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Finding Hidden Treasures In The New Pension Law

Responding to the severe economic downturn, Congress passed an emergency package of pension law changes late in 2008. The Worker, Retiree and Employer Recovery Act of 2008 (WREERA) temporarily suspended the rule requiring annual distributions from qualified retirement plans and IRAs. But the law also did much more. Dig a little deeper and you'll find additional breaks for individuals and employers, as well as important clarifications of the Pension Protection Act of 2006 (PPA). Consider the following key provisions of the legislation.



One-time break on required minimum distributions (RMDs). This is the part of the law that grabbed most of the headlines. Normally, you're required to begin distributions from IRAs and qualified retirement plans such as 401(k)s or 403(b)s by April 1 of the year following the year you turn age 70½. And the penalty for not taking the full RMD is severe—50% of the required amount you failed to pull out of the account. Normally, the only exception to this requirement applies to participants in employer-sponsored qualified plans who are still working and own less than 5% of the company.

If you have a large account balance, mandatory withdrawals may be substantial, and they may come at an inopportune time. To alleviate the strain on retirees who were affected by the stock market decline of 2008, Congress

waived the distribution requirement for defined contribution plans and IRAs (not defined benefit plans), but only for the 2009 tax year. If you turned age 70½ in 2008, you still had to take that tax year's distribution by April 1, 2009. Yet, while you would ordinarily have to take a second mandatory withdrawal, for the 2009 tax year, by December 31, the new law lets you skip it. And what if you turned age 70½ in 2009? You're not required to take the

RMD for 2009 that normally would have been due April 1, 2010, though you'll still be on the hook for the 2010 distribution, which you must receive by December 31, 2010.

The temporary suspension also applies to beneficiaries who have inherited retirement plan assets. The new law eliminates the required distribution for the 2009 tax year.

Clear rules on nonspouse rollovers. Prior to the PPA, only a surviving spouse was permitted to make a tax-free rollover from an inherited qualified plan to a traditional IRA. Nonspouse beneficiaries, such as a child or grandchild, didn't qualify. But the PPA authorized tax-free rollovers for trustee-to-trustee distributions made after 2006.

Originally, the IRS said employers weren't legally obligated to offer this option to beneficiaries of their qualified plans; then it flip-flopped on the issue. The new law settles the matter,

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The Roth 401(k): It's Not A No Brainer!

Employers are beginning to adapt a relatively new kind of retirement plan: a Roth 401(k). Unlike a normal 401(k) funded with pre-tax dollars, a Roth 401(k) uses after-tax contributions but provides tax-free distributions during retirement.

Although you can put a total of as much as \$16,500 into a 401(k) in 2010 and an additional \$5,500 if you're over age 50, if your company offers both traditional and Roth versions, you'll have to decide whether to contribute to one or both, and how much.

If you're just starting out, the Roth 401(k) could be appealing. Investment earnings compound free of taxes, just as in a traditional plan, and it could be an advantage to pay taxes on the money now, when you may be in a lower tax bracket.

However, because you're taxed on the salary deferral that funds a Roth 401(k), you'll take home decidedly less than if you were putting the money into a traditional 401(k). And your higher reported income could put you above the ceiling for child tax credits and other current tax breaks.

Moreover, your employer may have different rules for matching your contributions to a Roth 401(k), and the investment opportunities may not be the same. If your company offers this new type of retirement plan, we can help you weigh your options and decide how to maximize your benefits.

Sincerely,

Robert J. Pyle, CFP, CFA

Do You Really Need That Inheritance?

Sometimes it pays just to say “no thanks” to a generous bequest—even from your own spouse. There may be estate planning benefits to having the assets go directly to contingent beneficiaries named by the donor. If those beneficiaries are your children, this strategy could help them keep more of the bequest.

Officially declining an inheritance involves executing a legal document known as a “qualified disclaimer.” This refusal, which can apply to all or part of a bequest, must be executed within nine months of the donor’s death and before you’ve received any income from the inheritance. While this is generally a reactive measure, similar results can be obtained setting up a disclaimer trust as part of your estate plan.

One factor in deciding whether to refuse an inheritance is the uncertain future of the federal estate tax. Scheduled to be repealed for 2010, it will be revived in 2011 under unfavorable conditions. The amount of an estate that’s exempt from federal tax, which has gradually increased to \$3.5 million for those who die in 2009, will drop back to \$1 million for 2011, unless Congress enacts new legislation. Also, after gradually being reduced to 45%, the

top estate tax rate will return to 55%. The new administration and Congress will likely adjust the rules or change the timetable, but most experts expect the estate tax to continue to exist in some form. A qualified disclaimer or a disclaimer trust could help you prepare for whatever comes.



