SCARPETTI & SCROGGINS

Quarterly Review

Q4 2009 Newsletter

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May the holiday season bring health, joy and peace to you and your families...

Please remember that we're here if you need us!

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Scarpetti & Scroggins
PRESERVATION AND CONSERVATION OF WEALTH

2009 Legislation in Review

The year 2009 saw several important changes, some of which may also affect you in 2010.

Suspension of RMDs

One of the biggest changes for 2009 actually stemmed from a 2008 piece of legislation that suspended the rules requiring individuals older than 70½ to make withdrawals from certain retirement accounts. The one-year moratorium on required minimum distributions (RMDs) applies to 2009 only.

Without this suspension, individuals who reached age 70½ before 2009 would generally be required to take 2009 RMDs by December 31, 2009. Individuals who turned age 70½ *during* 2009 would generally have until April 1, 2010, to take 2009 RMDs--but the suspension applies to these individuals as well. The suspension of RMDs for 2009 also applies if you're the beneficiary of an inherited IRA or employer retirement account. Normal RMD rules apply for 2010.

American Recovery and Reinvestment Act of 2009 (ARRA)

In addition to extending several expiring tax provisions, this legislation made some changes, including the following:

- A new "Making Work Pay" tax credit was established for 2009 and 2010. This credit is equal to 6.2% of earned income, up to $400 ($800 in the case of a married couple filing jointly). The credit is phased out for higher-income individuals.
- The Hope education tax credit was expanded for 2009 and 2010, and renamed the American Opportunity Tax Credit. With an increased annual limit per student of $2,500, the expanded credit covers the first four years of post-secondary education, with up to 40% of the credit refundable.
- Up to $2,400 of unemployment compensation benefits received in 2009 are excluded from gross income for federal income tax purposes.

Energy-related tax changes

ARRA also created, extended, and modified several tax incentives to encourage the efficient use of energy sources and the development of energy-related technology. Among other things, the legislation:

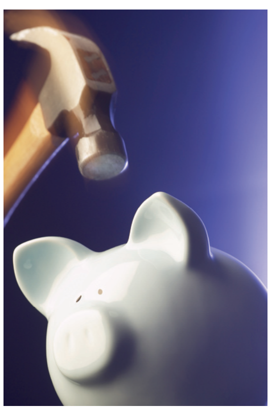
- Increased the lifetime tax credit cap for energy-efficient home improvements from $500 to $1,500 (for 2009 and 2010).
- Removed the separate $200 credit cap on window upgrades (the $1,500 lifetime cap applies, though).
- Removed the credit cap on qualified geothermal heat pumps, solar hot water heaters, and small wind energy property (through 2016).

Other changes

- A "first-time" homebuyer can qualify for a tax credit of up to $8,000 for the purchase of a qualified personal residence.
- A new government subsidy equal to 65% of COBRA premiums paid by eligible beneficiaries for up to nine months of health- care coverage was established. This subsidy was generally available to individuals whose employment was involuntarily terminated on or after September 1, 2008, and before January 1, 2010. The subsidy was phased out for individuals with higher incomes.
- The "Cash for Clunkers" program provided cash vouchers to encourage consumers to trade in older, less fuel-efficient vehicles for new vehicles that get better fuel economy. The government ended this program on August 24, 2009, as the program ran out of funds.

Retirement: Does Your Withdrawal Strategy Need a Second Look?

A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money.



In its simplest terms, a withdrawal rate is the percentage you withdraw from an investment portfolio in any particular year. However, in retirement income planning, what's important is not just your withdrawal rate, but your sustainable withdrawal rate.

A sustainable withdrawal rate represents the maximum amount (expressed as either a dollar amount or a percentage) that can be withdrawn from your retirement assets each year with reasonable certainty that the portfolio will provide income for as long as it's needed (for example, throughout your lifetime).

A commonly expressed rule of thumb states that your portfolio should last for your lifetime if you initially withdraw 4% of your balance (based on an asset mix of 60% stock and 40% fixed income securities), and then continue withdrawing that same dollar amount each year, adjusted for inflation. However, this rule of thumb has been under increasing scrutiny, and like any rule of thumb, it may not apply to you.

Why is it important?

A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money. You want to find a rate of withdrawal that gives you the best chance to maximize income over your entire retirement period.

Withdrawal rates are based on a number of assumptions, including your living expenses, projected lifespan, risk tolerance, projected rates of return and inflation, asset allocation, taxes, and whether you wish to leave a portion of your estate to others. As you progress in retirement, you'll have empirical data against which you can evaluate these assumptions. Plus, your investment horizon will be getting shorter. That's why it's important to periodically revisit your withdrawal strategy during your retirement to see if your assumptions are still accurate and whether your strategy needs to be modified.

