

Wealth Management For Your Future



Trust & Investments

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When Times Are So Scary, Opportunities Emerge

As the nation struggles through a severe financial crisis, you're undoubtedly worried about your financial security and the safety of your nest egg. But this is no time to sell stocks or make wholesale changes to a well-balanced portfolio that is aligned with your goals and investment time horizon.

Remember that short-term volatility isn't a big worry when you are invested for the long term. And though stocks have underperformed bonds during recent years, over many decades equity investments have almost always come out on top.

Even if the nation is in a recession, there is a lot in the economy that is doing pretty well. Unemployment, though rising, hasn't exploded, interest rates are still low, and inflation remains under control despite higher energy and food prices. The economy is resilient and the federal government is taking steps to get past the credit crunch.

As for stock prices, much of today's and tomorrow's bad news already has been factored into the market. Selling stocks or mutual funds after a decline simply means getting out at a low point. Nervously entering and exiting the market heightens your risks and lowers your returns.

So what should you do? Stay the course and remain diversified, but ask your advisor about adjusting your portfolio to take advantage of investments more likely to produce solid returns during a bear market. Here are several potential opportunities:



- Before their recent declines, global growth trends had sent commodity prices soaring for energy, agricultural products, and precious metals. Now, lower prices can give volatility-tolerant investors a good entry point for gains once the economy stabilizes. Commodities can also serve as a hedge against inflation.
- Yields on Treasuries dropped as shell-shocked investors fled to the safety of government bonds. But the market fallout should reiterate the importance of broad portfolio diversification—and that includes low-yielding treasuries. Allocation back into stocks and corporate bonds, while prices are low is also important.
- Though not quite as safe as Treasuries, municipal bond funds can deliver income that's not subject to federal and, sometimes, state income taxes. Muni prices have fallen and yields have risen, in some cases nearing the yields of corporate bonds even before figuring in the munis' tax advantage. But tread with caution: there are concerns about the worsening financial health of local and state governments, along with municipal bonds' lack of liquidity.
- Yields on corporate bonds, too, may be attractive today, when companies must offer higher rates in order to get the financing they need. Though default risks are also high, taking well-considered risks can improve potential returns.

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Changes On The Horizon For 2009

As we leave 2008, we know it will be a financial year not soon forgotten. With that said, we must continue to look forward to 2009 and beyond with an eye towards positioning ourselves appropriately for changes on the horizon.

And it appears that 2009 will definitely yield some significant changes as we start the year with a new president and Congress in Washington. New tax laws, government programs, policy changes, and new business models born in 2009 are sure to shape our futures.

We look forward to continuing to work through all of these developments, the issues discussed in this newsletter, and more in 2009 and to helping place you and your family in the best possible financial position.



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Go Directly From A 401(k) To A Roth IRA

Shall we dance? In the past, if you rolled over funds from a 401(k) plan to a Roth IRA, you had to do a Texas two-step: 1) Transfer the cash from your 401(k) to a traditional IRA 2) Convert the traditional IRA into a Roth IRA, paying income tax on the amount you convert.

Now, thanks to a recent tax law change, the choreography is simpler, with just one step required. Furthermore, new IRS guidance gives 401(k) plan participants a slight edge on Roth conversions.

With a 401(k) plan, you accumulate funds on a pre-tax basis. You make annual salary deferrals (of up to \$15,500 in 2008, plus \$5,000 if you're age 50 or older) that may be partially matched by contributions from your employer. Some plans also permit after-tax contributions. Plan investments compound tax free, but distributions from the 401(k) during retirement are taxed at ordinary income rates, currently as high as 35% plus the state tax obligation.

A Roth IRA works the other way around. Money goes in after taxes have already been paid, but qualified distributions, assuming the Roth has been around for at least five years, aren't taxed. To

qualify for a tax-free, penalty-free distribution, you have to be at least age 59½, though exceptions are made in the event of death or disability, or to pay expenses for a first-time homebuyer (up to a lifetime limit of \$10,000).

