



SOCIETY FOR FINANCIAL EDUCATION AND PROFESSIONAL DEVELOPMENT

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financial



U C C E S S

SUMMER 2010

Should You Convert to a Roth IRA?

Effective in 2010, all taxpayers, regardless of the amount of their adjusted gross income (AGI) or tax filing status, can convert a traditional individual retirement account (IRA) to a Roth IRA. Amounts converted must be included in income if taxable when withdrawn (i.e., contributions and earnings in deductible IRAs and earnings in nondeductible IRAs), but they are exempt from the 10% early withdrawal penalty.

If you make a conversion in 2010, the taxable amount will be included in income in two installments, half in 2011 and half in 2012, with no tax due in 2010. However, if you prefer, you can elect to pay the tax in 2010, which may make sense if the current lower tax rates are not extended beyond 2010 or you expect much higher income in 2011 or 2012. Taxes on conversions

made after 2010 must be paid in the year of conversion.

The question is whether it makes financial sense to pay what could be a large income tax bill now to avoid any future income taxes on your IRA. Several factors need to be considered before answering that question:

What is your income tax bracket now, and what will it be when the funds are distributed? If your tax bracket will be the same at both times, the financial results will be similar. Increasing income tax brackets generally make it advantageous to convert to a Roth IRA, since you are paying the tax bill

while income tax rates are lower. Decreasing tax brackets generally favor leaving the balance in the traditional IRA.

How will you pay the income taxes due from the conversion?

If you can pay the tax bill from sources outside your IRA, that is a strong factor in favor of conversion. By doing so, you are in essence making an additional contribution to the IRA in the amount of the tax paid. Conversely, paying the tax bill from your IRA account can be a strong factor against converting, since you are withdrawing funds from your IRA and may also have

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Don't Forget to Rebalance

Simply put, rebalancing a portfolio means restoring it to your long-term asset allocation plan so that you get back on track with the risk/reward strategy that meets your goals and risk tolerance. Rebalancing requires a strategic asset allocation plan. You then know when and what you want to sell when market forces cause your portfolio to move away from your asset allocation. You may choose to sell some of the assets that have grown to take up too large a share of your portfolio, using the proceeds to buy assets that have decreased from their intended size.

Even with the recent gains in the stock market, most portfolios have still suffered losses over the past couple of years in stocks. Thus, stocks likely will represent a smaller portion of your portfolio than originally intended. There are several ways to execute a rebalancing strategy. You can sell your worst performers, sell a percentage of your best performers, or cut your holdings across the board. As for timing, you can decide to rebalance according to a calendar date, such as annually or every quarter, or when your positions get distorted by a specific percentage, such as 5% to 10%. ○○○



Should You Convert?

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to pay a 10% penalty on that withdrawal.

When will you make withdrawals from your IRA? If you'll make withdrawals within five or 10 years of converting, that may not be enough time for the benefits of tax-free compounding to compensate for the current payment of income taxes. But if you don't need to make withdrawals, your balance in a Roth IRA can grow tax free for a longer time, since you don't have to make required minimum distributions after age 70 1/2.

How will the income from the conversion affect your overall tax situation? That additional income could raise your overall income to a point where you lose some tax credits, deductions, or exemptions in the year of conversion, or increase Medicare premiums.

Will your Social Security benefits be subject to taxes? In the year of conversion, the income from the conversion may affect your Social Security benefits. However, going forward, distributions from Roth IRAs are excluded from taxable income, while distributions from traditional IRAs may affect your benefits if you have significant amounts of taxable income from other sources.

Are you interested in other estate planning considerations? Paying income taxes currently

means that you remove those assets from your taxable estate, thus reducing estate taxes owed at your death. If you plan to leave the IRA balance to your heirs, they receive the Roth IRA proceeds free of income taxes, while income taxes would be due on the traditional IRA. Also, if you don't take withdrawals from the Roth IRA after age 70 1/2, you may end up leaving your heirs with a much larger balance.

After considering all of these factors, you can decide whether converting makes sense for your situation. Keep in mind that you do not have to convert your entire IRA balance at one time. You can convert over a number of years or only convert a portion of your IRA balance. However, be aware that if you have both deductible and nondeductible IRA balances, you cannot just convert the nondeductible balances to reduce your tax liability. You have to assume a pro-rated portion of both the deductible and nondeductible IRA funds are being converted.

Know When to Recharacterize

If you convert and your investments then decline, you end up paying taxes on more than the current market value. However, you can then recharacterize your conversion. For conversions made in 2010, you can recharacterize until October 15, 2011, meaning you can convert back to your original IRA. After the recharacterization, it is as if you did not convert, so you owe no taxes. You can then reconvert at the later of 30 days after the recharacterization or the beginning of the tax year following the first conversion.

You can recharacterize just a portion of the conversion. However, if you have several investments in the IRA, you can't simply choose the ones with the largest losses. In that situation, a pro-rated portion of



all the investments in the account will be considered in the recharacterization. You can bypass this rule by setting up separate Roth IRA accounts for each investment. Then, if one declines substantially, you can recharacterize that one Roth IRA account, leaving the other accounts intact.

Roth IRA Contributions

This new conversion provision effectively removes the income limitations for contributions to a Roth IRA. In 2010, Roth IRA contributions can be made by single taxpayers with AGI less than \$105,000 (contributions are phased out with AGI between \$105,000 and \$120,000) and by married couples filing jointly with AGI less than \$167,000 (contributions are phased out with AGI between \$167,000 and \$177,000). It doesn't matter whether you participate in a company-sponsored pension plan. Individuals with incomes over the limits can make contributions to a nondeductible traditional IRA and then immediately convert the balance to a Roth IRA. However, keep in mind that if you have other deductible IRA balances, you will have to assume a pro-rated portion of both the deductible and nondeductible IRA funds are being converted.

