

# 401(k) UPDATE

JANUARY 2009

## Rolling Over Pension Plan Assets to Roth IRAs

**S**tarting January 1, 2008, the Pension Protection Act of 2006 permits proceeds from qualified retirement plans, including 401(k), 403(b), and 457 plans, to be rolled over directly to a Roth individual retirement account (IRA). In the past, the proceeds had to be rolled over to a traditional IRA and then from the traditional IRA to a Roth IRA. Guidance was recently released by the Internal Revenue Service on how to apply this provision.

The Roth conversion rules still apply to these rollovers. Thus, in 2009, your modified adjusted gross income (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 Amounts converted must be included in income if taxable when withdrawn (i.e., contributions and earnings in deductible IRAs and earnings in nondeductible IRAs), but are exempt from the 10% early withdrawal penalty. Starting in 2010, all taxpayers can convert, regardless of their income.

When converting from a traditional IRA to a Roth IRA, you cannot convert just the nontaxable portion of your traditional IRA. You must assume that a pro-rata portion of both the taxable and

nontaxable IRA funds are being converted. With a rollover from a qualified retirement plan to a Roth IRA, however, you do not have to use the pro-rata rule. Thus, if a portion of your plan contains nontaxable funds, you can convert only that portion to a Roth IRA, putting the taxable portion in a regular IRA (if your plan allows you to split your funds for distribution purposes). This strategy would not require the payment of any income taxes following the conversion.

If you have some nontaxable funds in your retirement plan, but the plan does not allow split distributions, you have a couple of options:

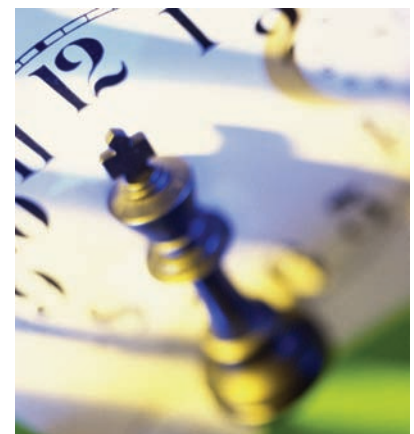
- ✓ Transfer all of the funds to a regular IRA and then convert a portion of the balance to a Roth IRA. This requires the use of the pro-rata rules, so you will owe

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## Check on Lump Sums

**A**s part of the Pension Protection Act of 2006, the interest rate used to calculate lump-sum distributions from defined-benefit plans changed in 2008. Instead of using the 30-year Treasury yield, corporate bond yields are used. Since corporate bond yields are typically higher than the 30-year Treasury yield, lump-sum distributions will now be lower. This change is being implemented gradually over a five-year period, with full implementation in 2012.

If you are entitled to a lump-sum distribution, determine whether it makes sense to take the distribution in the near future. You can't take a lump-sum distribution unless you are age 62 or older or have terminated from the company. However, if you are planning to retire in the next couple of years, you might want to calculate the difference those years will make on your lump-sum distribution. Not all plans allow lump-sum distributions, but approximately 48% do (Source: *Forbes*, 2008). ○○○



## Social Security Benefits for Married Couples

**W**hen should married couples apply for Social Security benefits? Before answering, you first need to understand the rules.

If benefits start at full retirement age, you are entitled to the larger of 100% of your benefits based on your earnings or 50% of your spouse's benefits. However, if you elect benefits before full retirement age, your spouse's benefits will be reduced by a larger percentage than your benefits were reduced. After your death, your spouse receives the larger of his/her benefits or 100% of your

benefits, provided he/she is over full retirement age. If not, your spouse receives between 71.5% and 100% of your benefits. Thus, the larger your benefits are, the larger your spouse's benefits may be after your death.

For individuals turning 62 this year, full retirement age for Social Security purposes is 66. If benefits are claimed at age 62, that individual would receive 75% of full retirement benefits. For each year past age 66, benefits increase by 8% per year, for maximum benefits at age 70 that are 132% of the full retirement benefits.

These amounts have been actuarially calculated, so that if you live to the average age, the benefits are approximately the same for a single individual, no matter when you start those benefits.

However, for married couples, benefits are not actuarially the same. Typically, the man is older, has higher earnings, and will not live as long as the woman. Because the surviving spouse can elect to receive 100% of the other spouse's benefit, it typically makes sense for the man to wait until age 70 to claim Social Security benefits, in order to provide his wife with the highest benefit possible after his death. On the other hand, there is usually no reason for the woman to wait beyond ages 62 to 66 to start Social Security benefits, provided she can claim benefits on her own earnings record. While the wife's benefits may be lower when her husband is alive, she will receive his higher benefits after his death.

A spouse who can't claim benefits on his/her own earnings record can claim spousal benefits, but he/she must wait until his/her spouse starts benefits or reaches full retirement age. Spousal benefits are reduced when taken at age 62, but do not continue to grow after full retirement age. However, a worker can apply for Social Security benefits at full retirement age, allowing his/her spouse to collect benefits, and then suspend his/her own benefits, reapplying at a later date.

