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Client Appreciation Day Speaker

Ms. Gina Despres will be the featured speaker this year at Client Appreciation Day. Ms. Despres is a Senior Vice President at Capital Research and Management Company. She is also the Vice Chairman and Chief Executive Officer of the New Perspective Fund, New World Fund, Capital World Growth & Income Fund, and EuroPacific Fund. Previously, Ms. Despres was Tax Council and Foreign Policy Advisor for Senator Bill Bradley of New Jersey. She also practiced law in firms in Los Angeles and Washington D.C. Ms. Despres is also a member of the Board of Trustees at Asia Foundation since August 2005. She is the Chairman of the company's global investments committee. In addition, Ms. Despres is a member of the Council of Foreign Relations, the International Women's Forum, and is on the Editorial Advisory Board of the International Economy Magazine.

BATES Briefings

Spring 2011

from George's Desk

We now have a new tax law, so at least we know what 2011, and possibly 2012 (Congress will have to pass another tax bill in late 2012), tax considerations will be. I would like to enumerate a few of the ones that will affect most of us.

1. Long-term capital gains will have a maximum tax rate of 15%. The same applies to "qualified" dividends. Generally that means dividends from stocks.

2. For those in the 15% bracket or lower, the tax rate is 0% on long-term capital gains and qualified dividends.

3. The federal estate tax gives a credit that in effect allows you to pass $5 million per person to your heir(s) other than a spouse, and a 35% maximum tax rate on the excess. The amount left to a spouse is unlimited for estate tax purposes.

4. For those of us in Illinois, we were the recipients of a new tax law that raises our income tax rate from 3% to 5%. That same law established a new inheritance tax provision that allows a person to pass $2 million to non-spousal heirs without tax, BUT if your estate is over $2 million you have an 8% tax going back to the first dollar.

5. The federal tax law re-instated the provision for taxpayers over 70-1/2 years of age to send part or all of their required minimum distribution from their IRA (maximum of $100,000) to a charity or charities of their choosing directly without having to include it in their gross income. I have written more about this in another article in this issue.

On another topic, I recently read of a proposal by the President of the Federal Reserve Bank, in Kansas City, to encourage Congress to pass a new law that would reinstate some of the provisions of the Glass-Steagall law that congress repealed (unwisely so in my opinion) in the late nineties. That law prohibited commercial banks, investment banks, investment brokerage firms or insurance companies to be owned by the same entity. The repeal of that law was, in my opinion, what allowed banks, brokerage firms and insurance companies to become "Too Big to Fail."

He also has taken the position that much stricter rules should apply on debt to equity ratios for these financial institutions. It was the absurd amount of leverage that these financial institutions employed that led to the bankruptcy of Lehman Brothers and the emergency takeover of firms like Merrill Lynch by Bank of America that prompted our government to "bail out" these companies in 2008. Unfortunately, the Dodd-Frank financial regulations law that was passed last year did little to address that problem.

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Reminder: *We cannot accept trade instructions left on voice-mail or sent via email. If you would like to add/withdraw money or make changes to your investments, please call during business hours.*

You Converted Your IRA to a ROTH IRA in 2010. Now How Do You Pay The Taxes?

by Mark Jones

2010 is gone and now 2011 is here. So, how do you pay those taxes on the money you converted from your IRA to your ROTH in 2010? I'm sure there are more than a handful of you reading this newsletter that spent a lot of time trying to decide on whether you should convert or not convert your IRA to a ROTH IRA. For those of you who chose to convert your IRA, that decision has now long been made. For those of you who did not convert you can still choose to do so in 2011 and beyond, however you won't be able to take advantage of the special provision that the "2010 converters" can take advantage of.

We are now in the first few months of 2011 and you still have to make a decision on how to pay the taxes on the amount that you converted in 2010 if you have not filed your taxes yet. The big question for those of you who decided to convert in 2010 is when to include the income for the conversion. If you converted in 2010 you have a choice to make. You can choose to include all of the income in 2010 or you have the special option of spreading the conversion income equally between 2011 and 2012. Remember that 2010 was the only "special" year that you had this option. If you convert in 2011 and beyond, the conversion income will be included in the year you do the conversion.

For those of you who decided to convert in 2010 and now you are possibly reconsidering your decision, you do have the ability to change your mind. Maybe your account has declined in value after you converted, you don't have the money to pay the taxes on the money you converted, or all of sudden you find yourself in a higher tax bracket than you expected. You will have until October 17, 2011 to "re-characterize" your conversion and switch the account back to a traditional IRA.

