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Do Roth IRA Conversion Rule Changes Help You?

Why would you volunteer to pay income tax next year by converting a traditional IRA to a Roth IRA? If you leave things alone, you won't owe any current tax on the assets in your account, regardless of their investment performance. But the promise of a future tax payoff—combined with the prevailing economic conditions—may warrant this unusual approach. And thanks to a recent tax law change, a conversion to a Roth in 2010 will be a possibility for all investors, regardless of income.

With a traditional IRA, contributions may be tax deductible, but the amount you deduct and subsequent earnings will be fully taxed as income when withdrawn during retirement. (The same rules apply to IRAs holding assets rolled over from traditional 401(k)s or other employer-sponsored plans.) And you generally must begin taking those taxable distributions during the year after the year in which you turn age 70½.

In contrast, contributions to a Roth IRA are never deductible, but qualified distributions from a Roth that has been established for at least five years are completely tax free. And because the government won't benefit when you take distributions, it doesn't require you to take them.

Until now, the catch has been that high-income individuals can't contribute to a Roth IRA, and converting a traditional IRA to a Roth hasn't been allowed if your adjusted gross income exceeds $100,000. The latter rule changes in 2010, when the income cap for conversions is eliminated. And though a conversion to a Roth requires you to pay income tax on the amount you convert, if you make the conversion in 2010, you're allowed to spread out your tax payment over 2011 and 2012.

Choosing between saving for retirement with a traditional IRA or a Roth is in part a question of whether it's better to pay the IRS sooner or later. Being taxed on current contributions to a Roth IRA or for a conversion from a traditional IRA takes money out of your pocket now, but you may do better later, either enjoying tax-free distributions or passing along the account to your heirs, whose withdrawals also won't be taxed. But the law permitting anyone to convert to a Roth, coupled with the bear market's depressed asset values, adds interesting twists to this debate. Consider these four reasons it may pay to convert.

1. You'll pay less to convert an IRA whose value has plummeted. Rare is the investor who hasn't seen retirement account values fall by at least 25% during the bear market. As painful as that has been, however, it can be an advantage if you choose to convert to a Roth IRA in 2010. You'll be taxed on the value of the account at the time of the conversion, regardless of what it may have been worth a few years earlier. Suppose the assets in your IRA were worth $500,000 a year ago,

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Adjusting To The New Reality About Your Retirement

Your nest egg has been battered by the global recession. Does that mean you will have to downsize your retirement dreams?

The answer depends on several factors, but one thing is sure: Those who realistically assess the damage now and adjust their planning accordingly will likely emerge in a better position than those who simply wait for their depressed asset balances to bounce back.

If you are nearing retirement and have seen your savings drop by 25% or more, you need to acknowledge a new reality—that this may be more than a bump in the road, and that you're likely to benefit from a clear-headed look at your retirement plans that can help you decide whether changes are necessary.

Do you really need a new car every three years for the rest of your life? How much can you afford to leave your children? Could a different kind of retirement be less expensive but just as satisfying? Could you work a little longer?

History says the markets eventually will recover, and your best bet is to remain invested for the long term with a portfolio that's broadly diversified and regularly rebalanced. But in the short term, prudence suggests making adjustments, either on the spending or the saving side of your retirement planning equation. By revisiting your financial plan today, you will put yourself in a better position tomorrow.

Sincerely,

Robert J. Pyle, CFP, CFA

Four Steps *Not* To Take Right Now

As the tough economic times push on and stock prices fluctuate, it's hard to know what moves to make as an investor. Though the panic you probably felt during the early months of the bear market may have ebbed, your account balances still aren't fun to look at, and the direction of the market is anything but certain. Was the spring-summer market rally the first leg of a new long-term bull market? Or will unemployment, lackluster corporate profits, and a shift from consumer spending to saving post-pone the recovery and keep share prices volatile?

Definitive answers may be a long time in coming. But in the meantime, there's no reason to abandon the fundamental investing principles that have worked for you in the past. Here are four moves *not* to make now.

1. Keep your money idle. It's tempting to sit on the sidelines while the markets sort themselves out. But there are two problems with that approach. The first is that if you're going to reach your retirement goals, you'll need growth in your portfolio, and that means putting your money to work in suitable investments. The second is that if your plan is to sit out until markets improve, you'll inevitably miss much of what the market provides. The best time to buy is when the market is down, not when you feel comfortable, and trying to time your entry and exit into the market almost never works.

2. Chase the golden goose. Trying to get well in a hurry by jumping on the bandwagon for high-flying stocks or high-yielding bonds is another common investing mistake. The best time to invest in a particular sector or category is before a market run-up, not after. You'll probably be too late to the party if you invest heavily when substantial gains have already been realized, and you may be left holding overvalued investments vulnerable to sharp declines, especially while the markets remain volatile.

