

## INSIGHTS FROM THE BRIDGE

### Are Credit Cards Offering IRA Points A Good Deal?

It's never a good idea to carry large balances on credit card accounts.

But plastic is undeniably convenient, and chances are you charge plenty of purchases every month. In the process, you probably rack up airline miles or rewards points that you can use to reduce the cost of a wide range of future purchases. Now, financial institutions have come up with a new twist, translating credit-card points into retirement plan contributions. Fidelity Investments recently led the way, and Charles Schwab sponsors a card that lets you deposit cash rewards into a regular brokerage account, from which you could move the money to your IRA. And while Fidelity and Schwab require you to put rewards cash into accounts at those brokerages, an independent rewards program, NestEggz, lets you direct money into any account at any bank or brokerage.

The new Fidelity retirement card, issued by American Express, awards two points for every dollar you spend on qualified purchases. Once you've accumulated a minimum of 5,000 points—in other words, you've purchased goods and services costing \$2,500—a \$50 contribution for the current tax year is swept into a retirement account you've designated. So your retirement account gets 2% of purchases you charge to the card. You can connect your credit card to a Fidelity traditional IRA, Roth IRA, or SEP-IRA. Fidelity also has an affinity card for rewards accrual in a

Section 529 college savings plan, as do many other providers including Upromise Inc.

Of course, the maximum contribution limits for these retirement accounts still apply. For the 2010 tax year, you can contribute up to \$5,000 (\$6,000 if you're age 50 or over) to a traditional IRA or a Roth IRA, or a combination of the two. With a SEP-IRA, you can make deductible contributions for the 2010 tax year of up to the 25% of compensation (or 20% of net earned income if you're self-employed) or \$49,000, whichever is less.

If you've already maxed out contributions to your IRA or SEP-IRA account, you can apply credit card points you earn to a different Fidelity account or redeem them for travel expenses, merchandise, or another reward. Or you could choose to roll over the points to be used for the same retirement account the following year.

There's no annual fee on the Fidelity retirement rewards card, so if you pay your account in full each month, this could be a painless way to give a small boost to retirement savings. But if you tend to run a balance on credit card accounts, that 2% reward on purchases will quickly be swallowed up by steep interest rate charges. Though there's a 1.99% introductory rate, that's replaced after six months by a 19.99% rate on purchases and 24.99% on cash

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### Look North For Solutions

Although the market has risen, we all know a serious government debt problem exists. In two short years, federal and state deficits have moved from being defined as "high" to becoming unsustainable. Some believe our neighbors to the north provide an example to follow.

For years, the Canadian government moved further to the left through higher spending, bigger government, and expanding entitlements. By 1993, it was in a fiscal mess and its economy was sinking under the weight of government debt. Canada had to act and it did. Over two years, it cut government spending by 9%, reduced government employment by 14%, and reduced outlays to the provinces.

There were some tax hikes, but spending cuts were more than four times greater than the hikes. The actions worked. Hopefully, some in Washington are aware we can learn from the good folks to the north who talk funny, have short summers, and use a coin called the Looney.

Our December jobs report reflected another 10,000 federal employees were hired. It is not good to continue this course. We are hearing more rhetoric from the politicians about the deficit concerns, but as we all know, actions speak louder than words.

We appreciate your business.

*Rich Locke*  
Lead Portfolio Manager

# 401(k) Alternatives For Business Owners

If you have fewer than 25 employees in your small business, a 401(k) plan may not be right for you. But if your business offers no retirement plan at all, you could lose out in attracting the most qualified job candidates. One or more of these alternatives might be a better fit for your situation.

**Simplified Employee Pension (SEP IRA).** A SEP IRA is low cost and low maintenance.

- The employer makes all of the contributions; employees can't add to their accounts.
- The plan must cover all eligible employees.
- There is no "plan document."
- You don't have to file annual reports with the IRS.
- Contributions are tax deductible.
- Contributions can vary from year to year. So if you hit a lean spell, you aren't locked in.

**Savings Incentive Match Plan for Employees (SIMPLE IRA).** For a business with fewer than 10 employees, the SIMPLE IRA is a great starter plan.

- Your contribution is required; employees have the option of contributing.
- But you can't sock away as much for yourself as you can with a SEP IRA, which for 2010 allows a maximum contribution

of \$49,000. SIMPLE IRA contributions are normally capped at \$11,500 (\$14,000 for those 50 or older at year's end) plus an employer matching contribution that can't exceed 3% of salary.

- Don't confuse the SIMPLE IRA with the SIMPLE 401(k), which is like a traditional 401(k) plan but with higher fees and less flexibility.

**Profit-Sharing Plan.** This gives each employee a slice of the company's earnings.

- An overall annual contribution, based on the company's performance, is apportioned to individual accounts according to each employee's salary.
- Contributions are discretionary and tend to vary from year to year.
- A business of any size may use a profit sharing plan and can combine it with other retirement plans.
- Businesses with profit-sharing plans must file IRS Form 5500 each year.



- Administrative costs may be higher than under more basic plans, because this plan must perform a non-discrimination test to ensure it doesn't favor highly compensated employees.