Keep in mind that these strategies are based on individuals living an average life expectancy. If you and your spouse live well beyond that age, it will typically pay for both of you to delay benefits until age 70. However, if you both die young, it would make more sense for both of you to claim benefits at age 62. ○○○

## The Benefits of Low-Correlated Assets

**A**t first glance, asset correlation may seem like a complex topic. However, it is important to understand the concept and how it affects your portfolio. By combining assets with low correlation, you can potentially improve portfolio returns while reducing risk.

Correlation is a statistical measure of how one asset class performs in relation to another asset class. Correlations can range from +1 to -1. A correlation of +1 means the two assets move very closely together in the same direction. Combining assets with a high positive correlation will not provide much risk reduction. A correlation of -1 indicates the assets move in opposite directions, a rare event in the investment world. A correlation close to 0 means no relationship exists in the price movements of the two assets.

Combining assets with consistently high correlations to each other does little to reduce risk. The greatest combination benefit to a portfolio seems to be achieved by combining assets with consistently low correlations, which

results in consistently reduced risk.

When selecting investments for your portfolio, consider the diversification aspects for your overall portfolio. While correlations change over time, general observations include:

✓ Stocks tend to have a low positive correlation with corporate and government bonds.

✓ Short-term bonds tend to have a low correlation with long-term bonds.

✓ Stock markets around the world are all positively correlated to some degree. In general, European stock markets are more closely correlated to each other and the U.S. than to markets in Japan or Asia. Correlations between developed countries tend to be higher than correlations between developed and emerging countries.

✓ Real estate tends to have a low correlation with stocks and bonds.

Past performance does not indicate future results. ○○○

## Roth IRAs

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some income taxes on the conversion.

✔ Request a check payable to you. You can deposit the check and then write two checks — one to the Roth IRA in the amount of your nontaxable funds and another for the balance to a regular IRA. However, the plan will be required to withhold 20% of the taxable amount for income taxes, which you will have to provide from personal funds to keep the entire balance invested. You will then get that money back when you file your tax return.

If you transfer the funds to a Roth IRA and find out that you are not eligible to do so (this would only be a concern in 2009), you can recharacterize the funds to a traditional IRA. The funds cannot go back to the retirement plan. A recharacterization eliminates any tax consequences from converting to a Roth IRA. You can also recharacterize if you decide you do not want to pay the income taxes or your account value decreased after conversion, so that you owe income taxes on more than your account is currently worth. You have until October 15 of the year following the year of the conversion to recharacterize.

Nonspouse plan beneficiaries can also roll over inherited retirement plan balances to an inherited Roth IRA, even though they cannot roll over an inherited traditional IRA to an inherited Roth IRA. The rollover is only possible if the plan permits nonspouse beneficiary rollovers, and it must be a direct transfer to the Roth IRA. Once the assets are rolled over, the beneficiary must take required minimum distributions starting in the year following the original owner's death, even though it is a Roth IRA, since the beneficiary is not the

## You're Never Too Old for a Roth IRA

**E**ven if you're retired, consider contributing to a Roth individual retirement account (IRA), provided you have some earned income. Single taxpayers with modified adjusted gross income (AGI) less than \$101,000 in 2008 and \$105,000 in 2009 and married taxpayers filing jointly with modified AGI less than \$159,000 in 2008 and \$166,000 in 2009 are eligible to make a nondeductible contribution to a Roth IRA. Contributions are phased out for married couples filing jointly with modified AGI between \$159,000 and \$169,000 in 2008 and \$166,000 and \$176,000 in 2009 and for single taxpayers with modified AGI between \$101,000 and \$116,000 in 2008 and \$105,000 and \$120,000 in 2009. In 2008 and 2009, the maximum annual contribution is the lesser of \$5,000 or earned income. Individuals age 50 and older can make an additional \$1,000 catch-up contribution. Pension, investment, and rental income are not considered earned income.

Roth IRAs are a flexible way to save for retirement. Contributions are withdrawn at any time with no tax consequences. Earnings and capital gains can be withdrawn on a tax-free basis if a qualified distribution is made:

- ✔ at least five years after your first contribution and
- ✔ you have attained age 59 1/2 or due to death, disability, or to pay



owner or his/her spouse. However, the distributions can be taken income-tax free. The beneficiary will have to pay income taxes on the taxable portion of the plan assets, but he/she will be entitled to the deduction for income in respect of a decedent, which will help offset some of the cost.

Typically, a Roth conversion makes the most sense when funds will not be deducted from the Roth

up to \$10,000 of first-time home buyer expenses.