You can convert a traditional IRA, built with pre-tax funds, into a Roth only in a year in which your adjusted gross income is \$100,000 or less. Beginning in 2010, however, there will be no income ceiling. That change is a provision of the Pension Protection Act of 2006, which also eliminated the need for a two-step move from a 401(k) to a Roth. Now, you can avoid the interim step of moving your money to a traditional IRA, though you'll still have to deal with the \$100,000 income ceiling until 2010. (Some employers now offer an after-tax Roth 401(k) option, and these plans also can be rolled over directly to a Roth IRA.)

In a recent notice, the IRS sweetened this deal with the news that no tax is owed if you convert only non-deductible 401(k)

contributions. In contrast, in any conversion from a traditional IRA to a Roth, all distributions must be based on the ratio of non-deductible contributions (ie., contributions that you can't deduct from taxes) to the total value in all of your IRAs.

Suppose you have \$200,000 in an IRA and \$200,000 in a 401(k) to which you made \$40,000 in non-deductible contributions to each. That five-to-one ratio means that if you convert \$10,000 from the IRA to a Roth IRA,

only \$2,000 will be exempt from tax. But if you convert \$10,000 in after-tax contributions from your 401(k) to a Roth, no tax will be owed.

Determining whether a Roth IRA conversion is right for you depends on a number of factors including your age and tax bracket. Though the Roth conversion dance is simpler now, you may still need a partner. We can help you determine whether a one-step rollover is right for your unique situation. ●



How Much Is Your Business Worth?

During the years you've spent building your business, you probably haven't had much time to worry about how much it is worth. But at some point you may need to find out—if you consider selling the company, or you decide to give shares to your children and require an appraised value to gauge the worth of those shares for tax purposes. Other estate planning strategies may also call for putting a dollar value on the business, as could a pending divorce or other litigation. Whatever the reason, when the time comes, you shouldn't try to go it alone.

Taking a guess based on a multiple

of earnings or another rule of thumb isn't likely to be good enough when it comes to valuing what's undoubtedly your largest asset. "The biggest mistake you can make is to do it yourself," says Kevin Yeanoplos, chairman of the Accredited in Business Valuation Credential Committee for the American Institute of Certified Public Accountants.

Business valuation is a technical field requiring a broad range of knowledge, and experience matters a great deal, Yeanoplos says. Also, the value of your business may vary

depending on the intended purpose of the valuation. In other words, the same

business may have a different nominal value if you're planning a sale, doing an estate plan, involved in litigation, or converting a business to another kind of entity—for example, from a privately held

company to an employee stock ownership plan.

Some of the variation involves the difference between fair market value



Tax Pros And Cons Of Municipal Bonds

For many investors, an investment in municipal bonds can be a sweet deal. Like other bonds, munis provide regular interest payments. But whereas interest on Treasury and corporate bonds is taxed as regular income, at a rate as high as 35% plus the applicable state income tax rate, the income from munis is exempt from federal tax and may also avoid state taxes. The same is true of distributions from a qualified municipal bond fund. And while munis typically offer lower yields than taxable bonds, municipal bonds and bond funds may provide higher after-tax returns to investors in high tax brackets. But munis also come with several drawbacks, and if you're not careful, your investment in municipal bonds or bond funds could trigger unexpected tax liability.

On the plus side, there are at least four significant tax advantages to investing in munis.

1. First, of course, is that exemption from federal income tax. Suppose you own a \$10,000 corporate bond that pays 6% interest, and you're in the 25% federal income tax bracket. Though you'll receive \$600 in annual income, you'll lose \$150 to the IRS, leaving you with only a 4.5% after-tax return. But with a muni, federal tax isn't an issue.