**Defined-Benefit Plan.**

This is the most costly, complex plan for small businesses, but it has one big potential advantage—it lets you make very large contributions that can quickly build your nest egg.

You're now allowed to fund a maximum annual retirement benefit of \$195,000.

- Your contributions are mandatory.
- You can't decrease benefits retroactively.
- Defined-benefit plans are available to businesses of any size and can be combined with other retirement plans.
- Requires filing an IRS Form 5500 with a Schedule B each year.

The Schedule B must be signed by an enrolled actuary, who will calculate contribution amounts based on your employees' ages and the target benefit. ●

## Retiree Relocation: Tax-Friendly States

Are you thinking about pulling up stakes when you retire?

You may want to move to a state with warm temperatures and lots of sunshine, but there's also another kind of climate to consider—the tax climate. State taxes as well as federal levies can take a big bite out of retirement income, and some states devour decidedly more than others do. Here are several factors to take into account.

**State income taxes.** Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—have no state income tax, and New Hampshire and Tennessee

tax only investment dividend income that exceeds specified limits.

However, many other states and the District of Columbia provide tax breaks for retirees, so you shouldn't automatically assume a no-tax state will be the best choice.

**Retirement income.** Most states that normally tax income provide partial exemptions for pensions. Even better, 10 states fully exempt income received from federal, state, or military pensions. And in Pennsylvania and Mississippi, all retirement income, including distributions from 401(k)s and IRAs, is state tax-free. Some other states

impose high income tax rates on retirement income, however, with California leading the way at 9.55% on income of less than \$1 million.

**Social Security benefits.** Up to 85% of the Social Security benefits you receive may be subject to federal income tax. However, the seven no-tax states, 27 others, and Washington, D.C. don't tax Social Security, though other special rules may apply. For instance, in Colorado, New Mexico, and Utah, you must add back a portion of Social Security benefits not taxed on a federal level when determining your eligibility for certain state income tax breaks.

# Five Second-Marriage Financial Snags

“Blended” families, once unusual, have become increasingly common. They’re typically the result of a divorce, after which one or both ex-spouses remarries, frequently to a husband or wife who also has children from a previous marriage. There are about one million divorces in the United States each year, and it’s estimated that almost half of all families today are of the blended variety.

Unfortunately, not every “Brady Bunch” lives in bliss and harmony, and discord is particularly likely after your death. Consider these five areas in which your blended family might face avoidable financial snags.

**1. Beneficiary designations.** Writing a former spouse out of your will may be at the top of your post-divorce to-do list, but it’s also crucial to remember all of the other places you designated your once beloved as primary beneficiary. That may include life insurance policies, retirement accounts, trusts, and annuities. And you likely shouldn’t just write in the name of your new spouse. Deciding how and whether your new spouse and your own children share in your estate may involve complicated planning and could mean establishing one or more trusts—and you’ll need to coordinate all beneficiary designations with the provisions of your revised estate plan.

**2. Tax-free gifts.** A relatively simple

way to look after the needs of children from a first marriage is through a series of tax-free gifts. You may currently give \$13,000 annual gifts to as many recipients as you choose without incurring gift tax liability. So, if you’re relatively young, you might use this provision to begin transferring assets to your children (and possibly your grandchildren), presuming you can afford to gift that much. Over a decade or two, you could help your offspring build substantial savings. But your early death would undercut this strategy, and it’s important to consider who’s getting the money. For example, making yearly gifts to both a child and the child’s spouse would enable you to give more but might put money in the hands of a son- or daughter-in-law who later divorces your child.

**3. Estate executors.** In simple estate planning situations, it often makes sense to choose a spouse or other trusted family member as estate executor. Particularly if that person stands to inherit a substantial part of your assets, he or she is likely to be conscientious about following the provisions of wills and trusts and making sure your wishes are carried out. But that approach isn’t likely to work in a blended family. A new spouse or one of your children will have different interests and may not be able to agree with other family members. Unless you want a judge to sort out the mess, it’s generally better

to appoint an independent third party. Moreover, a professional acting as executor may provide other valuable benefits to the estate.

**4. Power of attorney.** A power of attorney is a valuable estate planning tool, but your intentions may be thwarted if the wrong person gets this responsibility or it isn’t handled properly. This legal document establishes the right for another person to act on your behalf, and that person could use it to transfer assets to a trust, for example, or to make annual tax-free gifts—basically, to take over any tasks you may be unwilling or unable to handle yourself. This authority can be either broad or specific—for example, it could be limited to selling securities or other possessions. Here, too, it often makes sense to give this power to a family member, but in a blended family that could lead to conflicts. Appointing someone from outside the family may be preferable, and it generally makes sense to have a durable rather than a general power of attorney.

**5. Trusts.** Various trusts can help sort out assets and interests for blended families. But even some trusts frequently used in such situations could cause problems. For example, a “qualified terminable interest property” (Q-TIP) trust can divide your assets between a surviving second spouse and the children from your first marriage. Typically, the spouse gets to use the trust income, while the children, as trust beneficiaries, receive the trust assets after the spouse dies. But this arrangement may spark disputes between the spouse and the children regarding management of trust assets, with the spouse possibly emphasizing current income while the children preferring asset appreciation. One solution is to give an independent trustee the ability to make adjustments so that everyone is treated fairly.

