VESTPOINTEWEALTH
MANAGEMENT
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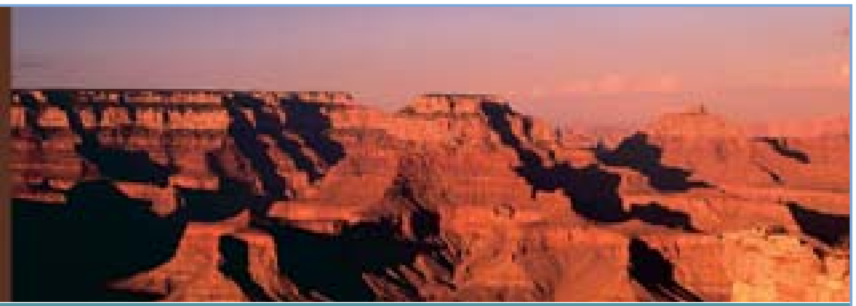
Fourth Quarter 2009



How Pre-Retirees Benefit From The Recovery Act

The American Recovery and Reinvestment Act of 2009, the keystone of the Obama administration's plan to jump-start the U.S. economy, contains a passel of new tax breaks for individual taxpayers as well as business owners. Most of those for individuals are retroactive to the beginning of 2009. Though provisions are largely targeted at low- and middle-income taxpayers—and are phased out for those earning more—some might lighten your tax load for 2009 and 2010.

Making Work Pay Credit. This is the linchpin of the President's tax plan. Whether you work for an employer or you're self-employed, as a single filer you're entitled to a payroll tax credit equal to 6.2% of earned income or $400, whichever is less. The maximum credit is doubled to $800 for joint filers. If you receive a paycheck and are subject to withholding, your employer was supposed to have reduced the amount that was witheld from your earnings, increasing take-home pay. This new credit applies retroactively to the beginning of 2009 and will also be available in 2010, but many taxpayers will earn too much to qualify. This benefit begins to phase out at a modified adjusted gross income (MAGI) of $75,000 for single filers and $150,000 for joint filers.

American Opportunity Tax Credit. This year's legislation revamps the Hope credit for qualified education expenses and gives it a new name. The maximum American Opportunity credit for 2009 and 2010 is $2,500 (up from the Hope's $1,800), and it will be available for all four years of college study (the Hope covered just the first two). In addition, 40% of the credit may come as a tax refund. And though this credit, too, will be out of bounds for many taxpayers, it's more generous than the Hope credit was. The phase-out in the new version begins at $80,000 of MAGI for single filers (up from $48,000) and $160,000 for joint filers (compared with $96,000).

Alternative minimum tax. Usually, Congress waits until the eleventh hour to "patch" the AMT for the current year. This time it acted early, building relief into the recovery act. The legislation lets individuals continue to use personal credits as AMT offsets in 2009 while bumping up AMT exemption amounts once again—to $46,700 for single filers (up from $46,200 in 2008) and $70,950 for joint filers (compared with $69,950 in 2008).

New car deduction. A late addition to the recovery act provides a deduction for state and local sales or excise taxes attributable to the first $49,500 of the price of a new vehicle. It applied to any vehicle weighing no more than 8,500 pounds—including cars, SUVs, light trucks, and motorcycles—purchased after Feb. 17, 2009 and before January 1, 2010. Motor homes also qualify. This special deduction was phased out for

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Cutting Healthcare Costs With A Health Savings Account

Enactment of The Tax Relief and Healthcare Act of 2006 made it easier to contribute to Health Savings Accounts (HSAs). Introduced in 2003 as an alternative to increasingly costly health insurance plans, an HSA allows an employee to sock away pre-tax income in a special account to pay for healthcare expenses.

HSAs work with high-deductible health plans (HDHPs). HDHPs typically require an employee to pay the first $1,500, and in many cases, more, of their medical expenses. But if you use money from an HSA to meet those high deductibles, you are paying with pre-tax dollars. If you're a 40% effective tax payer, using an HSA to fund your deductible generates the equivalent of 40% discount. And since high-deductible health insurance plans cost less, the savings on premiums combined with the HSA's benefits can be significant.

In 2010, you can contribute up to $3,050 to an HSA for individual coverage or $6,150 for families. If you are age 55 or older, you can contribute an additional $1,000. To qualify for HSAs, your HDHP must have a deductible of $1,200 for individual coverage and $2,400 for families.

