THE Pension Digest

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Resurrecting the IRA: Play It Again, Lloyd —

When Texas Democratic Senator Lloyd Bentsen's effort to revitalize IRAs expired in a death embrace with President Bush's capital gains proposal during the last session of Congress, many wondered whether a hoped-for resurrection would ever take place.

Whether successful or not, a resurrection is now in progress in the halls of Congress. Bentsen's proposal for restoring the full deductibility of IRAs, and his new "Super IRA," are getting new life with the co-sponsorship of Senator William V. Roth, Jr. (R., Delaware).

Not to be caught without an IRA plan of its own (though much narrower in scope) the Bush administration is also proposing some liberalization of the IRA rules, but targeted specifically at the first-time home buyer in order to stimulate activity in the housing industry.

Purchasers would be able to withdraw up to $10,000 for a first-time purchase, on a home priced at no more than 110% of the community's average price.

Any individual who has not owned a home in the previous three years would be considered a first-time buyer.

The President's proposal also included his earlier-championed Family Savings Account. Though not deductible, contributions up to $2,500 could be made for those with adjusted gross incomes less than $60,000 ($120,000 for those filing joint returns). If held in this account for more than seven years the earnings would be tax free.

This Family Savings Plan contribution could be made in addition to any other pension contribution, including IRA, 401(k) or qualified retirement plan.

Highlights of the Bentsen-Roth Bill

Much broader in scope, this bill is intended to stimulate national savings—among the lowest of the leading industrialized nations with whom the U.S. competes economically.

Bentsen and his supporters contend that the low U.S. savings rate contributes to higher interest rates, lower investment, a reduced rate of growth in U.S. productivity, and—ultimately—higher trade deficits.

With the loss of this universal deductibility in 1986, IRA participation fell by 50%. This—the logic contends—made a contribution to the decline in U.S. savings.

Specifically, the Bentsen-Roth bill would:

a) return full deductibility of IRAs, regardless of an individual or spouse's participation in an employer's retirement plan, and also regardless of household income.

b) allow contributions to a "Super IRA," with the following provisions:

- IRA deposits could be taxed NOW, rather than when the funds are withdrawn, if the deposits remained in the account for at least five years. The same would apply to account earnings.

- allow penalty-free IRA withdrawals for *first-time home purchases*, for *educational expenses*, or to pay for *"catastrophic" medical expenses* (those in excess of 7.5% of income).

- parents or grandparents of home buyers would also be allowed to tap their IRAs penalty-free to help a child or grandchild with a home purchase, or to pay for educational expenses.

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Do IRA Pluses Still Outweigh Minuses? — IRAs vs. Municipal Bonds

Critical reviews of IRAs appear from time to time in the financial press. Some are well-thought-out and balanced, others are less discriminating, and tend to compare apples to oranges in evaluating IRAs versus other retirement/investment programs.

Most recently, a "Your Money Matters" column by Barbara Donnelly in the Wall Street Journal compared IRAs to tax-exempt municipal bonds. The general impression left was that only in limited circumstances would an IRA be a best-choice.

The article was somewhat confusing in that it did not specify whether it was comparing *non-deductible* IRA contributions vs. municipal bonds. the earnings comparisons, however, suggest that this was the case, and the comments that follow are predicated on that. Had the article compared fully or even partially deductible IRA contributions, it's doubtful that the earnings comparisons would have put the municipals even in the same ball park.

Key Journal Points and Assumptions:

1) Over the life of the investment, a lower yield *tax-exempt* municipal bond investment at, say, 7% interest, may yield a higher post-tax dollar return than *tax-deferred* IRA earnings at a rate of 8 to 10% interest.

2) IRA investors who are unwilling to accept some of the risks of IRA investing in stocks or corporate bonds, would be better off—earnings-wise—investing their money in these same tax-exempt municipal bonds.

3) Retirees receiving benefits from either investment program would be in the 28% marginal tax bracket.

4) IRAs make sense only for those who don't plan to retire for along time. (This was presented as a criticism.)

But On The Other Hand...

1) Variability of Return

Just as CDs may be either fixed-rate or variable, not all municipal bonds guarantee an earnings rate for the entire period of the investment. And those that do are likely to have a lower rate, just like CDs.