The bottom line is that the special dynamics of blended families make careful estate planning imperative. We can work with you and your attorney to create planning strategies and vehicles that serve the needs of you and your family. ●

**Sales tax.** These levies are often overlooked when retirees contemplate a move. On the plus side, five states—Alaska, Delaware, Montana, New Hampshire, and Oregon—currently have no sales tax, and other states may exempt food, medicine, and other necessities. But California has an 8.25% rate, and many cities and counties pile on additional sales tax charges. In Chicago and Los Angeles, you’ll pay a combined rate of 9.75%—the nation’s highest. And things could get worse. In 2009, 649 U.S. cities imposed new sales taxes or increased existing rates, while only 192 reduced sales tax rates

(Source: Vertex Inc.).

**Property taxes.** The property tax burden varies widely throughout the country and even within states. The five states with the lowest median property taxes are Louisiana, Alabama, West Virginia, Mississippi, and Arkansas, while New Jersey, New Hampshire, Connecticut, New York, and Rhode Island have the highest.

Of course, tax rates aren’t likely to be your only reason for choosing a particular retirement location. But it can’t hurt to factor in these very real costs when planning your move. ●



# Veil Lifted From Municipal Bond Market

**M**unicipal bonds have long been prized for their tax-exempt status and because they aren't as likely to default as are corporate bonds. However, the default rate has skyrocketed amid the global economic crisis, increasing the need for transparency in this specialized market.

Regulators have responded with three new measures designed to help investors navigate the complex world of municipal bonds, which are debt instruments issued by cities, counties, and local agencies such as school districts, publicly owned airports, and development agencies. Munis pay for projects such as hospitals, schools, public buildings, roads, and utilities. Bonds that fund programs for the public good are usually exempt from most taxes, including federal. While mutual funds, banks, hedge funds, and corporations all invest in the \$2.7 trillion municipal bond market, 64% of muni investors are individuals.

In 2008, 140 issuers defaulted on \$7.6 billion in muni bonds as states and cities across the nation faced massive budget deficits. That compared with just \$226 million in defaults during

2007. This trend, which is likely to continue, makes munis a bigger risk, and means investors need timely information more than ever. Here are three ways the federal government is bringing more transparency to the muni market.

**Putting it all online.** Over the summer, a new website called Electronic Municipal Market Access (EMMA, at <http://emma.msrb.org>) began offering free information, from financial filings to trading records, on most of the 1.2 million outstanding municipal bonds. Operated by the Municipal Securities Rulemaking Board (MSRB), the site allows investors to research municipal bond issues and keep track of new filings. In the past, investors often were not aware if an issuer had failed to file statements or had taken some action affecting a bond or its rating. The site also offers educational materials.

**Into the open, and quickly.** The Securities and Exchange Commission has proposed a new rule that would

force issuers to disclose on EMMA any change in their financial status within 10 days. That would include changes in an issuer's credit rating, withdrawals from reserve funds, and late payments of principal or interest. In the past, investors have complained about delays in receiving this information and issuers' failure to file required disclosures.

## Turning up the heat.

The Financial Industry Regulatory Authority (FINRA) is looking into the sales practices of brokerage firms that sell municipal securities and has asked for detailed information on business conducted during 2009.

All of these actions should make for a more transparent municipal bond market. If you have questions about municipal bond investing or your muni holdings, please give us a call. ●



## IRA Points A Good Deal?

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advances—and 28.99% if you're late with a payment or exceed your credit limit. Those rates are much higher than the national credit card average.

Another downside to the Fidelity card is that you can deposit your rewards only to Fidelity accounts. And though you could open an IRA at the brokerage just to hold your rewards contributions, it's generally best to have as few IRAs as possible, for ease of managing the accounts and maintaining desired asset allocations.

Although it has the highest profile, the Fidelity retirement rewards card isn't the only new "savings" card in the marketplace. The NestEggz Loyalty Rewards

Credit Card, issued by MXT and sponsored by Vesdia Corp. in Atlanta, applies at least 1% of purchases charged to the card to a designated retirement or savings account at any financial institution. Buy at a cooperating retailer and you may get more. Purchases at Target.com, for example, earn a 3% reward. At Restoration Hardware, there's a 2% rebate, and 5% at Eddie Bauer. There's no annual fee for the NestEggz card, and interest on unpaid balances accrues at a flat 14% annual rate.

Charles Schwab offers a Visa card

that provides 2% back on purchases, with the refund automatically deposited into a Schwab One brokerage account each month.

Are the new credit cards worth a look? If you know you'll pay off your balance every month, they could provide a little "free money" for your retirement accounts. But keep in mind that even a month or two of paying interest on a large balance will negate anything you might gain with these

rewards programs. Also, be sure to compare other potential charges including custodial fees, transaction fees, and termination fees. ●

