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INSIGHTS

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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may be tax deductible, but the amount you deduct and subsequent earnings will be fully taxed as income when withdrawn during retirement.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 the income and 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

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A Personal Note From Global Wealth Advisors

As we anticipate the coming year with renewed optimism, we offer our customary variety of articles relevant to your planning for 2010 and beyond. Reflecting on the past year, we're reminded that successful investing includes a dose of fortitude to block out emotional reaction to short-term economic events. We (and our clients) are long-term investors, participating in globally diversified investments that make sense for each person's portfolio.

This year, much of the publicity you'll witness in the news will deal with Roth IRA conversions, with a similarly positive spin to our lead article. However, we urge caution: many clients will be better off not converting. We can perform the analysis required in your individual situation, and welcome your request for our opinion.

We also expect an additional flurry of activity from Washington DC in the form of new legislation and regulations ranging from financial industry reform and tax law change to healthcare and the environment. We'll keep you apprised on any significant impact on your investment and financial planning.

Thanks for your continued trust and confidence. Let us know of others who may benefit from our services.

Jim Knaus Mike Krencicki

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 postpone 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, dollar cost averaging into your 401(k) enhances returns when the market drops—a reward for continuing to save. ●

When Should You Amend A Tax Return?

Filing a tax return once is enough of a hassle. Doing an amended return for the same tax year—in other words, filing twice—seems like way too much. Yet millions of amended tax returns are filed by individual taxpayers each year.

Does an amended return increase your chance of being audited? Technically, no. But it will extend your exposure to IRS challenges. The agency can come after you for back taxes for up to three years from the date you file a return, and if you re-file, say, a year after the fact, that restarts the clock.

Still, filing an amended return can put money in your pocket. So here are some of the most common reasons to file IRS Form 1040X.

You get an amended 1099, K-1, or W-2. These are forms sent to you by banks, brokerages, investment partnerships, employers, or others. It's not uncommon for these firms to make mistakes and resend a corrected form months after sending the original. And even if the corrected form will mean only a small change in your tax liability, you'll still need to file an amended return, since the government also receives a copy of revised forms and will match them to your return.

You're a sole proprietor, a shareholder in an S-Corporation, or the owner of a partnership. As such, you may have strong incentives to file an amended return, since pension or profit-sharing plans for one year can oftentimes be funded with earnings from the following year. Say you receive a windfall prior to the due date for filing your return (excluding extensions), but after you already filed. You can use that windfall to increase your retirement plan funding for the prior year, retroactively giving yourself a larger deduction. You can reflect the change on an amended return.

You discover an overlooked deduction when checking through

The Dynamics Of China-U.S. Economics

In the autumn of 2008, China became the United States' biggest creditor, and Chinese leaders have wasted little time in flexing their growing economic muscle. China is demanding a stronger voice in global economic affairs and has proposed a new international currency that would supplant the dollar as the world's dominant medium of exchange. Should U.S. investors worry about China's emergence as a powerful economic force? And how will this "new world order" affect American consumers?

The Chinese have been buying up U.S. Treasury bonds for years, and by January 2009, China held $740 billion in U.S. Treasury securities, or 24% of the total outstanding Treasury debt. In September 2008, China had surpassed Japan as the U.S.'s largest creditor. China also has amassed the world's largest cash reserves, totaling about $1.9 trillion, and maintains the world's most lopsided trade surplus with the United States. That reflects the fact that China has become the world's No. 1 producer while America has become a nation of avid consumers. Monies from throughout the world are pouring into China's booming economy while American dollars flow outward to buy more goods and services.

These trends have led to controversy, with U.S. officials accusing the Chinese government of manipulating its currency to keep its exports competitive. But the Obama administration backed away from those claims early in 2009 after China allowed its currency to appreciate slightly against the dollar, thus slowing the nation's accumulation of cash reserves.

For now, leaders of both countries have agreed to work together to fight the global recession, joining countries in the European Union and around the world. But in the long run, China is building up a potentially alarming amount of influence over the American economy, analysts say. "The scale of financing the U.S. now receives from China truly is unprecedented: it now not only tops the largest inflow the U.S. ever received from another country, but it is clearly by far the largest inflow the U.S. has ever received from a government that the U.S. doesn't consider a close military ally," writes Brad W. Setser, geoeconomics fellow at the Council on Foreign Relations, in his blog for the Center for Geoeconomic Studies. "And I don't think it is in the interest of the United States to rely so heavily on a single country's government for financing."