2) Risk

Unfortunately, unlike most IRA deposit-instrument investments, there is no safety through deposit insurance provided for the municipal bond investor. "The investment ratings of states and municipalities are on a downward trend in many cases," according to CWF pension consultant Richard Moudry. This is a reflection of their perceived security. With a soft economy, more and more municipal investments may be on shaky ground. Defaults are not out of the question. This may get even worse with shrinking federal aid to state governments.

IRAs on the other hand, offer $100,000 per IRA/per bank insurance on time-deposit type investments. Risk is certainly a more important variable favoring IRAs in this comparison than seems to be recognized.

3) Liquidity of Assets

Getting the most from a municipal bond investment assumes that you can sell it at the value it has appreciated to at the time of sale. But municipal bond values are much more market-based than either certificate-based fixed return IRA accounts, or stock-based IRAs.

Selling a mutual fund investment may mean taking a loss if there are not willing and/or competing buyers. It's possible that no buyer will be found at any price. and when such an investment is liquidated, there will be broker or agent fees, further reducing the return from the municipal bond investment.

4) Duration of Investment; Time from Investment to Retirement

The comment was made that IRAs make most sense for investors who don't plan to retire for a long time. The whole *purpose* of retirement investing—and the intent of Congress in setting up the IRA—was to encourage saving for retirement, not to build up capital for prior or other uses. With this in mind, the better yielding IRAs *do* provide performance equal to or better than many municipal bonds, with few risks and liquidity concerns.

Nor are IRA assets totally untouchable prior to retirement. They are accessible without penalty in cases of disability or death. Admittedly, they are not as accessible for other expenditures, but they were not intended to be.

5) The 28% Tax Bracket Issue

Since the interest or other earnings earned on a nondeductible IRA

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IRS Ruling Allows Rollover of Funds from Account of Intestate Spouse

A spouse's right to elect to treat as his or her own IRA the account of a deceased spouse, is a very important tax planning device. This right to "treat as one's own" arises from the IRA regulations and from Internal Revenue Code section 408(d)(3). Exercising this right means that distribution and taxation will be deferred, normally until the surviving spouse must start to take required minimum distributions.

An Inherited IRA

Code section 408(d)(3)(C)(ii) states that an "inherited" IRA cannot be rolled over. Further, an "inherited IRA" by IRS definition is one which an individual (who is not the spouse of the accountholder) acquires an interest in or to, by reason of the death of the accountholder.

The IRS interprets this provision as implying that spouses have the right to roll over funds to their own IRAs.

An Intestate Situation

In a recent private letter ruling the IRS faced an interesting question. Does a surviving spouse still have this rollover privilege if her right to share in her deceased spouse's IRA arises not because she was the named beneficiary on an IRA beneficiary form, but rather because under the state's intestacy laws she was entitled to receive a share of the IRA?

Case facts: an IRA accountholder died without having named a beneficiary. Under the terms of his IRA agreement, the IRA funds were then to be paid to his estate. However, since he did not have a will, the intestacy laws of his state of domicile then applied. These laws indicated that the surviving spouse was entitled to 50% of the IRA, and three children by a previous marriage would share equally the other 50%. Again, the question posed to the IRS was: could the surviving spouse roll over her 50% share to her IRA?

Spouse Rollover Privilege Retained

The IRS in private letter ruling 9049044 confirmed that she could. The fact that the funds would be paid from the IRA account to the estate of the deceased accountholder, and then paid to the surviving wife, did not result in her losing the rollover right. As previously stated, by rolling over the funds to her own IRA she defers taxation to a later time.

This ruling dealt specifically with an intestacy situation. We believe the IRS would also allow a surviving spouse who would be the named beneficiary under the decedent's *will* to roll over the funds. The IRS would use the same rationale.

Obviously, when the surviving spouse is the named beneficiary as provided in the IRA account itself, he or she has the right to elect to treat the account as their own, or to roll over the funds into their own account. PD

Getting Emotional About IRAs

Marketing
Pension Products and Services

What do we say about Individual Retirement Accounts when we're trying to market them to our customers and potential customers ?

