ROTH CONVERSION IN 2009

You aren't allowed to convert your IRA to a Roth in 2009 unless your modified adjusted gross income is below $100,000. This $100,000 limit applies to single filers and joint filers alike. If you are married filing separately you aren't allowed to do a conversion at all. This rule will change in 2010 but we're stuck with it for the next 4 ½ months.

Modified adjusted gross income (MAGI) is your total income before certain deductions like an IRA contribution, Health Savings Account deductions and others. On the 2008 IRA form 1040, it is line 22 on the first page. There is still time to implement some strategies that you can implement to get your MAGI below the $100,000 in order to make a Roth conversion in 2009.

Increase your 401(k) pre-tax contributions – Wages are reported net after 401(k) contributions for federal tax purposes. The maximum 401(k) contribution in 2009 is $16,500. Those over age 50 can put in an additional $5,500 for a total of $22,000. You should do a projection of your income for the rest of the year to see if you will be close to the $100,000 limit. Adjust your 401(k) contributions to keep your taxable income low enough to get in under the limit.

Exchange taxable income for tax-free income – Any of your interest bearing investments can be moved to tax-free municipal bond investments to eliminate interest income. Interest income is reported on line 8(b) of IRS form 1040. It is late in the year to make a significant difference here. Municipal bonds can be purchased individually or in a mutual fund. If you are not familiar with investing in bonds or are not working with an investment advisor, you should invest with mutual funds. Go to Morningstar.com and look for "Find a Fund" on the home page. Choose fund screener and select your criteria. The website will give you a list of matches and instructions on how to buy the fund.

Remember that mutual funds do fluctuate in price. Municipal bonds are not as volatile as stocks but you can lose money. Municipal bond funds should not be used for your short term money. To eliminate taxable income on your checking and savings, look for tax-free money market and savings accounts. These accounts use short-term municipal bond investments that are free from federal tax but the principal does not fluctuate like a bond fund. Most of the large mutual fund companies like Vanguard and Fidelity have tax-free money market accounts that you can get check writing privileges on to access your money. These accounts are not insured and should not be viewed the same as a bank account that carries FDIC insurance.

<u>Harvest Capital Losses</u> – A capital loss occurs when you sell an investment for less than what you paid originally. The IRS allows you to offset any capital gains with capital losses and to take any net loss against your other taxable income up to a maximum of $3,000 in any one tax year. For example, Mr. Smith sold a building lot for a $50,000 capital gain. He also owns 2,000 shares of Citigroup that he paid $35 per share for that is now trading at $4 per share. The $62,000 loss in Citigroup does nothing for him from the IRS standpoint unless he sells it. The sale of Citigroup stock "realizes" the loss that Mr. Smith can then take against the $50,000 gain in the building lot. The net loss of $12,000 will show on Schedule D of his tax return and he will be able to take $3,000 this year against other income. The remaining loss of $9,000 will carry into 2010 and can be used against gains in that year. Mr. Smith will continue to carry the loss forward until it is either used to offset gains or $3,000 per year will be used to offset other income.

What if Mr. Smith believes that Citigroup is going to recover and he wants to buy it back? He will need to wait at least 31 days before he buys it again or it will trigger the wash sale rule. The wash sale rule says if you sell a security at a loss and buy the same or "substantially identical" security within 30 days, the loss is disallowed for income tax purposes. This raises an investment concern. Mr. Smith would not want to sell Citigroup at $4 per share only to see it go up to $8 per share while he is waiting 31 days to buy it back. The wash sale rule also applies to purchases made within the 30 days in a retirement account. For example, Mr. Smith cannot sell Citigroup in his taxable account and then buy it in his IRA without triggering the wash sale rule.

You will need to consider carefully your strategy for harvesting losses - balancing tax considerations with investment concerns. Tax loss harvesting is an excellent way to gain tax benefits and improve your investment portfolio when done properly.

<u>Manipulate Your Income</u> – Do you have flexibility with your employer? Ask if year end bonuses can be postponed until January. The employer may very well want to take that deduction in 2009 but it never hurts to ask. The economy has been challenging for many businesses and your employer may not need to take the deduction this year. Putting your bonus off until 2010 may be a win/win for both of you.

If you are self employed, pay your bills early to reduce income this year. Project your supply needs for next year and order them now. Consider making capital improvements in 2009. You may want to hold off your

December billings until January. Obviously there are cash flow considerations that may take priority.

Final Thoughts

Keep in mind that we are only trying to get your MAGI below $100,000. You don't need to implement all of these strategies - only enough to get your income below $100,000. These are strategies for people that think they will be close.

RECHARACTERIZATION

If you are not sure you if your MAGI will be under $100,000 you should do the conversion. You can always recharacterize if you find out you are not eligible. You can't back date the conversion if you discover you could have converted but didn't.

A recharacterization is essentially a do-over. You don't need a reason to recharacterize. We are talking about a failed conversion here. This is when you discover that you weren't eligible because your MAGI was too high. There were a lot of recharacterizations in 2009 because of the drop in the stock market.

The IRS allows you to recharacterize a conversion from a Roth back into an IRA and will treat it like the original transaction never took place. The deadline to recharacterize is the extended due date of your tax return for the year of the conversion. This would normally be April 15th of the year following the year of the conversion but it can be as late as October 15th if you obtain an extension. You may not recharacterize a Roth conversion and then reconvert the same IRA money in the same year. Even if you straddle calendar years you must still wait 30 days before reconverting to a Roth IRA.

USING "GREEN" TAX CREDITS

The new "Cash for Clunkers" program has received a lot of attention lately. 240,000 Americans traded in their clunkers in the first round of funding which far exceeded the most optimistic expectations. The program was designed as a "green" project to get Americans driving more fuel efficient cars. The unexpected side benefit has been the positive impact it is having on the weak automobile industry. But then again, I seem to remember the government owns an automobile company…

There are other green incentives that were passed as part of the stimulus bill that you may want to consider. The stimulus bill extends and modifies tax credits for insulation, windows & doors, roofing, HVAC, water heaters, and Biomass Stoves. The tax credit is equal to 30% of the cost (not including installation) up to a maximum of $1,500. There are several rules that must be followed to claim the credits:

- Improvements must be "placed in service" from January 1, 2009 through December 31, 2010.
- Taxpayer's principal residence.
- $1,500 is the maximum total amount that can be claimed for all products placed in service in 2009 & 2010.
- must have a Manufacturer Certification Statement to qualify
- improvements made in 2009 will be claimed on your 2009 taxes (filed by April 15, 2010) — use IRS Tax Form 5695 (2009 version) — it will be available late 2009 or early 2010

There are also more substantial credits for Geo-Thermal Heat Pumps, Solar Energy Systems, Small Wind Energy Systems and Fuel Cells. These credits are available at 30% of the cost but with no upper limit and you have until December 31, 2016 to place the systems in service.

Many local utilities are providing financial incentives for purchasing ENERGY STAR qualified products. These incentives may include sales tax exemptions or credits, rebates, and recycling incentives for the proper disposal of old products. Go to ENERGY STAR to find out what incentives are in your area.

NEED A SECOND OPINION?

Is your financial plan on track? Are you satisfied with your current advisor? Rodgers & Associates can help. We offer a free telephone consultation to evaluate your current plan and offer suggestions on how to improve it. Call Mark Eisenberger at (888) 876-3437 or email him: Mark@Rodgers-Associates.com to make arrangements.