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Foresight

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Greetings!

School is back in session and as we all settle back into our routines, remember September is National Life Insurance Awareness Month so please enjoy the conclusion of the excellent article on determining your life insurance needs. Additional, with so much discussion about taxes recently I also want to remind you about a unique tax opportunity for this year that is not likely to return again. Each month I share thoughts on various topics in the world of personal finance, investing, economics, and business through my writings below. May you find my musings informative, thought provoking, and enjoyable.

Thoughtfully,

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What You Shoud Know About Roth IRA Conversions for 2010

As 2010 is winding to a close, much of the talk today is on a topic generally discussed in April, which of course are taxes. While the debating over whether Bush era tax cuts should be extended, or allowed to expire, or should some compromise of the two approaches be established, there is still time for you to consider a unique financial opportunity. This year anyone may convert a traditional IRA to a Roth IRA. No income limits will stand in the way of the conversion.[1] Now a conversion to a Roth IRA will be treated as a taxable distribution from the traditional IRA, thus if you converted $50,000 then you have to include that amount as taxable income for 2010 (ouch).
Guess what, *the federal government is giving you a tax break this year*. If you do a Roth conversion in 2010, you can choose to divide the taxes on the conversion between your 2010, 2011 and 2012 federal returns. This means you won't have to finish paying the taxes until April 2013.[6] *Should you do it?* Here's why it may (or may not) make sense for you to go Roth this year.
Why you might want to consider it. A Roth IRA permits tax-free growth *and* tax-free income distributions in retirement (assuming you are age 59½ or older and have held your Roth account for 5 years or longer). You can contribute to a Roth IRA after age 70½, without having to take mandatory withdrawals. While contributions to a Roth

IRA aren't tax-deductible, the younger you are, the more attractive a Roth IRA may seem.[2]

However, older investors have reason to go Roth as well - especially if they don't really need to withdraw IRA assets. Under present tax law, converting an untapped traditional IRA to a Roth will shrink the size of your taxable estate, and careful estate planning could foster decades of tax-free growth for those IRA assets.[3] Currently, if you name your spouse as the beneficiary of your Roth IRA, your spouse can treat the inherited IRA as his or her own after you die and forego withdrawals. So those Roth IRA assets can keep compounding untaxed across the rest of your spouse's life.[4]

If your spouse then names a son or daughter as a beneficiary, that heir has the choice to make minimum withdrawals according to his or her life expectancy, all while the assets continue to compound tax-free. Currently, withdrawals from an inherited Roth IRA are not subject to income tax.[3]

Beyond the estate planning benefits to your heirs, the ability during your retirement to not be subject to Required Minimum Distributions from your Roth IRA and the freedom to make tax free withdraws for your self is something that you should give very strong consideration.

If you have money available from outside of the traditional IRA to pay the taxes due then a conversion might make sense because you're not using the tax-deferred account to pay the taxes. Were any of the contributions to the traditional IRA made with after-tax dollars? If so, this makes conversion less expensive because you already paid income taxes on some of the contributions.
You could simply do a partial Roth IRA conversion if converting the full amount would send you into a higher tax bracket. If you think you have more IRA assets than you need, a partial Roth conversion could result in a more manageable short-term tax impact as you pursue the objectives of having some tax-free retirement income or leaving some IRA assets to your heirs. It will further reduce the amount of required minimum distributions.
Before you convert, be sure to consult your tax advisor to discuss additional considerations. This is a very good idea before you arrange any rollover, trustee-to-trustee transfer, or same-trustee transfer of your IRA assets. There are many variables to consider, and they differ greatly from person to person. In any year, you should fully understand the potential tax impact of a Roth conversion on your finances and your estate. As mentioned earlier the IRS regards a traditional IRA-to-Roth IRA conversion as a distribution from a traditional IRA - a taxable event.[5] You will need to pay taxes on the entire amount of the conversion.
Perhaps if you talk to your tax preparer, CPA, or financial planner, the consensus on the direction of future marginal and capital gains taxes most likely would have all of them agreeing that future federal income tax rates are likely to be higher than they are now. This is another reason why 2010 may be a good time to convert to save money now while you can.

