McMahan Asset Management, LLC

Providing sound, comprehensive financial advice.

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Please enjoy this month's newsletter!

In this issue:

The Sandwich Generation: the Pickle in the Middle

Understanding Mutual Fund Expense Ratios

Tax Benefits of Conservation Easements

Can I buy gold and silver in my IRA?

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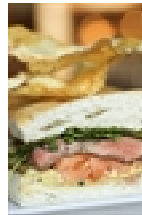
The Sandwich Generation: The Pickle in the Middle



If you're helping your parents and trying to meet your own children's needs while looking ahead to your own retirement, you're part of what's called "the sandwich generation." Here's a recipe to help you cope with being jammed in the middle.

Chart the terrain

First, conduct an assessment of your current financial situation and financial goals. Make improvements where you can, and develop a budget you can stick to. Be sure to monitor your finances so you can adjust to changing circumstances.

Then conduct a similar assessment of your parents' finances as well, so that you fully understand their current situation.

Keep your retirement savings plan on track

First and foremost, resist dipping into your current retirement savings, and try to keep your retirement savings plan on track. Make investing in your financial future a priority by maxing out your 401(k) and/or other retirement savings plan; at the least, contribute as much as your employer will match.

Put your child's college education on the front burner

Start saving, and with college tuition soaring, the sooner, the better. There are several college saving options--consider tax-advantaged strategies such as college savings plans, Coverdell education savings accounts, and U.S. savings bonds.

If necessary, look into the wide variety of financial aid programs available during college, such as scholarships, grants, work-study employment, and student and parent loans. Financial aid is based on two things: the cost of a college education and your ability to pay. You'll find an increasing number of families with significant incomes now qualify for aid.

Help your parents manage

If you need to help your parents manage their affairs, you'll need legal authority to do so. Make sure your parents have a durable power of attorney authorizing you to sign checks, pay bills, and make financial decisions.

Also make sure your parents have health-care directives allowing you to make medical care decisions according to their wishes. And be sure your parents have a will that's been updated recently.

If your parents have limited income, talk to them about their options. For example, can your parents sell their home or access the equity they have in it to increase their income? Will they need to move in with you or another family member? If they're not willing to discuss this with you, you may want to suggest they talk with a trusted professional.

Long-term care insurance

Since government programs such as Medicare and Medicaid, traditional health insurance, and disability insurance may not adequately cover the cost of long-term care, look into long-term care insurance. The cost of a long-term care policy will depend primarily on the ages of your parents (in general, the younger they are when the policy is purchased, the lower the premium will be), but it also depends on the benefits you choose.

Get support and advice

If you're feeling the squeeze, you're not alone. There's plenty of help out there, from local programs to national organizations, from books to websites. And consider discussing the specifics of your situation with your financial professional.

Understanding Mutual Fund Expense Ratios

Every mutual fund must disclose certain costs associated with running the fund. Those costs represent a fund's expense ratio, which is expressed as a percentage of a fund's assets. For example, a fund that has $100 million in assets and annual expenses of $1 million would report a 1% expense ratio (1% of $100 million = $1 million).

Why is a fund's expense ratio important? First, it can help you gauge how efficiently the fund operates. A high expense ratio reduces the amount that is paid to you as a shareholder. Second, a fund's expenses affect your net returns, particularly over the long term. For example, let's look at a hypothetical illustration (which doesn't reflect the performance of any actual security). Assume you have $10,000 in one stock fund that earns a 5.5% return and $10,000 in another stock fund that earns exactly the same return but that costs you an extra half-percent in expenses. The difference between 5.5% and 5% over 20 years means a $2,645 reduction in your bottom line.

That's not to say that you should automatically reject a fund just because it has a high expense ratio if the fund's performance is worth the higher cost. However, you do need to take expenses into account, especially if you're investing for the long term.

Some general categories of funds tend to have higher expense ratios than others. For example, a stock fund that specializes in emerging markets may have to spend more on research than a fund that invests only in large-cap U.S. stocks for which a great deal of information is readily available. A fund that is actively managed may have higher expenses than a fund that mirrors an index.

Each mutual fund's prospectus must include a table in the front that you can use to compare the expenses of various funds. The table lists the fund's expense ratio as well as a breakdown of the costs included in it, which fall into three general areas: management fees, marketing costs, and administrative fees.

