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## 2009 Legislation in Review

The year 2009 saw several important changes, some of which may also affect you in 2010.



### Suspension of RMDs

One of the biggest changes for 2009 actually stemmed from a 2008 piece of legislation that suspended the rules requiring individuals older than 70½ to make withdrawals from certain retirement accounts. The one-year moratorium on required minimum distributions (RMDs) applies to 2009 only.

Without this suspension, individuals who reached age 70½ before 2009 would generally be required to take 2009 RMDs by December 31, 2009. Individuals who turned age 70½ *during* 2009 would generally have until April 1, 2010, to take 2009 RMDs—but the suspension applies to these individuals as well. The suspension of RMDs for 2009 also applies if you're the beneficiary of an inherited IRA or employer retirement account. Normal RMD rules apply for 2010.

### American Recovery and Reinvestment Act of 2009 (ARRA)

In addition to extending several expiring tax provisions, this legislation made some changes, including the following:

- A new "Making Work Pay" tax credit was established for 2009 and 2010. This credit is equal to 6.2% of earned income, up to \$400 (\$800 in the case of a married couple filing jointly). The credit is phased out for higher-income individuals.
- The Hope education tax credit was expanded for 2009 and 2010, and renamed the American Opportunity Tax Credit. With an increased annual limit per student of \$2,500, the expanded credit covers the first four years of post-secondary education, with up to 40% of the credit refundable.
- Up to \$2,400 of unemployment compensation benefits received in 2009 are

excluded from gross income for federal income tax purposes.

### Energy-related tax changes

ARRA also created, extended, and modified several tax incentives to encourage the efficient use of energy sources and the development of energy-related technology. Among other things, the legislation:

- Increased the lifetime tax credit cap for energy-efficient home improvements from \$500 to \$1,500 (for 2009 and 2010).
- Removed the separate \$200 credit cap on window upgrades (the \$1,500 lifetime cap applies, though).
- Removed the credit cap on qualified geothermal heat pumps, solar hot water heaters, and small wind energy property (through 2016).

### Other changes

- A "first-time" homebuyer can qualify for a tax credit of up to \$8,000 for the purchase of a qualified personal residence.
- A new government subsidy equal to 65% of COBRA premiums paid by eligible beneficiaries for up to nine months of health-care coverage was established. This subsidy was generally available to individuals whose employment was involuntarily terminated on or after September 1, 2008, and before January 1, 2010. The subsidy was phased out for individuals with higher incomes.
- The "Cash for Clunkers" program provided cash vouchers to encourage consumers to trade in older, less fuel-efficient vehicles for new vehicles that get better fuel economy. The government ended this program on August 24, 2009, as the program ran out of funds.



## Retirement: Does Your Withdrawal Strategy Need a Second Look?

In its simplest terms, a withdrawal rate is the percentage you withdraw from an investment portfolio in any particular year. However, in retirement income planning, what's important is not just your withdrawal rate, but your sustainable withdrawal rate.

A sustainable withdrawal rate represents the maximum amount (expressed as either a dollar amount or a percentage) that can be withdrawn from your retirement assets each year with reasonable certainty that the portfolio will provide income for as long as it's needed (for example, throughout your lifetime).

A commonly expressed rule of thumb states that your portfolio should last for your lifetime if you initially withdraw 4% of your balance (based on an asset mix of 60% stock and 40% fixed income securities), and then continue withdrawing that same dollar amount each year, adjusted for inflation. However, this rule of thumb has been under increasing scrutiny, and like any rule of thumb, it may not apply to you.

### Why is it important?

A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money. You want to find a rate of withdrawal that gives you the best chance to maximize income over your entire retirement period.

Withdrawal rates are based on a number of assumptions, including your living expenses, projected lifespan, risk tolerance, projected rates of return and inflation, asset allocation, taxes, and whether you wish to leave a portion of your estate to others. As you progress in retirement, you'll have empirical data against which you can evaluate these assumptions. Plus, your investment horizon will be getting shorter. That's why it's important to periodically revisit your withdrawal strategy during your retirement to see if your assumptions are still accurate and whether your strategy needs to be modified.