How do we appeal to the buying public to make them aware of their need for a retirement plan such as an IRA? Let's talk a little bit about what underlies an advertising message, one that can generate customer interest in opening an IRA account.

Emotional Contact

One important factor that all successful advertising has in common, is the ability to make emotional contact with its audience. How does it do that? Such an ad "hits them where they live," to use the popular phrase.

For example:

a) an ad for AUTO SAFETY, or AUTOMOBILE TIRES, might focus on the precious cargo the car carries, our children for example.

b) an ad for LIFE INSURANCE might focus on the things that could be missing from our family's lives if we were to die underinsured—college education, vacations, a secure home and neighborhood, etc.

c) an ad for IRAs might focus on a life in retirement without the means to live as comfortably as we have in our employment years, unless we plan and save now, with IRAs being a good option.

These themes strike an emotional chord, one that resonates involuntarily within each of us when it is touched.

But not everyone in the population of potential customers is equipped with the same chords. We all have slightly different life priorities, things that we are deeply committed to and concerned about.

As marketers of IRAs—or other retirement plans for that matter—we need to identify some of the characteristics of the person likely to consider an IRA important. Once we've done that, we:

a) know what message to focus on, and (hopefully)

b) what words or images will touch that responsive chord.

Characteristics of Good IRA Prospects

Briefly summarizing what we outlined in the October Pension Digest, some of the best IRA prospects:

a) are in their 40s

b) are married

c) have household incomes of roughly $50,000 and up

d) have received some kind of post-high school education, college for many

e) are homeowners

There are numerous exceptions, and there is no intent to slight the people who don't fit the profile exactly. And, realistically, a person does not need to possess <u>all</u> of the above characteristics to be a good prospect. But in advertising you go for the percentages, and these are some of the most important characteristics to focus on when preparing your message.

How do we use this information to tailor our message?

We focus on the concerns of this segment of the population, among which are:

✓ the comforts and enjoyments they have now, and wouldn't want to give up

✓ their tendency to plan and be prepared for the future

✓ (hopefully without too much fear-mongering) the life led by people who haven't planned well for their retirement

✓ legitimate concerns about Social Security's ability to meet a retiree's financial needs; even its future solvency

✓ the need to act while there's time, now when they're in their prime employment years, when IRA deposits can still grow meaningfully

How do you translate these identified concerns into words and images?

Verbal Keys:

Key words like security, safety, happiness, loved ones, protection, etc., help to break through the barrage of messages that people receive every day. These words reach out and say "Pay attention. This is important to you."

Artwork:

Artwork should complement the verbal message. Sometimes the words are so compelling they don't need any artwork support. But often the message is more effective when you combine both.

That's where the "art" comes in. That's where the advertising agency, the "creative services" people at your newspaper, or the marketing personnel on your institution's staff, can shine. There's no guarantee they will. That's why it's more art than science.

To use the theme from an old tire ad, this is "where the rubber meets the road." This is where the job gets done, or it doesn't. Finding the right words, the right images in artwork or photography—the right combination of these—is the magic. PD

April 15 Not the End of IRA Interest

A common IRA misconception is that when April 15th arrives, both customer interest and promotional efforts cease. Not so for everyone. For some banks, this is when they begin some serious IRA marketing.

Why? Consider the example of a bank's Christmas Savings Club. Its concept is that savings begin a year in advance, in order to accumulate to a desired level at a future target date. These banks take the same approach with IRAs, recognizing that many of their customers can't find $2,000 overnight for IRA deposit at tax time.

One bank, Martha's Vineyard Cooperative Bank in Massachusetts, actually reduces its minimum CD deposit amount dramatically if the instrument will be part of an IRA.

The result is more IRA activity, and more core deposits that are likely to "stay put" in this institution. Plus, more total accounts means greater customer stability.

If you have further questions about advertising in the post-April 15th period, see the marketing assistance item on page 4. PD

Play It Again—*Continue from page 1*

Further, employer-provided 401(k) and 403(b) plans which allow employees to make tax-free retirement contributions, would be accessible for withdrawals for first-home purchases, or for educational expenses.