Dealing with market volatility

If you're currently withdrawing a fixed percentage of your investment portfolio each year, the amount you receive will fluctuate with the performance of your portfolio. Small changes may not significantly impact your lifestyle. But what if your portfolio suffers a serious decline due to a market downturn? Will you be able to meet your expenses with the reduced withdrawal amount you'll be receiving? If you're currently withdrawing a fixed dollar amount each year, you may be able to meet your expenses, but can your reduced portfolio continue to support that same dollar amount or will your assets be depleted much too soon?

The converse of this is also true. If your portfolio realizes a gain that's significantly greater than your assumptions, a fixed percentage withdrawal will provide you with more dollars than you had been taking. Do you need the additional income? If you're taking a fixed dollar amount each year, is it time to give yourself a raise?

Market volatility may also lead you to consider changes in your asset allocation. If your portfolio is down, you may be inclined to become more conservative to avoid additional losses; conversely, when your portfolio is up, you might contemplate becoming more bullish. But if your asset allocation is designed to produce sustainable long-term income, changes should be considered carefully and only implemented as part of a disciplined strategy.

Other factors to consider

When you review your withdrawal strategy, make sure you consider the following:

Inflation: Inflation erodes your buying power. If you've underestimated the inflation rate, you may need to increase your withdrawals. If your portfolio can't support additional withdrawals, you'll need to reduce your expenses, or find another source of income (e.g., part-time work) to maintain your lifestyle. If inflation is lower than you've anticipated, you may be able to withdraw less and prolong your portfolio's income-producing ability.

Lifestyle: You may find that your expenses during retirement decrease from your initial estimate as you travel less or downsize a home--or they may increase because of health care or other costs.

Legacy: A decision to increase or decrease the amount you leave to heirs or charities can have a significant impact on your withdrawal strategy.

Revisiting your withdrawal strategy will allow you to focus on changes that have occurred during your retirement and fine-tune your strategy going forward, helping to ensure your retirement will be a financially secure one.

Retirement Issues to Watch in 2010

Recent years have seen a flurry of legislation impacting retirement plans. Here are some of the more significant changes that take effect in 2010.

Nonspouse rollovers must be permitted

The Pension Protection Act of 2006 allowed, for the first time, nonspouse beneficiaries to make a direct rollover of inherited funds from an employer plan to an IRA. While the provision seemed fairly straightforward at the time, confusion arose as to whether plans were actually required to allow these rollovers. Congress addressed this in the Worker, Retiree, and Employer Recovery Act of 2008--beginning in 2010, employer plans *must* let nonspouse beneficiaries make a direct rollover to an IRA if they so choose. The new law also clarified that prior to 2010 employer plans could, but were not required to, allow the rollovers.

IRA conversions for (almost) everyone!

Beginning in 2010, if you own a traditional IRA, you'll be able to convert it to a Roth IRA. The income limits and marital status requirements that previously applied to Roth conversions were repealed by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

In addition, if you convert a traditional IRA to a Roth IRA in 2010, you'll be able to report half the income on your 2011 tax return and half on your 2012 return. Or, if it's to your benefit, you can instead elect to include the entire amount in income on your 2010 return. It's up to you.

If you inherit a traditional IRA from your spouse, and you elect to treat that IRA as your own, you'll also be able to convert the inherited IRA to a Roth IRA in 2010, regardless of your income or marital status. Nonspouse beneficiaries, however, still can't convert an inherited traditional IRA to a Roth.

Note that the income limits for contributing to a Roth IRA haven't changed for 2010. If your income is high enough, your ability to make regular contributions to a Roth IRA in 2010 may be limited, or even eliminated. The ability to convert a traditional IRA to a Roth without income limits, however, provides a potential workaround--you can make your annual contribution to a traditional IRA, and then immediately convert that traditional IRA to a Roth. You'll have to aggregate all your traditional IRAs when calculating the tax effect of the conversion, so speak with a financial professional first to make sure this strategy works for you.

Employer plan conversions for everyone!

Beginning in 2008, employees and beneficiaries were permitted for the first time to essentially "convert" employer plan distributions by rolling the funds over to a Roth IRA. This was allowed, however, only if the payee satisfied the income and marital status limits that applied to traditional IRA conversions. The elimination of those restrictions by TIPRA, described above, also applies to distributions from employer plans--so beginning in 2010, anyone who receives an eligible distribution of non-Roth funds from an employer plan can roll those funds over to a Roth IRA, regardless of income or marital status. This applies even to nonspouse beneficiaries--but only if the transfer to the IRA is done in a direct rollover.

