Johnston Investment Counsel

Trusted Fiduciaries & Fee-Only Advisors

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LIFE THE WAY YOU PLANNED IT.

401(k) In-Plan Roth Conversions

You may have heard the buzz ... 401(k) plans can now permit in-plan Roth conversions. But is this an option for you?

What is it?

A 401(k) in-plan Roth conversion (also called an "in-plan Roth rollover") allows you to transfer the non-Roth portion of your 401(k) account into a designated Roth account within the same plan. The amount you convert is subject to federal income tax in the year of the conversion (except for any nontaxable basis you have in the amount transferred), but qualified distributions from the Roth account in the future are entirely income tax free. The 10% early distribution penalty doesn't apply to amounts you convert (but that tax may be reclaimed by the IRS if you take a nonqualified distribution from your Roth account within five years of the conversion).

What part of my account can I convert?

Here's where it gets a bit tricky. Assuming your 401(k) allows in-plan conversions (plans aren't required to), you have to be entitled to a distribution from the plan in order to make a conversion. For example, you're generally entitled to a distribution from your 401(k) plan after you terminate employment. If your account balance is greater than $5,000, you also have the right to keep your money in the plan until you reach normal retirement age (typically 65). So in this case, your plan may allow you to transfer all or part of your account into a Roth account (except for any required distributions and certain periodic payments).

But what if you're still employed? If you want to transfer your pretax contributions and earnings into a Roth account, you'll generally only be able to do so if you're age 59½ or disabled, or you've received a qualified reservist distribution, because those are the only events that can trigger an eligible distribution (hardship withdrawals aren't eligible for rollover or conversion). In some cases, your vested employer contributions (and earnings) may also be available for distribution while you're still employed--for example, after the contribution has been in the plan for two years, or after you have 60 months of participation (the terms of your plan, and federal law, control). If your plan allows these distributions, it can also allow them to be converted.

Keep in mind that if you're entitled to an eligible rollover distribution, you can always roll those dollars into a Roth IRA instead of using an in-plan conversion.

Some employers aren't comfortable letting employees withdraw their retirement funds while they're still employed. The IRS has addressed this concern by letting 401(k) plans provide for the in-service distributions described above *only* if the employee intends to convert those funds. For example, a plan that currently doesn't let employees withdraw pretax dollars at age 59½ can be amended to allow those withdrawals, but only if an employee intends to roll those dollars into a Roth account--the employee would not be allowed to actually take a distribution of the funds, or roll the dollars over into an IRA.

What else do I need to know?

If you have the choice of an in-plan conversion or a rollover to a Roth IRA, which should you choose? There are a number of factors to consider:

- You can recharacterize (undo) a Roth IRA conversion if the conversion turns sour (for example, the value of the converted assets declines significantly), but you can't recharacterize in-plan conversions.
- In general, the investments available in an employer 401(k) plan are fairly limited, while virtually any type of investment is available in an IRA (on the other hand, your 401(k) plan may offer investments that you can't replicate in an IRA, or that aren't available at similar cost).
- Finally, 401(k) plans typically enjoy more protection from creditors under federal law than do IRAs (consult a professional if creditor protection is important to you).

Don't Be Nickeled-and-Dimed by Account Fees

If you encounter a fee you don't agree with, talk to an account representative at your bank or credit union. He or she may be willing to rebate the fee, or suggest alternatives to help you reduce or avoid future charges.

Interest rates on deposit accounts, such as savings accounts, interest-bearing checking accounts, and money market accounts have been persistently low, and rates aren't likely to improve any time soon. To make matters worse, financial institutions are under pressure to raise account fees, as they look to recapture some of the revenue lost in the wake of stricter financial regulations. The result is that some account holders now earn less interest on their money than they pay in account fees.

Though it's hard to find attractive interest rates, it's relatively easy to save on account fees if you're willing to do your homework. Start by reviewing your account statements to determine your spending and saving habits. What average account balance do you generally maintain? Do you pay monthly account maintenance or service fees? How many ATM transactions do you have in a month? Are you overdrawing your account? Once you know your financial habits, you'll be ready to take steps to reduce account fees.

If you pay account maintenance fees

An account maintenance or service fee is a common monthly service charge that applies to some accounts. Financial institutions offer a variety of products, each with their own fee structure. Often, higher maintenance or service fees may apply to accounts that pay higher interest rates. To help avoid these fees:

- Shop around, and compare your options--not all banks and credit unions charge maintenance fees.
- Make sure you understand and follow account requirements. For example, monthly maintenance fees may be reduced or waived if you sign up for direct deposit or online bill pay, maintain another account, or tie your account to a loan or mortgage.
- Read your account statements and notices you get from your financial institution. Otherwise, months may go by before you notice that fees have gone up or account requirements have changed.
- Reevaluate your needs regularly. They change over time, and you may want to switch your money to another type of account, or even find another bank or credit union that better suits your needs.