"Paid For Out Of Other Sources" Will Be The Rub

No one has predicted just how much the Bentsen-Roth bill would cost in terms of lost tax revenues. The Bush first-home plan is said to have an anticipated tax impact of approximately $400 million. A Senate staff aide has indicated a belief that Bentsen-Roth would not cost much more, though this is not at all certain.

The Bentsen-Roth position on where these funds would come from is that "under the terms of the recent budget agreement, any revenue losses resulting from the proposal would have to be offset by other changes in the law to ensure that the federal budget deficit is not exacerbated" (worsened).

Translated, this means that if approved, some other federal program will have its funding cut to pay for it, or taxes will be increased. In these days of strong special-interest budget influence, it may be an uphill battle to re-direct existing funds for such a proposal.

We will await developments in this legislation eagerly. PD

IRA Pluses—*Continue from page 2*

contribution will be subject to taxation when distributed, the IRA-vs. municipal bond performance comparison had to assume some taxation rate. The rate assumed in the article as 28%, and would equate to a retiree with a taxable income of $32,450 or more in 1990

The comparison used investment periods of 10, 15 and 20 years. One flaw in this performance comparison is its assumption that both the municipal bonds and the IRA balance would be distributed to the bondholder/ accountholder in lump sums.

This might be done by the bondholder, since the funds are tax-exempt. But it would rarely be done by an IRA accountholder, who typically elects a significantly longer distribution period—based on life expectancy—in order to stretch retirement dollars, and minimize taxes paid on earnings.

Thus, it is not at all certain that an IRA accountholder would pay 28% taxes on their earnings—their non-basis IRA assets. Some would most likely pay at the 15% level. But this comparison was not made. This lower marginal tax rate would certainly show a nondeductible IRA investment performing even better against even the best-case municipal bond.

Summary

The nondeductible IRA is not a retirement instrument that will outperform all other options in all cases. But when critically analyzed by those who know its true strengths and weaknesses, it comes closer to being a universal retirement instrument than the alternatives. PD

✔✔Check It Out

Question: Our bank just received a check and a transfer notice from the U.S. Government concerning Thrift Savings Plan funds for an individual who wishes to transfer these funds to an IRA with us.

Must we issue a Form 5498, as we would in other dissimilar plan transfers (as in a QP to IRA) in which the funds come direct to us, but the paperwork is completed as in a rollover—with the sending entity preparing a 1099-R, and we the receiving entity a 5498?

✔ Answer. This is one of those exceptions that proves the rule. Unlike most dissimilar plan transfers, a transfer from a U.S. government TSP does not require a 5498, and the TSP plan will not be issuing a 1099-R.

Question: A woman just brought in a check for $38,000 issued by a pension plan naming her husband as the payee. Assuming this is a payout which otherwise qualifies to be rolled over, may she roll over these funds to her IRA if he has endorsed the check to her?

✔ Answer. No. The tax rules allow only the person who is paid the funds to permissibly roll them over. Although the husband could give his wife this $38,000 (less applicable taxes) as a gift, she could not roll over such a gift. PD

The Pension Digest invites your questions and comments. Please address to "Check It Out," Collin W. Fritz & Associates, Ltd., P.O. Box 426, Brainerd, MN 56401.

CWF to Offer IRA, Pension Advertising Assistance

Many financial institutions have considerable expertise when it comes to handling the opening and ongoing administration of IRA and other pension plans.

Some have discovered the importance of maintaining a visible pension services profile the year-round, not only in the period just before April 15th.

But many institutions are presently not doing the marketing they would like due to factors such as expense, or simply the difficulty of finding a creative resource that understands pensions.

To better serve our Pension Digest and other pension services subscribers, Collin W. Fritz and Associates, Ltd. is adding to its traditional on-site and direct mail marketing assistance materials, and will become a resource for print advertising and point-of-purchase marketing items.

The initial offering includes the following ads:

- IRA, general
- IRA, special post-April 15th concept
- Simplified Employee Pension (group)
- Simplified Employee Pension (self-employed)
- 401(k)

Ads are offered with market-area-exclusivity, which will ensure no overlap of marketing messages between competing banks, but at rates far below traditional advertising agencies. Banks in any given market area will be served on a first-come basis.

Call 1-800-346-3961 for more information. Ask for Mike Rahn in Marketing Services. PD