While the special 2010 deferral rule described earlier doesn't apply to rollovers from employer plans to Roth IRAs, there's another potential workaround--you can simply roll your employer plan distribution over first to a traditional IRA, and then convert that traditional IRA to a Roth in 2010. (Again, however, you'll need to aggregate all your traditional IRAs to determine the tax consequences of the conversion, so first make sure this strategy works for you.)

Here comes the DB(k) …

Beginning in 2010, "small employers" (those that generally employ at least 2 and no more than 500 employees) can adopt a DB(k) plan--a single plan that incorporates both a 401(k) plan and a defined benefit plan (including a cash balance plan). A single trust is used, but there is separate accounting for the defined benefit and 401(k) portions of the plan.

The plan must meet certain benefit, contribution, vesting, and nondiscrimination requirements. In return, the plan will be exempt from top-heavy rules and certain 401(k) testing.

Because the DB(k) plan is one plan instead of two, it is expected that the plan will be simpler to administer and less costly than maintaining two separate plans. This, in turn, may provide an incentive for employers to begin offering defined benefit plans to their employees in addition to 401(k) plans. Whether this proves to be the case, however, remains to be seen.

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Ask the Experts

What is a short sale?

A short sale occurs when a mortgage lender allows a borrower (the short seller) to accept a sale offer that is less than ("short") the balance due on the outstanding loan.

Lenders generally will consider this option only when (a) the market value of the home is less than the mortgage balances due, and (b) the borrower, having fallen behind on mortgage payments, has little hope of bringing the mortgage current even if it were modified. The lender expects the proceeds from the short sale will be greater than what could be expected in a foreclosure.

If the proceeds from the sale don't satisfy the total mortgage and/or lien balances due on the property, one or more deficiencies may occur. Short sellers should always find out (in writing) what will happen to any deficiencies. If a deficiency isn't forgiven, the lender may be able (depending on state law and how the mortgage note or lien is structured) to pursue the borrower for it.

Junior liens (e.g., second mortgages, home equity loans, or other liens) are not dissolved in short sales (as they are in foreclosures). As a result, either the short seller or the first lien holder may have to give some consideration (something as low as pennies on the dollar) to junior lien holders to satisfy their claims. The short seller should again get notification in writing of what will happen to any remaining deficiencies.

Forgiven deficiencies can have tax consequences; the IRS generally considers debt forgiven or cancelled by a lender to be taxable income. However, recent legislation allows (for calendar years 2007 through 2012) up to $2 million of forgiven debt ($1 million if married filing separately) to be excluded if the debt was incurred to purchase or improve a principal residence.

After completing a successful short sale, borrowers may be eligible to apply for a new mortgage on another home after two years; foreclosures require a five-year waiting period.

What is a deed-in-lieu of foreclosure?

In a deed-in-lieu of foreclosure (often referred to as a DIL), a mortgage lender allows a borrower to sign the deed over to the lender in exchange for relief from the obligation to repay the mortgage.

DILs are usually issued only if the value of the property is less than the indebtedness against it and the borrower no longer has the ability to pay the mortgage. Prior to accepting a DIL, a lender usually must be convinced the property cannot be sold (even by short sale) within a reasonable amount of time.

Lenders will generally accept a DIL only if the property has no other liens against it. Department of Housing and Urban Development (HUD) borrowers may receive up to $2,000 in compensation to discharge junior liens. (If none exist, the borrower may use the money for relocation expenses upon vacating the property.) And the Making Home Affordable program directs the U.S. Treasury to provide $1 for every $2 paid by a lender toward the release of junior liens, up to a maximum contribution of $1,000.

HUD will accept DILs only on owner-occupied residences; the borrower must be one month or more delinquent on the mortgage. The DIL must be completed within six months of the date of default on the mortgage, or within 90 days of the failure of a special forbearance agreement or short sale attempt.

In most cases, a DIL agreement forgives a borrower of any obligation to repay a deficiency if all the conditions of the agreement have been met. Forgiven debt may be considered taxable income by the IRS. However, recent legislation allows (for calendar years 2007 through 2012) up to $2 million of forgiven debt ($1 million if married filing separately) to be excluded if the debt was incurred to purchase or improve a principal residence.

Homeowners who successfully complete a DIL are eligible to apply for a new mortgage four years after the execution of the DIL (two years if there are extenuating circumstances) and are required (for up to seven years) to provide a minimum 10% down payment. Foreclosures require a five-year waiting period.