If you frequently use ATMs

Withdrawing money from an ATM is so quick, it's easy to overlook how much it's costing you. Fees for ATM transactions generally range from $2 to $5, and may be higher. One way to minimize these fees is to choose a financial institution that owns many local ATMs, but that isn't your only option. To help reduce ATM costs:

- Ask for a list of surcharge-free ATMs. Many financial institutions participate in networks that enable account holders to withdraw cash from designated ATMs without paying a surcharge. You can also download an application to your mobile device to help you find surcharge-free ATMs anywhere in the country.
- Plan your spending. Withdrawing larger amounts when possible (at least enough to last for a week) will substantially reduce the number of ATM transactions you have.
- Look for a bank or credit union that rebates ATM fees imposed by ATMs owned by other financial institutions (limits may apply).
- Opt for cash back when you use your debit card (a minimum or maximum amount may apply). This is often a free or low-cost alternative to going to the ATM.

If you tend to overdraw your account

Overdrafts are common--a 2009 study by the nonprofit Center for Responsible Lending found that over 50 million Americans overdrew their checking account over a 12-month period. To help reduce or eliminate overdrafts:

- Look into online banking. Being able to track your account history whenever you want can help you avoid overdraft fees. You'll also be able to quickly transfer funds among accounts, should the need arise.
- Sign up to receive transaction or low balance alerts via your mobile device or computer.
- Link your savings account to your checking account so that money will be automatically taken out of your savings account should you overdraw your checking account (typically, little or no fee is charged).

The bottom line

Often, people choose a bank or credit union based on convenience--the location of branches, easy access to ATMs, and hours of service. Convenience is important, but so is cost. And you don't have to settle--there are plenty of banks and credit unions across the country that offer great products and excellent service, without hitting you too hard in the pocketbook.

Of the total new benefits awarded by Social Security in 2009, 16% was paid to survivors of deceased workers. Source: Social Security Administration

Social Security Survivor's Benefits

You might think Social Security is a program that only provides you with a monthly income after you retire. But what you might not realize is that Social Security may also provide monthly payments in the form of survivor's benefits, based on your work record, to certain members of your family after your death.

Earning survivor's benefits

In order to be able to provide Social Security survivor's benefits to your family, you have to earn those benefits. Generally, to be eligible for survivor's benefits, you must pay Social Security taxes and you have to work long enough to earn sufficient credits to be fully insured. The length of time you need to work and pay Social Security taxes depends on your age--the younger you are, the fewer years you need to work. But in any case, if you've worked at least 10 years (the equivalent of 40 credits) you'll be fully insured for any Social Security benefits, including survivor's benefits.

Even if you haven't worked long enough to be fully insured, if you've worked at least 1½ years out of the 3 years immediately before your death, survivor's benefits will be available to your dependent children and to your spouse if he or she is caring for your children.

Who can receive survivor's benefits?

Your spouse is eligible to receive full survivor's benefits at your spouse's full retirement age. Full retirement age is 66 for people born between 1945 and 1956, and gradually increases until reaching age 67 for people born in 1962 or later. Your spouse can receive reduced survivor's benefits as early as age 60. If your spouse is disabled, he or she can begin receiving survivors benefits as early as age 50. And your spouse can receive survivor's benefits at any age if he or she is caring for your child who is receiving Social Security benefits and is under age 16 or disabled.

Your former spouse, if you've been divorced, may receive survivor's benefits if your marriage lasted at least 10 years, and your former spouse does not remarry before age 60 (remarriage after age 60 will not affect your former spouse's eligibility for benefits based on your work record). If your former spouse is caring for his or her child who is under age 16 or who is disabled and entitled to benefits based on your work record, your former spouse may receive benefits at any age. In that case, your former spouse need not meet either the age or length-of-marriage requirements.

Your unmarried children may receive survivor's benefits if they are younger than age 18 or age 19 if they're attending elementary or secondary school full-time. If your child was disabled before reaching age 22, and remains disabled, he or she is eligible for benefits at any age. Also, your stepchildren, grandchildren, stepgrandchildren, or adopted children may be eligible for benefits under certain conditions.

Your dependent parents can get survivor's benefits if they're at least age 62 and you provide at least one-half of their support.

How much will the benefits be?

