



Strategic Advisor Newsletter

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CALL (610) 404-3014 WITH QUESTIONS AND/OR TO SCHEDULE APPOINTMENTS



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Autumn is here, the weather is getting cooler, the leaves are turning, and it is time to start looking ahead to the tax season. At this time of year I like to look back and thank our many clients for what you mean to us. We appreciate the trust you have always placed in us, and we take that trust very seriously. Helping you work toward achieving your financial goals is of great importance to us here at Strategic Money Management. Thank you for allowing us to be a part of your lives in this way. Perhaps the most gratifying part of this all is that after working with you year after year you have become so much more to us than just clients. We have developed real friendships.

On another note, we have received many requests over the past year to pass along to you much of the information I have received from my personal on-going study with Ed Slott. I will therefore be writing newsletters throughout the year that will address various IRA topics.

The topic I would like to discuss in this newsletter has to do with a question I frequently receive. The question is as follows: "What if I make or have made both pre-tax (tax deductible) and after-tax (non-deductible) contributions to an IRA (or other qualified plan such as a 401k) over the years? How am I to keep track of the amount that will be taxed vs. the amount that will be tax-free when I take a future distribution?" Another question is: "Can I first remove from the IRA the non-deductible contributions that I made? Since they were after-tax contributions, I will not pay tax when I take out that portion. Correct?"

To answer these questions, I need to first point out that when you are mixing both after-tax and pre-tax contributions in an account you must complete IRS form 8606 to be submitted with your tax return. This form should also be kept up-to-date each year so that you have a continual record accounting for both types of contributions. Because you have already paid tax on the non-deductible contributions, you can take those amounts out tax-free in the future. The mistake many people make however, is in believing they can take just that amount out at any time. This can be a costly mistake.

Think of your normal pre-tax contributions going into the account as black coffee added to a cup. Then think of the after-tax contributions as cream stirred in. Once the coffee and cream are combined in a cup there is no way to take out just the cream. If we have 95% black coffee and 5% cream in the cup, any amount we take out will still consist of coffee and cream in the same proportions. The same applies to your IRA. It is impossible to take out just the after-tax amount (unless you are okay with the penalties). Each distribution must consist of both pre-tax and after-tax amounts in the same percentages as are in the account. Therefore, some of each distribution will be taxable and some will not. You must also file form 8606 along with your return when distributions are made. Understanding these rules will make planning easier, will help you at tax time each year, and will keep you out of hot water with the IRS! Please remember: tax laws can change and we recommend you consult your tax advisor regarding your situation.

As always, if you have any question on this or other topics, please contact me at the office. Thank you.