

# Asset Strategies Advisor

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## Changing Jobs? Take Your 401(k) and ... Roll It!

If you've lost your job, or are changing jobs, you may be wondering what to do with your 401(k) plan account. It's important to understand your options.

### What will I be entitled to?

If you leave your job (voluntarily or involuntarily), you'll be entitled to a distribution of your



vested balance. Your vested balance always includes your own contributions (pretax, after-tax, and Roth), and any investment earnings on those amounts. It also includes employer contributions and earnings that have satisfied your plan's vesting schedule. In general, you

must be 100% vested in employer contributions after 3 years of service ("cliff vesting"), or you must gradually vest 20% per year until you're fully vested after 6 years ("graded vesting"). Some plans have 100% immediate vesting. You'll also be 100% vested if you've reached your plan's normal retirement age.

Special vesting rules apply to certain plans, so make sure you understand how your particular plan's vesting schedule works. This is important, because you'll forfeit any employer contributions that haven't vested by the time you leave your job. If you're on the cusp of vesting, it may make sense to wait a bit before leaving, if you have that option.

### Don't spend it, roll it!

While this pool of dollars may look attractive, don't spend it unless you absolutely need to. If you take a full distribution you'll be taxed, at ordinary income tax rates, on the entire value of your account except for any after-tax or Roth 401(k) contributions you've made. And, if you're not yet age 55, an additional 10% penalty may also apply to the taxable portion of your payout. (Because of the 5-year holding period requirement, there won't be any tax-

free qualified distributions from Roth 401(k) accounts until 2011 at the earliest. And special rules may apply if you receive a lump-sum distribution and you were born before 1936, or if the lump sum includes employer stock.)

If your vested balance is more than \$5,000, you can leave your money in your employer's plan until you reach normal retirement age. In many cases, however, your best bet will be to roll the funds over to an IRA. Your investment alternatives will be almost limitless, and you'll have better control over when and how to take distributions from your account.

Your employer must allow you to make a direct rollover to an IRA. As the name suggests, in a direct rollover the money passes directly from your 401(k) plan account to your IRA. This is preferable to a "60-day rollover"--where you get the funds and then roll them over to an IRA yourself--because your employer has to withhold 20% of the taxable portion of a 60-day rollover. You can still roll over the entire amount of your distribution, but you'll need to come up with the 20% that's been withheld from other funds until you recapture that amount when you file your income tax return.

If you really do need to use some of the money, and you have nontaxable after-tax or Roth contributions in your account, keep in mind that you may be able to roll over the taxable portion of your distribution to an IRA, and take a distribution of just the nontaxable portion of your account.

### What if I have an outstanding plan loan?

In general, if you have an outstanding plan loan, you'll need to pay it back, or the outstanding balance will be taxed as if it had been distributed to you in cash. If you can't pay the loan back before you leave, you'll still have 60 days to roll over the amount that's been treated as a distribution to your IRA. Of course, you'll need to come up with the dollars from other sources.

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## Refinancing Your Mortgage: Is It Worthwhile?

**The Home Affordable Refinance program allows the refinancing of certain Fannie Mae or Freddie Mac mortgages so long as the new mortgage doesn't exceed 105% of your home's current market value. Additionally, if your existing mortgage payment doesn't include private mortgage insurance (PMI), you won't be required to buy it when refinancing.**



### Other considerations:

- The interest you pay on a no-cash-out mortgage refinancing is tax deductible only to the extent as was the interest on your original mortgage.
- Refinancing may allow you to switch to a different type of mortgage (e.g., from an ARM to a fixed-rate mortgage) and/or a shorter mortgage term.

Mortgage rates on 15- and 30-year fixed mortgages are at all-time lows. So, is now a good time to refinance your existing mortgage? That depends on several factors.

The first, of course, will be your loan-to-value ratio. In no-cash-out refinancing (where the amount of your new loan doesn't exceed the balance of your existing loan, plus points and closing costs, if applicable), you may be able to borrow as much as 95% of your home's value. However, if the value of your home has fallen below the amount of your existing mortgage balance, you may be unable to refinance at all, except through the American Recovery and Reinvestment Act of 2009's Home Affordable Refinance program (see sidebar). But let's assume your loan-to-value ratio is still "above water"—that is, the value of your home is still greater than your mortgage balance.

If you refinance your mortgage to a lower interest rate, you may save a substantial amount on your monthly mortgage payment—which will give you more money to put toward your savings goals or reducing your other expenses. This is one of the main reasons people consider refinancing their mortgages. But what other factors do you need to consider?

### How much will it cost?

The cost of refinancing can include both points you pay and other expenses (called "closing costs") related to refinancing.

One point equals 1% of the amount to be financed. So, if the refinancing costs will include an up-front charge of 0.5 points and you're refinancing \$200,000, you will incur a charge of \$1,000 (special tax treatment applies to points).

