

TIME TO SAVE WITH CHRIS & DAVE

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**“The secret of getting ahead is getting started.”
- Mark Twain**

Mark Twain must have had the beginning of a New Year in mind when he made that statement as many advertisements at the beginning of every year dial into the message of hope and renewal that all of us can improve our lives by setting goals for the future. Honestly, who hasn't seen or heard a fitness commercial in the last week touting a low, introductory gym membership rate for those whose New Year's Resolution is to lose weight?

For 2010, Chris and I are following a similar principle as we renew our efforts to educate and help those who want to take more control over their personal financial situation. Unfortunately, Chris and I see and hear stories everyday of Americans who aren't putting the necessary time and effort into managing their own finances thus putting their future at risk. For those individuals that do try to manage their own finances, we are finding some of them become frustrated and confused due to the myriads of caveats, rules, and laws within this industry. Unfortunately, when you are unaware of all the little details and don't have an articulate plan, it can add up to a costly mistake. Since Chris and I have worked in the business for many years, we are aware of many of those small mistakes that can end up costing you a lot of money in the end. At The Advisors Group of Pittsburgh, our services are geared towards helping you avoid mistakes, if possible, and putting you on track to increase your net worth.



From our experience, personal financial matters often get overlooked because they occur around the time of a life changing event, like getting married or divorced, having a child, moving or buying a home, having a death in the family, changing jobs, or being diagnosed with a health problem and just forgetting to adjust your plan in the process. For example, if you have a second child, logically you know it is going to cost more to raise two children instead of one. But, with all the baby preparations you neglect to call your financial advisor to see if your life insurance coverage is as sufficient as it once was. Just so you know, if any of these life events I mentioned above have happened to you over the past year or you anticipate one of them occurring in 2010, please make it a point to contact us immediately so that we can show you how they may impact your overall financial plan. The one part of your plan that it may affect the most is your own retirement.

Retirement, for most people, is an extremely important goal in life. It is a time to say, “I have worked hard for many years and I now want to slow down and enjoy some of the things I may have neglected or not had the chance to do previously.” Since we are all going to need money to live on in retirement, the next question becomes, where will that money come from?

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Well, hopefully, some of it will come from Social Security. As you know, Social Security is a government program that we pay into in exchange for a future benefit. The problem with Social Security is it is in financial trouble and it was originally designed to only supplement one's retirement living expenses. Just to give you some perspective, for those individuals who make \$106,800 or more a year, they are currently projected to receive only \$27,876 a year (\$2,323 a month) in benefit from Social Security. As you can imagine, having someone's income reduced from \$106,800 a year to \$27,876 a year is a major lifestyle adjustment. As such, this is why many individuals save additional monies on their own through work retirement plans, such as 401(k)'s, and/or personal Individual Retirement Accounts (IRA's).



For 2010, we wanted to make you aware of a significant change in tax law which will affect anyone saving for retirement. In particular, this quarter's newsletter will talk about those who may own a Roth IRA or Traditional IRA.

Before I proceed with my discussion, I would first like to revisit the major difference between the older, more popular Traditional IRA and the newer Roth IRA. A Traditional IRA is almost always funded on a tax-deferred basis, just like a 401(k) or retirement plan through work. Basically what that means is you can deduct any money you contribute to a Traditional IRA on your tax return assuming you meet certain income requirements. For example, if you are single, make \$50,000 a year, and contribute \$5,000 to a Traditional IRA; you only pay taxes on \$45,000 of income when you file your tax return. While the major advantage of funding a Traditional IRA is the immediate tax break today, taxes will eventually be paid in the future whenever you decide to withdraw money from the account.

If, instead, you chose to contribute to a Roth IRA, it is the exact opposite of a Traditional IRA in that you do not get an immediate tax break. So, using the same example above, if you are single, make \$50,000 a year, and contribute \$5,000 to a Roth IRA, then you are still going to pay taxes on \$50,000 of income when you file your annual return. The advantage of the Roth IRA, however, is you will not have to pay taxes when you take a qualified distribution from the account. To summarize, then, individuals saving for retirement need to decide whether they want to pay taxes today and fund a Roth IRA or wait till later to pay taxes and fund a Traditional IRA instead.