Suppose that under your current will, all of your assets are to go to your spouse if you die first, and vice

versa. Then, at the death of the surviving spouse, the remaining assets will be divided among your children. With this arrangement, there’s no estate tax due after the first death—because a spouse can inherit an unlimited amount tax free—and the surviving spouse’s estate can be reduced, for tax purposes, by whatever individual exemption is in effect at the time. But this wastes the first spouse’s exemption. Instead, the surviving spouse could disclaim an amount equal to the estate tax exemption, passing it directly to contingent beneficiaries. The first spouse’s exemption relieves the heirs of any current estate tax liability, and later the surviving spouse’s own exemption can be used.

Before disclaiming any assets, one’s current and future potential need for the disclaimed assets needs to be carefully analyzed by a financial planner, since this is an irrevocable decision. We can work with you and your attorney to consider whether turning down an inheritance might make sense for you, and help you follow the rules that govern the process. Also, if your net worth nears or exceeds federal estate tax exemption limits, we can discuss how setting up a disclaimer trust now can benefit your heirs. ●

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

Many Tax Cuts For Retirees In Recovery Act

There's something for almost everybody in the American Recovery and Reinvestment Act of 2009. The stimulus legislation is brimming with tax breaks for wage-earners, including the highly publicized Making Work Pay Credit and enhanced fringe benefits for employees. Though provisions are largely targeted at low- and middle-income taxpayers—and are phased out for those earning more—some might lighten your tax load this year, even if you're already retired. Consider these new tax provisions:

One-time payments to people living on fixed incomes. The act authorizes a one-time payment of \$250 for certain individuals living on a fixed income. The primary recipients are Social Security beneficiaries, railroad retirees, and disabled veterans. In addition, retired government workers who are not eligible for Social Security benefits may receive the \$250. (If you're entitled to a Making Work Pay Credit—up to \$400 for single filers and \$800 for joint filers—your credit will be reduced by a payout under this provision.)

Relief on capital gains for investors in small businesses. If you invest in qualified small business stock (QSBS), you can normally exclude tax on 50% of the gain from selling shares you have held for at least five years. For the purposes of this tax break, a small business is one that

has gross assets not exceeding \$50 million. Under the recovery act, the tax exclusion is increased to 75% for QSBS acquired after February 17, 2009 and before January 1, 2011.

Credit for new homeowners. As long as you haven't owned a home during the past three years, you're eligible to claim a tax credit for "first-time homebuyers." The recovery act raises the maximum credit to \$8,000 (up from \$7,500 in 2008) for a principal residence purchased after December 31, 2008 and before December 1, 2009. Also, unlike the rules in effect for 2008 home purchases, the new provision doesn't require you to repay the credit to the IRS as long as you live in the home for at least three years. But the credit phases out for certain high-income tax filers. Update: The credit has since been extended to May 1, 2010, with certain modifications, including higher phase-out levels and availability to a wider group of homebuyers.



Car buyer tax break. The recovery act creates a brand-new tax break for car purchases. It allows you to deduct sales and excise taxes attributable to the first \$49,500 of the price of a new vehicle bought after February 17, 2009 and before January 1, 2010. This deduction applies to any vehicle weighing up to 8,500 pounds, including cars, SUVs, and light trucks.

Motor homes may also qualify. But the deduction is phased out for single filers with an AGI of \$125,000 and joint filers making \$250,000, and you can't claim the new deduction if you elect to deduct state and local sales taxes instead of state income tax in 2009.

Alternative minimum tax relief. In each of the past several years, Congress has enacted last-minute legislation sparing thousands of taxpayers from the AMT. This time, it acted early, building relief into the recovery act. The legislation lets individuals continue to use personal credits as AMT offsets in 2009 while bumping up AMT exemption amounts once again—to \$46,700 for single filers (up from \$46,200 in 2008) and \$70,950 for joint filers (compared with \$69,950 in 2008).

Energy efficiency credit. The stimulus bill boosts the residential energy credit to 30% of the cost of qualified expenses (up from 10%) and increases the maximum dollar amount to \$1,500. This credit covers insulation materials; exterior windows (including skylights); exterior doors; central air conditioners; natural gas, propane, and oil-fired water heaters or furnaces; hot water boilers; electric heat pump water heaters; certain metal roofs; stoves; and advanced air-circulating fans. These provisions are in effect for installations made during 2009 and 2010.

