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Leading Economic Indicators

By John Brand

Assistant Treasurer/Investment Officer

Since the beginning of this decade, the annual total return on the S&P 500 has averaged -1.2%, certainly not enough to compensate investors for the risk in their portfolios over that period. The numbers are a little disingenuous though; the measurement period starts at the beginning of the collapse of the technology bubble and ends during a recovery from the worst post-WWII recession on record. If you take a longer-term perspective over the last 30 years, you will see that the S&P 500 grew at an annual average rate of 9.3%, this time period includes five recessions and a plethora of domestic and international challenges along the way. The question going forward is whether the market will continue its long-term growth trajectory or continue the painful correction that began in October 2007.

The best way to gauge the future direction of the stock market is to look at the underlying economic conditions that drive it. As recently reported by the Bureau of Labor Statistics, our nation's unemployment rate has reached 10%, the highest level in over 26 years. Although the unemployment rate is one of the most closely followed statistics on the strength of the economy, it tends to do a better job of confirming where we were, rather than where we are going. The unemployment rate is a lagging indicator; employers are slow to re-hire when the business cycle transitions from a recession to a recovery. Companies want to make sure conditions are improving, and will continue to improve, before they bring on new workers.

More forward looking indicators in the labor market (initial jobless claims, manufacturing overtime and manufacturing average-hours worked) all point to a stabilizing labor force. In addition, the Census Bureau's monthly Retail Sales Report,

although well below its peak in 2007, has been improving since the beginning of the year. The Retail Sales Report is a timely snapshot of the state of consumer spending and is used to calculate the Personal Consumption Expenditures component of the quarterly GDP report, which represents two-thirds of our nation's output.

The Institute for Supply Management Manufacturing Index is another closely followed and timely report on the health of the U.S. economy. This data is released the first business day of every month and is based on a survey of manufacturing companies, asking whether conditions are worse, the same or better than they were one month prior. The ISM Index is the timeliest snapshot of our nation's manufacturing sector. Readings above 50 indicate that conditions have improved from the prior month, implying an increase in production. The Index crossed 50 in August and has continued to expand the last three months.

Although our economy faces serious challenges, it has made tremendous progress from its perilous state earlier in the year. Forward looking economic indicators point to a stabilizing labor market, improving retail sales, and increased production in the manufacturing sector. The housing and financial sectors remain a concern, but the Fed's decision to keep interest rates at record lows is an aggressive response to the problem. Investing in equities always has inherent risks; it is vital to have the appropriate time horizon to ride out fluctuations in the market. Equities will continue to be the best way to grow the real (inflation adjusted) value of your assets over time. Investors should be cautiously optimistic based on recent economic indicators and not lose sight of their long-term goals.



The Estate Tax



By Catherine Crandall

Vice President/Trust & Estate Manager

Since the early 1900's, the United States has imposed some type of estate or wealth transmission tax. Based on the provisions of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, this tax will be repealed in 2010. Its scheduled repeal is, however, short lived. Due to national budget technicalities, in 2011, the estate tax would reappear with a lower exemption amount and a higher rate. Since 2001, there has been much debate over a full repeal or reformation of the tax. With 2010 just around the corner, until recently, the debate was almost forgotten. This article will examine the estate tax and what is being bantered around (albeit quietly) in the halls of Congress and how it may effect you.

What is the Estate Tax?

The estate tax is a tax on the right to transfer property at death. Basically, at the time of your death, all the property you own or have "incidents of ownership" is valued. You are allowed as deductions against this number a whole host of things such as expenses, bequests to charity, and transfers to a spouse, etc. Once these deductions are made a tentative tax is calculated. You are also allowed a further credit against this tax, which basically allows \$3.5 million dollars (for 2009) to transfer tax free.

What is the effect of EGTRRA on the tax?

If EGTRRA is not altered, there would be no estate tax in 2010. In 2011, a similar calculation to the above would be reinstated, but with only a \$1 million exemption.

Why do we even have an Estate Tax?

Taxes like the estate tax are neither new nor unique. As early as 700 B.C., Egypt imposed a 10% tax on property on death. The U.S. estate tax started at first as a way to help offset the costs of war, but remained after the wars were over as a means to ensure wealth did not become concentrated in a few familial dynasties. Interestingly, one of its most ardent supporters was one of the countries wealthiest men at the time, Andrew Carnegie, who believed in the evils of amassing and passing wealth for opulent lifestyles.

Policy aside, the estate tax has accounted annually for 1.5 - 2% of federal revenues and has affected 1 - 2% of the population.

If the Estate Tax raises such a small percentage of revenue, why not just maintain the repeal?

Percentages can be deceiving. Various estimates of the cost of repeal show that between 2012 and 2021 the cost could equal \$1.1 trillion dollars.

Can I just get around the Estate Tax by giving everything away before death?

Over the years, much legislation has been adopted to plug any potential loop holes to the estate tax. This includes a gift tax and generation skipping transfer tax. These provisions are often what make the tax so complicated.

Even \$1 million seems like a lot of money, why should I worry?

