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Retirement Planning: 2009 Cost-of-Living Adjustments

Every year, certain cost-of-living adjustments (COLAs) are announced that may increase what you can contribute to your retirement plan and IRA. Social Security benefit amounts rise and other figures related to Social Security change as well. (The 5.8% increase in benefits is the largest since 1982).

Here are some of those numbers, and others, that you will find useful as you do your retirement and Social Security planning.

Maximum retirement plan contribution limits

The 2009 maximum IRA/Roth IRA contribution limit is \$5,000. If you are 50 or older the contribution limit is \$6,000. For singles, eligibility for the Roth IRA contribution phase-out range is between \$105,000 and \$120,000. If you are married filing a joint return, the phase-out range is between \$166,000 and \$176,000.

For contributions to a traditional IRA, the deduction phase-out range for those covered by a retirement plan at work ranges between: \$166,000 and \$176,000 if only one active participant spouse; \$89,000 and \$109,000 if both spouses are active participants; and \$55,000 and \$65,000 for singles and heads of households.

The 2009 401(k) contribution limit is \$16,500 and \$22,000 if you are 50 or older. This year's Social Security tax rate for employees is 7.65% and the tax rate for self-employed is 15.30%.

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Maximum earnings taxable

Maximum earnings taxable for Social Security wage base is \$106,800. There is no limit on the Medicare wage base. Of the estimated 164 million workers who will pay Social Security taxes in 2009, about 11 million will pay higher taxes as a result of the increase in the taxable maximum.

Retirement earnings test exempt amounts

If you are under full-retirement age the retirement earnings test exempt amount is \$14,160 (\$1 in benefits is withheld for every \$2 in earnings above the limit.) The year in which full-retirement age is reached the test-exempt amount increases to \$37,680 (\$1 in benefits is withheld for every \$3 in earnings above the limit, but only for months prior to reaching full-retirement age.) After full-retirement

age is reached there is no limit on retirement earnings test exempt amount. The maximum Social Security benefit at full retirement age is \$2,323 per month.

Taxation of Social Security benefits

If you are single with a provisional income of less than \$25,000 a year there is no tax on benefits. The IRS defines provisional income as your modified adjusted gross income (MAGI) plus nontaxable interest plus one-half of your Social Security benefits. (MAGI is adjusted gross income plus tax-exempt income.) If your income range is \$25,000 to \$34,000 there is a tax on 50% of benefits and a tax on up to 85% of benefits with an income over \$34,000.

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Congress Authorizes 2009 Required Minimum Distribution Relief

IRA owners received an early Christmas present at the end of 2008 when Congress suspended the rule that requires mandatory withdrawals starting at age 70 1/2. The suspension, which is in effect for 2009 only, also applies to other retirement plans such as 401(k)s and IRA beneficiaries who must withdraw funds from inherited IRAs over five years.

If you have a traditional IRA, you must take a minimum annual amount from your IRA beginning in the year that you reach age 70 1/2. The amount is based upon your account balance at the end of the previous year and your life expectancy. If you don't make a withdrawal or withdraw the correct amount, there's usually a large penalty—50% of the difference between what you should have withdrawn and what you actually did withdraw, in addition to the usual ordinary income tax that you have to pay. Congress has removed the 50% penalty from the books for this year, eliminating the need to take money from your IRA if you don't need it. As it stands now, mandatory withdrawals will be in effect once again in 2010. For people who have inherited IRAs and are required to withdraw everything within a five-year period, if 2009 falls within those five years, the period is extended automatically by one year.

Is the RMD Change Good News?

If you've seen your IRA balance tumble, as most people have, it's some relief that you won't have to take a payout that would further deplete the account (or be forced to sell assets with depressed values that you would rather hold on to for now). And, of course, even as the markets recover, with less in your IRA, the harder it will be to bring the balance back to where it was before the decline. The opportunity to avoid a withdrawal does not eliminate the need to pay tax—it simply delays it. Using some round numbers, if you have, say, \$200,000 in your IRA right now, and your required payout was 4%, you would have pulled out \$8,000. At an income tax rate of 35%, you would have owed \$2,800. You still will need to pay that amount when you eventually withdraw the money.

