



JOHNSTON INVESTMENT COUNSEL

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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

The Independent 529 Plan



If you're a parent or grandparent looking at your state-sponsored 529 prepaid tuition plan as a vehicle to stash your college savings, you may

be interested to know there's another type of prepaid tuition plan that is sponsored by colleges. To date, only one such national prepaid plan run by a consortium of private colleges exists--the Independent 529 Plan.

How does it work?

The Independent 529 Plan operates like a typical prepaid tuition plan by allowing you to prepay tuition today that your child or grandchild can use in the future at any member college. But instead of the *state* carrying the risk that contributions won't meet future tuition increases, the *colleges* carry that risk. Specifically, the member colleges guarantee that the amount of tuition you purchase today will satisfy the proportionate amount at the time your child or grandchild enrolls.

For example, let's say you purchase tuition certificates today that are worth two years of tuition at College ABC. Your child or grandchild would then be covered for two years of tuition in the future at College ABC, no matter how much tuition rises or what happens in the markets.

Member colleges and tuition certificates

Currently, there are over 270 participating member colleges in the Independent 529 Plan (for a complete list, call 1-888-718-7878 or visit www.independent529plan.org). When you open an account, you purchase a certificate in the child's name. You don't choose a college ahead of time. The certificate you purchase will represent a different value at each member college because each college has a different tuition rate. For example, a \$20,000 certificate purchased today may be worth one year of tuition at College ABC but only half a year of tuition at College XYZ.

Each year, new tuition rates are set for each member college. As an added bonus for plan

participants, member colleges must discount their tuition between 0.5% and 2% from their official "sticker price" rates. Any certificate you purchase is valued at the plan's current year's tuition rates. Each certificate must be held for at least three years before it can be used. If a member college ever withdraws from the plan, it is obligated to honor all certificates that were purchased prior to its withdrawal.

One last point: keep in mind that opening an account in the plan doesn't guarantee that your child or grandchild will be accepted at a member college--the application process is separate and unrelated.

Other benefits

The Independent 529 Plan has no joining fees, maintenance fees, or annual fees--all administration and management costs are paid by the member colleges. And like state-sponsored prepaid tuition plans, the increase in value between the amount you prepay and the amount of tuition for which the certificate is redeemed is free from federal income tax. Anyone can open an account, and you can contribute as little as \$25 per month or larger lump sums up to \$190,000--the 2009/2010 contribution limit.

What if my child or grandchild doesn't attend a member college?

If the child doesn't attend a member college, you can: (1) get a refund, subject to a maximum return/loss of +/- 2% per year (the withdrawal amount will be free from federal income tax if it's used for the child's qualified education expenses); (2) change the beneficiary to a different family member without penalty; or (3) roll over the account tax free into a state-sponsored 529 prepaid tuition plan or college savings plan.

Note: Before enrolling, read all plan documents carefully. Also, before investing, consider whether your state offers a 529 plan with favorable state tax benefits. For additional help, contact your financial professional.

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LIFE THE WAY YOU PLANNED IT.

They're Baaack: RMDs for 2010

Required minimum distributions, often referred to as RMDs, are amounts the federal government requires you to withdraw annually from traditional IRAs and employer-sponsored retirement plans after you reach age 70½ (or, in some cases, after you retire). RMDs are also required if you inherit an IRA (traditional or Roth) or employer plan account. You can always withdraw more than the minimum amount from your IRA or plan in any year, but if you withdraw less than the required minimum, you'll be subject to a federal penalty tax equal to 50% of the shortfall.

In response to deteriorating economic conditions in 2008, Congress (as part of the Worker, Retiree, and Employer Recovery Act of 2008, or "WRERA") waived RMDs from IRAs and defined contribution employer plans for the 2009 calendar year. This allowed individuals to avoid having to deplete retirement plan assets while the value of those assets was suddenly depressed. But RMDs are back for 2010. Here's how the rules apply.

IRA owners and employer plan participants

If you turned 70½ before 2009, your RMD for the 2009 calendar year, which was due by December 31, 2009, was waived. You must now resume taking RMDs. Your next RMD (based on your December 31, 2009, account balance) must be taken no later than December 31, 2010.

If you turned 70½ in 2009, your first RMD (for the 2009 calendar year) was due by April 1, 2010. This RMD was waived. You must now take your first RMD (for the 2010 calendar year, based on your account value as of December 31, 2009) no later than December 31, 2010. You'll need to take your second RMD from the account (for the 2011 calendar year) no later than December 31, 2011.

If you turned 70½ in 2010, your RMDs are not impacted by the 2009 waiver at all. Your first RMD (for the 2010 calendar year) is due by April 1, 2011, and is based on the value of your account on December 31, 2009. You'll need to take a second RMD from the account no later than December 31, 2011.