3. Rely too much on "safe" investments. Diversifying your portfolio with reasonable allocations to low-risk, low-return investments such as bonds and money markets is smart, but veering too far in that direction can be just as damaging to your long-term prospects as chasing hot stocks or trying to time the market. "Safe" investments bring their own risks, including a loss of value when interest rates rise and inflation picks up.

4. Stop saving for retirement. When times are tough, paying bills may have to take precedence over saving. But your future needs are also crucial, and continuing to contribute to your 401(k) or other retirement plan—even, or especially, if its value has plummeted—is the only way to ensure that you'll reach your long-term goals. These turbulent times too shall pass, and it only makes sense to keep working toward your ultimate objectives. In fact, cost averaging into your 401(k) enhances returns when the market drops—a reward for continuing to save. ●

A SCIN Is A Timely Estate Tax Strategy

If there's a single, central objective of most estate plans, it's to transfer property to younger family members while minimizing estate and gift tax liability. Among the many strategies and structures designed to accomplish that goal, one less well-known vehicle—a self-canceling installment note, or SCIN (pronounced "skin")—may work particularly well with today's depressed asset values and low interest rates.

With a SCIN, you sell real estate, a business interest, or other assets to one or more younger family members, such as your children, in exchange for an installment note with a term shorter than your expected life span. That aspect is required; to realize tax benefits, the note's term must be shorter than the seller's life expectancy, according to IRS tables. But under the "self-canceling" feature of the note, your heirs' obligation to repay the loan automatically disappears if you die before the end of the term.

A SCIN provides several potential tax benefits. If you die early and there's an unpaid balance on the loan, that amount won't be considered part of your taxable estate. Yet the property still ends up in the hands of your heirs. And because the transfer is a sale for fair value, not a gift, there's no gift tax.

There's also an advantage in using a SCIN to pass along property that has appreciated in value. Though you may owe capital gains tax on the sale, you can spread out that liability over the note's term. (Note that if the assets' buyers are family members, they must wait at least two years to sell the property in order for the capital gains to be prorated and deferred.) The longer term might help you avoid moving into a higher tax bracket, particularly if the term of the loan

Seven Tax Moves To Make Right Now

Last-minute tax-saving opportunities are always welcome, of course, but you're more likely to make a noticeable dent in your tax bill if you plan well and begin early. Smart tax planning is a year-round proposition, especially if you run a small business or are self-employed. Here are seven moves to consider before the end of the year.

1. Make the most of travel deductions. Even in this age of teleconferencing, there's often nothing more productive than a face-to-face business meeting, and deducting travel costs can make overnight trips more affordable. The IRS lets you write off airfare or car mileage as well as meals and lodging, as long as business is the primary purpose of a trip. (The deduction for meals is limited to 50% of the cost.) And taking time out for pleasure is allowed as long as you spend more time on business than on pleasure. Just don't deduct what you spend on personal pursuits.

2. Limit your time at your vacation home. Renting out a second home will do more to cut your tax bill if your personal use of the property doesn't exceed the greater of 14 days or 10% of the time it's rented. If you're there less than that and your costs exceed the rental income, you'll be able to claim a deductible loss. Go past that threshold, and you'll be able to use expenses only to offset the income. Keep in mind that the time you spend getting the place ready for renters or making repairs doesn't count as personal use, even if your family tags along just for fun.

3. Buy a new vehicle. This year's stimulus legislation created a tax-saving opportunity for car-shoppers. If you buy a new vehicle before January 1, 2010, you can deduct the sales and excise taxes attributable to the first $49,500 of the vehicle's price. This tax break applies to passenger cars, motorcycles, light trucks, SUVs, and even motor homes weighing no more than 8,500 gross pounds. But this deduction is phased out if your adjusted gross income (AGI) exceeds $125,000 for single filers and $250,000 for joint filers.

4. Hire your child. Giving your son or daughter an after-school job not only provides valuable experience; it also can deliver up to $5,700 of tax-free income to a child in 2009. If your business is unincorporated, you don't have to withhold employment taxes for achild under age 18, and any business can deduct the child's wages as long as they're reasonable for the work being done.

5. Entertain your clients. You can deduct 50% of the cost of treating a client as long as the entertainment follows or precedes a "substantial business meeting." For example, if you finalize a new contract in the morning, you could write off a golf outing or a fishing expedition in the afternoon and dinner and drinks at night. If the client has traveled a long distance, the entertainment may take place the day before or the day after the meeting.

6. Save on energy and taxes. The stimulus act also enhances tax incentives for installing energy-efficient home improvements. Now you get a residential energy credit of 30% of the cost of the work, up from 10%, and the lifetime $500 cap on the credit has been replaced by an annual limit of $1,500. The credit covers wide-ranging improvements, from adding insulation to installing a whole-house fan or central air-conditioning, and covers work done in 2009 and 2010.

