

# BFAS Money Line

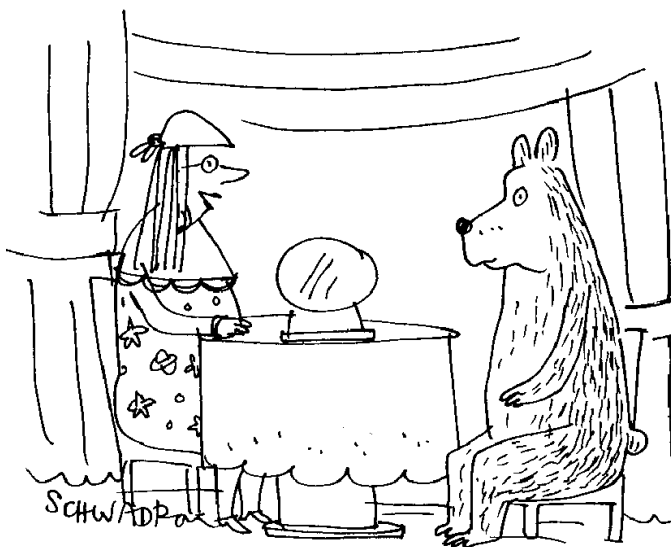
## Another Rocky Start

Just like last year, the market is finding the negative in every positive development. Yes, the economy is growing a little slower than last year (3% thus far this year, versus 4% last year). However, 3% is pretty near the long-term average growth of our economy.

Interest rates, while rising at the short end, remain lower than historical norms. Companies are still showing great profits (with the exception of GM/Ford and the airline industry). The unemployment rate is lower than normal.

I have read commentary that the market will gain 25% this year as well as commentary that it will drop 20%. I generally throw out the highs and lows, and go with the consensus, which is a modest increase of less than 10%. However, **since the market's direction is unknowable, predicting it is frankly an exercise in futility** (but still sells lots of books, magazines and TV time).

**I do know that the market is going to be up in the long-term (20 – 30 years).** Since most people will live that long in retirement, they should be invested for the long-term, not tomorrow or



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*“Frankly, I don’t see any chance of your hitting it big in the stock market.”*

next month.

Back when many baby boomers were born, January 1950, the **S & P 500** was at **17**. After twenty years of cold war, nuclear war fears, Vietnam and racial turmoil it was at **90** in January 1970. After ten years of stagflation and Arab oil embargoes it was **114** in January of 1980. Despite huge budget deficits during the 80’s it was **360** in January 1990. After the Persian Gulf war and two recessions it was **1455** in January 2000. After the Internet bubble burst, the S & P 500 dropped to **776**, then by January 2005 has risen back to **1202**.

The point is, when you step back from all of the “white noise” we receive from the media, the long-term growth of the market is pretty amazing. In fact, there are **no 20-year periods since 1925 where the market lost money**. There are, however, 15, 10 and 5 year periods of negative markets. We **have just finished a five year negative market (Jan ’00 to Jan ’05 = -11%)**. This is why I **generally recommend against putting money in the market that you know you’ll need within five years**.

The table on the next page shows what the various markets did in the last year:

<b>Asset Class</b>	<b>1 Yr Rtn (04/29/05)</b>
<b>S &amp; P 500</b>	<b>+06.33%</b>
<b>NASDAQ</b>	<b>+ .08%</b>
<b>Lg Cap Gwth</b>	<b>+ 1.47%</b>
<b>Lg Cap Val</b>	<b>+ 9.14%</b>
<b>Mid Cap Gwth</b>	<b>+ 4.06%</b>
<b>Mid Cap Val</b>	<b>+11.02%</b>
<b>Sml Cap Gwth</b>	<b>+ 1.08%</b>
<b>Sml Cap Val</b>	<b>+ 9.38%</b>
<b>Foreign</b>	<b>+13.08%</b>
<b>Interm Corp Bds</b>	<b>+ 4.25%</b>
<b>Foreign Bds</b>	<b>+ 9.93%</b>

## IRA Asset Protection

A recent Federal Supreme Court ruling said that IRAs have protection from creditors similar to 401(k), 403(b) and other plans governed by the Employee Retirement Income Security Act (ERISA). The ruling came about partly because Congress recently legislated that you can freely move your retirement money between all of these plans.

ERISA plans are employer sponsored retirement plans with rules governed by the Labor Department. IRAs (including SEP IRAs, SIMPLE IRAs, etc.) are governed by IRS rules.

When Congress passed ERISA in the 70's, it significantly reduced abuses in pension plans. ERISA also provided creditor protection for company sponsored retirement plans (401(k), 403(b), Profit Sharing, etc.)

