PARTNERS
WEALTH MANAGEMENT

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Is Converting To A Roth IRA Right For You?

For the first time, many higher income earners may qualify for a Roth IRA conversion. Before 2010, you couldn't convert a traditional IRA into a Roth in a year in which your modified adjusted gross income (MAGI) exceeded $100,000. But now, that income restriction has been eliminated. What's more, though converting to a Roth results in income taxes on the amount you transfer, there's a bonus for conversions made in 2010—you get to spread out the income and the resulting tax liability over 2011 and 2012. That not only delays some of the pain of paying for a conversion; it may also save you actual tax dollars, if the lower installment payments keep you from being bumped into a higher tax bracket and tax rates don't increase significantly in 2011 and 2012.

There are good reasons to convert to a Roth. Qualified distributions from a Roth that has been established for at least five years are completely exempt from income tax. You're eligible to receive this tax-free income once you reach age 59½, and qualified distributions are also possible in case of death or disability or to pay first-time homebuyer expenses (up to a lifetime limit of $10,000). And with a Roth IRA, there's no rule requiring that the distributions must begin for holders of traditional IRAs after age 70½. So if you don't need the money, investment gains in your account can continue to compound without being eroded by taxes until a non-spouse inherits the IRA.

Yet these advantages don't necessarily mean you should immediately transfer all of the assets in your traditional IRAs into a Roth. There are numerous variables to consider, and it doesn't have to be an all-or-nothing proposition. It could be beneficial to convert only a portion of your traditional IRA assets. Your answers to these questions could factor into your decision.

1. How will you pay the tax on the conversion? If the money has to come out of the tax-deferred assets you're transferring, it will limit the benefit of the conversion.

2. What's your tax rate? How much you pay now and your expected tax rates during retirement directly affect the conversion equation. While you might normally expect to be in a lower bracket during retirement—thus reducing the value of tax-free Roth income then—federal tax rates are scheduled to revert to higher levels in 2011 and even greater levies could follow for those in top brackets. State and local taxes may also increase.

3. Did you make nondeductible contributions to your traditional IRA? You won't be taxed to convert the nondeductible contributions, but the earnings will be subject to tax.

4. How old are you and other members of your family? This affects how long assets will be able to grow in a converted Roth IRA—and the longer they grow, the bigger the tax

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Are You Person Number One? Or Are You Person Number Two?

Auto insurance. Homeowner's insurance. Health insurance. We all have them. We all hope we never need them. What makes long-term care insurance any different?

Long-term care insurance may seem like expensive and unnecessary coverage to some, especially those who are currently healthy. However, according to a study done by the National Academy of Elder Law Attorneys, long-term care is the greatest financial risk facing the elderly, even when compared to a major auto accident or house fire.The study shows the rate of financial devastation caused by long-term care is 1 out of 2 (50%) people.

The good news is recent tax law changes have made it less painful to pay long-term care premiums. If you have existing life insurance or annuity contracts, you can now pull money out to pay for your long-term care insurance without incurring any taxes.

In addition, there are many new products that combine life insurance with a long-term care benefit rider. This coverage typically costs less than a traditional LTC product, and if you never need the long-term care, you still have the benefit of the life insurance.

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Social Security Benefit Cuts Are Likely

You've been paying into the Social Security system your entire adult life. At some point, you expect to retire and collect your fair share of benefits. But will the money be there?

Many experts believe Social Security benefits will be reduced or watered down through taxes and other adjustments during the next few decades. Because you may receive less from Social Security, you may need to save more in other retirement accounts.

The Social Security Administration (SSA) says the program's annual costs will exceed its revenues in 2016. And while the SSA projects that the system's trust fund will be able to cover the shortfall through 2037, that's down four years from last year's estimate. And with unemployment still rising—leading to lower tax revenues to fund Social Security benefits—the deficit could worsen, putting pressure on future payments to retirees.

How will Social Security's future play out? The system's financial situation is clearly deteriorating as there are fewer workers to fund retirement benefits for the huge baby boom generation, and there's little appetite for yet another taxpayer-funded bailout of a cash-strapped government program. Yet the likelihood that Congress would actually approve cuts to a program long known as the third rail of American politics also seems low. If benefit reductions come, it may be through the action of a bipartisan commission charged with solving the system's financial woes.

In the meantime, de facto cuts have already begun. An earlier Social Security commission recommended raising the full retirement age from 65, and current rules are gradually increasing the full retirement age to 67 for those born in 1960 or later. You can still choose to begin taking benefits as early as age 62, but you'll receive sharply lower monthly amounts than if you had waited until today's older full retirement age.

Rising Medicare premiums, normally deducted from a recipient's Social Security payments, also serve to undercut cost-of-living benefit increases. Moreover, you're increasingly likely to be taxed on a portion of your Social Security benefits. While only about 30% of current beneficiaries are taxed on benefits, that's projected to rise to 42% by 2020, and high-income retirees may pay tax on up to 85% of benefit payments.

