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MONEY MOVES
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Do Roth IRA Conversion Rule Changes Help You?

Why would you volunteer to pay income tax this 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may be tax deductible, but the amount you deduct and subsequent earnings will be fully taxed as income when withdrawn during retirement.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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Goals, Opportunities & Rules

Happy New Year! I hope that you are off to a great start in 2010 and this new decade. As I write this, I am about to begin my annual exercise of committing my yearly goals to paper. As Henrik Ibsen said, "To seek one's goals and to drive toward it, steeling one's heart, is most uplifting!" Though many of my 2009 goals weren't accomplished, I take satisfaction in those that were and for the progess made. The alternative? To quote Michel de Montaigne, "No wind serves him who addresses his voyage to no certain port."

The articles in this issue of our newsletter have the common theme of being about rules: rules for Roth conversions and non-spousal rollovers, changes in financial aid rules, and rules for charitable contribution deductions. Last but not least, I've included an article providing some guidelines on when to amend your income tax returns.

I chose these articles because I thought they would be relevant to you, my clients. Although rules may not be particularly exciting, they are important to keep in mind. You can leave the details to the professionals you work with, like your CPA and me, but my hope is that you'll talk to us prior to taking any important financial actions where these or other rules may come into play. We're here to help.

All the Best,

Jean Sinclair

Rule Change Helps Non-Spouse Rollovers

Most 401(k)s and other employer-sponsored retirement plans are bequeathed to spouses, and with good reason. Until a recent change in rules, only a spouse could inherit a retirement plan other than an IRA and avoid immediate taxes. Now, although the process must be handled carefully, any beneficiary should be able to receive a retirement plan and enjoy the same tax-postponing benefits that a husband or wife always could.

Under the old rules, if your spouse got the money, it could be rolled over into his or her own IRA and lifetime withdrawals would be permitted. Though each year's required distribution would add to your spouse's taxable income, the rest of the account would continue to compound, and there might be a sizable balance left at your spouse's death.

But what about your daughter? Most employer plans require an account to be emptied within five years of an employee's death. She would have had to take the money and, under the old rules of not being allowed to move it into an IRA, would have been stuck paying income tax immediately, which likely would have diminished her inheritance by a third or more.

The new rules are much kinder to non-spouse beneficiaries. Now, any beneficiary that you name may roll over the inherited plan to an IRA. But the law is prickly about the process. To make a successful rollover, your heir must do the following:

- Open an inherited IRA to take the money. A spouse who inherits a 401(k) can merge the account with her own IRA, but others must set up a new account specifically created to receive funds transferred from the deceased's retirement plan.

- Be sure to title the new account correctly. For instance, "Dad IRA (Deceased) FBO Daughter."
- Make sure the money goes directly from the company plan to the heir's new IRA. If your beneficiary touches the money, he or she will be immediately taxed.

If you've ever changed jobs, you may already have transferred retirement funds from your former employer to an IRA. Until the rules changed, that was the only way to ensure favorable tax treatment for a non-spousal heir. And even now, a rollover to an IRA of your own is often advisable. IRAs tend to offer a wider range of investment options than you get in a typical 401(k), and it's easier to monitor investments in a single account. Moreover, you may feel a lot more comfortable having the funds deposited in your own IRA rather than an account being administered by a former employer.

There is at least one advantage to keeping money in a 401(k), however. If you retire, you may begin taking distributions from an employer plan at age 55 without incurring the 10% early withdrawal penalty you would owe for withdrawing assets from an IRA before age 59½. Under the new rules, you can have the penalty-free early access of a 401(k) while also accommodating non-spousal heirs. ●

Uncle Sam Changes Financial Aid Rules

The budgetary imbalance addressed by the Deficit Reduction Act of 2005 (signed into law in 2006) is, of course, the government's. But if paying college bills is in your future, this legislation could affect your family's budget, too. Changes made it easier for some students to qualify for financial aid. And if you or your kids borrow money to cover educational costs, you will save on loan origination fees and could ultimately benefit from a shift from fixed to variable interest rates.

New treatment of custodial accounts. The current federal financial aid formula makes a sharp distinction between student and parental assets. Students who have money held in their name in a custodial account—a UGMA (Uniform Gift to Minors Act) or UTMA (Uniform Transfer to Minors Act)—are expected to contribute 35% of the value of the account each year. So if your daughter has $100,000 in a UGMA, the aid formula's "expected family contribution" will include $35,000 from the account. Parental assets, on the other hand, including funds held in a 529 plan established for a student, are assessed at only 5.64%. UGMA assets moved into a "custodial" 529 plan are also considered a parental asset, according to Joe Hurley, founder of Savingforcollege.com. But one custodial account drawback will remain after the transfer, Hurley notes. When your child reaches age 18 or 21, depending on your state, the account will still become the child's property.

