you'll be limited to the investment choices in your new employer's plan. Those may be better or worse than you had before, but the third option—rolling over assets to an IRA—is likely to provide more investing flexibility and a wider menu of choices.

Move your account balance to a rollover IRA. Just as when you transfer assets to a new 401(k) plan, you may continue tax-deferred savings by rolling over your retirement savings to a traditional IRA. And here, too, you can avoid automatic tax withholding by using a trustee-to-trustee transfer. Otherwise, you have 60 days to complete the rollover without triggering income tax liability or an early withdrawal penalty.

This may be the most advantageous approach. Again, an IRA generally offers greater investment flexibility, letting you invest in a wide variety of stocks, bonds, and mutual funds, compared with 401(k) choices that tend to be more limited. And the IRA may give you greater control over distributions during retirement.

Beginning in 2010, all employees now also have a fourth option—rolling over employer plan funds to a Roth IRA that provides tax-free distributions during retirement. (Previously, Roth conversions were allowed only in a year in which your adjusted gross income didn't exceed $100,000.) But moving money to a Roth means paying income tax on the untaxed portion of your account, unless you have large tax deductions that you can claim to offset this extra income.

Almost all of these options are likely to be preferable to leaving your 401(k) account with your former employer. We can help you explore the possibilities and find the best approach for your situation. ●

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