Please call if you'd like help deciding whether you should convert to a Roth IRA. ○○○



Claiming Social Security Benefits

There are three basic retirement benefit types for workers and/or their spouses:

✓ A worker benefit, payable to the worker based on length of employment and earnings.

✓ A spousal benefit, payable to the worker's spouse based on the worker's record.

✓ A survivor's benefit, payable to the worker's spouse once the worker dies.

While full retirement age for Social Security benefits is gradually increasing from the current age of 66 to 67, you can still start benefits at age 62. However, by doing so, your benefits will be permanently reduced by 20.8% to 30%, depending on when you were born. Waiting until you are older than full retirement age to claim benefits will increase your benefits by 3.5% to 8% annually, again depending on when you were born. The maximum benefits are reached at age 70.

While most individuals simply apply for Social Security benefits when they want to retire and draw those benefits for life, there are three strategies for claiming benefits that can increase lifetime benefits in certain circumstances:

Withdraw your application.

You can undo your decision to claim Social Security benefits by filing form 521, "Request for Withdrawal of Application," with the Social Security Administration. You must pay back benefits received, but you do not have to pay interest or inflation adjustments. When does it make sense to do this? Suppose you retire at age 62 and decide by age 63 that you really don't enjoy retired life. You can pay back your benefits for that one year, work for seven more years, and then reapply at age 70, receiving substantially higher benefits.

One way to evaluate your decision is to first determine how much

your benefits will increase, including additional income your spouse may receive after your death. Then, find out how much an annuity from a private company would cost for that incremental income. If paying back your Social Security benefits costs less than purchasing an annuity, it's worth considering.

Claim benefits and immediately suspend them. Once you reach full retirement age, you can claim Social Security benefits and immediately suspend them, which allows your spouse to claim spousal benefits. Your spouse's benefits equal half of your benefits. Spousal benefits are reduced when taken between the ages of 62 and full retirement age, but do not continue to grow after full retirement age. By delaying your benefits, you increase those benefits as well as any survivor's benefits.

Claim a spousal benefit now and a worker benefit later. A married individual can claim spousal benefits at full retirement age and then claim worker benefits at a later date. This allows you to collect benefits while still increasing the value of your worker benefits. For instance, assume a husband is already claiming benefits and his wife reaches full retirement age of 66 this year. She can claim spousal benefits and continue working. Once she reaches age 70, she can stop the spousal benefits and claim her own benefits, which will have reached maximum value. To use this strategy, the spouse must have reached full retirement age when applying for the spousal benefits.

Please call if you'd like to discuss these strategies in more detail. ○○○

Estate Planning for Blended Families

While estate planning can be complex for all families, it can be especially complex for those in other than a first marriage. Consider these tips:

✓ **Sit down with your spouse and discuss both of your desires.** Your estate planning documents should support these decisions. Keep in mind that even if you have a will, your spouse can often override the terms and elect to receive a statutory percentage of your estate. To prevent this, you typically need a prenuptial or nuptial agreement.

✓ **Determine whether trusts are necessary to protect your children's inheritance.** When assets are left outright to your spouse, your spouse controls the ultimate distribution of those assets. You may want to use a qualified terminable interest property trust (commonly referred to as a QTIP trust) to protect your

children's interests. Assets you designate are placed in this trust, with income distributed to your spouse during his/her lifetime. After your spouse's death, the principal is distributed to your heirs.

✓ **Review beneficiary designations and life insurance amounts.** These assets will be distributed to your named beneficiaries, regardless of the terms of your estate planning documents. Thus, take a look at those designations to ensure they are coordinated with your estate plans.

✓ **Check how your property is titled.** Jointly owned property automatically passes to the co-owner. You cannot change this distribution through a will.

✓ **Discuss your plans with your family.** Especially in situations involving stepparents and stepchildren, you should communicate your plans for your estate. ○○○



The Third Annual Financial Literacy Leadership Conference “Financial Literacy: Next Steps”



The Third Annual Financial Literacy Leadership Conference will give you the opportunity to gain important information, strategies, and partnerships to help you enhance the financial literacy of your constituent group, institution, organization or community. The theme of the conference is: “Financial Literacy: Next Steps.” There will be financial education experts, senior administration officials and special guest speakers along with key panelists to present and discuss issues and strategies that have never been discussed before in a forum of this kind. Moreover, you will have the opportunity to present your perspective and interests regarding matters that will help you become more effective in the delivery of financial education.

Make Your Plans Now

To register, visit www.sfepd.org or call 703-920-3807, Monday-Friday 9:00AM-5:00PM EST. The registration fee is \$175.00; late registration fee \$200.00. For accommodations call Crystal Gateway Marriott at 703-271-3230. The discounted conference rate is \$229.00/night, plus taxes, single or double occupancy until September 24, 2010. Early-bird registration ends September 24, 2010 at 5:00PM (EST).

Highlights of Conference Subjects

- ★ Understanding Gender and Money Personalities
- ★ Cultural Differences and Financial Education
- ★ Methods and Strategies to Market Financial Education
- ★ Methods and Strategies to Provide Financial Education to the Disabled (Hearing or Sight Impaired)
- ★ What Every Financial Educator Should Know About the Credit Card Act of 2009, Credit Scoring, and Financial Reform
- ★ Financial Literacy Research, Surveys, Evaluation and Analysis
- ★ Methods and Strategies to Provide Financial Education to the Elderly
- ★ Methods and Strategies for Teaching Financial and Economic Education to Children



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