2. The interest income from munis is also exempt from state tax as long as the bonds are issued within your state.

and investment value. The former refers to the value of an entity when a willing buyer and seller agree on a price with no compulsion on the part of either to exchange the item. Investment value, in contrast, may refer to a situation in which a specific buyer has a particular reason to want the entity. For instance, a company within the same industry looking to expand likely would pay a premium—an amount above the fair market value—for a similar business in a new area.

In the case of an ardent suitor, you could seek out a business valuation expert who specializes in business-to-business sales. On the other hand, if you need a valuation for calculating a divorce settlement, you'd need a

valuation expert whose experience involves family law. Finding a valuation specialist who focuses on businesses in your industry or companies of a size similar to yours can also be helpful.

3. Interest payments from munis don't increase your adjusted gross income (AGI). That's beneficial because many tax breaks are phased out when AGI exceeds specified levels.

4. The higher your income, the more likely you are to gain from an investment in munis. That's because the value of tax-exempt income rises as you move into higher tax brackets. For example, if you're in the 25% bracket, a municipal bond paying 4% will give you as much after-tax income as a taxable bond with a 5.33% yield. But if you're in the 35% bracket, it will take a yield of 6.15% to match the muni's 4%. Yet as helpful as muni investments may be to many investors, they also bring potential tax traps. Consider these six:

1. If your municipal bonds are issued by an entity in another state, you'll owe state income tax on the interest you receive.

2. If you sell a municipal bond for more than its face value, you may owe federal capital gains tax. The prices of munis, like those of other bonds, fluctuate with changes in interest rates, and if rates dip below the coupon rate on a bond you own, another investor may be willing to pay a higher price for it. But if you bought a \$10,000 bond at its face value and sell it for \$10,500,

Choosing the right appraiser should also include considering credentials, such as the AICPA's Accredited in Business Valuation (ABV) and the Accredited Senior Appraiser (ASA) credential from the American Society of Appraisers in Business Valuation. Such designations ensure specialization, education, and experience.

If you seek assistance in locating the right appraiser, call our office and we can help. ●

you'll pay capital gains tax on your \$500 profit. (The capital gains rate for most taxpayers is 15% on investments held for more than a year; short-term gains are taxed as ordinary income.)

3. The sale of a municipal bond can also result in ordinary income tax. Suppose you acquire a discounted muni in the secondary market and then sell it. Your profit will be taxed as ordinary income to the extent of the accrued discount. For example, if you pay \$9,500 for a muni with a face value of \$10,000 and a maturity of 10 years and then sell it for \$9,800 after five years—at a \$300 gain—\$250 of your profit will be taxed as ordinary income and \$50 taxed as a capital gain.

4. Selling a muni bought at a premium, however, won't produce any tax benefit. For example, if you buy a bond for \$10,500 that will mature at \$10,000 and you hold it until maturity, you can't claim a capital loss or any other deduction on your tax return. Tax rules require you to amortize the premium over the life of the bond.

5. Interest payments from "private activity" municipal bonds, used to finance airport construction or other nongovernmental projects, aren't exempt from federal tax for taxpayers who owe the alternative minimum tax (AMT).

6. Owning munis could result in tax on Social Security retirement benefits. Normally, Social Security benefits are exempt from increased tax. However, if your "provisional income" exceeds specified levels, you'll be taxed on up to 85% of your benefits. Provisional income is equal to the sum of your AGI plus any tax-exempt interest—such as income from munis and municipal bond funds—and 50% of your Social Security benefits.

Weighing munis' potential benefits and drawbacks involves complex calculations and depends on each investor's needs and circumstances. If you'd like to discuss the possible role of municipal bonds or bond funds in your portfolio, please give us a call. ●

Want To Cut College Costs? Hire Your Kids

Spending even more on your children can actually save you money. Sounds paradoxical? Thanks to a strategy called income shifting that lets you transfer assets to a family member in a lower tax bracket than yourself, it's true. Hiring your kids broadens this option by lessening your taxable income and slicing business taxes.