The new tax law allows individuals to make tax-free rollovers from a Flexible Spending Account, Health Reimbursement Account, or Individual Retirement Account into an HSA, and the added flexibility is likely to make more businesses adopt HSAs.

Uncle Sam Changes Financial Aid Rules

The budgetary imbalance addressed by the Deficit Reduction Act of 2005 (signed into law in 2006) is, of course, the government's. But if paying college bills is in your future, this legislation could affect your family's budget, too. Changes made it easier for some students to qualify for financial aid. And if you or your kids borrow money to cover educational costs, you will save on loan origination fees and could ultimately benefit from a shift from fixed to variable interest rates.

New treatment of custodial accounts. The current federal financial aid formula makes a sharp distinction between student and parental assets. Students who have money held in their name in a custodial account—a UGMA (Uniform Gift to Minors Act) or UTMA (Uniform Transfer to Minors Act)—are expected to contribute 35% of the value of the account each year. So if your daughter has $100,000 in a UGMA, the aid formula's "expected family contribution" will include $35,000 from the account. Parental assets, on the other hand, including funds held in a 529 plan established for a student, are assessed at only 5.64%. UGMA assets moved into a "custodial" 529 plan are also considered a parental asset, according to Joe Hurley, founder of Savingforcollege.com. But one custodial account drawback will remain after the transfer, Hurley notes. When your child reaches age 18 or 21, depending on your state, the account will still become the child's property.

A big break for prepaid tuition plans. A special type of 529 plan offered by 13 states lets you prepay your child's tuition at a state college or university. You pay what tuition costs now, and the state promises to pick up the much higher tab when your child matriculates. These plans come with several restrictions and may not be the best way to save for college. But one of their biggest shortcomings, before the Deficit Reduction Act, involved financial aid. Any award had to be reduced dollar for dollar by a payment from a prepaid plan. Now, such money is treated like any other 529 asset, as a parental resource to be assessed at a maximum of 5.64%.

More predictable loan costs. Of course, if your income is high, your child isn't likely to qualify for need-based aid no matter where you hold your savings. That could mean taking a loan. The interest rate on Stafford loans, for students, is permanently fixed at 6.8%, while PLUS loans, for parents, have a fixed rate of 8.5%. Meanwhile, loan origination fees, which had been as high as 4% of the borrowed amount, are being phased out by 2010. ●

Using Your IRA To Pay Education Expenses

IRAs, obviously, are for retirement. And except in very special circumstances—say, if you've come into a major inheritance—the money in your retirement account ought to be off limits for any other purpose. But if your financial plan shows you really won't need your IRA for retirement, there's another way you could use it, even if you have not yet passed the age-59½ threshold to make penalty-free withdrawals. You could pull out cash to pay for your children's education.

The basic rule is pretty simple. Though you'd ordinarily incur a 10% early withdrawal penalty for taking a distribution from your IRA before age 59½, that doesn't apply if the money goes to pay qualified education expenses for you, your spouse, or any child or grandchild of you or your spouse. And for these purposes, "child" is defined rather broadly. A stepchild, a legally adopted son or daughter, or even a foster child (subject to some conditions) can qualify.

Almost any post-secondary educational expenses count for this preferential treatment. The money for tuition, fees, and books can come out of your IRA as long as it goes to an accredited college, junior college, or graduate or professional school. The school can be public or private, nonprofit or for profit. If the student is attending at least half time, room and board counts, too.

Though there's no preordained ceiling on the educational costs an IRA withdrawal can cover, you can't take out more than the total qualified expenses incurred during a particular tax year. You'll also have to subtract the amount of any other tax-advantaged distributions or aid applied to school costs. This may include tax-free Coverdell distributions, the non-taxable portion of scholarships or fellowships, Pell grants, or tax-free assistance from your employer, among

The Dynamics Of China-U.S. Economics

In the autumn of 2008, China became the United States' biggest creditor, and Chinese leaders have wasted little time in flexing their growing economic muscle. China is demanding a stronger voice in global economic affairs and has proposed a new international currency that would supplant the dollar as the world's dominant medium of exchange. Should U.S. investors worry about China's emergence as a powerful economic force? And how will this "new world order" affect American consumers?

The Chinese have been buying up U.S. Treasury bonds for years, and by January 2009, China held $740 billion in U.S. Treasury securities, or 24% of the total outstanding Treasury debt. In September 2008, China had surpassed Japan as the U.S.'s largest creditor. China also has amassed the world's largest cash reserves, totaling about $1.9 trillion, and maintains the world's most lopsided trade surplus with the United States. That reflects the fact that China has become the world's No. 1 producer while America has become a nation of avid consumers. Monies from throughout the world are pouring into China's booming economy while American dollars flow outward to buy more goods and services.

