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## Tapping Retirement Savings for College Expenses

Should you tap your retirement funds to help pay your child's college expenses? Well, you can. But is it a good idea?

### The double problem with double dipping



Financial professionals generally recommend using your retirement funds for one purpose only--retirement. Why?

Because frequent dips into your retirement funds will reduce your ultimate nest egg. Plus, there will be less money available to take advantage of the twin benefits of tax deferral and any compounding earnings. Depleting your retirement funds too soon can create a dire situation. Remember, there is financial aid available to help pay for college, but none for retirement.

### But, if you must...

If you absolutely must dip into your IRA to pay college costs, there is a bit of good news. Generally, if you withdraw money from a Roth or traditional IRA before age 59½, you'll owe a 10% premature distribution penalty tax on the earnings portion of the withdrawal. However, there is an exception to this penalty if the money is used to pay the qualified education expenses for you, your spouse, your children, or your grandchildren. That's the good news.

The bad news is that you'll owe income tax on the earnings portion of your IRA withdrawal. But fortunately, for Roth IRAs, there is a tax ordering for distributions--contributions come out before earnings. This is important because contributions to a Roth IRA are made with after-tax dollars and can be withdrawn income tax free at any time (even before age 59½) and for any purpose. You'll only owe income tax if you dip into the earnings. (Once you reach age 59½ and have held your Roth IRA for five years, even earnings are income tax free.)

### What about your 401(k)?

Generally, tapping your 401(k) is even worse than tapping your IRA, because 401(k) plans don't offer a college exception to the 10% penalty tax. Plus, you'll generally pay income tax on the entire amount of your withdrawal. So all other things being equal, withdrawing from your IRA is the better choice.

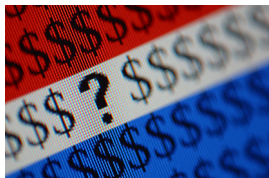
However, you might be able to borrow from your 401(k) account--something you can't do with an IRA. Assuming your plan allows plan loans, loans are not taxed or penalized, as long as you repay the funds within a specified period of time. But make sure to compare the cost of borrowing from your 401(k) account with other financing options. Although interest rates on plan loans may be favorable, the amount you can borrow is limited, and you generally must repay the loan within five years (some plans require that you repay the loan immediately if you lose your job).

### The financial aid factor

Assets in retirement accounts aren't counted at all by the federal government's financial aid formula. So they don't affect your child's eligibility for federal financial aid. However, distributions are counted; specifically, all withdrawals from retirement accounts--principal and earnings--are counted as parental income and assessed at rates as high as 50%.

### Alternatives

Before you dip into your IRA or 401(k) account to pay college expenses, make sure to investigate the cost of private borrowing, as well as any federal, state, or college-based financial aid loan programs that might be available. For example, under the federal PLUS loan program, you can borrow up to the full cost of your child's education (minus any financial aid received) if you have a good credit history. Similarly, your state's higher education authority might have a financing arm that offers favorable loan terms for college.



*Changing consumption patterns can have implications for a variety of companies and industries, and create investing opportunities.*

## Coping with a Slower Economy

Economics isn't called the "dismal science" for nothing. There's an old joke that accuses economists of having predicted 9 of the last 5 recessions (and yes, those figures are in the correct order). However, forecasting the direction of the economy can seem easy compared with trying to figure out how to weatherproof your finances. It can help to understand some of the questions that many investors ask themselves if they're concerned about the potential impact of slower growth.

### Is it time to check my portfolio?

Changing consumption patterns can have implications for a variety of companies and industries, and create investing opportunities. Some investing sectors might be especially economically sensitive and might therefore suffer from any economic downturn. On the other hand, some industries or companies may actually benefit from a slower economy. For example, companies that produce high-end goods might be relatively immune from economic pressures--or maybe not. Shifts in spending patterns could also mean that consumers continue to spend money but choose less expensive alternatives, or focus more on getting the greatest value from each dollar.

If you rely on your investments for income, you may want to review how sensitive your portfolio might be to changes in interest rates. If the Federal Reserve Board sees greater danger from a slowing economy than from the possibility of higher inflation, lower interest rates could cut into your income. Conversely, if the Fed becomes increasingly concerned about inflation, rates could go up. It might be a good time to see whether the yields you're receiving are competitive, and what kind of impact on your monthly income you might expect from any changes in rates.

