HAAS Financial Services Incorporated

Center for Financial Gerontology

Money Monitor

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Mark's Memo

The 529 question: In-state or out-of-state?

One of the best tax advantaged investments created was codified in Section 529 of the US Tax Code in the Taxpayer Relief Act of 1997. The early plans were very restrictive, allowing parents and grandparents to invest in state-specific plans. Your student had to be a resident of, and was required to use the plan in the same state for the giver to enjoy state tax benefits. Don Haas thoroughly analyzed Michigan's Education Assistance Plan (MEAP) and concluded it was usually inferior to investing in Uniform Gift to Minor Accounts.

The Economic Growth and Tax Relief Reconciliation Act of 2001 completely changed Section 529, for the better. The new and improved rules vastly expanded the eligible funding beyond ***tuition*** to other reasonable college costs such as ***books, fees, room and board***. Lastly, states could create ***tax-deferred***, portable plans flexible enough to be used ***tax-free*** at any post-secondary educational facility which participates in the Federal Student Aid (FSA) program.

The only string attached to that piece of legislation was something called a ***sunset*** provision. The 2001 law limited the tax benefits to ten years. The Pension Protection Act of 2006 made the 2001 provisions permanent.

When you follow the rules, benefits received are said to be ***qualified withdrawals.*** Imagine you were in the early 1990s and put $10,000 in a moderately conservative equity account. That account could very well have grown to $40,000 by the end of the 1990s. You paid tax on the $10,000 invested then spent it all, by the rules, for your child. You just made $30,000 tax-free.

There is no question in my mind, this is a good deal. Here are the rest of the rules: Any student is qualified to have the plan. There are no age limits and no income limits. There is no time limit for how long it takes the student to graduate and no requirement to graduate. The student is called the ***beneficiary***.

You may change a beneficiary to: A son or daughter, or a descendant of either; A stepson or stepdaughter; A brother, sister, stepbrother, or stepsister; The father or mother, or an ancestor of either; A stepfather or stepmother; A cousin; A son or daughter of a brother or sister; A brother or sister of the father or mother; A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; or The spouse of the designated beneficiary or the spouse of any individual described above.

You may change the investment account only ***once per year.*** The amount of benefit you spend on the combined books, fees, room and board is published by the educational institution. The institution must be a qualifying institution.

If you break any one of the rules, you may incur adverse tax consequences. Any profits could be taxed as ordinary income (i.e. at your highest marginal rate) and could be subject to a 10 percent penalty.

INSIDE THIS ISSUE:	FYI	JIM'S JOURNAL

All 50 states and the District of Columbia now offer at least one plan. With so many plans in place, the decision to choose one over all the others can be very difficult. The factors to take into consideration are: Investment quality and performance; Investment suitability; Investment Advice; Expenses; Service; and not least, Tax Consequences.

Let's start with tax consequences in Michigan's plan. There are two levels of benefits the State of Michigan offers to contributors.

The first level of benefit is the most restrictive. If your student is a Michigan resident, is 6 or younger when the account is opened, and has never had a 529 account before, and the student's parents make less than $80,000, then the student may receive a match contribution of $1 for every $3 contributed, not to exceed $200, limited to the first year of contributions.

In other words, if you qualify (see run-on sentence above) and you make a $600 contribution, your child will get a matching contribution of $200. But wait, there are strings attached. If your student doesn't use the money at an eligible institution, dies, becomes permanently disabled or receives a full scholarship or is 30 or older and an account balance still exists the student forfeits all match amounts in the account.

The second lever of benefit is offered to Michigan resident tax payers who are Account Owners. An Account Owner is the person who gives the money and whose name is listed on the 529 Plan as the owner. If the account owner is married and files a joint tax return, the couple may enjoy a State Tax Deduction of $10,000. Only net contributions (contributions minus qualified withdrawals, calculated on a per-account basis) may be deducted up to the limits each year. For joint filers, married couples need only establish one account to take the maximum deduction.

Individuals will get half that benefit. In simple terms, a $5,000 contribution in 2007 would have saved the taxpayer $217 (i.e. 4.35% tax rate). $10,000 would have saved the taxpayer $435.

Are there strings attached? Oh yes there are. If the money is transferred to another state's plan or if you break any of the rules mentioned in the first half of this article, you forfeit the original tax savings.

As you can see, tax benefits are quantifiable. It also possible to definitively calculate fees and expenses, but with some difficulty (it takes a bit of reading, analysis and calculation). The fees are published in the state's *Official Statement* and the investment *Prospectus*.

After fees and expenses, the grantor of the funds needs to match their investment with investment needs. This takes a careful examination of the age of the student, needs of the student, risk tolerance of the investor, need for advice and state's offerings. State tax benefits and a cheap investment plan is not necessarily the best match.

As difficult as it is to find the right 529 plan, I am personally convinced the other alternatives pale in comparison. In reality, most parents can't really afford to properly fund these plans. Grandparents in my experience have been the most consistent contributors and managers of these valuable gifts.

Just a little background; the motivation for writing this article came from watching my son GarrettLee Alexander Davis, age 18, graduate from High School on 29 May this year. I am very proud of him and hope he goes on to graduate from college as well.