Tax reduction on unemployment benefits. Finally, if your retirement has been hastened by a layoff or downsizing, the recovery act exempts from federal income tax the first \$2,400 of unemployment benefits received in 2009. For a retiree in the 25% tax bracket, this amounts to a tax cut of up to \$600.

Beyond these tax breaks, you might be able to benefit from bigger education credits for paying college tuition for your grandchildren, reduced tax liability for some S corporation shareholders and other potential advantages. We can work with you and your tax advisor to gauge the law's impact on your financial situation. ●

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. ●

Estate Planning For A Non-Citizen Spouse

With estate laws in flux, planning is especially difficult right now. But it is even more complex if you or your spouse isn't a U.S. citizen. Special measures may be needed to avoid a large estate tax bill.

Under the rules of the landmark 2001 tax cut, the top tax rate on inheritances has been gradually reduced from 55% to 45%, while the maximum amount that can be passed along exempt from estate taxes has risen, to \$3.5 million in 2009. The estate tax is scheduled to expire in 2010 but will be revived in 2011, with a top rate of 55% and an exemption of \$1 million.

Although Congress is expected to take action on a permanent fix for estate rules, no one knows exactly what will happen. The only thing that's reasonably certain is that there will continue to be an unlimited marital deduction. That has been a constant of estate law—that a spouse may inherit unlimited wealth without any estate tax liability.

But that rule doesn't apply if your spouse is not a U.S. citizen. Even

permanent U.S. residents don't qualify for the unlimited marital deduction; instead, they may owe estate tax on inherited assets that exceed the normal exemption for bequests to non-spouses. There are, however, a couple of ways for non-citizens to sidestep problems.

Reduce a taxable estate through lifetime gifts to a spouse. If the citizen spouse has substantially more wealth than the non-citizen, a series of gifts could shift the balance. Tax rules allow tax-free gifts to a non-citizen spouse of up to \$133,000 in 2009. (The amount is indexed for inflation.) This is a strategy you'll need to establish early, and it may work best as a complement to the second approach.

Establish a qualified domestic trust (QDOT). This trust lets a non-citizen spouse take advantage of the deceased spouse's assets without paying estate tax. All trust income must be paid to the surviving spouse, and no estate tax is owed until the second

spouse dies and the remaining trust principal is distributed to heirs (usually the couple's children). To qualify for these advantages, the QDOT must meet these requirements.

- At least one trustee must be a U.S. citizen or a domestic corporation.
- The trust must be established no later than nine months after the first spouse's death.
- The executor must make an election for the QDOT on the deceased spouse's estate tax return.
- If QDOT assets exceed

\$2 million, the U.S. trustee must be a bank, or an individual trustee must furnish a bond or letter of credit equal to 65% of the value of trust assets.

If you or your spouse isn't a citizen, timely estate planning could be crucial. We can work with you and your attorney to make sure your estate plan takes that special circumstance into account and helps you avoid unnecessary taxes. ●



The New Pension Law

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establishing that for plan years after 2009, the rollover option for trustee-to-trustee transfers is mandatory.

Single-employer pension funding relief. One PPA goal was to shore up defined-benefit pension plans, requiring employer-sponsored plans to move quickly toward 100% funding of their obligations. Now, though, many companies in dire financial straits may have trouble meeting government targets, which called for 94% funding in 2009. Under the PPA, failure to meet the target triggers the so-called cliff rule, which calculates the plan's shortfall by comparing funding to 100% rather than to the target percentage. So a plan that was 93%

funded in 2009 would have a 7% deficit, not 1%. WRERA eliminates the cliff rule and gives plans that miss the target seven years to catch up. That helps employers whose obligations have soared as the value of pension fund investments has spiraled downward.

Extra time for multi-employer plans. The PPA created specific funding rules for multi-employer plans classified as "endangered" or "critical." The new law eases some of those requirements. For example, a plan that has suffered losses may be able to freeze the prior year's funding

certification status. And whereas plans had 10 years to improve funding under the PPA, now some will have 13 years—and plans considered "seriously

endangered" will get 18 years, not 15.

Finally, WRERA includes numerous corrections to the PPA and technical changes related to at-risk plans, hybrid plans, automatic enrollment plans,

and other pension-related provisions of the tax code. We can work with you and your benefits professionals to sort through the changes and help you or your business navigate this difficult economic environment. ●

