



RBC Wealth Management

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In this issue:

Year-End Tax
Planning--Special Concerns
for 2010

In-Service Withdrawals from
401(k) Plans

How Will Financial Reform
Affect You?

Is it time to give mobile
banking a try?

Wealth Monitor

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Year-End Tax Planning--Special Concerns for 2010



Year-end tax planning is as much about 2011 as it is about 2010. Often, there's a real opportunity for year-end tax savings when you can predict that you'll be paying taxes at a lower rate in one year than in the other. For example, under the right circumstances, deferring a year-end bonus or potentially accelerating deductions into the current year can pay off in a big way. Of course, to effectively plan, it helps to have a good idea of what next year's tax rates will be. Unfortunately, as 2010 draws to a close, 2011 brings some uncertainty in that regard.

Will there be higher tax rates in 2011?

Currently, there are six marginal federal income tax brackets: 10%, 15%, 25%, 28%, 33%, and 35%. These brackets--the result of 2001 tax legislation--expire at the end of 2010. As things stand now, in 2011 the 10% bracket disappears, and the remaining brackets return to their pre-2001 levels: 15%, 28%, 31%, 36%, and 39.6%. Though it would take action by Congress, the president has indicated that he would like to permanently extend the 2010 rates for individuals earning less than \$200,000 and married couples earning less than \$250,000 (these dollar benchmarks would be reduced by an amount that reflected the standard deduction and exemption amounts), but allow the two highest brackets to return to 36% and 39.6% for higher earners.

What about long-term capital gains?

Currently, long-term capital gain is generally taxed at a maximum rate of 15%. If you're in the 10% or 15% marginal income tax bracket in 2010, though, a special 0% rate applies (in other words, you owe no tax on any long-term capital gain). The same rates apply to qualified dividends received in 2010.

These rates also expire at the end of the year. The maximum rate on long-term capital gain in 2011 will generally increase to 20%, with a 10% rate applying to individuals in the lowest tax bracket (special rules would apply to qualifying

property held for five years or more). Qualifying dividends will be taxed as ordinary income. The president has proposed to permanently extend the 0% and 15% rates, with a new 20% rate applying to high-income individuals (those in the 36% and 39.6% tax brackets). Again, though, that all depends on what Congress does in the next few months.

Other considerations

- **2010 Roth IRA conversions:** A special rule applies to Roth IRA conversions in 2010 that allows you to postpone paying federal income tax on the income that results from the conversion. Instead of including the taxable income that results from the conversion on your 2010 federal income tax return (still an option if you so choose), you can report half the income on your 2011 return and half on your 2012 return. Whether a Roth conversion makes sense for you depends on your individual circumstances, including your marginal income tax rate in 2011 and 2012.
- **Alternative minimum tax (AMT):** In a now-familiar pattern, legislation that temporarily increased AMT exemption amounts, forestalling a dramatic increase in the number of individuals ensnared by the tax expired at the end of 2009. Congress is likely to act, but the specifics are uncertain.
- **Required minimum distributions (RMDs):** The requirement to take minimum distributions from IRAs and defined contribution plans was temporarily suspended for 2009; minimum distribution requirements are once again in effect for 2010.
- **Pending legislation:** Legislation is pending to extend some popular provisions that had expired, including the ability to deduct state and local sales tax in lieu of income tax on Schedule A, the additional standard deduction for state and local real property tax, and the above-the-line deduction for qualified tuition and related expenses. And additional legislation is likely, too, so stay up-to-date.



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In-Service Withdrawals from 401(k) Plans

You're probably familiar with the rules for putting money into a 401(k) plan. But are you familiar with the rules for taking your money out?

All 401(k) plans are not the same

Federal law specifies the withdrawal options that a 401(k) plan can offer. But your plan can be stricter than the law allows (i.e., offer fewer withdrawal options), and may even provide that you can't take any money out until you reach normal retirement age (usually 65). However, many plans are more flexible.

Withdrawing your own contributions

If your plan allows, you can withdraw your own pretax and Roth contributions (and in some cases, any investment earnings on them) for one of the following reasons:

- You terminate employment
- You attain age 59½
- You become disabled
- You incur a hardship

Hardship withdrawals are permitted only if you have an immediate and heavy financial need, and only in an amount necessary to meet that need. In most plans, you must need the money to (1) purchase a principal residence or repair a principal residence damaged by an unexpected event (e.g., a hurricane), (2) prevent eviction or foreclosure, (3) pay medical bills, (4) pay certain funeral expenses, (5) pay certain education expenses, and (6) pay income tax and/or penalties due on the hardship withdrawal itself. In addition, you generally must have already utilized all other available distributions and nontaxable loans under all plans maintained by your employer. But think carefully before making a hardship withdrawal--in most plans your employer must suspend your participation in the plan for at least six months after the withdrawal, and you could lose valuable employer matching contributions.