Now that we know that a Traditional IRA is a tax deferred vehicle and a Roth IRA is tax free, Chris and I wanted to talk about a strategy that allows anyone who owns Traditional IRA account to change it to a Roth IRA account. This is what is known as a Roth IRA conversion. Should you elect to do this, you must add the amount of the conversion to your income for that tax year possibly resulting in additional taxes. So, for example, if you are single, earn \$33,000 this year, and have \$4,000 in a Traditional IRA, you may elect to convert that to a Roth IRA. When you do, you will have to pay taxes on \$37,000 of income for the 2010 tax year which would effectively bump the additional income from the 15% tax bracket to the 25% tax bracket.

Unfortunately, up until this year, if your adjusted gross income was over \$100,000 for the calendar year, the option to convert your Traditional IRA to a Roth IRA was not available to you thereby eliminating many taxpayers who wanted to do a conversion. Well, starting in 2010, the government is permanently removing the \$100,000 restriction in an effort to raise revenues. As such, now anyone, no matter their income, may convert a Traditional IRA to a Roth IRA. But, alas, there are several advantages and disadvantages to contemplate before making this decision. So, let's take a moment to look at some of those in greater detail.

First of all, I believe there are five important advantages.

1. ***Roth IRA withdrawals are tax free for the remainder of your life*** – This may be the most important factor of all. How would you like to be retired and not have to pay taxes on your IRA withdrawals? A Roth IRA would allow you to do that. Remember, with the Traditional IRA you must pay taxes whenever you withdraw money from the account. With the Roth IRA, the account will not only grow tax free for the remainder of your life; but it can also be tax free for the remainder of your children's lives too, assuming you have a balance in the account at your death and they are named beneficiaries.

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PROS

2. **Convert now while your account is down in value** - Remember, you will owe tax on the value of the IRA on the day it is converted to a Roth IRA. In light of the fact that the Dow Jones Industrial Average is still below its market peak of 14,000 in October 2007, many people's portfolios may still be down in value from their peak too. So, if you convert now, you will pay less in taxes than if you waited until your account balance went back up.

3. **Tax rates are expected to be higher in the future.** - In speaking with several CPA's, they anticipate that tax rates will need to increase in the near future to pay for the financial and auto industry bail-outs, the wars in Iraq and Afghanistan, health care reform, and our ever expanding federal deficit. By converting now at low tax rates, you may be able to pay less in taxes than if you waited till later. Just to give you an example, let's say you are 60 years old, have \$16,000 in an IRA and will not need any money from the account for at least ten years. You are currently in the 25% tax bracket and withdrawing the entire amount would result in \$4,000 in taxes. Unfortunately, if tax rates go up to 28% next year, you would be looking at paying an additional \$480 in taxes. On the other hand, if you converted at age 40 when the account was valued at \$4,000, you would have paid only \$1,000 in taxes assuming you were in the same 25% tax bracket.

4. **You don't have to take Required Minimum Distributions from your Roth IRA** - For those of you who have Traditional IRA's, once you reach age 70 1/2, you are required by law to take a minimum amount out of that account every year or face a stiff 50% penalty. Roth IRA's do not have this stipulation thus allowing your money to continue to grow tax free. And, finally,

5. **What if you convert and the Roth IRA goes down in value?** - Well, there is another part of the tax code that allows you to undo the conversion like it never happened. By doing so, you will have to file an amended return and get the taxes you paid back on the higher amount. Then, after a certain time period elapses, you can convert the IRA back to a Roth at the lower value thus paying less in taxes. This is what is known as a recharacterization and basically means you can't lose if you convert. If the Roth IRA goes up in value, you have more tax free income in retirement and if the account goes down in value, you can recharacterize, get the taxes you paid on the higher amount back, and then reconvert paying less in taxes. Please note that you only have until October 15th of the year following the original conversion to do a recharacterization.

So far, this strategy sounds pretty good. But, with anything in life, it does have a few drawbacks and there are two in particular worth mentioning.