As mentioned previously, the estate tax attaches to anything you own, including life insurance you own on your life. If you are a parent of minor children or if you own a closely held business, it is quite possible you have more than \$1 million in life insurance.

Also, it's not just the federal government that has an estate tax. New York State also has an estate tax that kicks in at the \$1 million level.

Is Congress expected to take action?

Several bills have been proposed with varying proposed exemption levels and tax rates. It seems the consensus is the estate tax will remain with an exemption level somewhere between \$2 - \$5 million and a tax rate likely to be at the 45% level.

The consensus is that passing legislation to keep the current (2009) tax rates and exemption levels in effect, at least for the short term, is likely. This would allow lawmakers in Washington to put off any meaningful debate until a later time.

Is there any action I should take?

Estate planning should be done for many reasons other than estate tax. Complexities such as beneficiary designations of retirement and life insurance, as well as the income tax consequences to certain assets, makes estate planning prudent even for individuals who may not meet their state's threshold or the federal threshold.

Individuals should keep a tally of their potential estate value and if the value is estimated at the \$1 million level (for a N.Y. resident) you should consider consultation with your attorney. For those with estates of greater value, there are many potential changes to the tax that consultation with your legal advisor in 2010 is prudent.

Roth IRAs — What's involved? And is it in your best interest?

By *Sabrina Chilson*
IRA Administrator

In 2006, President Bush signed into law the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). One of the provisions for individuals was the elimination of income limits on Roth IRA conversions for tax years beginning after 2009. So beginning in 2010, higher earning Americans will have the opportunity to convert their existing IRAs into Roth IRAs. What is the difference between the two and is it in your best interest to convert?

The main differences between a Roth IRA and a Traditional IRA are:

- deductibility of contributions
- the tax treatment of investment earnings
- the timing of the payment of taxes

Traditional IRAs allow most people to deduct annual contributions made to the account. The payment of taxes can be deferred until distributions are taken from the account. As distributions are made, income tax is paid on the portion of the account that was deducted earlier and also on any earnings received.

Whereas with the Roth account, taxes are paid upfront; when funds are withdrawn (after a five-year waiting period and reaching age 59½), both the earning and the original contributions will be tax-free. The IRS requires Traditional IRA owners to take minimum distributions each year beginning with the year they turn 70½, but Roth IRA owners are not required to take any distributions at all.

When considering a conversion it is important to be aware that it will be treated as a taxable distribution. The taxable part of the converted amount is included as income in the year that the conversion is completed -- except in 2010! In 2010, the IRA owner will have the option to either pay all taxes in 2011 or split the tax bill between 2011 and 2012. Even people who are under 59½ and people who are over 70½ are allowed to convert their IRAs. However, the Required Minimum Distribution for participants over 70 ½ for that year cannot be included in the conversion amount.

This could be a great opportunity for planning your estate. Be sure to consult your tax advisor before making any concrete decisions about performing a conversion. But, you do have the option to change your mind. If, after completing a conversion, it is determined at it is not beneficial to your financial circumstances, there is a way to undo the transaction. A recharacterization offers flexibility when circumstances change; if utilizing this option, it must be requested no later than October 15, 2011. There is a small price to pay for a recharacterization; the tax payer would not be able to attempt another Roth Conversion until the first day of the next taxable year.

As with all financial decisions, each person should examine their own financial situation and consult their tax advisor before making any decisions about a Roth Conversion.

CCTC on WETM TV

Now you can watch Tom Wirth every Friday on the 5:00 pm news program on WETM Channel 18. The segment includes a recap of the week's market performance and a discussion of any newsworthy topics or events that have impacted the market during the week.



Interested in our Investment Outlook?

The *Investment Outlook*, written by Thomas W. Wirth, Sr. Vice President/Sr. Investment Officer, is produced monthly in an effort to provide our clients with some insight into current economic conditions, the markets, and our response to those events.

If you are interested in receiving the *Investment Outlook* each month via e-mail, please notify Eileen McCarthy at emccarthy@chemungcanal.com.





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Noteworthy

Trust E-Statements are here!

- Starting with your January 2010 statement, you can now take advantage of this convenient service, while doing your part to help the environment!

In the future, instead of receiving a paper statement by mail, your statements will be available through the Trust Web-Banking site. The statements are in PDF format and can be saved on your computer for your permanent records.

If you are interested in receiving Web Statements, please contact your account representative so you can enjoy secure, convenient access to your accounts!

- We are pleased to welcome Ed Morton, Vice President and Private Banker. Ed is responsible for managing the Trust & Investment Center's newest service - Private Banking. Our Private Banking service was developed in response to a growing number of high net worth clients and business owners who desire a highly responsive, personalized and seamlessly coordinated approach to handling all of their financial affairs (consumer, business, trust, insurance, brokerage, etc.) through one person serving as conduit. As a Private Baker, Ed is responsible for serving as that conduit. If you would like more information on Private Banking Services, please contact Ed at 607-277-6184.
- If you missed our recent seminars on Gas Leases and are looking for information on the issue, please call Pat Gilliam at 607-735-2061.

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