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SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

August 2007

MARKET SNAPSHOT

The economy and market are still flashing yellow.

Business Cycle Conditions are poor, but stable. The Leading Economic Indicators still point to, and are telling us that a contraction of general business activity is occurring, and a recession possible.

1) Notwithstanding the roller coaster ride we've been on for about a month now (better get used to it), the stock market continues to look bullish. Bond yields are back below 5% and earnings for the S&P500, according to Thomson Financial, are on track to rise about 9% (up from the expected 4%).

2) The meltdown in the housing market, and in particular the sub-prime mortgage market remain a serious concern. We're seeing significant spillover into most major financial institutions. We've haven't seen the bottom of this yet!

3) The smart money in the market is still betting on more upside ahead for the immediate future.

4) The top 10 Market Watch services are bullish. Beware however. Things can change quickly.

To avoid nasty market surprises, make sure you are Asset Allocated and have stop loss triggers so you know what your investments are doing.

When is a Rollover Not a Rollover?

The IRS will let you take money from an IRA, hold onto the funds for 60 days, and put it into another IRA without paying any tax or penalty on the transaction. If you don't complete the rollover within the 60-day window, the withdrawal becomes a taxable event. Plus if you haven't reached age 59½, you could face a 10% penalty.[1] Fairly simple rule to follow, right? Well, not exactly, since there are a few lesser-known details that if ignored, could cost some IRA owners or beneficiaries a lot of money.

Investors have been known to run afoul of the "same property" rule, which is within the IRS rollover regulations.[2] This law states that a rollover from one IRA or qualified retirement plan to another IRA can only consist of the same property. For instance, you cannot take a cash payment from a 401(k), buy stocks, and then roll the stocks over to your IRA.

If you did that, the IRS would consider the cash distribution from the 401(k) income subject to taxes at the current ordinary income rate. Plus you might have to pay any applicable penalties. Instead, for the above example, you would have to deposit cash in the IRA in order for the transaction to be classified as a tax-free rollover.

Another potential problem can surface for IRA beneficiaries.

Only spouses can roll over an inherited IRA into their own IRA. But they are not under any obligation to do so.[3] It can be done anytime, which allows flexibility for a survivor.

The surviving spouse can move the funds in two ways: (1) withdraw the deceased's IRA and deposit in her IRA within 60 days or (2) directly move the funds via a trustee-to-trustee transfer.

Non-spouse beneficiaries, including trusts, cannot

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1 http://www.irs.gov/pub/irs-pdf/p590.pdf, page 21.

2 http://www.irs.gov/pub/irs-pdf/p590.pdf, page 22.

3 http://www.irs.gov/pub/irs-pdf/p590.pdf, page 17.

do IRA rollovers.[3] Therefore; they can't use the 60-day rollover rule. And this is where they can get into trouble.

For example, suppose that your son is your IRA beneficiary. After your death, he decides to roll over the money to his own IRA. So he receives a check from the IRA trustee with the intention of depositing it in his IRA within 60 days. Shortly after getting the money, he receives a Form 1099-R from the IRA trustee notifying him of a taxable distribution. He tries to get the transaction reversed but cannot and is now forced to use 35% of his inheritance to pay the income taxes because of the error. I always recommend investors consult with their own qualified tax and financial advisors prior to making any investment decisions.

For help in transferring or rolling over money from your retirement plan or IRA, check off and send in the enclosed coupon.

Which Source of Funds Comes First – Taxable or Qualified?

When it comes time to tap your savings and investment accounts, clients often wonder which source should come first. In general, many experts advise investors to draw from their taxable accounts first, then tap qualified accounts such as IRAs and 401(k)s further down the road. There is a logical reason for this--prolonging withdrawals from your qualified accounts gives these assets additional time to grow with the benefit of tax-deferral. There are other reasons why this strategy could be efficient from a federal income tax perspective.

Let's say that you have three sources of investment funds, a regular taxable account (which could hold individual stocks, bonds, or mutual funds) and two qualified accounts: a traditional IRA and a Roth IRA. What happens if you tap your traditional IRA? First, all withdrawals from a traditional IRA are taxed at your current income tax rate. Second, a 10% federal income tax penalty will usually apply to traditional IRA withdrawals taken prior to age 59½ (subject to a few limited exceptions explained in IRS Publication 590. Exceptions include but are not limited to: withdrawals for qualified higher education expenses, first-time home buyers, medical insurance premiums for certain unemployed taxpayers, and withdrawals taken by disabled taxpayers).

What about taking money from a Roth IRA? If you are less than 59½ years of age, or you do not hold the Roth for more than five years, the distribution could also be subject to the 10% federal income tax penalty. By leaving the money in the traditional and Roth IRAs, you have the opportunity to accumulate tax-deferred investment growth over the life of both the owner and the beneficiaries. Assuming the age and holding period requirements are met, all Roth distributions also come out free of future federal income taxes to the account owner, as well as the beneficiaries.

What if you tap your taxable account first? You will owe taxes on any capital gains you realize from the sale of investments in this portfolio. Assuming you have held the asset for more than one year, your rate will be lower than your current income tax rate (5% for taxpayers in 10-15% brackets; 15% for all tax brackets exceeding 15%). You might also be able to soften the blow of your annual tax bill. As you gradually tap your taxable account, the distributions you receive from these investments will slowly recede, thus lowering your tax burden from dividends and capital gains paid to you. Moreover, your qualified accounts could potentially have longer time to grow with the power of tax-deferral, which could enhance the value of your qualified retirement funds.

Eventually, you will have to take minimum distributions from your traditional IRA once you reach age 70½. Although these distributions will be taxed at your ordinary income tax rate, you could be in a lower tax bracket by then. As previously mentioned, these distributions are taken, in many cases, over the life expectancies of the owner and the beneficiaries. On the other hand, traditional IRAs do not receive a step-up in income-tax basis when they are transferred to younger beneficiaries at the owner's death. Although there is something to be said about the power of deferring taxes, one should also consider future income tax consequences to younger family members before making a decision.

Assuming you have assets in Roth IRAs, you should know that minimum distributions are not required. In view of this and the fact that withdrawals will come out free of federal income taxes (assuming the age and holding period rules are met), you may want to consider your Roth assets as your source of last resort.

Deciding which account to tap first depends on your financial and tax situation now and during your retirement years. **If you would like to review some withdrawal strategies for your various investment accounts, please complete the enclosed reply coupon.**