### Should I review my asset allocation?

Now might also be a good time to reexamine how your assets are divided among various types of investments. If you decide you need to shift a portion of your portfolio, those changes don't necessarily have to be made all at once. Consider:

- Adjusting only a portion of your bond or stock holdings
- Using systematic investing to shift allocations over time
- Investing any new money differently to

increase your exposure to asset classes you may have neglected

### How close am I to the edge financially?

The benefits of reducing debt should be pretty obvious, given the recent credit crisis. Troubles in the mortgage industry have driven home the importance of managing debt wisely. The last thing you need if you're worried about uncertain economic times is to lock yourself into spending patterns that push you beyond your means.

Whether the economy is in robust health or seems to be catching the flu, it's never a bad idea to have a cushion against unexpected financial stress. An unanticipated medical emergency--and is there any other kind?--a sudden job loss, or anything else that affects your income stream can bring the effects of a slower economy home in a dramatic way.

If you're employed in a highly cyclical industry or one that's undergoing substantial changes, having a financial reserve becomes even more important. And if a lot of your retirement plan savings are invested in your employer's stock, think about whether your long-term finances might potentially face a double whammy. Serious financial trouble at your company could mean the possibility of layoffs, a drop in the value of your holdings--or both.

### Have I planned for the unexpected?

If you're planning to retire in the next few years, consider the potential impact if you were to be "retired" prematurely. It's easy to assume you'll work until a certain date or earn income after retirement, but health concerns and the job market don't always permit that. Doing some "what if?" calculations with an earlier retirement date than you might otherwise choose could prepare you for what might happen if you were laid off and had difficulty finding new employment, or were unable to work for health reasons.

A transition to a post-retirement career is likely to be easier if you plan thoroughly. For example, launching a small business can be challenging under the best of circumstances; try to have as much of the groundwork laid as possible before relying on it for your entire income. Sales estimates that are more conservative than they might otherwise be may help minimize cash flow problems.

Asking questions such as these lets you hope for the best while preparing for the worst.

## Tax-Wise Gifting Strategies for Seniors

You've spent most of your life building your wealth. Now, your concern may have shifted to reducing your estate and saving taxes.

Making gifts is one way to reduce your estate. But because gifting can trigger federal gift tax, as well as federal generation-skipping transfer tax (GSTT) if the gift is to someone who is more than one generation below you (e.g., grandchildren), you'll want to consider making gifts in ways that will minimize tax. Here are some tax-wise gifting strategies to consider.

### Take full advantage of the federal annual gift tax exclusion and lifetime exemption

For 2008, you can give tax free up to \$12,000 per recipient (\$24,000 if the gift is from both you and your spouse) under the annual gift tax exclusion. Gifts over that amount are tax free to the extent of your \$1 million lifetime gift tax exemption (\$2 million lifetime GSTT exemption).

### Contribute to 529 plans

If you fund a 529 plan for your grandchild's college education, you can contribute up to five years' worth of gifts at once; that's \$60,000 per child, or \$120,000 per child if you and your spouse elect to make the gift.

### Pay tuition and medical expenses

You can make unlimited tax-free gifts by paying medical bills or college tuition on behalf of a recipient. Payments must be made directly to the medical care provider or college.

### Make charitable donations

Donations to charity are completely free from gift tax and are also generally deductible for income tax purposes, subject to certain limitations.

### Make gifts and pay the gift tax

This may seem counterintuitive, but sometimes making gifts and paying the gift tax can be advantageous. The reason is that gift tax paid is removed from your estate. So, gift taxes paid on lifetime gifts can significantly reduce overall federal gift and estate taxes.

### Types of property to gift

Selecting the type of property to gift can be very important. Here are some things to consider:

- Gift property that may grow substantially in value over time, such as common

stock, antiques, art, and real estate. This strategy removes any future appreciation of this property from your estate.