Withdrawing employer contributions

Getting employer dollars out of a 401(k) plan can be even more challenging. Many plans won't let you withdraw employer contributions at all before you terminate employment. But some plans are more flexible, and let you withdraw at least some vested employer contributions before then. "Vested" means that you own the contributions and they can't be forfeited for any reason. In general, a 401(k) plan can let you withdraw vested matching or profit-sharing contributions if:

- You become disabled
- You incur a hardship
- You attain a specified age
- You participate in the plan for at least five years, or
- The employer contribution has been in the account for a minimum of two years

Taxation

Your own pretax contributions, company contributions, and investment earnings are taxable when withdrawn from the plan. If you've made any after-tax contributions, they'll be nontaxable when withdrawn. Each withdrawal is deemed to carry out a pro-rata portion of taxable and nontaxable dollars. Any Roth contributions, and investment earnings on them, are treated separately: if your distribution is qualified, then your withdrawal will be entirely free from federal income taxes. If your withdrawal is nonqualified, then each withdrawal will be deemed to carry out a pro-rata amount of your nontaxable Roth contributions and taxable investment earnings. And keep in mind that taxable distributions made prior to age 59½ are generally subject to a 10% premature distribution tax in addition to any income tax due, unless an exception applies.

Plan loans

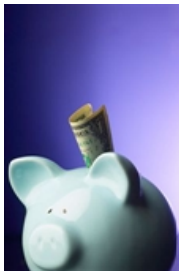
Many 401(k) plans allow you to borrow money from your own account. A loan may be attractive if you don't qualify for a withdrawal, or you don't want to incur the taxes and penalties that may apply to a withdrawal.

In general, you can borrow up to one half of your vested account balance (including your contributions, your employer's contributions, and earnings), but not more than \$50,000.

You can borrow the funds for up to five years (longer if the loan is to purchase your principal residence). In most cases you repay the loan through payroll deduction, with principal and interest flowing back into your account. But keep in mind that when you borrow, the unpaid principal of your loan is no longer in your 401(k) account working for you.

Be informed

You should become familiar with the terms of your employer's 401(k) plan to understand your particular withdrawal rights. A good place to start is the plan's summary plan description (SPD). Your employer will give you a copy of the SPD within 90 days after you join the plan.



Remember that your 401(k) account is there for your retirement. Using it before then should be a last resort only.

How Will Financial Reform Affect You?

In response to an outcry for reform, on July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. Much of the legislation centers on new regulations affecting how Wall Street functions, including the infusion of new powers in the Federal Reserve, and new government authority to shut down large financial companies on the brink of failure.

Nevertheless, while the bulk of the legislation is aimed at Wall Street, most consumers want to know how the law will affect them. Here are some of the provisions that may directly affect consumers like you.

Revised mortgage lending practices

The legislation institutes new mortgage lending rules intended to provide more borrower protection. For instance, lenders will have to follow defined standards to verify whether, based on income, credit history, and other data, a borrower has a reasonable ability to repay a loan including associated taxes and insurance. And if the lender doesn't adhere to this "ability to repay" standard, or if the mortgage has excessive fees or abusive terms, the borrower may raise those factors as a defense to foreclosure without regard to any statute of limitations.

Lenders also must retain at least a 5% interest in loans they make that don't meet certain standards, so that a lender will be less inclined to make a loan to a borrower who can't afford it; the law is also designed to prevent a lender from selling the loan and passing all of the risk of default onto the secondary mortgage buyer.

While these rules may limit the size of the mortgage you qualify for, they're intended to prevent you from being steered into a loan that's not suitable for you. Lenders can no longer provide mortgage originators and loan officers with financial incentives such as higher commissions for directing potential borrowers to mortgages with higher interest rates. And lenders can't coerce or encourage an appraiser to make a faulty appraisal of a property's value so the borrower may obtain a loan more easily.

Making the entire process of obtaining a loan more transparent is a key goal of financial reform. For instance, loan originators of residential mortgages must disclose any conflicts of interest and compare costs

and benefits of a mortgage offered to a potential borrower. Prepayment penalties on balloon loans and adjustable-rate mortgages (ARMS) are banned and must be disclosed on other loans. If you have a hybrid ARM, the lender must give you at least six months notice in advance of any change in the interest rate. And if you're unable to make your mortgage payments as a result of losing your job or because of a medical condition, you may now qualify for up to \$50,000 in assistance loaned through HUD's existing Emergency Mortgage Assistance Fund.