Closing costs typically include an application fee, attorney's fee, appraisal fee, credit report fee, loan origination fee (which can be 1% or more of the amount you refinance), title search fee, and title insurance. These costs can vary from state to state. Get a "good faith estimate" from each potential lender and compare both closing costs and interest rates.

Be careful about lenders that advertise "no points, no closing costs" refinancing deals. Often these plans simply roll the closing costs into the amount to be refinanced, or come at a higher interest rate.

### How long will it take to recoup the costs?

To determine your break-even point (the point at which you'll begin to save money after

paying fees and closing costs), divide the amount of your monthly mortgage payment savings due to refinancing into the cost of refinancing; the result is your break-even point, expressed in months.

**Example:** *If you're saving \$100 per month on your refinanced monthly mortgage payment, and your refinancing costs totaled \$3,700, your break-even point is in 37 months.*

It makes sense to refinance if you're certain that you'll be able to recoup your refinancing costs while you're still living in your home. Ideally, you should recover your costs in one year or less.

### A matter of term

In many cases, refinancing may mean taking out a mortgage with a new term equal to the *original* term of your refinanced mortgage, not equal to the *remainder* of the term on that mortgage. Depending on when you refinance, this can make a significant difference in the amount of interest you'll pay overall.

**Example:** *You have a \$200,000 30-year fixed mortgage at 6%, with a monthly payment of \$1,199. After 6 years, you have paid \$69,131 in interest on that mortgage. At that point, you refinance your remaining principal balance of \$182,796 for a new 30-year fixed mortgage at 5% with a monthly payment of \$981. Over the life of that new mortgage, you will pay \$170,468 in interest. So, your total interest payment will be \$239,599 (\$69,131 + \$170,468). If you had stayed with your old mortgage at 6%, you would have paid a total of \$231,676 in interest. Instead, by refinancing when you did, you'll pay an extra \$7,923 (\$239,599 - \$231,676) in total mortgage interest.*

Because of this, you may want to consider applying the monthly mortgage payment savings after refinancing toward additional principal payments. By doing so, you can reduce both the term of your mortgage and the total interest you'll pay.

### Crunch the numbers first

In many cases, refinancing looks attractive in the short term because your monthly mortgage payment will be lower—and that can be important to your monthly budget. But will it really save you money to refinance, both in the short run and in the long run? That depends on many factors. Look at them all before you make your decision.

## Estate Planning Opportunities in a Down Market

A down market can mean tough times, but it can also present unique opportunities to minimize property transfer (gift and estate) taxes. While owning assets that are losing value might seem like a bad thing, it may actually be a great time to reduce your taxable estate by gifting those assets to beneficiaries. That's because current low asset values and interest rates enable you to make gifts at a lower gift tax cost. And, if and when the market rebounds, those assets will be growing in your beneficiary's estate and not in yours. Here are a few gift-giving techniques that take advantage of today's economic climate.

**Note:** *This article discusses federal tax rules only. Individual states impose their own property transfer taxes using rules that may be different from the federal rules.*

### Basic gifting

Each year, you can make gifts of up to \$13,000 to anyone you want, to as many people as you want, tax free under the annual gift tax exclusion. You can give away twice that amount if both you and your spouse make the gifts together (this is called gift splitting). And, you can give away an unlimited amount if you pay tuition or medical bills on behalf of another person (just be sure to make these payments directly to the school or health-care provider).

### Family loans

You can lend money to your children at the current IRS minimum interest rate (known as the AFR, which changes monthly), and then potentially forgive an amount equal to the gift tax exclusion each year. (The gift tax exclusion amount is adjusted for inflation; \$13,000 is the figure for 2009.)

### Grantor retained annuity trust (GRAT)

A GRAT is an irrevocable trust with a specified term (e.g., 10 years) into which you gift assets that you expect will greatly increase in value in the future. You receive annuity payments during the trust term, and at the end, your beneficiaries receive any remaining property.

The transfer of assets to the GRAT is a taxable gift to the trust beneficiaries. The value of the gift for tax purposes is determined based on the current IRS rate (known as the 7520 rate, which also changes monthly).

Tax savings are achieved because the

annuity payments are calculated to result in a gift tax value of zero. It's anticipated, however, that the actual interest earned will be higher than the 7520 rate, leaving a substantial value in the GRAT at the end of the term. This remaining value is passed on to your beneficiaries tax free.

### Intentionally defective grantor trust (IDGT)

An IDGT is an irrevocable trust that has a purposeful flaw (i.e., you retain some control over the trust) so that you, and not the trust entity, pays the income [taxes](#) on trust income (thus, an IDGT is ideal when you want to transfer income-producing assets). Even though you retain some control over the trust, IDGT assets will generally not be included in your taxable estate at your death.

You sell assets to the IDGT in return for an installment note, with interest calculated based on the current AFR. There is no gift tax because it is a "sale" (except for an initial gift that "seeds" the trust). However, because you and the trust entity are considered the same taxpayer, no gain is recognized on the sale, and interest you receive under the note is not considered taxable income.

