Johnston Investment Counsel

Trusted Fiduciaries & Fee-Only Advisors

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Johnston Investment Counsel
Gregory A. Johnston, CFA, CFP, QPFC, AIF
President & Chief Investment Officer
331 Fulton
Suite 429
Peoria, IL 61602
309-674-3330
309-685-6957
gjohnston@jicinvest.com
www.jicinvest.com

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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.

Estate Planning for a Second Marriage

Giving love another chance:

- *12% of men have married twice*
- *13% of women have married twice*
- *3% of each have married three or more times*

Source: U.S. Census Bureau, 2008.

They say that love is lovelier the second time around. But for many individuals, remarriage later in life can create some unique estate planning issues.

If you're anything like the typical person contemplating a second (or third) marriage, you're older, you have children, you've accumulated property, and you've been enjoying a standard of living you would like to maintain. Entering into a new marriage can raise many, perhaps conflicting, concerns such as:

- How can you protect assets you already own?
- How can you provide for children from a previous marriage?
- How do you share assets acquired or inherited after the marriage equally or fairly?
- How do you ensure your prospective spouse's future financial security?
- How can you avoid family disharmony?

How should you address these concerns?

Put your financial cards on the table

Money is a major cause of stress in any marriage, but it can be especially so in a second one. You and your future spouse should discuss and agree on all important financial issues, and formulate plans that, hopefully, everyone can live with. Full disclosure is important, especially if you intend to...

Protect your assets with a prenuptial or postnuptial agreement

You're probably well aware that life is not a stroll down the primrose path, so while the suggestion of a prenup or postnup may not fan the flames of romance, you should know that this contract is important if you're bringing assets into the marriage. Why? By law, a surviving spouse has the right to take an "elective share" of the deceased spouse's estate, regardless of what is in the will. An elective share is typically one-third or one-half of the estate. An elective estate can include almost all the decedent's property, even property with beneficiary designations and property held in trust. If your surviving spouse takes his or her elective share, this may result in the unintentional disinheritance of your children or other heirs.

The only way to supersede elective share laws is with a prenup or postnup, in which both parties can waive their rights to the elective share. This way, you can minimize the chance that state law will interfere with your intended estate plans.

Revise your will and other estate planning documents

Remarriage does not revoke a will (although state law can trump a will, as we have just discussed). It is vital, therefore, that you draft a new will in light of your new circumstances. While you're at it, review and update other estate planning documents, such as your durable power of attorney, health-care directives (e.g., living will, health-care proxy), trusts, and beneficiary designations (for life insurance and retirement plans, for example).

Providing for your children from a previous marriage

A big concern in many second marriages is providing for the new spouse without disenfranchising children from a prior marriage. Having your assets pass into a "QTIP" trust can be part of the solution. With a QTIP, all trust income is used to support the surviving spouse while the principal is preserved for the children. And there's a bonus: assets passing to a valid QTIP qualify for the marital deduction, helping to minimize potential estate taxes at your death.

Dealing with wealth disparity

In second marriages, it's not uncommon for one spouse to be wealthier than the other. If estate taxes are a concern, equalizing your estates to take advantage of both spouses' exemptions ($3.5 million in 2009, subject to change thereafter) may be in order. Without equalization, you may lose valuable tax savings if the less wealthy spouse dies first.

Apportioning estate taxes

If both spouses have children from a previous marriage, you may want to plan for the payment of estate taxes in such a way that each child will bear the burden equally.

Conclusion

Each couple entering into a second marriage has unique concerns and goals. It's important to deal with your issues squarely, and create a plan that will optimize dispositions, minimize taxes, and avoid unintended results, family disharmony, or even litigation.

Going to Graduate School: Ways to Pay

Are you thinking about going to graduate school? Whether you want to advance in your current field or move your career in a new direction, graduate school might open doors for you. But it isn't cheap. Here are some suggestions on where to look for financial help.

Loans, loans, loans

Students attending graduate school can borrow from two sources: the federal government and private lenders. Uncle Sam's three major loan programs--the Stafford loan, Perkins loan, and graduate PLUS loan--are all available to graduate students, provided they attend school on at least a half-time basis. The following chart highlights each loan program:

	Stafford	Perkins	PLUS
Based on need?	Subsidized:[1] Yes Unsubsidized: No	Yes	No
Loan limit for 2008/09	Subsidized: $8,500 Unsubsidized: $12,000	$6,000	Up to full cost of education for year
Interest rate	Subsidized: 6.0%[2] Unsubsidized: 6.8%	5%	8.5%

[1] Subsidized means the government pays the interest during school, deferment, and grace periods.

[2] The interest rate on subsidized Stafford loans disbursed on or after July 1, 2009, and before July 1, 2010, is 5.6%.

To apply for federal loans, students should file the government's aid application, the FAFSA. It can be filed online at www.fafsa.ed.gov.

Students can also obtain loans from private lenders, though such loans typically carry higher, variable interest rates.

Scholarships and grants

At the graduate level, most scholarships and grants come from the school itself, rather than outside organizations, and are often awarded on the basis of merit, not need. So it's always a good idea to contact the financial aid office of any school you're considering to see what special scholarships and grants they offer for graduate students. Many scholarships and grants are awarded at the departmental level, so your chances might depend on what subject you plan to study.

Employer educational assistance

If you plan to work while you attend graduate school, check to see if your employer offers any educational assistance. The first $5,250 of such assistance is exempt from federal income tax. But make sure to read your employer's fine print: some may require that you maintain a certain grade, or that you remain at the company for a certain number of years after you obtain your degree.

Education tax benefits

Education tax benefits may not help you pay the upfront costs of tuition, but they might help defray some of those costs later on when you file your taxes. For more information, see IRS Publication 970, *Tax Benefits for Education*. In 2009, you may qualify for the:

Lifetime Learning credit--Is worth up to $2,000 for tuition and fees if your modified adjusted gross income (MAGI) is below $50,000 (single) or $100,000 (married filing jointly).

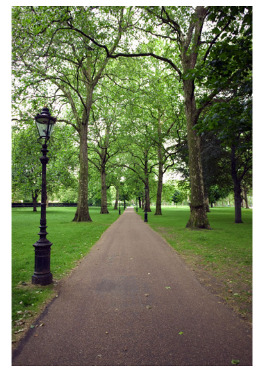
Deduction for qualified higher education expenses--Lets you deduct $4,000 in tuition and fees if your MAGI is below $65,000 (single) or $130,000 (married filing jointly).

Student loan interest deduction--Lets you deduct up to $2,500 of qualifying student loan interest if your income is $60,000 or less (single) or $120,000 or less (married filing jointly).

A partial credit/deduction is available for each of these tax benefits for filers with slightly higher incomes than those listed.

Look before you leap

Finally, before you make that first tuition payment, ask yourself whether a graduate degree makes sense for your long-term career goals. Will you be more marketable after getting your degree? Will the return on your investment be worthwhile? Do you plan to stay in this career going forward? Assuming the answers to these questions are yes, the expense of graduate school might be a worthwhile investment for you.



Graduate school numbers heading up

Many colleges have seen graduate school applications rise 10% to 20% over last year, and applications are expected to grow even more next year, because graduate school enrollment is typically a lagging indicator of the economy.

Source: Council of Graduate Schools, Washington, D.C.

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gjohnston@jicinvest.com
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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.