You may be tempted to use the current IRA assets to pay the conversion tax, but should you? If you're younger than 59½, you're looking at a 10% penalty on the amount you withdraw, and you'll lose the chance for tax-free compounding of those assets within the Roth IRA.[6] Other questions for you and your advisor to consider:

- Are you subject to the alternative minimum tax, or AMT? Being

subject to the AMT can make it more expensive to convert.
- Are you planning charitable contributions? Plan on donating part of your account balance to charity? If so, it doesn't make sense to pay taxes on the conversion only to donate the money to charity.
- What's the impact of conversion on Social Security benefits? The increase in income resulting from a Roth IRA conversion **can** increase the income taxes due on Social Security benefits in the year of conversion. *Future distributions* from the Roth won't impact/increase the taxation of your Social Security benefits.

Lastly, remember that while the income limit on Roth IRA conversions will go away in 2010, the income limits on Roth IRA *contributions* still apply next year and for the foreseeable future. So high-income IRA owners can make the conversion, but they may not be able to pour new money into the account. For 2010, the maximum adjusted gross income (MAGI) phase-out limits starts at $105,000 for single filers and $167,000 for joint filers. [7] However, those income limits don't prevent you from contributing to a traditional IRA in 2010 and converting that IRA to a Roth IRA.[8]

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Citations

[1]kiplinger.com/magazine/archives/2009/01/sweet-deal-on-roth-ira-conversion.html [1/09]

[2]thestreet.com/print/story/10505164.html [5/26/09]

[3] smartmoney.com/personal-finance/retirement/estate-planning-with-a-roth-ira-7966/ [1/22/09]

[4]smartmoney.com/personal-finance/retirement/roth-iras-to-convert-or-not-7965/ [1/10/08]

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[6]cnbc.com/id/34511917 [12/21/09]

[7]irs.gov - see IRS Publication 590 for current complete explanation of Roth IRA provisions and requirements

[8]northjersey.com/news/business/82334757_Make_a_New_Year_s_to-do_list_to__bring_home_the_bacon__.html [1/22/10]

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Part 2 - How Much Life Insurance Do I Really Need?

September is Life Insurance Awareness month and last month, I talked about the four main cornerstones of sound financial planning when it comes to life insurance. This article will discuss the four steps you should take to determine how much life insurance is right for you.

Step 1: Determine Your Family's Short-Term Needs

Short-term needs are financial obligations and/or expenses arising within six months of death. Examples of short-term needs include expenses you pay now such as:

- Loan balances (automobile loans, etc)
- Outstanding credit balances (credit cards, revolving lines of credit, etc)
- Mortgages (first and second mortgage, home-equity loans, lines of credit)

Add to these current expenses any death-related expenses that must be paid in the short term:

- Funeral expenses
- Final medical costs
- Estate settlement costs and probate
- Estate taxes due
- Charitable bequests you would like to make upon your death

If you don't already have one, your survivors should be left with a liquid emergency fund sufficient to get them through any unexpected financial needs. Most advisors recommend between three and six months' worth of living expenses.

Step 2: Determine Long-Term Needs

In addition to covering your survivors' short term needs, some level of monthly income will be needed to maintain their current standard of living and meet financial goals such as saving for retirement and funding college for children.

The value of these future obligations is discounted back to present value amounts to provide a dollar amount that, if invested, could provide an adequate income stream to fund all of your long-term goals.

Step 3: Calculate Your Total Available Resources

By this point, you should have a good idea of your family's total cash needs in the event of your untimely death. With any luck, you have already begun to set money aside to cover some of these costs. Other resources that may be available to your family include pensions, annuities, funds from retirement accounts, employer-provided life insurance, and Social Security.

The Social Security program offers benefits to survivors under age 17, and those whose spouses were receiving retirement income from Social Security can also count on survivorship benefits.

The total value of these future resources is discounted back to present value amounts. This gives us a single dollar amount that we can use to offset your total needs.

Step 4: Provide Funds To Cover A Shortfall

In most cases, comparing total needs to total resources will result in a shortfall. That's where life insurance comes in. Without it, your survivors will be left with the choice of either finding or creating additional resources (such as having the surviving spouse return to work) or experience a decline in the quality of their lifestyle.

Life insurance is uniquely suited for covering such a shortfall. It is a means of sharing the financial risk of premature death with many, many others who have similar concerns.

You pay a relatively small premium to an insurance company in exchange for their promise to pay your beneficiaries a specified death benefit in the event of your death. You may find it ironic that a financial need arising from death can be alleviated by a financial resource that is created after death. That's why life insurance, although something no one hopes to ever need, is indeed for the living. It's also a vital issue we can help you investigate in greater detail to ensure your family's financial future will be protected.

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Citations

"Life Insurance Awareness Month," LIMRA International, August 2004

Read the full article, *How Much Life Insurance Do I Really Need* here.

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