This became important to O.J. Simpson when he lost a civil judgment to his former wife's family. He had put all of his retirement assets (\$25 million) into his retirement plan so that it was out of reach from the Goldman family.

The argument made to the Supreme Court was that just moving retirement money from the exempt 401(k) to the non-exempt IRA should not make it available to creditors. The Supreme Court agreed that the purpose of IRAs, like 401(k)'s is to enable Americans to save for their retirement. The court also said that the right to receive income from IRAs, like 401(k)'s is based upon age (penalty of 10% for withdrawals before 59 ½ and mandatory distribution after 70 ½). Note: Since Roth IRAs don't have minimum distribution requirements, the court might not exempt them from bankruptcy.

However, all is not rosy. Unlike ERISA plans that are totally protected from creditors, IRAs are only protected to the extent they are needed to support the debtor and dependents. Thus, very large IRAs may not be protected and the amount will vary by how much you can prove you need for support.

Having creditor protection for IRAs is important because investment choices within 401(k) plans are very limited. Usually a 401(k) will have from 4 – 15 options; whereas an IRA can be invested in cash, CDs, any stock, bond or one of over 17,000 mutual funds.

Thus, there is frequently a performance penalty of leaving money in a 401(k) due to limited

choice, poorly performing choices, and high costs. This performance penalty must be offset against the unlimited creditor protection of a 401(k). An IRA has lower costs, unlimited choice of investment (and usually better performance), but less creditor protection.

The Supreme Court ruling applies to federal bankruptcy laws, not state laws. Five states – Arkansas, Massachusetts, Minnesota, South Carolina and Wisconsin as well as the District of Columbia – allow residents to choose between state and federal bankruptcy exemptions. In another 10 states where one can choose, there is already "nearly unlimited protection" offered under state law so most people would choose state law. In the remaining 35 states (including Virginia), state law governs and the Supreme Court ruling may not apply.

Virginia bankruptcy law allows enough of an IRA to be protected from creditors to generate \$17,500 in income. They use a table to determine the actual amount based upon age. The maximum amount is \$143,000 at age 65; at age 50 the amount is only \$38,000.

However, the new bankruptcy law Congress passed allows a \$1 million exemption for IRAs. There is some question as to which exemption amount will apply in Virginia. Upcoming court cases or legislation will sort it out.

As you can see, everyone who moves money from an ERISA plan to an IRA needs to understand the pro's and con's before making the

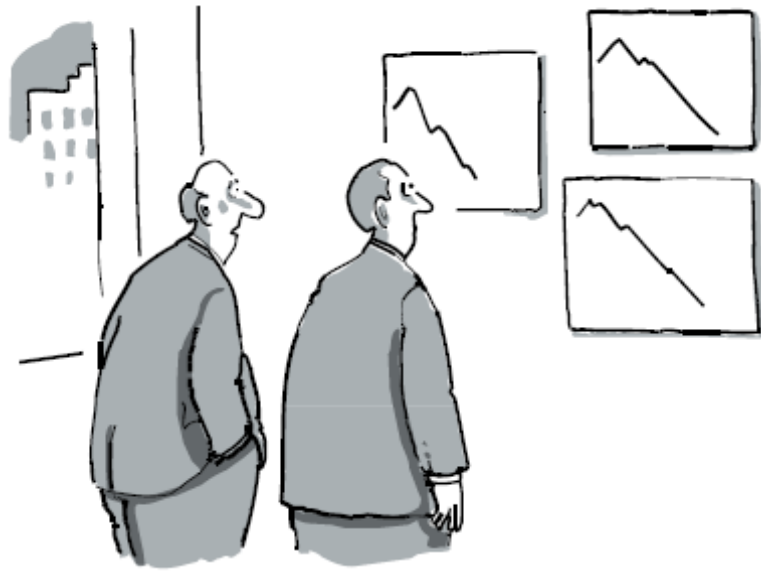
move. Those at low risk of litigation and/or bankruptcy may just cover the risk with an umbrella personal liability policy (in addition to the normal liability protection that comes with home/car insurance). Those at high risk may choose to accept the reduced choice and lower returns of their ERISA plan.

## 529 Plans and Taxes

If you contributed to a 529 last year, do you have any tax consequences? On your federal form, no. Your 529 contributions are not deductible and earnings are not taxable at the federal level.

However, you may (depending upon your state) have a state tax deduction. In Virginia, those under 70 may deduct up to \$2,000 per plan for contributions (over 70 can deduct the entire amount contributed). Contributions not deducted in one year are carried over in following years until the entire contribution is deducted on your Virginia taxes.