CONS

1. **You have to pay taxes on the amount you convert** - This may be the biggest drawback of all. Suppose you are single, have no income in 2010, have \$100,000 in a Traditional IRA, and are in the 28% tax bracket. If you convert the full amount to a Roth IRA in 2010, you are looking at owing \$21,720 in taxes. That is a huge amount of money that you are going to have to come up with out of pocket and that you may not currently possess. As such, if you are looking at doing this strategy, you will want to begin saving as soon as possible to pay the tax liability. One good thing about this change in law is the government is allowing you to either pay 100% of the tax on your 2010 return or you can stretch the payments over two tax years, paying 50% in 2011 and 50% in 2012. So, in the example above you could pay \$21,720 in 2010 or \$10,860 in 2011 and \$10,860 in 2012. This should give you the time to save up the money to pay the taxes on the conversion. Remember, this is going to cost you more in taxes in the short term but will hopefully mean less taxes paid over the long term.

2. **What if you convert and then later decide you need to withdraw money to pay for some unforeseen expenses?** - A Roth IRA that was converted from a Traditional IRA must be established for five years and you must be 59 1/2 years old, disabled, or buying your

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your first home (\$10,000 limit) to withdraw the converted funds tax free. If you do not meet those qualifications, you will pay a 10% early withdrawal penalty. So, please don't be mistaken in thinking that you will be able to convert and withdraw the money in a quick fashion tax-free as that is not the case.

Now knowing the advantages and disadvantages of converting, Chris and I feel certain investors would benefit more than others from doing a Roth IRA conversion. In particular:

- ◆ ***If you are young.*** Let's face it, the more time you have to allow your Roth IRA to grow tax free the better off you should be. On the other hand, if you are going to retire in five years and start withdrawing money from your account, this may not be the best strategy.
- ◆ ***If you think your account balance will be higher in the future.*** Would you rather pay taxes on a smaller amount or a higher amount? I would rather pay taxes on the lower amount and by converting today you may be accomplishing that.
- ◆ ***If you expect your tax bracket to be the same or higher in the future*** - Income tax rates in the future are unknown versus the current rates which are known. If you are in a low tax bracket today and expect to be in a higher bracket at retirement or income tax rates to be higher in the future, it may be appropriate.
- ◆ ***If you want to control how and when you pay taxes*** – Chris and I always talk about the importance of diversifying your investments amongst several different asset classes. Historically this has shown to reduce risk. By having some of your money in a Traditional IRA and some in a Roth IRA, this will give you the flexibility in when and how you pay taxes on your retirement savings. So, if you have a year where your income is higher, you can withdraw money from your Roth IRA. Likewise, if you have a year where your income may be lower, you can withdraw money from your Traditional IRA instead.
- ◆ ***If you don't plan on spending all your retirement savings*** - If you have so much saved that you don't plan on spending it all, what better way to give assets to your heirs than tax-free? All you have to do is name your children as beneficiaries of the Roth IRA allowing them to keep the tax free status over their lifetime.
- ◆ ***If you have a small business that passes through income*** – If you own a business that allows you to pass-through income on your tax return, like an S Corporation, Limited Liability Corporation, or Partnership, and expect to have more expenses than income, you can use those business losses to offset the taxes on the conversion amount. (Please note that C Corporations are not eligible under this scenario.)

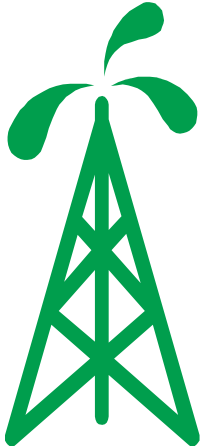
Just a few final comments. While the \$100,000 limit is being permanently removed, 2010 is the only year that you will be able to spread the taxes out over a two year period. Also, you are not required to convert the full amount of your Traditional IRA to a Roth IRA. You may also do what is called a partial conversion and this may make more sense if the amount you are converting bumps you into a higher tax bracket thus requiring you to pay more in taxes.

In summary, a Roth IRA conversion is something that anyone who has a Traditional IRA should consider in 2010. Due to the fact that taxes will need to be paid, I highly recommend that you contact your tax advisor to determine whether or not this strategy makes sense for you. As always, Chris and I are willing to work with your tax advisor to determine a game plan for saving you money on taxes over your lifetime.

As Mark Twain said once again, "the secret of getting ahead is getting started." Chris and I want you to know that whatever your resolution(s) may be for 2010, we believe in you. We believe that you can achieve your goals this year and every year going forward and that we are here to assist and encourage you along the way whenever you may need a helping hand. If you would like to set up an appointment to start a Roth IRA conversion or see the need to start financial planning for you and your family, please don't hesitate to give one of us a call at (412) 539-0055.