In this volatile environment it is prudent not to rely too heavily on Social Security to provide a large percentage of your retirement income. With the system's future uncertain, your benefits could fall, and even the loss of, say, $1,000 a month could have a negative impact on your retirement plan. We can help you reexamine your retirement income projections, recommend strategies for replacing what you might lose from Social Security, and show you strategies for reducing the amount of taxable Social Security benefits. ●

Succession Planning After The Crisis

The recession took its toll on businesses of all sizes, and the impact went beyond dwindling cash flow. Small-business succession plans—and their role in personal estate plans—have also been affected, and you may need to revisit your blueprint for leaving the company and make adjustments to address a changed economic landscape. But you might also find ways to turn the downturn to your advantage.

A succession plan maps out guidelines for when you're ready to call it quits. You may intend to hand over the reins to one or more new leaders gradually, staying on for awhile as an advisor, or you could plan to get out altogether. The plan may be to have a family member succeed you, or you could promote another company employee or sell to an outside group.

One crucial element of any succession plan is a buy-sell agreement that establishes how the value of the business will be determined when you leave. But in the wake of the economic downturn, your company may well be worth less than it was a few years ago. If you're counting on proceeds from a sale to fund your retirement, you could decide to delay your exit until the company's value rebounds, or you might need to look for other income sources, perhaps from part-time consulting for other businesses that could supplement the sale proceeds.

If you're transferring all or part of the business to family members, however, a decline in its value could be helpful. Assuming the company profits from the economic rebound, shares you give away now should be worth more later, maximizing the impact of current tax-free gifts.

Suppose you and your spouse have equal interests in a business that was worth $5 million in 2007 but is now valued at $3 million. Each of you is entitled to a $1 million lifetime gift-tax exemption, and you might use the

Seven Moves To Make 2010 Less Taxing

For most people, tax planning comes down to an end-of-year scramble. You make a few charitable donations, do some tax-loss selling of disappointing investments, and maybe send in an early mortgage payment to increase your itemized deductions. Yet while such moves can reduce what you owe on April 15, you could save much more by taking a year-round approach. Here are seven tax-saving opportunities you might consider as the months roll along.

1. Lock up the homebuyer's credit. Under the recently revised rules for this tax break, a long-time homeowner can claim a credit of up to $6,500 for a purchasing a new home before May 1, 2010. To qualify, you must have owned your principal residence at least five out of the eight previous years. Are you running out of time? As long as there's a binding contract in place by the end of April, you have until July 1 to close the deal. (This credit is phased out for high-income taxpayers.)

2. Avoid wash sales. Normally, you can use capital losses from stock sales to offset capital gains plus up to $3,000 of ordinary income. But that doesn't mean you can sell a stock to book a loss, then immediately replace the shares if you still like the investment. "Wash sale" rules say you can't deduct a loss if you acquire a substantially identical stock within 30 days of a sale. One way around the problem is to "double up," buying a new block of shares and then waiting more than 30 days to sell your original holding. (Any loss that's disallowed can be added to your basis in the stock, reducing any future gain or increasing the loss.)

3. Check your AMT status. The alternative minimum tax (AMT) can sneak up on unsuspecting taxpayers. Each year, you must calculate your taxes under both normal and special AMT rules—and then pay whichever bill is higher. If your tax advisor estimates your AMT liability midway through the year, you may have time to make adjustments, postponing "tax preference" items that increase your AMT levy—or, conversely, accelerating income to be taxed at AMT rates of 26% or 28% if you expect to be in a higher bracket in 2011, when income rates are scheduled to rise.

4. Generate an energy credit. You can claim a credit equal to 30% of the cost of making qualified energy-saving improvements to your home. Those can range from installing central air conditioning to adding new skylights or more insulation. But the maximum credit allowed for the period spanning 2009 and 2010 is $1,500. If you haven't hit the maximum yet, consider the possibilities for cutting energy bills along with your taxes.

5. Position your investments. Most investment decisions have consequences come tax time, and you could save money with tax-aware moves. For example, if you acquire six-month Treasury Bills after June 30, 2010, you won't be taxed on the income until 2011. Also, keep a running count of capital gains and losses that could offset each other. If you've already realized substantial gains, look for underperforming assets you might unload to limit your tax liability. Or, if you're showing a net loss for 2010, that may give you leeway to sell some appreciated positions.

6. Keep your dependents. Is this the year your family celebrates a high school or college graduation? Even if your child gets a full-time job, you can generally still claim an exemption if you provide more than half of the child's annual support. For 2010, the exemption amount (the same as your personal exemption) is $3,650. One idea is to give a generous graduation gift that is sure to put you over the half-support mark. But keep in mind that hiring your kids won't work—that money counts as support children provide for themselves.

7. Send your kids to day camp. If you pay someone to watch your children (under age 13) while you and your spouse work, you may be eligible for a dependent care credit. You can usually claim a credit equal to 20% of the first $3,000 of qualified expenses for one child, or of $6,000 for two or more children. This tax break isn't limited to babysitters and day care centers—you may also get a credit for the cost of sending kids to summer day camp. But sleepaway camp doesn't count.