Here's the math in a nutshell: The salary expense reduces your business profit, so you save on taxes at your marginal rate. Your child may even be able to earn an annual salary reaching five figures without paying income taxes. That means potential savings of several thousand dollars for your family.

The job must be real. For your business to deduct the salary, the expense must be necessary for its operation. You can't pay your child for doing chores around the house and expect a tax deduction. Recently, a physician's payment of \$11,000 to his son to empty trash, sort mail, and answer telephones was found "unreasonable" by the IRS and the salary was recharacterized as a taxable gift. Researching local job-market conditions can help document a fair wage for the job.

Administratively, treat your child as you would any employee. Prepare a job description, keep time sheets, and put your child on payroll—in other words, don't pay him as an independent contractor.

Besides tax rules, you may need to comply with federal and state labor laws, depending on your child's age, the type of work performed, and other factors.

Determine the savings. There are several tax benefits. Not only do you pay taxes on less income, your child gets breaks that may not be available to you. For instance, he can take a personal exemption for himself, saving you from being hit with higher taxes if you earn \$239,950 or more for 2008. Married taxpayers whose earnings exceed this amount forfeit all or a portion of their deduction for dependents. Moreover, your child may qualify for either the Hope or Lifetime Learning education credits, both of which begin to phase out in 2008 for couples who earn more than \$96,000.

However, that's not quite the whole story. Total family payroll taxes may actually increase by about 12% of the salary paid, offsetting some of the income-tax savings described above. But even so,

this strategy can slash the family's taxes. If a business owner with an annual profit of \$250,000 hires and pays his 20-year-old son \$20,000, the family's total tax bill will be almost \$5,000 lower, assuming a 5% state income tax. At \$350,000 of profit, the savings would be \$6,000.

Consider financial independence. If your child provides more than half of his own support—which presumably he will if the salary helps fund college or other expenses—you generally can't claim him as a dependent. While the family's total IRS bill may be reduced, consider whether employing your child can have a negative affect on financial aid. ●

If you were to pay your child just \$2,000 per month, here's what would happen:

\$24,000 salary (adjusted gross income)
- \$3,200 personal exemption
- \$5,000 Standard Deduction
= \$15,800* TOTAL FEDERAL TAXABLE INCOME
\$2,005 Federal income tax on \$15,800
- \$2,000 Education credit (maximum*)
= \$5 INCOME TAX

* If your child is over age 18, you would need to withhold FICA.

** Assumes Lifetime Learning Education credit based on \$10,000 of qualified education expenses.

Opportunities Emerge

(Continued from page 1)

- With the Federal Reserve likely to keep interest rates low, inflation could continue to be a concern, and Treasury Inflation-Protected Securities, or TIPS, can help insulate you against that risk. TIPS' principal increases in step with rises in the Consumer Price Index, and at maturity the buyer receives either the adjusted principal or the original principal, whichever is greater.
- Domestic stocks began their fall before international stocks and could be first to recover. Also, as overseas economies



weaken, the dollar may resume its recent climb, reducing the value of foreign holdings for U.S. investors.

- European bonds may be a good bet as European countries drop interest rates in order to boost ailing economies. Declining interest rates favor bond holders.
- U.S. small-cap stocks may be preferable to large-caps because larger, multinational companies tend to have more exposure to international financial woes. Also, small caps tend to rebound first after a recession.
- Investing in surviving financial services firms might be worth considering,

though only for those who can tolerate risk in a sector undergoing profound, unpredictable changes, and who have an advisor that has studied this sector significantly. ●

These views represent an appraisal of possible events. Outcomes and performances are not guaranteed. The investments discussed may go up or down in value and are not suitable for all investors. The information provided is not specific financial advice or a recommendation to buy or sell. We must review your profile, needs, and accounts specifically to determine what is right for you.

You should consider any investments objectives, risks, charges, and expenses carefully before you invest. Information regarding potential investments, including a fund's prospectus, contains this and other information and should be read carefully before investing. Prospectuses and information may be obtained from our office.

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