FYI

Minimum Required Distributions

As many of you know, tax law pushes you to take minimum distributions from your IRA, 401k, TSA or like pension account after you turn 70 and 1/2 years old. The penalties for neglecting to do so are extreme (50% tax on amount you did not, but were required to take). Therefore; we send you notice early in the year rather than later, just too carefully ensure compliance.

For those of you who do not have enough cash assets in your IRA to satisfy your distribution we have waited longer this year than usual because of the persistent low stock market. "Plan A" has been that we would see a rally to improve your account values before taking the money out. That has not happened.

"Plan B" is we start taking the distribution at the end of July regardless of what the market does. As always, each of your portfolios will be examined and a recommendation will be made to take your distribution from the most appropriate place. Once you take your distribution you may want to consider reinvesting in the same type of account. This would be a defensive action to conserve your investment position in a down market.

Feel free to call us for more detailed and personalized advice.

Jim's Journal

"What's Your NAAIM?

"What's your NAAIM? Is it Mary or Sue? What's your NAAIM? Can I have this dance with you? It's so hard to find a personality with charm like you..." Or do you remember, "The NAAIM Game"? You are at least a Baby Boomer if you can recall these songs so you can probably NAAIM That Tune. And as Shakespeare's Juliet would express to Romeo, "What's in a NAAIM? That which we call a rose. By any other NAAIM would smell as sweet." Finally, as we all know, everyone likes to hear the sound of their own NAAIM.

Please excuse my play on words of substituting NAAIM for NAME. I recently joined a group called the National Association of Active Investment Managers or NAAIM and these little phrases have been dancing thru my head so they just needed an outlet. Thanks for humoring me for a moment.

NAAIM was formed in 1989 as a non-profit association of registered investment advisors who provide active money management services to their clients. The goal of this organization is to produce favorable risk-adjusted returns as an alternative to more passive, buy, and hold strategies. Collectively, the 200 firms that belong to this group manage an estimated $17 billion dollars and range in size from small regional (sometimes only one person) to large national firms. Haas Financial Services, Inc is now a member and I am the representative for our firm. My reason for joining was to be able to interact with a group of people who would be willing to share their expertise on active money management.

It was thus with great excitement that I attended my first national NAAIM conference in Irvine, California (not a bad place to share ideas considering Michigan's rather cold spring). My expectations were exceeded. From technology in the small office to investing in foreign currencies, the sessions were a wealth of information- some of which I have already applied to the Money Management Program.

One particular session dealing with market cycles provided a report that forecasted stock prices would bottom on May 19-20. As it turned out, the

DOW was down -199.48 points on May 20 and -227.49 points on May 21. In this business, missing the mark by only a day is pretty impressive. At this time I do not know if there is any consistency of predictability here yet, but I am subscribing to their newsletter and will be following their market reports. This information is potentially of great value to the Money Management Program.

Another session dealt with some of the "investing myths" that we frequently hear in our business. One such "truism" is that the market is always good in the long term. That is certainly true if you have the life span of a giant tortoise or a sequoia tree. But consider this-most humans have about 15-20 years to accumulate their retirement wealth. Raising children and putting them through college is typically not a great time to save a lot of money. Consequently, most serious retirement saving start after age 40. Few people wish to work beyond 65 and most would prefer to retire even earlier. Hence, the compressed time for retirement savings. If you have already retired, the negative effect is intensified because you are most likely to be on a fixed income and not earning a regular paycheck. Look at the following chart and pay particular attention to the number of years it has taken to break even after various bear markets.

Bear Market	Months Duration	% Decline	Years to Break Even
9/29 - 6/32	33	87%	25
7/34 - 3/35	20	34%	2
3/37 - 3/38	12	54%	9
11/38 - 4/42	41	46%	6
5/46 - 3/48	22	28%	4
8/56 - 10/57	14	22%	2
12/61 - 6/62	6	28%	2
2/66 - 10/66	8	22%	1
11/68 - 5/70	18	36%	3
1/73- 10/74	21	48%	8
11/80 - 8/82	21	27%	2
8/87 - 12/87	4	34%	2
7/90 - 10/90	3	20%	0.5
4/00 - 10/02	31	45%	7.5
Average	**18**	**38%**	**5.3**
Exclude 1929	**17**	**34%**	**3.8**

If you were lucky, after the 1966 bear market, it only took one year to recover. If you were unlucky and in the market during 1929-32, it took 25 years to recover. While we can never really know how long it will take for our portfolios to recover after a bear market, we usually have an idea if we will be retiring soon or if we already retired. The closer we get to these events, the more influence negative markets have on us. This is my case for having at least part of your portfolio in the Money Management Program. Not only am I looking to try and enhance returns but I am also trying to manage downside risk by keeping losses within certain parameters. Losses always have and always will be part of the investing cycle; however, I believe one key to market success is to limit losses. Please call me for more information.

Note: At printing of this newsletter, I have moved to a 50% cash position since I believe there is more downside potential than upside potential at this point. As always, market conditions change and I am always looking for the best possible path to take.

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