These are just seven of many ways you may be able to minimize your taxes with careful planning. What's important is to start looking around now, not later, for moves that could save you money. You can always make additional adjustments at year's end, but by then you may have missed out on larger opportunities. ●

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combined amount now to transfer two-thirds of the business to your heirs. Before the recession, a $2 million transfer would have left $3 million that could be subject to estate tax. Each spouse can also transfer an additional $13,000 annually to each heir, so this can add up if there are multiple beneficiaries.

Other estate planning techniques can capitalize on a business's temporarily reduced value. For example, an intentionally defective grantor trust (IDGT) can effectively freeze the value of shares at current levels. Or, with a grantor retained annuity trust (GRAT), the assumed value of a future gift to your heirs will be reduced not only by the low current value of the business but also by today's rock-bottom interest rates. That could limit or eliminate your gift-tax liability. We can work with you and your attorney to evaluate your succession plan and consider whether these or other techniques and strategies could be financially advantageous.●

Should Retirees Carry A Mortgage?

Your home mortgage is likely to be the biggest debt you ever take on. And if you've moved or refinanced a few times since your first home loan, you may be years or even decades away from owning your house free and clear. But that begs the question: What about retirement? If you're getting ready to retire or already have stopped working, does it make financial sense to keep making monthly payments? Or should you use some of your savings to retire that debt?

Traditionally, paying off the mortgage was a pre-retirement objective, but the recent trend has been to carry the debt longer. A study by the Center for Retirement Research at Boston College found that in 2007, 41% of households with people in their 60s still had a mortgage, even though more than half owned sufficient assets to repay the loan.

Why would you hold a mortgage in retirement? Depending on your situation, you may value the tax benefits and liquidity. Consider these four critical factors.

1. Investment returns. Recently, the average 30-year fixed rate for mortgages has been between 5% and 5½%. You might keep your mortgage if you think you can do better investing the money you would spend to retire it. But retirees who invest heavily in low-risk vehicles such as bank certificates of deposit (CDs) and Treasury securities are likely to come up short. And though stocks and mutual funds may provide higher rates of return, they carry greater risks, and if your portfolio plummets, you could have trouble making mortgage payments.

2. Tax breaks. You can generally write off mortgage interest if you itemize deductions. But people who claim the standard deduction—and that's almost two out of every three taxpayers—receive no tax benefit from mortgage interest payments. So if you're not an itemizer, it may make sense to pay off the mortgage. Also keep in mind that the tax benefit of itemized deductions will be reduced if your income is high.

3. Retirement accounts. It's generally not a good idea to pay off your mortgage if you have to invade your retirement accounts to do it. The money you pull out of a 401(k) plan or an IRA will be reduced by taxes—at ordinary income rates of as high as 35%—plus you'll be hit with an additional 10% penalty if you're under age 59½. And you'll be left with fewer funds to draw upon during retirement.

4. Refinancing. One alternative to paying off the mortgage may be to refinance it at a lower interest rate. That can reduce your payments, or you could use the opportunity to pull out equity you've built. But the deep decline in real estate values has underscored the risks of financial strategies built around home loans.

Choosing what to do about your mortgage is a major financial decision. We can help you choose the best approach for your situation. ●

Should You Convert?

(Continued from page 1)

advantage. If you have young children who might inherit the income tax-free assets, they may be able to spread out distributions (required after the account goes to the next generation) over many decades.

With all of these factors to consider, deciding whether to convert can be complicated. Suppose, for example, that you are 55, your spouse is 50, and your only child is 25. You have $500,000 in a traditional IRA and you're in the 33% tax bracket. Assume you're planning to convert to a Roth in 2010, you'll elect the two-year schedule recognizing income and paying conversion taxes, and the money will come from outside your IRAs. The Roth IRA assets will earn 4% annually, and you intend to begin withdrawing $1,000 per month at age 70.

The Roth IRA Conversion Optimizer, a tool for wealth management professionals, shows that the optimal "net benefit" of this Roth conversion would be $1.19 million, assuming you transferred all of the traditional IRA's assets.

But changing the scenario slightly results in a different outcome. Suppose you can pay only half of the conversion taxes with outside funds. In this case, converting 100% of the assets would provide a $725,000 net benefit. However, converting only 60% of the traditional IRA assets would produce a net benefit of $809,000.

If you don't have any outside funds to pay the conversion taxes and instead use only the IRA's funds, the net benefit of the Roth conversion greatly decreases. In this example, the benefit is only $231,000 for a 100% conversion and for a 60% conversion it's $320,000. This demonstrates the importance of using outside funds to pay taxes and why a partial conversion can be ideal when outside funds are insufficient.

The variations can be mind-boggling, but you don't have to crunch the numbers on your own. Give us a call and we'll help you decide what works best in your situation. ●

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