Management fees

Every fund has an investment management or advisor firm that manages the fund and makes investment decisions. Even an index fund, which does relatively little trading and whose investments basically duplicate those of an index, will have a firm or an individual who handles any transactions. Management fees often represent the single largest portion of a typical fund's expense ratio.

Marketing costs

These costs also are known as 12b-1 fees, after the legal provision that permits them. They were originally designed to let funds recoup costs associated with distribution and advertising, on the theory that attracting new investors and additional assets would help make a fund more cost-effective for each investor. In recent years, there has been discussion of whether 12b-1 fees should be eliminated--especially for funds that are closed to new investors and therefore should have little need to market themselves--but they are still very common.

Administrative fees

This category of fees includes the cost of recordkeeping, custodianship, taxes, and legal, accounting, and auditing services.

What's not included in an expense ratio

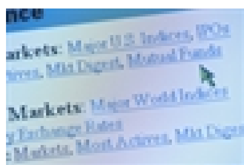
Trading expenses represent the cost of buying or selling securities, and also can have a substantial impact on your net return over time. Trading costs, which include commissions paid by the fund when it buys or sells a security, aren't included in a fund's expense ratio. However, funds are required to report the per-share cost of their annual commissions; this can be found in a fund's annual report or Statement of Additional Information.

Also not included in the expense ratio is any redemption fee a fund might charge if you sell your shares before a specified time, or any sales charge the fund might impose at the time of purchase or sale.

Before investing in a mutual fund, carefully consider its investment objectives and risks as well as its charges and expenses. This information is available in the prospectus, which can be obtained from the fund. Read it carefully before investing.

Running the numbers

To get a true picture of a fund's performance, you do not need to deduct a fund's expense ratio from the returns quoted in its prospectus. The figures that measure average annual and cumulative return have already taken both operating and trading costs into account.



"Some general categories of funds tend to have higher expense ratios than others."

Comparison shopping

The "Tools and Calculators" section of the Financial Industry Regulatory Authority (FINRA) website includes an online Fund Analyzer that lets you compare the impact over time of the fees and expenses of as many as three funds.

Tax Benefits of Conservation Easements

A conservation easement (also called a conservation covenant or restriction) is an encumbrance on privately held real estate that prohibits the development of that property in perpetuity. The landowner enters into an agreement with the easement holder--either a qualified charitable organization (referred to as a land trust) or a government agency (federal, state, or local). The agreement imposes specific restrictions on the use of the property, and it remains legally binding even when the property is subsequently passed on to heirs or sold to another private owner.

Property owners who grant conservation easements not only conserve their land for future generations, but they may also conserve their wealth for their heirs due to the many tax benefits that are available.

Federal income tax deduction

A gift of a conservation easement is considered a charitable donation that can be deducted on the donor's federal income tax return, if the easement meets all of the following IRS requirements:

- The easement is permanent
- It is donated to a qualified conservation organization
- It serves a valid conservation purpose (which can only be for outdoor recreation or education, habitat protection, historic preservation, or open space protection)

Generally, the value of the easement is the difference between the land's fair market value with and without the easement. For example, if land is valued at $1 million without restrictions and $750,000 with the easement, then the value of the easement is $250,000. The value must be substantiated by a qualified appraisal.

For individual taxpayers, the deduction is generally limited to 30% of adjusted gross income in the year of the gift. Any excess can be carried forward over the next 5 years. Any deduction that is not used up in that 6-year period is lost.

Note: *For donations made in 2006 through 2009, the limitations were 50% (100% for qualified farms and ranches) and 15 years, respectively. There is legislation in Congress that extends this provision, retroactive to January 1, 2010.*

Federal gift or estate tax deduction

A landowner can claim a federal charitable gift tax deduction (if the easement is made during his/her life) or an estate tax deduction (if made after death) for the *full* fair market value of the easement. The easement must satisfy the same requirements as the federal income tax deduction, *except for the conservation purpose requirement*.

Federal estate tax exclusion

In addition to the federal deductions, up to 40% of the *after-easement value of the land* can be excluded from the landowner's estate for federal estate tax purposes, up to a maximum of $500,000, if all of the following requirements are met:

- The donation is eligible for the federal income tax deduction
- The easement must prohibit more than a de minimis use of the property for a "commercial recreational activity"
- The easement must be donated by the decedent, his/her family member, the executor of his/her estate, or the trustee of the trust in which the land is held
- The land must have been owned by the decedent or his/her family member for the entire 3-year period preceding the decedent's date of death

To be eligible for the full 40% exclusion, the easement must reduce the value of the land by at least 30%. For every percentage that falls short of the 30% threshold, the exclusion is reduced by 2%.