Other characteristics of a Roth IRA may make it an attractive investment for retirees:

- ✔ You can make contributions as long as you have earned income, no matter how old you are. With traditional deductible IRAs, you must stop making contributions when you reach age 70 1/2.
- ✔ Mandatory withdrawals after age 70 1/2 are not required. You can take out as much or as little as you want, whenever you want, after age 59 1/2. If you don't need the money, the balance can continue to grow on a tax-free basis.
- ✔ Qualified distributions from Roth IRAs are not included in AGI. Thus, these distributions will not affect income taxation of your Social Security benefits.
- ✔ Roth IRAs can provide a tax-advantaged way to accumulate assets for heirs. Both traditional and Roth IRAs are subject to estate taxes. However, the beneficiaries of a traditional IRA must also pay income taxes on the proceeds, while beneficiaries of a Roth IRA receive qualified amounts income tax free.

With all of the advantages, retirees with earned income should definitely take a look at Roth IRAs. ○○○

IRA for a significant length of time. Since a nonspouse beneficiary must start taking distributions in the year following the original owner's death, he/she should carefully analyze whether it makes sense to convert. The younger the nonspouse beneficiary is, the more benefit he/she receives from the conversion, since distributions are made over the beneficiary's life expectancy. ○○○

## Draw Down Retirement Funds Carefully

Your withdrawal amount can be calculated based on your life expectancy, expected long-term rate of return, expected inflation rate, and how much principal you want remaining at the end of your life. To help ensure you don't run out of retirement assets, consider these strategies:

✓ **Use conservative estimates in your drawdown calculations.** Add a few years to your life expectancy, reduce your expected return a little, and increase your inflation expectations. That will result in a lower withdrawal amount, but it will also help ensure that your funds don't run out. Take a careful look at any answer that indicates you can take out much more than 3% to 5% of your balance each year, which is a reasonable withdrawal amount if you want your funds to last for several decades. That doesn't mean you can't take out more, but you should be very confident of your assumptions before doing so.

✓ **Review your calculations every couple of years.** This is especially important during your early retirement years. If you find you're depleting your assets too rapidly, you may be able to go back to work on at least a part-time basis. If you find out late in life that you're running out of assets, that may not be an option.

✓ **Place three to five years of living expenses in short-term investments.** That way, if there is a severe market downturn, you won't have to touch your stock investments for at least three to five years, giving them time to recover. ○○○

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## Market Data

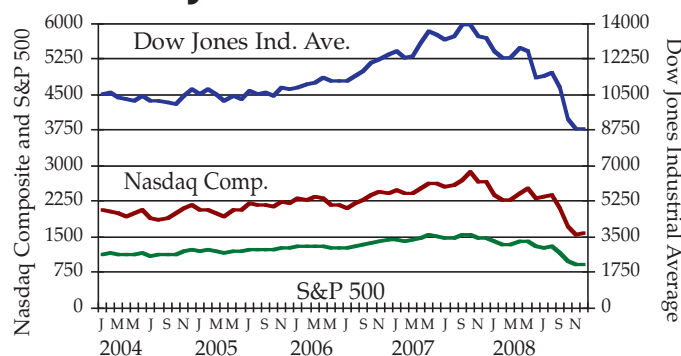


	Month End			% Change	
	Dec 08	Nov 08	Oct 08	2008	2007
Dow Jones Ind.	8776.39	8829.04	9325.01	-33.8%	6.4%
S&P 500	903.25	896.24	968.75	-38.5	3.5
Nasdaq Comp.	1577.03	1535.57	1720.95	-40.5	9.8
Wilshire 5000	9087.17	8945.22	9768.64	-38.7	3.9
Gold	846.75	812.50	730.75	1.6	31.9
				Dec 07	Dec 06
Prime rate	3.25	4.00	4.00	7.25	8.25
Money market rate	1.84	2.33	2.45	4.49	4.68
3-month T-bill rate	0.05	0.15	0.90	3.28	4.88
20-yr. T-bond rate	3.04	4.14	4.46	4.58	4.82
Dow Jones Corp.	7.16	8.12	8.71	5.89	5.71
Bond Buyer Muni	6.02	6.15	6.07	4.88	4.61

Sources: *Barron's*, *Wall Street Journal*

## Stock Indices

### January 2004 to December 2008



Past performance does not guarantee future results.

## Thoughts about Retirement Planning

According to a new survey, approximately one-third of workers age 55 to 64 (32%) said they postponed plans to retire due to stock market losses. Some 30% of those age 65 or older said they have been forced to put off retirement (Source: AARP, 2008).

Working one additional year boosts annual retirement income by an average of 9%. (Source: The Urban Institute, 2008).

A new study revealed that 28% of retirees annually withdraw 10% or more of their retirement savings (average savings: \$375,000), while 38% withdraw 5% or less. Despite higher-than-advised withdrawal rates for a majority of retirees, 91% feel confident their savings will last. (Source: *Journal of Financial Planning*, June 2008).

In 2007, about 82% of all taxpayers were eligible for both types of IRAs, 10% for a Roth IRA only,

3% for a traditional IRA only, and 5% for neither (Source: Tax Policy Center, 2008).

Last year, 18% of workers borrowed from their 401(k) plan compared to 9% in 2005 (Source: Boston College Center for Retirement Research, 2008).

In a recent survey, 28% of employed adults age 45 or older said they planned never to retire (Source: Society of Actuaries, 2008). ○○○