In conclusion, whether you have chosen to convert in 2010 or later, I would like to remind you that converting to a ROTH is not an "all or nothing" deal. You can convert as little or as much as you want of your IRA and to determine what would be best for your particular situation you should contact your Bates advisor.

From George's Desk…

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I can hear some saying, "George, enough already, this is way over my head." I am sorry, but most of us need to pay more attention and become more informed about what our government is doing. Our financial future is at stake! BIG TIME!

On a happier note, I read with great interest portions of a speech given by the highly acclaimed Jeremy Siegel, professor at the Wharton School. His view is, that based on historical data, the stock market is currently 20% below the long-term trend line. The recent decline of 39.4% below that line was the 5th largest deviation in the last 145 year history of the U.S. stock market. Now the good news: "On average, markets rallied 24% in the year following those 5 deviations and investors have received a 21.4% average return each of the 3 years following, and 18.4% average return per year over the following 5 years."

There was much more in his speech that would probably cause some of your eyes to glaze over, but I will summarize it by saying on an inflation adjusted basis the market at current levels is almost 25% undervalued by historical standards when compared to corporate earnings.

CHARITABLE CONTRIBUTIONS

Here is just a quick note regarding the new tax legislation passed by Congress in December of 2010.

In the bill they renewed the provision that individuals required to take a distribution from their IRA can have all or part of it (up to $100,000) sent to one or more charities, which results in the distribution being excluded from that individual's gross and taxable income.

This exclusion is available for 2010 and 2011. If you file the short form for federal income taxes, making a charitable contribution this year out of your IRA could lessen your burden come tax time. It could also potentially increase your medical deductions if you file the long form. In addition, it could also potentially reduce or eliminate the taxes on your social security. Finally, for those in higher income brackets it could reduce your Medicare part B premiums.

Entitlements *by George E. Bates CFP®*

Much is being discussed, argued, and demonstrated for and against the amount of government spending and accumulated debt by both the state and national governments. The states of Illinois and California teeter on the brink of financial collapse by most accounts. The U.S. government appears to have little resolve in their actions to reduce the trillion dollar plus budget deficits for a number of years in the future. So what are you and I to do or think about this?

At the risk of offending some, I would like to make a few comments. First, I do not believe this is a Democratic, Republican or Independent problem. It is a National problem. Our elected officials have over promised what they can deliver. The subject most discussed is the deficit and the debt, but I would suggest the "un-funded" liabilities in Social Security, Medicare and Medicaid are a bigger problem. By recent reports these entitlements have an unfunded liability of 50 trillion dollars (to give a little perspective that translates to $50,000,000,000,000.00). That is over 3 times our national debt. The primary difference is, the debt is <u>money</u> we owe other people and governments, and the entitlements are <u>promises</u> we have made to people.

I believe most national government or business leaders will admit we cannot fix our deficit problem without addressing these entitlements, but it is political suicide for one political party's leaders to introduce legislation to change the terms of these promises.

In recent memory (almost thirty years ago) the leaders of both major political parties came together and made, what were considered, radical changes in Social Security. They phased in over thirty plus years the age at which one could receive full benefits from 65 to 67 years of age. We need to do something like that again. As many of you probably know, when Social Security was first enacted in 1935, the age for full benefits was 65 and life expectancy was 61. In addition, since then we have added death benefits, disability benefits and dependant benefits without proportionally raising the tax rate.

As I have mentioned before, when Medicare was enacted in 1965 the expected expenditures would rise from $3 billion in 1965 to $12 billion in 1990. However, by 1990 the Medicare expenditures were $107 billion and in President Obama's recently released budget proposal for fiscal 2012 it is over $700 billion. What you may not know is the premium Medicare recipients pay for Part B (doctor bills) and Part D (prescription drugs) is based on their income and those in the highest tax bracket pay almost 4 times as much as those in lower brackets.

"What can I do?" you ask, I am just one person. I propose there are 4 things you can do: First, write your Congressman and Senator and tell them you understand they are going to have to "attack" the "holy grail" of politics, and reduce the promises that they or their predecessors made regarding Social Security and Medicare, and you will not hold that against them, because it is something that HAS to be done to keep our country strong financially. Secondly, you have to realize we are going to have to do more for ourselves, or our children and grandchildren are going to inherit a second or third class nation financially. Third, when a politician accuses people of the other party or an opponent in a primary of wanting to "take away" your Social Security or Medicare benefits, they are demagoguing and you should not trust them. I do not care what party or political movement they belong to. Lastly, if you have an idea that you believe might be a solution or partial solution to these challenges, write it down and send it to your representatives in Washington. I have done this, and though I do not get much, if any response, I am going to keep doing it.

We are <u>all</u> in this together folks!