Further, the tax basis of the land must be carried over from the decedent to the heirs, to the extent the value of the land is excluded from the decedent's estate.

State tax and property tax benefits

Some states offer an income tax deduction and/or tax credit, and many states offer property tax incentives to conservation easement donors.

Note: *A conservation easement can also be sold, but a sale will not confer the same tax benefits as a donation.*

For more information, see your financial professional.

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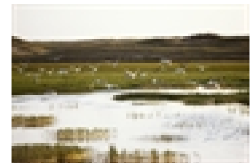

How popular are conservation easements?

According to the 2005 National Land Trust Census, the total acres conserved by local, state, and national land trusts doubled to 37 million acres in just the past five years. This is an area 16½ times the size of Yellowstone National Park.

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Ask the Experts

Can I buy gold and silver in my IRA?

Yes, but you'll need to establish a self-directed IRA with a trustee/custodian who has experience with precious metals and is able to take physical possession of the assets. The company you purchase the metals from will generally have a relationship with a trustee/custodian who can set up a precious metals IRA for you.

Under IRS rules, holding certain collectibles, including metals, gems, or coins, in your IRA can result in a prohibited transaction. That doesn't mean you can't do it. But if you do, there can be serious tax consequences--the value of the collectible will be treated as a distribution to you, and will be subject to income tax and a 10% penalty (unless you're 59½ or another exception applies).

However, certain precious metals are specifically excluded from the definition of "collectible." The following are currently permitted as IRA investments:

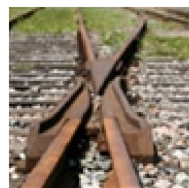
- American Eagle gold, silver, and platinum bullion coins
- Coins issued by any state

Also allowed is any gold, silver, platinum, or palladium bullion, in coin form or otherwise, that meets certain purity requirements (for example, gold coins and bars must be at least 99.5% pure). Currently this includes:

- Canadian gold, silver, and platinum Maple Leaf coins
- Australian Philharmonic, Kangaroo/Nuggets, Kookaburras, and Koala coins
- Mexican Silver Libertads
- Isle of Man Noble platinum coins
- Gold, silver, platinum, and palladium bars and rounds of specific purity

Of course, you can also buy mining stocks, as well as gold and silver ETFs, in your IRA. For some, this is a more convenient way of adding this asset class to an IRA portfolio.

Frequently asked questions about 2010 Roth IRA conversions



1. How does the special deferral rule for 2010 conversions work? I've heard that I calculate the conversion tax in 2010, but can pay half in 2011 and half in 2012.

No, this is a common misconception. If you make a conversion in 2010, you will calculate the amount of taxable income in 2010. But then you have a choice: you can either report all of the taxable income on your 2010 tax return, or instead report half of the income on your 2011 return and half on your 2012 return. So, your tax liability will depend on your marginal tax rates in 2010, 2011, and 2012. (Note that tax rates will increase in 2011 if the Bush tax cuts are allowed to expire.)

2. Does the special deferral rule for 2010 apply to distributions I roll over from my 401(k) plan to a Roth IRA in 2010?

Yes. If you receive a distribution of non-Roth funds from your 401(k) plan in 2010 and roll those funds into a Roth IRA, the taxation is similar to a conversion of a traditional IRA to a Roth IRA. You can report all of the resulting income on your 2010 tax return, or half on your 2011 return and half on your 2012 return.

3. Is it true that anyone can make annual contributions to a Roth IRA beginning in 2010, regardless of how much they earn?

No. You can contribute to a Roth IRA only if your income is within prescribed limits. These limits have not been repealed. What has been repealed are the income limits that used to apply to Roth conversions, beginning in 2010. But even if you can't contribute to a Roth IRA directly in 2010 because of the income limits, there's an easy workaround: you can make your annual contribution first to a traditional IRA (virtually anyone under age 70½ can make nondeductible contributions to a traditional IRA), and then convert that IRA to a Roth. Remember, though, that when you calculate the taxable amount due as a result of the conversion, you need to aggregate all of your traditional IRAs. See IRS Form 8606 for additional details.