The easiest way to find out how much your family may receive in survivor's benefits is by checking your Social Security statement, which is sent to you each year beginning at age 25. Generally, survivor's benefits are based on your basic benefit amount, which can be increased by delayed retirement credits, or reduced if you claimed retirement benefits before reaching full retirement age. The amount your survivors receive is based on a percentage of your basic benefit, and the percentage, in turn, is based on the survivor's age and relationship to you.

For example, at full retirement age, your surviving spouse can receive 100% of your retirement benefit. However, if your spouse claims survivor's benefits between age 60 and under full retirement age, then the benefit will be reduced to between 71% and 99%, depending on his or her age. An eligible child and a surviving spouse caring for a child under age 16 would receive 75% of your benefit amount. At your death, there is also a one-time death benefit of $255 paid to your surviving spouse or child under certain circumstances.

Limits on benefits

Depending on the circumstances, the total amount of monthly benefits your family can receive is capped at between 150% and 180% of your retirement benefit amount. Your survivor's benefits may be reduced if you're receiving a pension from an employer that didn’t contribute to Social Security, like federal civil service, or if you're under your full retirement age but still working, and your earnings exceed certain limits.

Social Security survivor's benefits are an important means of providing for the continued support of your family members after your death. For more information, go to the Social Security website, www.ssa.gov.

Ask the Experts

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What health-care changes become effective in 2011?

The Patient Protection and Affordable Care Act (PPACA), signed into law in 2010, makes significant changes to our health-care delivery system. Here are some of the most important changes scheduled to take effect in 2011.

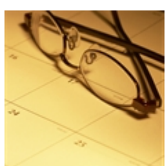
The cost of over-the-counter drugs not prescribed by a doctor can no longer be reimbursed through a health reimbursement account or a health flexible spending account, nor can these costs be reimbursed on a tax-free basis through a health savings account (HSA) or Archer medical savings account. Also, the tax on distributions from HSAs and Archer MSAs that are not used for qualified medical expenses increases to 20% (up from 10% and 15% for HSAs and Archer MSAs respectively).

Medicare Part D participants will receive a 50% discount on brand-name prescriptions filled in the coverage gap (i.e., the "donut hole") from pharmaceutical manufacturers, and federal subsidies for generic prescriptions filled in the coverage gap will start to be phased in.

Also, certain preventive services covered by Medicare are no longer subject to cost-sharing (co-payments), the deductible is waived for Medicare-covered colorectal cancer screening tests, and Medicare now covers personalized prevention plans including a comprehensive health risk assessment.

Medicare Advantage (MA) plans can no longer impose higher cost-sharing for some Medicare-covered benefits than would be imposed by traditional Medicare insurance. Also, MA plans cannot exceed a mandatory maximum out-of-pocket amount for most Medicare services. The maximum amount in 2011 is $6,700, but MA plans can voluntarily offer lower out-of-pocket amounts. Also, the annual enrollment period for MA plans is changed to October 15 through December 7.

The requirement that employers report the total value of employer-sponsored health benefits on employees' W-2s was to begin in 2011. However, the IRS has deferred this requirement until 2012.



Are some preventive care services free?

Generally yes. Under the Patient Protection and Affordable Care Act (PPACA), qualifying health insurance plans must offer certain preventive care services to you and your family at no cost.

If your health insurance plan is subject to these new requirements, you and your family may be able to receive important preventive health-care services without having a co-payment, deductible, or co-insurance. Many of the covered services are based on your gender, health status, and age. Some of these services include:

• Blood pressure, diabetes, and cholesterol screenings

• Mammograms, colonoscopies, and many other cancer screenings

• Routine vaccinations against diseases such as measles, polio, and meningitis, as well as flu and pneumonia shots

• Wellness counseling for such issues as quitting smoking and losing weight

• Screenings for depression and alcohol abuse

A current list of preventive care services can be found on the government website: www.healthcare.gov.

To be eligible, you must be enrolled in a health plan through your employer or have individual health insurance put in place after March 23, 2010. The preventive care services will then be effective on the next policy anniversary occurring on or after September 23, 2010, or as of January 1, 2011, for calendar-year plans. If your health plan is "grandfathered" (in place on or before March 23, 2010, and has not been materially changed), these benefits may not be available to you.

Free preventive services may only be available for in-network providers (you may have to pay for preventive services received from an out-of-network provider). Also, if your doctor provides preventive services, such as cholesterol screening, and other diagnostic or therapeutic services during the same office visit, you may have to pay for part of the office visit and the other services given by your doctor, but not the preventive services.

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