Inherited accounts

In general, if you inherit an IRA (traditional or Roth) or employer-plan account, you must begin taking RMDs over your life expectancy ("life expectancy" rule) starting with the year

following the year of the account owner's death. Alternatively, you may elect, or your plan may require, that you withdraw the entire account by December 31 of the calendar year containing the 5th anniversary of the account owner's death ("five-year" rule).

- Per the WRERA, if you inherited an IRA or employer account, and you were using the life expectancy payout rule, then your RMD for the 2009 calendar year was waived. You must take an RMD for the 2010 calendar year no later than December 31, 2010.
- If you inherited an IRA or employer account, and you were using the five-year rule for RMDs, you ignore 2009 when determining when your five-year period ends. So, for example, if your original five-year deadline was December 31, 2009, you ignore 2009 and you now have until December 31, 2010, to complete withdrawals from the account. Similarly, if your original five-year deadline was December 31, 2013, your new deadline, ignoring 2009, is December 31, 2014.
- If you inherited an employer plan account, you may have been given the right to elect whether to use the five-year rule or the lifetime expectancy payout rule for taking RMDs. This election is generally required no later than December 31 of the year following the year of the account owner's death. Per IRS Notice 2009-82, if your deadline for making the election was December 31, 2009, you now have until December 31, 2010, to make that election.
- If you inherited an employer account from someone other than your spouse, and the five-year rule applies to your benefit, you generally have until December 31 of the year following the year of the account owner's death to make a direct rollover of the account to an inherited IRA, and use the lifetime expectancy payout rule for distributions from the IRA. If the account owner died in 2008, you generally would have needed to complete your rollover by December 31, 2009. Per Notice 2009-82, you have until December 31, 2010, to complete the rollover.

As you can see, the 2009 waiver significantly complicates the RMD landscape for 2010. If you're taking RMDs from an IRA or employer-sponsored retirement plan, you may want to consider reviewing your situation with your financial professional.



As you can see, the 2009 waiver significantly complicates the RMD landscape for 2010. If you're taking RMDs from an IRA or employer-sponsored retirement plan, you may want to consider reviewing your situation with your financial professional.

Transferring Your Family Business to Your Children

You've spent years building your family business. It's been a source of pride and income for both you and your family. But now you may be thinking about how to hand over the reins to your children. Because transferring your business interest to your children may have income, gift, and estate tax consequences, it can take careful planning to prevent some (or all) of the business assets from having to be sold to pay those taxes. Your business succession planning should include ways to ensure the continuity of your business with the smallest possible tax consequences.

Some common strategies for minimizing taxes are discussed briefly below, but remember, none of these strategies are without drawbacks. Before you act, consult a tax professional as well as your estate planning attorney.

Gifts or bequeathing your interest outright

If you don't need continued income from the business and you don't want to retain some control, you can simply give the business to your children outright. To minimize the gift tax consequences, you can first use your \$1 million lifetime exemption. Then, you can begin a systematic program of making annual gifts to your children in amounts that equal the annual gift tax exclusion (currently \$13,000 per year per recipient). By transferring your interest in this manner, you may be able to transfer all or a significant portion of the business free from federal gift tax (although these transfers may still be subject to state gift tax). The disadvantage here is the amount of time that may be needed to transfer your entire interest.

If you can wait and transfer your business at your death, Section 6166 of the Internal Revenue Code allows any estate taxes incurred because of the inclusion of your family business in your estate to be deferred for 5 years (with interest-only payments for the first 4 years and interest plus principal due in the fifth year), and then paid in annual installments over a period of up to 10 years. This will allow your beneficiaries more time to raise sufficient funds to pay the taxes or obtain more favorable interest rates if they need to borrow the money. Be aware that the business must exceed 35% of your gross estate and other requirements must be met.

Selling your interest outright

If you need income from your business, you can sell your business interest (for full fair market value) to your children. This will avoid gift and estate taxes, but you may owe capital gains taxes. Long-term capital gains tax rates,

however, are currently lower than gift and estate tax rates.

Using a buy-sell agreement

If you want to sell your business interest to your children but retain control over the business for a while, consider using a buy-sell agreement. This is a legal contract that prearranges the sale to happen when a specific event occurs, such as your retirement, disability, divorce, or death. When the triggering event occurs, the children will be obligated to buy your interest from you or your estate. The price and sale terms will have been predetermined.

Remember, however, that you will be bound under a buy-sell agreement: you won't be able to sell or give your business to anyone except the buyers named in the agreement (unless they consent).

