

# THE GRAY REPORT

Autumn 2007

*"The income tax has made more liars out of the American people than golf has." —Will Rogers*

## How to Set Financial Priorities

People often make mistakes in their financial priorities. Most of us need to save more and get rid of debt, but some tasks are more pressing than others. For instance, parents frequently, and understandably, save for their children's college education when they should be saving more for their own retirement first.

Priorities are the key. Here is the right order in which to prioritize your financial goals:

- **Debt.** The first priority is to pay off high-cost, nondeductible consumer debt.

Do not even bother saving for retirement or saving for college if you have not paid credit card debt. That is because paying off a credit card that is charging 18% interest is like earning an 18% risk-free, tax-free rate of return.

There are a couple of different strategies for getting rid of debt. Some people like to first pay off the credit card with the lowest balance, to see faster

results. The most cost effective method is to pay off the card with the highest interest rate first.

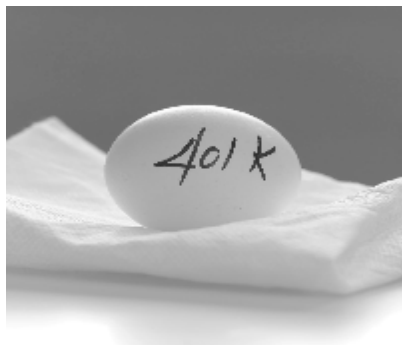
- **Cash savings.** Once, the credit card debt is gone, save enough cash to live on for three to six months, and keep it easily available in a money-market account for emergencies. Someone with more financial flexibility, who could use a credit card if the car breaks down, could



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## Tax Law Change for Those Inheriting Retirement Plan Assets

Most 401(k)s and other employer-sponsored retirement plans are bequeathed to spouses, and with good reason. Until a recent change in rules, only a spouse could inherit a retirement plan other than an IRA and avoid immediate taxes. Now, although the process must be handled carefully, any beneficiary should be able to inherit a retirement plan balance and enjoy the same tax-postponing benefits that a husband or wife always could.



Under the old rules, if your husband got the retirement plan assets, fine; he could roll over the windfall into his own IRA and make withdrawals over the course of his expected lifespan. Though each year's required distribution

would add to his taxable income, the rest of the account would continue to compound, and there might be a sizable balance left at his death.

But your daughter? Most employer plans require an account to be emptied within five years of an employee's death. She would have had to take the money and, not being allowed to move it into an IRA, would have been stuck paying income tax immediately—and likely would have lost a third or more of her inheritance to taxes in the process.

The new rules are much kinder to non-spouse beneficiaries. Now, should you choose to leave your 401(k) to a child, a same-sex partner, or anyone else, that person may roll over the inherited plan to an IRA. But the law is prickly about the process. To make a successful rollover, your heir must:

- Open an *inherited* IRA to take the money. A spouse who inherits a 401(k) can merge the account with her own IRA, but others must set up a new

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## Financial Priorities

set aside less cash. But you should save as much as possible if a job loss or other major event could be on the horizon.

• **Retirement savings.** Once you have a cash cushion, you should contribute to retirement account as soon as you hit the work force. Invest at least the amount of the company match, because that is free money.

People should be saving 15% of their salary for retirement. An investor could contribute \$15,500 into a 401(k) plan, which is for people in the private sector, or a 403(b) plan, for people in academia or nonprofits. People 50 and older can contribute an extra \$5,000 annually to these accounts. Depending on your tax situation, and especially if your employer does not offer a pension, you should also contribute to an individual retirement account.

• **College savings.** Saving for retirement must come before saving for college for the kids.

That is because there are many ways to pay for college. A student could borrow, get scholarships or attend a less-expensive community college or state university. But no one is going to lend you money or give you a scholarship for retirement.

Retirement is a priority. If you need to, you can borrow to go to college, but you can not borrow for retirement.

If you are saving 15% of your salary in a 401(k), by all means put some money away for your children's education. The most effective way to save is to contribute after-tax income into a state-sponsored 529 college-savings plan. Money in these accounts grow tax-free and can be withdrawn free of

income tax on investment earnings as long as it is used to pay for higher-education. New York State allows a deduction for contributions to the New York State 529 plan.

• **Prepaying your mortgage.** Many people find it tempting to prepay their mortgage. You are probably better off putting that extra money into your 401(k), at least up to the maximum matched by your company.

Prepaying is a good idea if you are close to retirement or already saving enough for retirement. Consider prepaying if you are in the latter portion of a mortgage, just to be rid of the small balance, which provides only a negligible tax savings.

• **Buying insurance.** If you have not evaluated your insurance coverage in a while, do it now. Home values have soared in recent years. Make sure that your homeowner and auto policies are up-to-date and that the deductibles make sense.

Do you have enough life insurance? As a general rule of thumb, a full-time worker with a family should have life insurance equal to six-to-ten times salary. In recent years, the cost of life insurance has dropped significantly, especially term life.

Additionally, people need to consider whether to buy long-term-care insurance, which can help pay for time spent in nursing or assisted-living care.

