

Turning Lemons into Lemonade

IT WAS MY DAD WHO TAUGHT ME TO LOOK FOR THE SILVER LINING IN EVERY CLOUD. DON'T SIT AROUND COMPLAINING ABOUT THE RAIN, HE TOLD ME MANY TIMES, BUT FIND A WAY TO USE IT TO YOUR ADVANTAGE AND THEN GET OUT THERE AND DO SOMETHING ABOUT IT. THAT SAME ADVICE COULD BE APPLIED TO THE ECONOMIC TURMOIL THAT IS HAVING AN EFFECT ON OUR PERSONAL FINANCES.

Growing up on a farm in Central Pennsylvania taught me valuable life lessons, including the importance of using circumstances to your best advantage. For example, I remember one year when corn prices were very low. Instead of selling our corn to the mill, my dad started raising hogs. Why? Hog prices were up at the time and Dad reasoned that the corn could be put to better use to fatten the hogs that would later be sold at auction.

2008 was an awful year for the financial markets. Rather than finding a way to take advantage of the lower markets, many people choose to sit around and complain about how much their investment accounts have declined. I say it's time to stop complaining and look for the silver lining in this black cloud.

Here are six ways you can take advantage of the market downturn:

Harvest Losses in Taxable Accounts

Investment positions that are currently worth less than what you purchased them for can be sold to realize a tax loss if they are in a taxable account. First, losses can be used to offset capital gains. Then, you can offset ordinary income up to \$3,000 per year. How? Any net loss over \$3,000 can be carried forward into future years

until the losses are used completely.

There are several reasons why you want to do this. First, it can lower your current tax liability in many ways. The obvious reduction of \$3,000 in taxable income can lead to lower tax on your Social Security benefits for retirees; higher deductibility of some of your itemized deductions (medical expenses and miscellaneous deductions are reduced by total income); and higher deductibility of all your itemized expenses and personal exemptions for those in the higher tax brackets.

Secondly, the stock market will not stay down forever. Having the loss carry forward into future years will help keep your income taxes down as capital gains are realized during the stock market recovery. Tax brackets will probably not stay as low as they are now when the federal government turns its attention to paying for all the economic stimulus packages. Loss carry-forwards could help offset future tax increases.

Convert Your IRA to a Roth IRA

If your total adjusted gross income will be below \$100,000 this year, you should consider converting some part of your IRA to a Roth IRA. The conversion will create a taxable event in 2009 requiring payment of income taxes on the amount you convert. Yes, the payment of taxes in this year is the downside. However, the reason to convert is because all the post-conversion earnings in the IRA will be tax-free after they are in the account for five years and you reach the age of 59-1/2.

The goal is to convert IRA assets while they are at depressed levels in order to maximize the amount of the conversion. It's highly unlikely that the federal government will raise taxes in 2009 while they are trying to stimulate the economy. The rate of tax you pay on the amount you convert could be a

lot lower in 2009 than in future years.

Employer Stock in Your Company Retirement Account

Holding stock of your employer in your 401(k) plan could have significant tax advantages when you retire. Funds distributed from a retirement account are normally considered ordinary income, which could be taxed as high as 35 percent. Employer stock distributed from the company retirement plan is taxed at ordinary income rates based on what you paid for the stock. The value of the stock above your cost could be taxed as capital gains. (There are specific tax rules to follow to get this treatment. Consult a tax professional to see if you qualify.)

Long-term capital gains are currently taxed at a maximum of 15 percent. You want to keep your cost as low as possible. If you currently hold stock in your company plan that is worth less than your cost, consider selling it and buying it back to establish a lower cost basis.

The Worker, Retiree and Employer Recovery Act of 2008

This law was passed late in 2008 and, among other things, permits IRA owners age 70-1/2 to skip required minimum distributions (RMDs) in 2009. Choosing to skip taking your RMD can have significant implications, as it will lower your taxable income in 2009. For example, Medicare Part B premiums are based on income, and reducing your income by skipping your RMD in 2009 could mean lower Medicare premiums. The taxable portion of your Social Security is based on total income, as well. You may be able to eliminate or significantly reduce income taxes on Social Security ben-

efits by skipping your RMD.

Finally, RMDs cannot be converted to Roth IRAs. However, you may be able to do a Roth conversion this year because you don't have to take the RMD.

Gifts to Family

The annual gift exclusion has increased in 2009 to \$13,000 per person. This means that a husband and wife can each give \$13,000 (total of \$26,000) to each of their children and not have to pay gift tax or file a gift-tax return. People who are looking to pass assets to their heirs should take advantage of lower asset values in their stock and real-estate holdings this year. Even if you exceed the \$13,000 limit, you have a lifetime gift exclusion of \$1,000,000 before you pay gift tax. You would need to file a gift-tax return to report the gift and keep track of the amount given.

Last But not Least, Invest

Not everyone can take advantage of the five items listed above, but everyone can take advantage of the lower prices in the financial markets. Many people are fearful of what is going to happen in the market this month, this quarter, this year. Instead, investors should be looking beyond what happens in any one year. History has taught us that the financial markets eventually recover and move higher. Don't wait for the stock market to go up before investing. Take advantage of the lower markets by investing now and having at least a five-year time horizon to measure success. You may never get another chance to buy into the stock market at these levels. ❖



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