Using a grantor retained annuity trust (GRAT)

A GRAT is a trust into which you would transfer your business interest. The value of the gift is determined using the IRS's current interest rate (published monthly by the IRS). The trust must terminate at a specified time (e.g., 10 years). You receive annuity payments during the term of the trust, and at the end, your children will receive the business. Hopefully, the business will have appreciated beyond the IRS's interest rate, allowing the excess to pass tax free. Be aware however, that if you die during the GRAT term, your entire business interest will be included in your gross estate for federal estate tax purposes. You will have failed to transfer your business interest and lost the tax advantages of the GRAT, and you will have incurred the costs of creating and maintaining the GRAT for nothing, so structure your GRAT carefully.

Creating a family limited partnership (FLP)

An FLP is a type of business entity. First, you establish a partnership with both general and limited partnership interests. Then, you transfer the business to this partnership. You retain the general partnership interest for yourself, allowing you to maintain control over the day-to-day operation of the business. Over time, you gift the limited partnership interests to your children, leveraging your lifetime gift tax exemption and the annual gift tax exclusion. You also save taxes because the value of the gifts may be eligible for valuation discounts, such as the minority interest and lack of marketability discounts.



With a GRAT, you receive a fixed dollar amount that does not change even if the value of the trust property (corpus) increases or decreases. You may, alternatively, retain the right to receive a fixed percentage of the trust corpus, determined annually. That type of trust is called a grantor retained unitrust (GRUT).

A rolling or cascading GRAT is a technique that involves creating a series of short-term GRATs (typically two or three years) with each successive GRAT being funded by the annuity payments from the previous ones. This technique can minimize the risk of the grantor dying during the GRAT term, and can also minimize interest rate risk.



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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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Ask the Experts



Is it time to give mobile banking a try?

If you like the idea of paying your bills or tracking your saving or spending 24/7, then you might want to consider mobile banking.

With mobile banking, you can use your cell phone or other mobile device to check your account balances, including savings and checking accounts, IRAs, loans, and credit cards, and then transfer money from one account to another if necessary. You may also monitor credit card activity, check bill or loan due dates, and pay one-time or recurring bills. (Not all financial institutions offer all these services, though.)

Depending on your needs, you can access information in a variety of ways. For example, you can sign on to your financial institution's website or install an application on your mobile device to enable you to log on more quickly. Or, if you don't want to download software or special browsers, or your device isn't web-enabled, you can use text messaging features to request information or view your account balances on registered devices. You

may also be able to sign up for low balance or transaction alerts via text messaging.

While it's hard to take issue with the convenience of mobile banking, what about safety? In general, mobile banking offers at least the same level of security and encryption as online banking, and account data is typically not stored on your mobile device. However, like online banking, mobile banking is subject to certain risks, and safeguarding your personal and account information is vital. For example, download mobile applications from reputable sources only, use strong passwords, and read your financial institution's mobile banking agreement and disclosures. If possible, avoid using free wireless service available at public locations when conducting sensitive financial transactions.

Finally, how much of a concern is cost? While most financial institutions offer free mobile banking services, normal transaction fees will apply. And your wireless service provider may charge you for text messages or downloads, so check the terms of your data plan agreement.



How secure is your mobile device?

A host of financial applications, or "apps," available for use on a smartphone or other web-enabled mobile device has made handling your

finances easier. Among other things, you can manage your accounts using integrated money management tools, plan a budget, track business mileage, compare prices, calculate loan payments, and track the stock market in real time--wherever and whenever you want. But using these apps without first making sure your device is secure can expose you to unnecessary risks.

Start with the basics--read the manual. Find out what security features are included and activate them according to the manufacturer's instructions.

One major risk is that mobile devices are frequently lost or stolen, potentially exposing your personal and financial information. As inconvenient as it might be, using a passcode on your device is an essential first step to keeping your information safe. If your

device has a smart card (called a SIM card) with a microchip that stores your personal information, you'll want to add a passcode to that too. You may also want to purchase software that will allow you to remotely lock your device, wipe data from it, or even track it via GPS.

As the use of smartphones and other mobile devices grows, mobile cybercrime is also growing. Be especially careful when downloading apps. To reduce the odds that you'll end up with malicious code on your device that could compromise your security, deal only with reputable vendors and sites. Make sure that you have installed antivirus, anti-spam, and encryption software that will help protect your device from spyware, viruses, and other threats, and keep it up-to-date. Avoid storing confidential information on your phone, and never respond to messages or click on attachments sent by individuals you don't know.

Finally, if your phone or device is lost, stolen, or otherwise compromised, contact your data plan provider immediately to report the incident, and have your service suspended.