If you withdrew funds during the year, you should receive a Form 1099-Q showing how much of the distribution was basis (non taxable) and earnings (possibly taxable). You will not have to report anything on your federal return if the withdrawal was a rollover into another 529 plan or if the withdrawal was a "qualified withdrawal". To be qualified, the beneficiary must have attended an eligible post-secondary institution and incurred "qualified higher education expenses" during the year equal to or greater



*"The board is probably going to cut me back to an 80% salary increase this year."*

than the withdrawal (See IRS Pub 970).

If the withdrawal was neither a rollover or qualified, you will need to report the earnings on the beneficiary's tax return (Line 21). Taxable earnings will incur a 10% penalty as well (unless the distribution was due to death, disability, receipt of a scholarship, or when qualified expenses are adjusted by the Hope or Lifetime Learning credit expense. Finally, if you have a loss, you can deduct it as a miscellaneous itemized deduction.

**If your contributions to 529 plans are less than \$11,000 for any one beneficiary, you should not have to file a gift tax return (Form 709). Married couples can contribute \$22,000 per year if they agree to split gifts, but they must file a gift tax return so they can indicate they agreed to split gifts.**

Thus, if any donee gets more than \$11,000 from you, a gift tax return must be filed. You will also have to file a gift tax return if you make a large contribution and elect to have it spread over five years (maximum allowed).

**So, you can contribute \$55,000 (\$110,000 for married couples) to one beneficiary in one year and file a gift tax return spreading that contribution over the next five years. No need to file gift tax returns after the first year.**

One last note on bankruptcy treatment of 529 plans. According to the new bankruptcy law, all funds contributed to a 529 two years before filing for bankruptcy are exempt. Only \$5,000 is protected if contributed within one to two years. The account beneficiary must be the debtor's child, stepchild, grandchild, or step-grandchild.

You can't set up a 529 for yourself and expect the

money to be exempt! As soon as someone tries to cram all their assets into 529 plans to avoid creditors, Congress may well change the law to prevent such "abuse".

## New SSI Rules

After many years of struggling with the issue of **clothing, Social Security changed their rules in March**. From now on, **clothing provided "in kind" (gifts, etc.) will not be counted as "income" to a disabled child**.

Prohibitions against "in kind" support in the form of food or shelter remain. It is important to avoid this type of income because it will reduce a person's SSI benefit on a dollar-for-dollar basis.

Social Security indicated that items of clothing were received infrequently and sporadically and generally had no substantial value. Tracking gifts of clothing was burdensome and provided a disincentive for family members to help needy relatives.

There is one exception to the new rule. **Social Security will count as income clothing provided by an employer**.

One result of this new rule is that **Special Needs Trusts can now purchase clothing for beneficiaries without jeopardizing the beneficiary's SSI payments**.

**Social Security also eliminated the \$2,000 value exclusion limit for household goods and personal effects**. In addition

to no longer counting household goods and personal effects, Social Security will exclude items of cultural or religious significance and any items required because of any impairment (not just physical impairment). Gems, jewelry that is not worn or held for family significance, and collectibles are still considered countable resources.

**Social Security also deleted the \$4,500 limit on the one car that would not be a countable resource. Thus, the value of one car, no matter the value, is now excluded from countable resources**.

(The above was adapted from an article in the Feb 18, 2005 Elder Law News published by the law firm of Oast & Hook).

## Medical Insurance

**Few Virginia families with disabled children are aware that their family medical insurance premiums could be paid by Medicaid**. The Health Insurance Premium Payment Program (HIPP) is a program of the Virginia Department of Medical Assistance Services.

**To be eligible for HIPP, you or a family member must be Medicaid eligible, be employed and be able to get group health insurance from your employer**. Medicaid is always the secondary payer if you have a group health plan from an employer. Therefore, it's less expensive for Medicaid to pay to keep your group plan in place than to pay all of your medical costs.

**To apply just fill out a HIPP Application with social Services. Once accepted, you will receive a check every month that covers the cost of your group health insurance**.

So, here's the deal. You have a disabled child who is eligible for Medicaid living with you at home. Your employer has group health insurance that covers your whole family. (Note: **Many employers will cover adult disabled children after age 22 – 23 if you supply appropriate documentation, but they often give you only a 30-day window to supply the documentation or lose the option forever**).

You apply for the HIPP program and get accepted. Thereafter, you will receive a monthly check to you for the amount on your company paystub related to health insurance. It's that simple and **can save you thousands of dollars!** Check it out!! **Call 800-432-5924**.

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