### Dealing with market volatility

If you're currently withdrawing a fixed percentage of your investment portfolio each year, the amount you receive will fluctuate with the performance of your portfolio. Small changes may not significantly impact your lifestyle. But what if your portfolio suffers a serious decline

due to a market downturn? Will you be able to meet your expenses with the reduced withdrawal amount you'll be receiving? If you're currently withdrawing a fixed dollar amount each year, you may be able to meet your expenses, but can your reduced portfolio continue to support that same dollar amount or will your assets be depleted much too soon?

The converse of this is also true. If your portfolio realizes a gain that's significantly greater than your assumptions, a fixed percentage withdrawal will provide you with more dollars than you had been taking. Do you need the additional income? If you're taking a fixed dollar amount each year, is it time to give yourself a raise?

Market volatility may also lead you to consider changes in your asset allocation. If your portfolio is down, you may be inclined to become more conservative to avoid additional losses; conversely, when your portfolio is up, you might contemplate becoming more bullish. But if your asset allocation is designed to produce sustainable long-term income, changes should be considered carefully and only implemented as part of a disciplined strategy.

### Other factors to consider

When you review your withdrawal strategy, make sure you consider the following:

**Inflation:** Inflation erodes your buying power. If you've underestimated the inflation rate, you may need to increase your withdrawals. If your portfolio can't support additional withdrawals, you'll need to reduce your expenses, or find another source of income (e.g., part-time work) to maintain your lifestyle. If inflation is lower than you've anticipated, you may be able to withdraw less and prolong your portfolio's income-producing ability.

**Lifestyle:** You may find that your expenses during retirement decrease from your initial estimate as you travel less or downsize a home—or they may increase because of health care or other costs.

**Legacy:** A decision to increase or decrease the amount you leave to heirs or charities can have a significant impact on your withdrawal strategy.

Revisiting your withdrawal strategy will allow you to focus on changes that have occurred during your retirement and fine-tune your strategy going forward, helping to ensure your retirement will be a financially secure one.

**A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money.**



## 2009 Year-End Tax Planning Considerations

Here are some things to consider as you weigh potential moves between now and the end of the year.

### Year-end moves and the AMT

Deferring income to next year—for example, by delaying a year-end bonus—is a common year-end tax planning strategy. Similarly, individuals often look for ways to accelerate deductions into the current year—for example, by paying deductible expenses in December rather than in January. If you're subject to the alternative minimum tax (AMT), however, these traditional year-end maneuvers may actually hurt you.

Essentially a separate federal income tax system with its own rates and rules, the AMT effectively disallows a number of itemized deductions, making it a significant consideration when it comes to year-end tax planning. For example, if you're subject to the AMT in 2009, prepaying 2010 state and local taxes won't help your 2009 tax situation, but could hurt your 2010 bottom line.

Legislation earlier this year forestalled a dramatic spike in the number of individuals subject to AMT by temporarily increasing AMT exemption amounts for 2009. If you're one of the millions of individuals still expected to be subject to AMT in 2009, however, that won't be much comfort. Taking the time to determine whether or not you may be subject to AMT before you make any year-end moves can save you from making a costly mistake. If you're not sure, talk to a tax professional.

### RMDs suspended for 2009

When you reach age 70½, you're generally required to start taking required minimum distributions (RMDs) from any traditional IRAs or employer-sponsored retirement plans you own. Individuals are required to take these distributions each year, withdrawing the minimum amount by the end of the year (individuals who turn 70½ during the year generally get until April 1 of the following year to take their first RMD).

Legislation in late 2008, however, suspended RMDs for 2009. (This suspension of RMDs also applies to amounts required to be paid to beneficiaries after an IRA owner's or plan participant's death.) This presents an opportunity for those normally required to take RMDs to postpone the receipt of taxable income.

### 2010 Roth conversion rules

It's also worth looking ahead to the special rules that will apply in 2010 when a traditional IRA is converted to a Roth IRA. Current limitations based on income and filing status that prevent many individuals from converting to a Roth IRA will be eliminated. Additionally, if you convert in 2010, half the income that results from the conversion can be reported on your 2011 federal income tax return and half on your 2012 return.

This 2010 conversion opportunity might influence your 2009 year-end planning. For example, if you're currently working but aren't eligible to contribute to a Roth IRA, you might consider making nondeductible contributions to a traditional IRA for 2009 in anticipation of making a conversion in 2010.