There is a small economic benefit for the continued tax deferral on the \$8,000 for one year. Assuming that you earn 5% on that money for a year before it is withdrawn, it's \$400 more in your IRA. Not much, to be sure, but certainly welcome in times such as these.

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Teens Worry About Tough Times Too: Discussing the Economy with Your Teen

Worry about economic conditions is not confined to the adult world.

Many psychologists believe that children, especially teenagers, are well aware that their parents are concerned and are feeling—if not necessarily expressing—their own anxiety. In an ABC News poll conducted last November, 75% of 12- to 17-year-olds who said that their parents were worried about the economy also said that they were worried.

Parents are often reluctant to initiate discussions about family finances. It's a natural instinct for parents to want to shield their offspring from worry. Janet Bodnar, deputy editor at *Kiplinger's*, and a nationally recognized expert in the field of children's and family finances, believes that discussions with children are important. Although young children are apt just to need reassurance, she suggests that a talk with a teenager should be more in-depth.

Framing the discussion

The first step is to identify a time that is distraction free, when no one needs to be somewhere else. Remind them, as they are instructed in movies and concerts, "to turn off all cell phones and pagers."

A good way to start the discussion is to find out to what extent teens know what is going on. For example, do they understand what a recession is? Because they were too young during the recession that began in the early 2000s, a brief explanation of its effects—a falling stock market, job losses, and a drop in consumer spending—will shed some light.

You don't want to give teens any false hopes, but you can explain that, although the economic challenges that we face may last for some time, the

economy runs in cycles and will recover in time. Then ask them if they have questions.

From there, bring the macrocosm down to the microcosm (Example: what does all of this mean to the family?) Answer as straightforwardly as you can. You don't have to share every detail of your finances, but you might talk about how the family is coping by cutting back on spending and reducing expenses, said Dr. Mary Gresham, an Atlanta psychologist who specializes in financial issues, in a recent *Money* magazine article.

Make it a learning experience

Although the main goal is to ease a teen's concerns, a discussion also can be what some describe as a "teachable moment." For example, use the news about the rash of foreclosures to stress the necessity of living within one's means and the consequences of failing to do so. Explaining bankruptcy naturally leads to an understanding of why saving is important.

Find ways to actively involve teens in financial planning and money management. Allow them to help set family goals, small or large. Ask them to express their opinions about whether to "downsize" a vacation or to put off a major purchase for a time. Look together at the options for ways to save more for their college education.

Discussing the need to save to reach one's goals may be a good jumping-off point for introducing some investing basics. Because of the depth and breadth of the discussion, it may be a good idea to lay the groundwork with a few general concepts and then to set a time to sit down again to cover the subject in more detail.

Money management lessons

A dialogue about how difficult things are right now also affords an opportunity to review (or introduce) the fundamentals of how to manage money when you cut the purse strings.

A good way to make teens more aware of the importance of following an organized regimen is by showing them the mechanics of bill paying; how to record checks and debit card transactions in a checkbook, and how to reconcile them against a monthly statement. You can apply the same principles if you bank online.

Teens can then apply what they have learned to their own finances. It's easy enough to deposit checks and make withdrawals for them, but it's better to open a joint bank account with each of your children so that they learn the practicalities. Parents often provide older teens with credit cards as they enter college, so they can establish their own credit. If you are planning to do so, set the ground rules about what they can charge and what they can't. Be sure that they understand the consequences of not paying off a balance in full each month and, especially, how expensive it is if they don't.

Finally, move on to the need to budget. With an understanding of current events and the effects that they can have on personal finances, teens who have a job or an allowance should now understand the need to wisely spend their money. Have them list their required expenses (say, filling the gas tank or paying a share of the car insurance) and the discretionary (eating out with friends, buying clothes). Ask them, then, how much that they will have left to save every month.

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