Lenders are prohibited from refinancing an existing mortgage unless the new mortgage offers a net benefit to the borrower, and borrowers are entitled to a copy of the lender's appraisal of the property no later than three days prior to the closing.

Consumer protection provisions

The law provides for regulation of consumer financial products under the auspices of a single agency: the Consumer Financial Protection Bureau. This government entity will serve as a consumer protection watchdog, able to write rules for consumer protections governing all financial institutions--banks and other institutions offering consumer financial services or products. This agency will also regulate the private student loan industry while giving students access to information about private student loans.

Increase in FDIC account protection

During the financial crisis, the Federal Deposit Insurance Corporation (FDIC) temporarily increased the amount it will insure on deposit accounts in FDIC-insured banks from \$100,000 to \$250,000. The law makes the \$250,000 limit permanent. For example, you and your spouse can each have separate deposit accounts as well as a single joint account and qualify for up to \$1 million worth of total FDIC protection.

Another change is your ability to get your credit score for free if you were turned down for credit, housing, or a job based, in part, on your credit score. You can also get your credit score if your credit card company changes your credit terms based on a negative credit score. The free look at your credit score isn't available if you don't have a negative credit experience, however.



The new law offers a reward to whistle-blowers with information that leads to monetary sanctions of more than \$1 million. Whistle-blowers will receive 10% to 30% of the amount collected from the offender.



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Ask the Experts



Is it time to give mobile banking a try?

If you like the idea of paying your bills or tracking your saving or spending 24/7, then you might want to consider mobile banking.

With mobile banking, you can use your cell phone or other mobile device to check your account balances, including savings and checking accounts, IRAs, loans, and credit cards, and then transfer money from one account to another if necessary. You may also monitor credit card activity, check bill or loan due dates, and pay one-time or recurring bills. (Not all financial institutions offer all these services, though.)

Depending on your needs, you can access information in a variety of ways. For example, you can sign on to your financial institution's website or install an application on your mobile device to enable you to log on more quickly. Or, if you don't want to download software or special browsers, or your device isn't web-enabled, you can use text messaging features to request information or view your account balances on registered devices. You

may also be able to sign up for low balance or transaction alerts via text messaging.

While it's hard to take issue with the convenience of mobile banking, what about safety? In general, mobile banking offers at least the same level of security and encryption as online banking, and account data is typically not stored on your mobile device. However, like online banking, mobile banking is subject to certain risks, and safeguarding your personal and account information is vital. For example, download mobile applications from reputable sources only, use strong passwords, and read your financial institution's mobile banking agreement and disclosures. If possible, avoid using free wireless service available at public locations when conducting sensitive financial transactions.

Finally, how much of a concern is cost? While most financial institutions offer free mobile banking services, normal transaction fees will apply. And your wireless service provider may charge you for text messages or downloads, so check the terms of your data plan agreement.



How secure is your mobile device?

A host of financial applications, or "apps," available for use on a smartphone or other web-enabled mobile device has made handling your

finances easier. Among other things, you can manage your accounts using integrated money management tools, plan a budget, track business mileage, compare prices, calculate loan payments, and track the stock market in real time--wherever and whenever you want. But using these apps without first making sure your device is secure can expose you to unnecessary risks.

Start with the basics--read the manual. Find out what security features are included and activate them according to the manufacturer's instructions.

One major risk is that mobile devices are frequently lost or stolen, potentially exposing your personal and financial information. As inconvenient as it might be, using a passcode on your device is an essential first step to keeping your information safe. If your

device has a smart card (called a SIM card) with a microchip that stores your personal information, you'll want to add a passcode to that too. You may also want to purchase software that will allow you to remotely lock your device, wipe data from it, or even track it via GPS.

As the use of smartphones and other mobile devices grows, mobile cybercrime is also growing. Be especially careful when downloading apps. To reduce the odds that you'll end up with malicious code on your device that could compromise your security, deal only with reputable vendors and sites. Make sure that you have installed antivirus, anti-spam, and encryption software that will help protect your device from spyware, viruses, and other threats, and keep it up-to-date. Avoid storing confidential information on your phone, and never respond to messages or click on attachments sent by individuals you don't know.

Finally, if your phone or device is lost, stolen, or otherwise compromised, contact your data plan provider immediately to report the incident, and have your service suspended.