### Also worth noting

- A tax credit up to \$8,000 is available in 2009 for qualified first-time homebuyers.
- The first \$2,400 of unemployment compensation received in 2009 is excluded from income for federal income tax purposes.
- If you itemize deductions, 2009 is the last year you'll have the option to deduct state and local sales tax in lieu of state and local income taxes.
- The temporary deduction for sales and excise tax relating to the purchase of a qualified new automobile, light truck, or motorcycle applies to vehicles purchased through December 31, 2009.
- The above-the-line deduction for qualified tuition and related expenses expires at the end of 2009.
- The provision allowing small businesses to take an additional 50% in first-year depreciation expires at the end of 2009; the expanded \$250,000 Section 179 expensing limit for small businesses also expires at the end of 2009.

### Stay informed

It's always possible that legislation late in the year could extend some of the provisions above, or add new wrinkles—so stay informed. A financial professional can help you evaluate your situation and determine which year-end moves make the most sense for you.



### AMT "triggers"

*You're more likely to be subject to the AMT if you claim a large number of personal exemptions, deductible medical expenses, state and local taxes, and miscellaneous itemized deductions. Other common triggers include home equity loan interest when proceeds aren't used to buy, build, or improve your home, and the exercise of incentive stock options.*

## Ask the Experts



### What is a Build America Bond (BAB)?

Investors have a new way to invest in municipal bonds. The American Recovery and Reinvestment Act of 2009 authorized a subsidy for local and state governments that issue what are known as Build America Bonds (BABs) before January 1, 2011.

Unlike most municipal bonds, the interest payments you receive on a BAB are taxable on your federal income tax return. However, the federal government subsidizes 35% of those interest payments. That subsidy is made in one of two ways:

1. As a direct payment to the governmental body that issued the BAB, or
2. Via a 35% federal income tax credit on the net coupon interest to the bondholder

The governmental body that issues a BAB determines in advance which type of subsidy it prefers; so far, most governmental bodies that have issued BABs have chosen to do so

using the direct payment method rather than offering the tax credit.

If you're interested in tax credit bonds, don't assume the credit automatically makes them more valuable than a fully taxable bond. Because both the bond's interest payments and the value of the tax credit will be included in your gross taxable income, the calculation depends not only on the coupon rate but also on your tax bracket. It's best to check with your financial professional to compare a BAB to both taxable and tax-free municipal bonds to determine which is the better choice for you. Any unused portion of a BAB's tax credit may be carried forward to successive years.

Before investing, make sure you know if a given BAB offers the 35% tax credit, and what it would mean given your tax bracket. Also, remember that even though the federal subsidy is designed to help lower local governments' cost of financing projects, it does not mean that the bond is guaranteed by the U.S. government, as Treasury securities are.

### What is a refunded municipal bond?

In a time of falling interest rates, homeowners often try to refinance their mortgages to reduce their monthly interest payments. Issuers of municipal bonds often do something similar, issuing new bonds to pay off older debt.

The proceeds of the new bond or bonds can be used to replace a specific revenue source that was pledged to repay the interest and principal of older bonds (for example, a tax collected by the issuer or the revenues of a bond-funded project). The money received from issuing the newer bond is generally put into escrow and paid out over time as the older bond's obligations come due. Because the older bond no longer relies on its original funding source, but on the escrowed proceeds of the newer bond, the older bond is then considered a refunded bond.

Bonds that are refunded through their maturity dates are said to be "escrowed to maturity." The escrowed money is typically invested in or collateralized by U.S. Treasury securities timed to mature as the refunded bond's

interest and principal payments are due. If a refunded bond's original documents include a call provision that allows the issuer to pay off the bond before its maturity date, the bond is referred to as a pre-refunded bond.

Because refunding typically occurs after interest rates have fallen, refunded bonds generally offer a higher coupon rate than equivalent newer issues, and often sell at a premium to their par value. Also, because they are backed by escrowed money that is typically invested in or collateralized by U.S. Treasury securities, they are generally considered high quality bonds, much as Treasuries are.

However, even though it may be backed by Treasuries, a refunded bond itself is not guaranteed by the full faith and credit of the U.S. Treasury. Also, municipal bonds are subject to the risks associated with any fixed income security, including interest rate risk, credit risk, and reinvestment risk. Reinvestment risk is even greater if a bond is callable, meaning it could be redeemed prior to the maturity date.

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