These trends have led to controversy, with U.S. officials accusing the Chinese government of manipulating its currency to keep its exports competitive. But the Obama administration backed away from those claims early in 2009 after China allowed its currency to appreciate slightly against the dollar, thus slowing the nation's accumulation of cash reserves.

For now, leaders of both countries have agreed to work together to fight the global recession, joining countries in the European Union and around the world. But in the long run, China is building up a potentially alarming amount of influence over the American economy, analysts say. "The scale of financing the U.S. now receives from China truly is unprecedented: it now not only tops the largest inflow the U.S. ever received from another country, but it is clearly by far the largest inflow the U.S. has ever received from a government that the U.S. doesn't consider a close military ally," writes Brad W. Setser, geoeconomics fellow at the Council on Foreign Relations, in his blog for the Center for Geoeconomic Studies. "And I don't think it is in the interest of the United States to rely so heavily on a single country's government for financing."

Chinese leaders have recently expressed concern about the strength of the U.S. economy—and, by extension, the safety of China's Treasury investments—and signaled a desire to diversify. Should China shift a significant amount of money out of U.S. government bonds, other international and domestic investors could follow the Chinese lead. Any run on Treasury bonds would hurt the U.S. government's ability to pay for hundreds of billions of dollars in recession-fighting stimulus spending and would increase borrowing costs for U.S. companies and individuals. Such a move could, however, improve the trade deficit, because it would weaken the dollar, making U.S. exports more affordable. Currently, the U.S. imports from China five times as much as it exports to China.

While China cut back on U.S. Treasury purchases earlier this year, analysts agree that at least in the near term, the Chinese will continue to invest in U.S. bonds, both to maintain China's trade advantage and because the global recession presents few safe investing alternatives. Still, China's emergence as America's No. 1 creditor signals a basic change at a time of great economic uncertainty. During past economic downturns, the U.S. was always the largest creditor nation in the world. That was a good position to be in, because it meant other countries owed the U.S. more than it owed them.

During the current global recession, the reverse is true. America has become the world's largest debtor nation. As long as interest rates stay low, that alone is not a problem. However, as interest rates increase, it will become more expensive for American companies and consumers to borrow money, for everything from business equipment to houses. And that can only make emerging from the recession a longer and more difficult process. To put individual households and the country as a whole on more sustainable footing in preparation for future downturns, Americans will need to make the painful transition from spending to saving more of their hard-earned dollars. ●

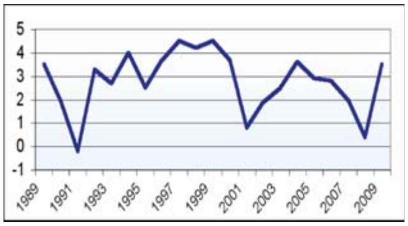
other things. But the amount you can withdraw without penalty won't be reduced by payments from other sources, including your income, loans, gifts, or withdrawals from 529 college savings accounts.

The only real downside to using IRA money—again, assuming you won't need it for retirement—is that withdrawals for education from a traditional IRA will be taxed as income. If the withdrawal comes from a Roth IRA funded with after-tax dollars, only the portion deemed to come from account earnings will be taxed. After the Roth has been in existence for five years, distributions are completely tax-free if made after age 59½.

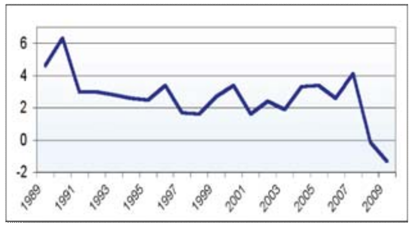
Moreover, any tax you pay on an IRA withdrawal poses another problem. Your penalty-free distribution is capped by the amount of qualified educational expenses less any adjustments for tax-free awards. You can't withdraw enough to generate that total amount after taxes; you can take only the amount itself. So, for example, if the expenses amount to $50,000 and you pay total federal and state taxes of 40%, that extra $20,000 will have to come from outside the IRA. If you take the entire $70,000 from your IRA, the 10% penalty applies to the $20,000, increasing your tax bill by $2,000.

