VESTPOINTEWEALTH MANAGEMENT
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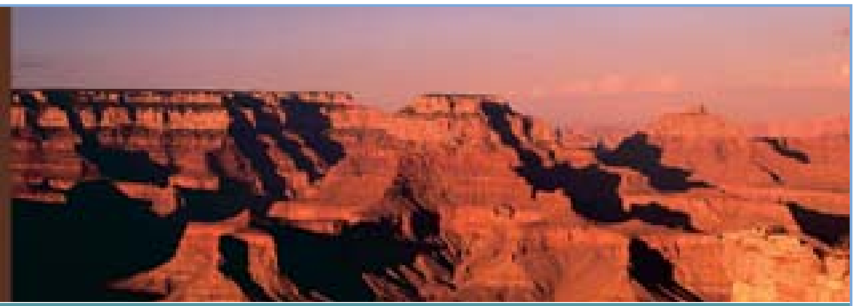

Do Roth IRA Conversion Rule Changes Help You?

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may be tax deductible, but the amount you deduct and subsequent earnings will be fully taxed as income when withdrawn during retirement.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

(Continued on page 4)

Keeping Guard Against Inflation

If you don't think inflation could rear its ugly head again, you could be fooling yourself. Currently, the Obama administration is most worried about price deflation. But recent events could change that outlook.

For starters, the federal government is spending money at an unprecedented clip. It has approved a $787 billion stimulus program, a budget of $4 trillion (up from $3 trillion the prior year), and hundreds of billions more in rescue packages. Also, short-term interest rates, guided by the Federal Reserve, have hit rock-bottom, and rates are quite low in other countries, too.

All of this is kindling waiting for a spark. Once ignited, growth and inflation could come roaring back to life.

For that reason, it's smart to allocate a portion of your fixed-income investments to Treasury inflation-protected securities (TIPS). These bonds are backed by the U.S. government, and have built-in protection that boosts their value when inflation rises. Since inflation might not return for a few years, and TIPs currently have extremely low nominal yields, averaging into these investments over time could be a better strategy than investing a large sum all at once.

Another inflation-hedging strategy is to invest in commodities. When growth resumes, demand for oil, copper, and other commodities will rise, increasing their prices. But given the volatility of commodities, it's generally recommended that you keep no more than 5% to 10% of your portfolio in this asset class.

CBO Report: Tax Rates Must Rise 90 Percent

Largely lost in the rush to allocate hundreds of billions of dollars to rescue the U.S. economy is another pressing reality. Paying for Medicare and Social Security as the baby boom generation moves into retirement will require trillions in new spending, and unless something is done to curb the growth of those "entitlement" programs, taxes may have to rise dramatically. According to a recent analysis by the Congressional Budget Office, tax rates would have to increase by 90% to pay for projected spending in Medicare and Social Security through 2050.

As the population ages, the study says, the lowest tax rate on individual income will need to jump from 10% to 19%, the tax rate on incomes in the current 25% bracket will have to soar to 47%, and the highest rate could jump from 35% to 66%. To meet the accelerating cost of entitlements, the top corporate income tax rate also will likely need to increase from 35% to 66%.

The study was released in May 2008, before the current financial crisis threw the nation into a tailspin. Deficit spending to stimulate the lagging economy could mean additional pressure on future tax rates. And the CBO is not alone in its predictions. David Walker, former comptroller general of the United States, warned in March 2007 that the federal government's promises have outrun its likely revenue by such a margin that there will be no choice but to raise taxes. Ben Bernanke, chairman of the Federal Reserve Board, has made the same point.

What can you do to prepare for the likelihood of much higher taxes in the years ahead?

Get your finances in order. To improve your financial picture in advance of higher tax rates, consider locking in a low mortgage rate, putting aside a cash reserve of six months' living expenses, and ramping up your personal savings rate.

Open a Roth IRA. With a Roth you pay income taxes on contributions, but withdrawals during retirement are tax-free. That's a great formula if you expect future tax rates to rise sharply. Also consider converting a traditional IRA to a Roth. The current $100,000 income ceiling for conversions is due to disappear in 2010.

Contribute to your company's Roth 401(k) plan. Very similar to a Roth IRA, the 401(k) version offered by many employers also taxes current contributions rather than later payouts, when tax rates could be much higher. Also consider non-retirement investment accounts over tax-deferred plans for the same rationale.

Consider selling successful investments. Stocks will eventually recover from their current slump and taking investment profits sooner rather than later could be wise. The current 15% tax rate on capital gains is likely to increase during the next few years.

Consider other types of investments. If tax rates rise 90%, the high expenses associated with variable annuities will appear much lower. Tax-free municipal bonds will also become more important to a tax-efficient portfolio.

Ask for our help. We can work with you to make sure your financial plan prepares you for higher tax rates or other changes in the years to come. ●

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 post-pone 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

Year-End Tax Planning: Strictly Business

Most of the advice you'll read about year-end tax planning involves strategies for cutting personal taxes. But there are numerous moves you can make to cut the tax bill of your business, too. Here are seven possibilities that might work for your company at the end of 2009.