Tax savings are achieved because, hopefully, the value leaving your estate via the sale will exceed the value returned to your estate via the note. You also reduce your estate by paying the income taxes on IDGT income.

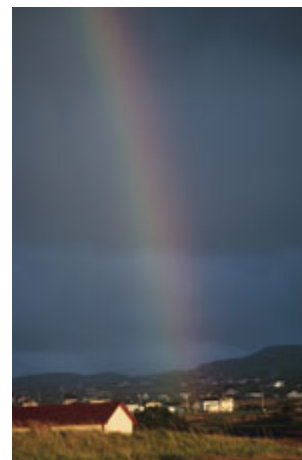
### Charitable lead trust (CLT)

A CLT is an irrevocable trust with both charitable and noncharitable beneficiaries. It's called a lead trust because it is the charity that is entitled to the first or lead interest from the trust property. After the specified term, the remaining trust property passes to you or another named noncharitable beneficiary.

At the time assets are placed into the CLT, you receive a current gift tax deduction equal to the present value of the income stream that will be going to the charity. The interest rate used is based on the current 7520 rate. The lower the interest rate, the higher the deduction. As with a GRAT or IDGT, it is hoped that the CLT assets will appreciate beyond the 7520 rate, allowing the excess to pass tax free.

### Conclusion

These gifting strategies, and others, can turn this economic downturn into a mixed blessing.

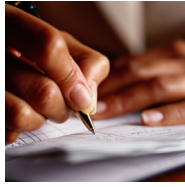


**A down market can mean tough times, but it can also present unique opportunities to minimize property transfer (gift and estate) taxes. While owning assets that are losing value might seem like a bad thing, it may actually be a great time to reduce your taxable estate by gifting those assets to beneficiaries.**

**Estate planning tools that are generally less attractive when interest rates are low:**

- *Qualified personal residence trust (QPRT)*
- *Charitable remainder annuity trust (CRAT)*

## Ask the Experts



### What is the Credit CARD Act of 2009?

On May 22, 2009, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act (the Credit CARD Act) of 2009. This Act amends the Truth in Lending Act, and includes the following provisions:

- Credit card companies are prohibited from increasing the annual percentage rate (APR) applicable to a cardholder's existing balance unless the account falls 60 days past due, or other specific conditions apply. If the APR is increased because the account falls 60 days past due, the cardholder must be informed that the rate increase will be terminated (and the rate restored to what it was before the increase) once the credit card company receives the minimum payments due in a timely fashion for six months.
- Credit card companies must notify a cardholder in writing of any change in the annual percentage rate (APR) on the account at least 45 days prior to the change. The notification must also inform

the cardholder of the right to cancel the account before the effective date of the rate increase. If the cardholder cancels the account, that won't be considered a default on the account or trigger an obligation to repay the account in full.

- Credit card companies are prohibited from calculating interest using a two-cycle billing method.
- Credit card companies are required, in cases where different annual percentage rates apply to different balances (purchases, balance transfers, cash advances), to allocate payments exceeding the minimum payment due to the balance with the highest rate first.
- Credit card companies are prevented from issuing a card to any individual under 21 years old, unless the individual demonstrates the independent means of repaying the debt or has a cosigner over 21 capable of repaying the debt.

Notification requirements take effect August 2009, and the remaining requirements take effect in February 2010.

### What is two-cycle billing?

Most credit cards compute any applicable finance charge using a single-cycle billing formula (generally a month), where the average daily balance for the cycle is multiplied by the daily interest rate and the number of days in that cycle. Assuming that you had no balance carryover from the previous billing cycle, are given a grace period, and pay your balance in full, you incur no interest charge on purchases you made during that cycle. And if you make no purchases in the following cycle, you incur no finance charge for that cycle either, because your average daily balance for that cycle is zero.

Two-cycle billing, however, computes the finance charge based on the average daily balance over two billing periods. If you consistently carry a balance, you won't experience much difference between single-cycle and two-cycle billing finance charges. However, if you incur charges in the first cycle, pay them in full by the due date, and incur no new charges in the second cycle, under the two-cycle billing method, you'll still owe a

finance charge for the second cycle. Why? Because, under two-cycle billing, your average daily balance isn't zero for the second cycle.

Here's a simple example: Assume no previous balance and a \$10,000 purchase (you bought a living room suite for your new home) on the first day of the first 30-day cycle that's paid in full on the last day of that cycle. Further assume a second 30-day cycle during which you make no purchases. Your average daily balance for the second 30-day cycle under the two-cycle billing method is \$5,000 (\$10,000 x 30 days, divided by 60 days). At an annual rate of 18% (0.0493% daily), the finance charge for the second 30-day cycle would be \$73.95 (\$5,000 x 0.000493 x 30).

As of February 2010, creditors will no longer be allowed to use two-cycle billing.

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