Just be sure you don't need the money to fund your retirement, and have that all figured out first in a detailed financial plan. ●

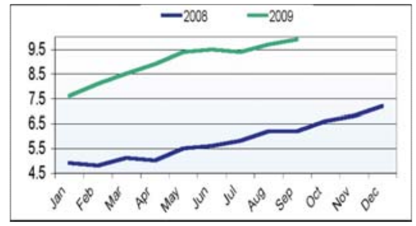
Economy Watch: 3rd Quarter 2009



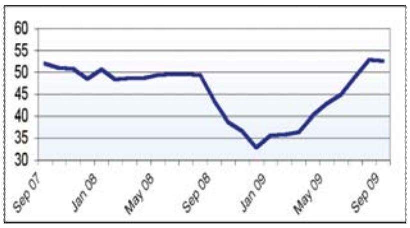
U.S. Economic Growth
After contracting for a full year, gross domestic product—the broadest gauge of the economy's health—expanded in 3Q09 at an annualized 3.5% rate, feeding speculation that the long recession was on the verge of ending.



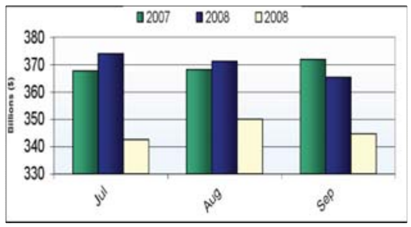
Inflation
Weak demand for goods and services kept prices under pressure. Retail costs were down 1.3% in 3Q09 on a year-over-year basis, but outright deflation was largely limited to the volatile energy and food categories.



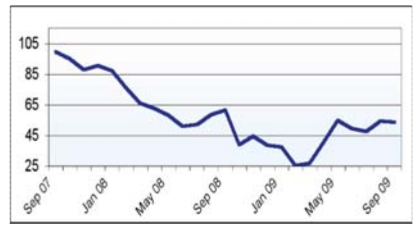
Jobs
The labor market continued to reel as corporations made do with leaner payrolls. By quarter's end, the national unemployment rate had climbed to a new 26-year high of 9.8%, leaving millions of Americans looking for work.



Manufacturing Growth
Industrial activity picked up in 3Q09 as the "cash for clunkers" new car subsidy galvanized the beleaguered automotive industry. However, manufacturers warned that the environment remained difficult.



Consumer Spending
Despite a flurry of car buying in August, previously free-spending American families kept their budgets under tight control. As a result, retail sales remained 6% to 9% below year-ago levels throughout the third quarter.



Consumer Confidence
Between the job market and stagnant local housing markets, American households' take on the economy remained diffident at best throughout 3Q09, although well off the nadir touched earlier in the year.

Data for the CPI, Unemployment Rate and Non-farm Payrolls are from the Bureau of Labor Statistics. Data for the GDP are from the Bureau of Economic Analysis. The Purchasing Managers Diffusion Index is a release of the Institute of Supply Management. Retail spending data are from the Bureau of the Census. Data for Consumer Confidence comes from the Conference Board.

Pre-Retirees Benefit

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single filers with a MAGI of $125,000 and joint filers making $250,000.

First-time homebuyer credit. The stimulus legislation improved a credit for first-time homebuyers that first became available in 2008. It defined "first-time homebuyer" as anyone who had not owned a home during the past three years, and increased the credit to the lesser of 10% of the purchase price or $8,000 (up from $7,500) for homes bought after December 31, 2008 and before December 1, 2009. Also, you no longer had to repay the credit if you lived in the home for at least three years. But the tax credit was phased out for certain high-income tax filers. In November, 2009, the credit was extended to May 1, 2010, with certain modifications, including higher phase-out levels and added availability to non-first-time homebuyers.

Unemployment benefits. Anyone who has lost a job is eligible to deduct up to $2,400 of unemployment benefits received on 2009 federal income tax returns.

Child tax credit. Parents of children under age 17 are entitled to a $1,000 tax credit per child in 2009 and 2010.

Residential energy credit. The stimulus bill boosts the residential energy credit to 30% of the cost of qualified expenses (up from 10%) and increases the maximum dollar amount to $1,500. This credit covers insulation materials; exterior windows (including skylights); exterior doors; central air conditioners; natural gas, propane, and oil-fired water heaters or furnaces; hot water boilers; electric heat pump water heaters; certain metal roofs; stoves; and advanced air-circulating fans. These provisions are in effect for installations made in 2009 and 2010.

Even if you earn too much to qualify for some of these tax breaks, you may benefit indirectly as the stimulus legislation's hundreds of millions of dollars begin to flow into the economy. We can work with you and your tax advisor to gauge the law's impact on your financial situation. ●

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