• **Estate planning.** No matter the size of your estate, it is important to update your will to ensure that your wishes are carried out. That means you also should have durable power of attorney and a health-care power of attorney, which authorizes someone to make medical decisions if you cannot make them yourself.



## An Internet Chain Letter

Here is one we received which contains some excellent advice.

A corporate attorney sent the following out to the employees in his company:

1. "The next time you order checks, have only your initials (instead of first name) and last name put on them. If someone takes your checkbook, he will not know if you sign your checks with just your initials or your first name, but your bank will know how you sign your checks.

2. Do not sign the back of your credit cards. Instead, put "PHOTO ID REQUIRED."

3. When you are writing checks to pay on your credit card accounts. DO NOT put the complete account number on the "Memo" line. Instead, just put the last four numbers. The credit card company knows the rest of the number, and anyone who might

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## Chain Letter Advice

be handling your check as it passes through all the check-processing channels will not have access to it.

4. Put your work phone number on your checks instead of your home phone. If you have a PO Box, use that instead of your home address. If you do not have a PO Box, use your work address. Never have your Social Security number printed on your checks, (DUH!). You can add it if necessary. However, if you have it printed, anyone can get it.

5. Place the contents of your wallet on a photocopy machine. Copy both sides of each license, credit card, etc. You will know what you had in your wallet and all of the account numbers and phone numbers to call and cancel. Keep the photocopy in a safe place. Also carry a photocopy of your passport when traveling.

6. When you check out of a hotel that uses cards for keys (and they all seem to do that now), do not turn the "keys" in. Take them with you and destroy them. Those little cards have on them all of the information you gave the hotel, including address and credit card

numbers and expiration dates. Someone with a card reader, or an employee of the hotel, can access all that information.

Here is some critical information to limit the damage in case this happens to you or someone you know:

### MAJOR CREDIT BUREAUS:

#### EQUIFAX

[www.equifax.com](http://www.equifax.com)

Fraud line: 1-800-525-6285

Credit report line: 1-800-685-1111

#### EXPERIAN

[www.experian.com](http://www.experian.com)

Fraud line: 1-888-397-3742

Credit report line: 1-888-397-3742

#### TRANS UNION

[www.tuc.com](http://www.tuc.com)

Fraud line: 1-800-680-7289

Credit report line: 1-800-916-8800

### SOCIAL SECURITY ADMINISTRATION

Fraud Hotline: 1-800-269-0271

1. We have been told we should cancel our credit cards immediately. The key is having the toll free numbers and your card numbers handy so you know whom to call. Keep those where you can find them.

2. File a police report immediately in the jurisdiction where your credit cards, etc., were stolen. This proves to credit providers you were diligent, and this is a first step toward an investigation (if there ever is one).

3. Call the three national credit reporting organizations and the Social Security Administration immediately to place a fraud alert on your name and Social Security number. The alert notifies any company that

checks your credit that your information was stolen, and requires them to contact you by phone to authorize new credit."

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## Inheriting Retirement Plan Assets

account specifically created to receive funds transferred from the deceased's retirement plan.

- Be sure to title the new account correctly. For instance, Dad IRA (deceased) FBO Daughter.
- Make sure the money goes directly from the company plan to the heir's new IRA. If your beneficiary touches the money, he or she will be immediately taxed.

If you have ever changed jobs, you may already have transferred retirement funds from your former employer to an IRA. Until the rules changed, that was the only way to ensure favorable tax treatment for a non-spousal heir. And even now, a rollover is often advisable. IRAs tend to offer a wider range of investment options than you get in a typical 401(k),

and it is easier to monitor investments in a single account.

There is at least one advantage to keeping your money in a 401(k), however. If you retire, you may begin taking distributions from an employer plan at age 55 without incurring the 10% early withdrawal penalty you would owe for withdrawing assets from an IRA before age 59½. Under the new rules, you can have the penalty-free early access of a 401(k) while also accommodating non-spousal heirs.

Why not take a minute right now to see how Gray CPA can help you? Whether you need to review your existing plan or need to develop a plan from scratch, we have the expertise to help you get started and look forward to hearing from you.



# GRAY CPA

*Financial Clarity*

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### Our Newsletter is Now Available Via Email!



If you would like to sign up to receive our e-newsletter, please send us an email to [info@graycpa.com](mailto:info@graycpa.com).

## We're Growing!

We are pleased to announce the addition of Patricia Lough to our team! Patti graduated from SUNY Binghamton in May and will be taking the CPA exam soon. We are very excited to have her join us and know you will enjoy working with her.



# Happy Thanksgiving



*Thanksgiving...a time of great joy, warm thoughts, and sincere gratitude.*

*It is the perfect time of year to send our sincere thanks for your business.*

*Wishing you all the best at Thanksgiving and always.*

Thank you for all of your past referrals, and a special thank you in advance for your very welcome future referrals. We really do appreciate them!

If you know of anyone who might benefit from our services, please continue to let us know. You may call or email us. You can be sure that your referrals will be in very good hands.