7. Be a first-time homebuyer—again. Unless you're a confirmed city dweller and have always rented, you've probably owned more than one home over the years, and you wouldn't expect to qualify for a tax break offered to "first-time" homebuyers. But the new law defines a first-timer as anyone who hasn't owned a principal residence during the past three years. So if you've been renting for a while, even if you've purchased houses in the past, you may be eligible. You'll need to buy before December 1 to claim a tax credit equal to the lesser of $8,000 or 10% of the purchase price, and the credit is phased out if your AGI exceeds $75,000 for single filers or $150,000 for couples filing jointly.

These are just a few of the many opportunities to cut your tax bill long before December 31 rolls around. On the personal side, for example, the ongoing turbulence in the stock market might give you a chance to generate capital losses while improving your portfolio. We can work with you and your tax professional to explore options that make sense for your business or your personal finances. ●

extends into your retirement years, when your income may be declining. Meanwhile, if the transferred property continues to appreciate, those gains will be outside your estate.

Because the self-canceling aspect of a SCIN is a risk to your estate, the note must include either an inflated market value for the assets or an interest rate that's higher than the applicable federal rate, or AFR. That can be a drawback of this estate planning technique. But interest rates now are exceptionally low, and the value of most assets is well below what they may have been worth in recent years. As a result, the interest rate required for a SCIN may still be quite reasonable. And with asset values depressed, the principal of the note will be lower, and any rebound in prices will, again, occur outside your estate.

If you are interested in transferring property to your heirs, we can work with you and your attorney to consider whether a SCIN could help. ●

Move Fast To Corral Emergency SBA Loans

The Small Business Administration (SBA) has announced details of its much-anticipated program to free up emergency loans for struggling businesses. The "America's Recovery Capital" (ARC) program kicked off on June 15. The money, provided by private lenders but fully guaranteed by the SBA, may be available until program funding runs out or until September 30, 2010, whichever comes first. And with loans to qualifying businesses made on a first come, first-served basis, it makes sense to apply as soon as possible. If you've had trouble getting capital, this may be an opportunity you don't want to miss.

Authorized by this year's massive economic stimulus law, the ARC program is supported by $255 million that Congress set aside to pay for loan guarantees and interest subsidies. But the actual funding will be higher, according to the SBA. That's welcome news to entrepreneurs caught in today's tight-money squeeze. The stimulus legislation encouraged lending to small businesses, raising loan guarantee ceilings and waiving fees on SBA-backed loans, and average weekly loan volume increased by more than 25% percent this spring. But that jump was from very low levels. The number of first-quarter loans made by private lenders through the SBA's popular 7(a) program declined by 57% in the first quarter of 2009 compared with the same period a year earlier, and major lenders outside the program have also reported tighter credit.

The ARC program provides business owners with short-term loans of up to $35,000 that may be used temporarily to cover payments on existing debt. The SBA is subsidizing the loans, making them interest free to business owners. No repayments are required during the first year and you can take five years to repay the loan.

The loans are designed to help businesses experiencing "immediate financial hardship." To qualify, you must have an established business, provide financial statements demonstrating your business was profitable in at least one of the past three years, and be able to project sufficient cash flow to meet loan payments during the two years following loan approval.

Funds will be distributed to business owners during the six months following loan approval. The money may be used for paying principal and interest on existing small business debt, including mortgages, term and revolving lines of credit, capital leases, credit card obligations, and notes payable to vendors, suppliers, and utilities.

ARC loans are made by participating banks, but with a 100% guarantee from the SBA. If a business owner defaults, the SBA will repay the loan's full value to the bank. That feature should encourage plenty of lenders to offer ARC money, and owners of businesses hurt by the recession are lining up. Applying now could be wise. ●

Roth IRA Conversion

(Continued from page 1)

but in 2010, they are worth only $400,000. At the top current income tax rate of 35%, that saves you $35,000.

2. You'll avoid a higher tax bill later if rates rise. With individual tax rates at near-record lows and tax revenue falling far short of federal budget commitments, tax rates are likely to go up in the near future. It may be better to take your lumps under current tax law—even if all or part of the conversion is taxed at the top rate of 35%—than to risk losing much more of your investment to the IRS later.

3. Converting to a Roth IRA gives you maximum flexibility on distributions. There's not much give in the rules on withdrawals from traditional IRAs and 401(k)s. Beginning the year after the year you reach 70½, you'll face minimum annual distributions designed to use up the account during your expected life span—and you'll pay a 50% penalty on any shortfall from the required amount. With a Roth, you can take as large or small a distribution as you choose each year, and you have the option of leaving the account intact to provide tax-free income to your heirs.

4. A partial conversion to a Roth lets you customize your tax liability and benefits. A Roth IRA conversion needn't be an all-or-nothing proposition. You can convert as much or as little as you want each year (although the option of stretching out tax payments applies only to conversions in 2010). Making a partial conversion lets you limit current payments to the IRS while also providing some tax-free income during retirement.

We can help you decide whether a conversion makes sense in terms of your unique situation and overall financial goals. ●

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