- Be careful when gifting appreciated property. Because a property's basis (generally its cost) is carried over to the recipient, gifts of appreciated property can be good in some circumstances but not in others. You may not want to give highly appreciated property if the recipient will recognize a substantial capital gain when the property is sold. On the other hand, you may want to make that gift if the sale of the property is imminent anyway and the recipient would owe less tax than you upon the sale.
- You should avoid giving property that is likely to lose value after the gift has been made. Also, it's not generally a good idea to give away depreciated property. The recipient's basis for recognizing a loss is the lower of your basis (carryover basis) or the current fair market value. The recipient may be unable to recognize the loss on the property. Both you and the recipient may lose the loss deduction.
- Gift assets that yield higher amounts of income instead of those that yield lower amounts. This will prevent the buildup of income in your estate. Similarly, gift assets that produce taxable income instead of those that produce less taxable income, such as municipal bonds.
- It may be possible to reduce your ownership interest in a closely held business (or an interest in real estate) so that it may be valued at a discount. For example, if you have a minority interest (49% or less) in the stock of a closely held business, you may qualify for a discount. Also, a fractional interest in real property may be valued at a discount. It may be beneficial to make a gift of stock or an interest in real estate to qualify for the discount.
- Be careful when giving S corp stock to a trust, as the business may lose S corp status.



### When giving to charity:

- Only give to "qualified" charities. See IRS Publication 78.
- Avoid giving cash, unless you get a receipt.
- You must obtain a "qualified appraisal" for donations of property worth over \$5,000 (other than cash and publicly traded securities), and you must attach an appraisal summary (IRS Form 8283) to your tax return.



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## Ask the Experts



### Can I enroll in Medicare at age 65, even if I'm not yet eligible for full Social Security benefits?

Yes. Although full retirement age for Social Security is increasing, 65 remains the age at which most Americans become eligible for Medicare. You don't have to be retired to enroll in Medicare, so you should still consider signing up for Medicare Part A (hospital insurance) and Medicare Part B (medical insurance) at age 65, even if you plan on working longer. Make sure to contact the Social Security Administration approximately 3 months before your 65th birthday to discuss your options, because enrollment rules are relatively complicated, and there may be consequences if you wait until later to sign up.

For example, when you become eligible for Medicare Part A at age 65, you have a certain period, called your initial enrollment period, in which to sign up for Medicare Part B. Most people won't pay a premium for Part A, but you'll always pay a premium for Part B. Your initial enrollment period is a seven-month

period that begins three months before your 65th birthday, includes the month you turn age 65, and ends three months after your 65th birthday. If you don't sign up for Part B during your initial enrollment period, you can't sign up until the next general enrollment period that runs from January 1 through March 31 of each year, and you'll generally pay a higher premium for Part B coverage. Your monthly premium will increase by 10% for each 12-month period you were eligible for, but did not enroll in, Medicare Part B, unless you were covered by group health insurance through your employer or your spouse's employer. In that case, you may qualify for a special enrollment period, and you may not have to pay a premium penalty.

For more information about enrollment requirements and other factors you should consider when deciding when to sign up for Medicare, contact the Social Security Administration at (800) 772-1213 or visit the Medicare website at [www.medicare.gov](http://www.medicare.gov).

## What are Medicare Advantage plans?

Most people who are covered by Medicare are enrolled in original Medicare. Original Medicare includes Part A, which helps cover inpatient hospital care, skilled nursing care, hospice care, and some home health care, and Part B, which covers medically necessary services, including doctor's visits, outpatient care, and some preventative services.

As an alternative to original Medicare, you may opt to enroll in a Medicare Advantage (MA) plan when you first become eligible for Medicare (and have already enrolled in Parts A and B), or during certain enrollment periods. MA plans are also called Part C plans, and although they are part of the Medicare program, they are managed by private companies. MA plans provide all the benefits and cover all of the services that original Medicare provides. However, they may also offer benefits and services that are not covered under original Medicare (but which may be covered under an optional supplemental policy), including prescription drug coverage, vision care, dental services, and hearing aids, although coverages vary.

But while original Medicare allows you to visit any health-care provider or facility that accepts Medicare, most MA plans are managed care plans—either HMOs or PPOs—that have provider networks. This means that you'll usually need to see a health-care provider who belongs to the plan or receive health-care services through a facility included in the network. This may limit your choice of health-care providers. Other MA plan types may be available, including private fee-for-service plans, but these are less common.

You can generally join an MA plan if you live in the service area covered by the plan, and you have Medicare Parts A and B. But before choosing an MA plan, make sure it suits your needs. Review the benefits provided and coverage limits, and the provider network (if any). You should also make sure you understand what out-of-pocket costs may apply. These may include premiums, deductibles, and copayments that are different than those in original Medicare or a supplemental policy.