A big break for prepaid tuition plans. A special type of 529 plan offered by 13 states lets you prepay your child's tuition at a state college or university. You pay what tuition costs now, and the

The Real Rules On Charitable Deductions

Cleaning out your closet could be a great way to cut your tax bill and be philanthropic at the same time. If you itemize deductions, you can write off charitable contributions of as much as 50% of this year's adjusted gross income, and if you exceed that amount, you can carry over the remainder for future tax years. You get the same benefits as an owner of a partnership, limited liability company, or S corporation when the business donates property to eligible charities. And a C corporation can take charitable deductions on its own tax return.

Still, Internal Revenue Service rules governing gifts of tangible personal property—anything you can see, touch, or feel, excluding land or a building—are complex, as a reading of Publication 526 quickly reveals. And you must keep copious records. With the IRS expanding its staff of auditors, it's important to know the requirements and follow them carefully.

The size of your deduction depends on myriad factors, such as whether the donated property is worth less now than when new—usually the case for a late model used car, for example, and most clothing. With such gifts, you can generally deduct the item's fair market value, or street value. Websites like autos.yahoo.com can help you approximate what a car is worth, taking into account its age and condition; for clothing, the fair market price might be what you'd get selling to a thrift shop. For donations of household items, a deduction is allowed only if the item is in good condition.

When you give away non-business property that has appreciated, you may deduct its fair market value as long as you have owned the property for more than a year and the charity anticipates using it in a way related to its tax-exempt purpose. For instance, you qualify if an art museum accepts your artwork and agrees to display it. A big advantage of giving away appreciated collectibles such as fine art, vintage wines, and guitars signed by the Beatles, is that your profit from selling them would be taxed at 28%. That's almost double the 15% rate that applies to most capital gains.

You won't make out nearly as well with gifts of appreciated business property or if the charity plans to sell your donation. In such instances, you can usually deduct only the asset's basis. For business property, such as outdated computers, that's the original cost minus depreciation write-offs you've taken. For personal assets you've inherited, it's what the gift is worth on the day the executor values the estate—either the date of death or six months later. For a gift you've received, the basis is what the original owner paid. So if your great aunt gives you a white mink coat she bought in 1958 for $250, that's all you're entitled to deduct if you donate the fur for auction at a church fair, even if the coat fetches more.

For every non-cash gift, you'll need a receipt or acknowledgment from the charity showing the date and location of the donation and a reasonably-detailed description of the gift. For gifts of $250 or more, the charity's written acknowledgment must also say whether you received goods or services in return.

With greater IRS scrutiny of high-income returns likely, it's wise to heed these rules

In addition, you must keep your own written records, including the terms of any conditions attached to your gift and how you figured your deduction. Deductions of more than $500 require you to substantiate how and when you obtained the donated property, and your basis in it. If that's not available, you must explain why in an attachment to your tax return in order to get the deduction.

If you deduct more than $5,000 for a single donated item or group of similar items, such as a coin collection, you'll need a written appraisal and the qualified appraiser's signature on IRS Form 8283, which you must file with your tax return. Someone from the organization that received your gift must also sign the form and indicate whether the charity intends to put the property to an unrelated use.

So give, and your magnanimity will be rewarded—as long as you keep good records and don't overestimate the value of your generosity. ●

state promises to pick up the much higher tab when your child matriculates. These plans come with several restrictions and may not be the best way to save for college. But one of their biggest shortcomings, before the Deficit Reduction Act, involved financial aid. Any award had to be reduced dollar for dollar by a payment from a prepaid plan. Now, such money is treated like any other 529 asset, as a parental resource to be assessed at a maximum of 5.64%.

More predictable loan costs. Of course, if your income is high, your child isn't likely to qualify for need-based aid no matter where you hold your savings. That could mean taking a loan. The interest rate on Stafford loans, for students, is permanently fixed at 6.8%, while PLUS loans, for parents, have a fixed rate of 8.5%. Meanwhile, loan origination fees, which had been as high as 4% of the borrowed amount, are being phased out by 2010. ●

When Should You Amend A Tax Return?

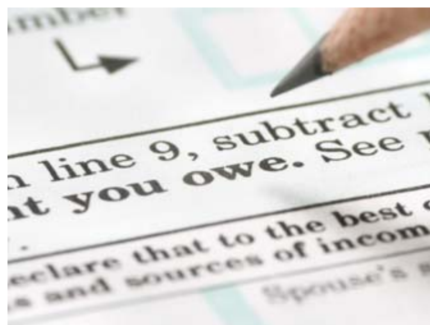
Filing a tax return once is enough of a hassle. Doing an amended return for the same tax year—in other words, filing twice—seems like way too much. Yet millions of amended tax returns are filed by individual taxpayers each year.

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 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). ●

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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