1. Section 179 deductions. Under Section 179 of the tax code, a business can deduct, or "expense," the full cost of tangible assets (new or used) placed in service during the year. In 2008, thanks to a new law intended to boost economic activity, the maximum deduction was increased to $250,000 (twice the 2007 limit of $125,000), provided that total purchases don't exceed $800,000. (For each dollar above that ceiling, your deduction is reduced by a dollar.)

Now the new economic stimulus law enacted in February—the American Recovery and Reinvestment Act of 2009 (ARRA)—extends this tax break for another year. Caveat: Just be sure to get any equipment up and running before January 1, 2010.

2. Bonus depreciation deductions. The 2008 economic law also allowed businesses to claim a 50% "bonus depreciation" deduction for new (not used) business equipment bought and placed in service during 2008. As with the enhanced Section 179 deduction, the ARRA extends the bonus depreciation tax break through 2009. Note: Your company can also take a normal depreciation deduction for the remaining value of the equipment after it claims the bonus depreciation "off the top."

Also, the bonus depreciation deduction can be combined with the Section 179 deduction for a powerful one-two punch. To qualify for bonus depreciation, assets must be deductible under the Modified Accelerated Cost Recovery System (MACRS) and have a depreciation recovery period of 20 years or less. Specified water utilities, computer software, and leasehold improvements also qualify. For some property with a depreciation period of 10 years or longer, the deadline for placing into service is December 31, 2010.

3. Bad business debts. If your business uses the accrual method of accounting and you're having trouble collecting from customers this year, you may be able to take some consolation by writing off the debts. The IRS lets you deduct unpaid bills during the year they become totally worthless, so consider stepping up collection efforts before the end of the year. You could send a series of dunning letters and follow up with phone calls and emails. Or you might hire a collection agency. Keep detailed records of all your activities.

4. Travel and entertainment. The tax law generally allows you to deduct 100% of travel expenses when you're away from home on business and 50% of the cost of business-related meals and entertainment. This can be especially helpful during the final months of the year, when you may meet with clients to plan for 2010 or take them out to thank them for their business. You could also host a holiday party for your staff and deduct 100% of the cost as long as everyone in the company is invited.

5. Business repairs. You can currently deduct the cost of necessary repairs made on the business premises, but capital improvements must be capitalized. A repair keeps the property in good operating condition over the course of its intended useful life. For example, if you replace a broken window or fix a leaky faucet, the cost is treated as a repair. Conversely, an improvement extends the useful life of the property, increases its value, or adapts it for a different use. One example is putting a new roof on the building.

6. Work Opportunity Tax Credits. Your business may claim a Work Opportunity Tax Credit (WOTC) for hiring workers from one of several designated "target groups." The credit is generally equal to 40 percent of the first $6,000 of the worker's first-year wages. The ARRA expands the list of groups eligible for the WOTC in 2009 to include unemployed veterans and "disconnected youth" between the ages of 16 and 24.

7. Business supplies. Finally, don't forget you can deduct the cost of supplies for the office, ranging from paper clips to laser printer cartridges. Stock up on routine supplies you'll need soon anyway to increase your deduction this year. The cost is deductible on your company's 2009 return even if you charge it and pay the bill in 2010.

These are just seven ways that your business can cut taxes at year-end. Others may be suitable for your situation. Meet with your tax advisors to develop the best strategies under the circumstances. ●

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

A SCIN Is A Timely Estate Tax Strategy

If there's a single, central objective of most estate plans, it's to transfer property to younger family members while minimizing estate and gift tax liability. Among the many strategies and structures designed to accomplish that goal, one less well-known vehicle—a self-canceling installment note, or SCIN (pronounced "skin")—may work particularly well with today's depressed asset values and low interest rates.

With a SCIN, you sell real estate, a business interest, or other assets to one or more younger family members, such as your children, in exchange for an installment note with a term shorter than your expected life span. That aspect is required; to realize tax benefits, the note's term must be shorter than the seller's life expectancy, according to IRS tables. But under the "self-canceling" feature of the note, your heirs' obligation to repay the loan automatically disappears if you die before the end of the term.

A SCIN provides several potential tax benefits. If you die early and there's an unpaid balance on the loan, that amount won't be considered part of your taxable estate. Yet the property still ends up in the hands of your heirs. And because the transfer is a sale for fair value, not a gift, there's no gift tax.

There's also an advantage in using a SCIN to pass along property that has appreciated in value. Though you may owe capital gains tax on the sale, you can spread out that liability over the note's term. (Note that if the assets' buyers are family members, they must wait at least two years to sell the property in order for the capital gains to be prorated and deferred.) The longer term might help you avoid moving into a higher tax bracket, particularly if the term of the loan extends into your retirement years, when your income may be declining. Meanwhile, if the transferred property continues to appreciate, those gains will be outside your estate.

Because the self-canceling aspect of a SCIN is a risk to your estate, the note must include either an inflated market value for the assets or an interest rate that's higher than the applicable federal rate, or AFR. That can be a drawback of this estate planning technique. But interest rates now are exceptionally low, and the value of most assets is well below what they may have been worth in recent years. As a result, the interest rate required for a SCIN may still be quite reasonable. And with asset values depressed, the principal of the note will be lower, and any rebound in prices will, again, occur outside your estate.

If you are interested in transferring property to your heirs, we can work with you and your attorney to consider whether a SCIN could help. ●

Roth IRA Conversion

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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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