Chinese leaders have recently expressed concern about the strength of the U.S. economy—and, by extension, the safety of China's Treasury investments—and signaled a desire to diversify. Should China shift a significant amount of money out of U.S. government bonds, other international and domestic investors could follow the Chinese lead. Any run on Treasury bonds would hurt the U.S. government's ability to pay for hundreds of billions of dollars in recession-fighting stimulus spending and would increase borrowing costs for U.S. companies and individuals. Such a move could, however, improve the trade deficit, because it would weaken the dollar, making U.S. exports more affordable. Currently, the U.S. imports from China five times as much as it exports to China.

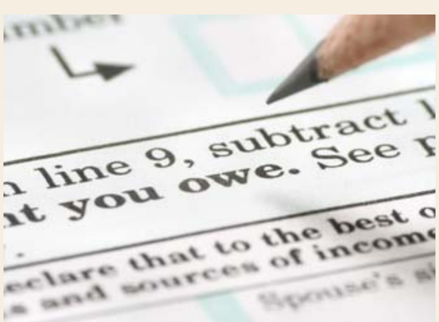
While China cut back on U.S. Treasury purchases earlier this year, analysts agree that at least in the near term, the Chinese will continue to invest in U.S. bonds, both to maintain China's trade advantage and because the global recession presents few safe investing alternatives. Still, China's emergence as America's No. 1 creditor signals a basic change at a time of great economic uncertainty. During past economic downturns, the U.S. was always the largest creditor nation in the world. That was a good position to be in, because it meant other countries owed the U.S. more than it owed them.

During the current global recession, the reverse is true. America has become the world's largest debtor nation. As long as interest rates stay low, that alone is not a problem. However, as interest rates increase, it will become more expensive for American companies and consumers to borrow money, for everything from business equipment to houses. And that can only make emerging from the recession a longer and more difficult process. To put individual households and the country as a whole on more sustainable footing in preparation for future downturns, Americans will need to make the painful transition from spending to saving more of their hard-earned dollars. ●

your records, such as from a charitable contribution.

The law or IRS rules have changed. Sometimes the IRS clarifies a rule or a court ruling will liberalize a tax break.

You miscalculated when figuring your tax liability for selling a mutual fund. Often, investors count only their original purchase price as their cost, not realizing that reinvested income also qualifies. Your actual gain could be much lower than the amount you reported to the IRS.



In most cases, filing an amended return will not be expensive. And if only one or two calculations have to be changed, it shouldn't be a big deal. No one likes to deal with the IRS and taxes, but you could be leaving money on the table by shunning a 1040X.

To keep up-to-date on tax law changes affecting your taxes and your business, visit www.irs.gov or call 800 829-1040 (individuals) or 800 829-4933 (businesses).

Be Charitable Without Cutting Inheritance

With the uncertainty of future estate tax laws, you may be understandably reluctant to lock yourself into long-term wealth transfer strategies. But some estate planning moves do more than slice your tax bill. With a charitable remainder trust (CRT), for example, you get the satisfaction of supporting a favorite philanthropy. You also stand to save a lot on income taxes. And you can make sure your heirs won't lose out, either.

A CRT is relatively simple. You start with an irrevocable transfer of assets into the trust. Ideally, you should contribute an appreciated asset—stock or real estate, for example, that would generate a taxable capital gain if it were sold outside the CRT. With a CRT, you don't have to pay for those gains. Just keep in mind that irrevocable means just that. These assets aren't coming back.

A trustee you appoint—an institution or an individual—controls the assets, and under the terms of the trust, you or other beneficiaries receive regular income. At the death of the last remaining income beneficiary (or after a term period not to exceed 20 years), the trust assets go to the charity you selected. During your lifetime, you can change the designated charity. You can also specify how it is to use the donation.

Suppose you and your spouse own real estate purchased two decades ago for $200,000. You transfer the property, now worth $1 million, into a CRT. The trust sells the property, invests the proceeds, and pays you and your spouse 8% ($80,000) in annual income.

Your tax benefits include:

- The CRT pays no capital gains tax. Realized capital gains distributed to beneficiaries are taxed at favorable capital gains tax rates when received.
- An income tax deduction for making a charitable donation. The amount of the deduction depends on the present value of the future gift, the ages of you and your spouse, prevailing interest rates, the type of charity, the amount of income you receive, the kind of gift, and the trust's terms.
- No estate tax. If you'd left your children the property instead, they might owe up to 45% of its value (based on the estate tax law for decedents dying in 2009).

Of course, even a bequest reduced by taxes would be more than your kids get from the CRT. To remedy that, use part of your current tax savings to purchase a $1 million "second-to-die" life insurance policy with an irrevocable life insurance trust naming your children as beneficiaries. The cost depends on the ages of you and your spouse and other factors. Then, when you and your spouse are both gone, the kids receive $1 million in tax-free proceeds and the charity receives the trust assets. And, chances are, you'll be fondly remembered. ●

Roth IRA Conversion

(Continued from page 1)

IRA were worth $500,000 a year ago, 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