Product Update

How would you like to convert your Traditional IRA to a Roth IRA and pay little in taxes or none at all? One way to accomplish this is through a Direct Participation Program (DPP) or Limited Partnership (LP). Basically, instead of paying taxes on your conversion to the government, you use those funds to purchase a DPP or LP instead.



A DPP or LP is a sophisticated, illiquid, long-term investment that is designed for individuals who may owe significant taxes in any calendar year. For those of you converting a large Traditional or Rollover IRA thus incurring a much larger tax bill, this may apply to you. Some of the more common types of these programs are real estate, equipment leasing, and oil and gas. For example, in an oil and gas LP, in exchange for an initial purchase, you get an immediate 80-100% deduction from income on your taxes, just like when you contribute to a Traditional IRA. Once the oil and gas wells are drilled and start producing, you will begin to receive monthly dividend checks as return of principal. If you chose to pay federal income taxes on the Roth IRA conversion instead, you would not receive any type of dividend income from the government. Thus, buying a LP or DPP is a good way to keep assets in your net worth instead of the government's coffers.

If you and your accountant are seriously considering a Roth IRA conversion in 2010 or beyond and would like more details about these types of programs, please don't hesitate to give us a call so we can show you how the purchase of a limited partnership may be helpful.

LOOKING FOR TAX FORMS AND INFORMATION?

For those of you looking for cost basis to provide to your accountant to complete your 2009 tax return, please look on your December 2009 Pershing brokerage statement under the section titled Schedule of Realized Gains/Losses Year to Date. Likewise, 1099-DIV's, 1099-INT's, and 1099-R's will be mailed from our home office no later than February 15, 2010.

FOR THOSE OVER AGE 70 ½

Required Minimum Distributions from IRA's are mandatory for those over age 70 ½. Please contact your respective custodian or financial advisor to make sure that the proper amount is deducted for 2010.



Website of the Quarter

www.diapers.com – This website was provided to me by a first time mom and client. I thought that it may be valuable to those of you who may have a newborn or are expecting a baby this year. This company's mission is "to offer the lowest prices moms and dads will find online, along with the convenience of fast, free shipping and the best customer service around." Some other advantages of using this website are they allow you to use manufacturer's coupons, you will receive a free subscription to Parenting Magazine, and you can avoid state sales taxes. I have already received positive feedback from several clients so please take a moment to check it out. Finally, any new customers who elect to sign up will get \$10 off their first diaper order by entering the code **RRLE9529**. Hope this helps all you new parents out there. And, if you come across a website that may benefit us and others, please share it so that I can include it in a future newsletter.



We are looking for your help!

We hope that many of you see the value in the services and advice Chris and I provide. As I'm sure you know, it is costly for Chris and I to maintain a financial planning office. As such, some of our time each month is dedicated to marketing our firm to expand our clientele. From experience, we have found that the most satisfied client we can get is one referred to us by an already existing client. If you are indeed satisfied with our services and know of a relative, neighbor, co-worker, or friend who may benefit from meeting us, we would greatly appreciate it if you could furnish their contact information or personally mention us to them. There is no better compliment than referring us to another. And, the less time and effort we have to spend on marketing, the more we can work on servicing and meeting all of your needs. Thank you very much for your business and friendship.



Important Date to Remember



January 18, 2010 - Office closed, Martin Luther King Jr. Day

February 22, 2010 - Office closed, President's Day

March 13, 2010 - Chris Volk's birthday. Surprise him with a call to wish him a happy 58th!

March 14, 2010 - Daylight Savings Time starts - remember to turn your clocks ahead an hour & change the batteries in your smoke detectors!

**** A Final Word From Dave ****

Chris and I wanted to extend a warm and Happy New Year to each and every one of you and your families. We hope that 2010 will be filled with good health, peace, and prosperity. Let us all make a continued effort to make 2010 a year to remember; by taking the little steps to making this world a better place for all of us to live in.

In next quarter's issue I'm going to revisit the stock market bottom of March 2009 and talk about what we all can learn from that scary moment. Stay tuned...

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