Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

Kane Company, P.C. 515-270-2727 Fall 2009

Pre-Retirees, Retirees Switch To Roth IRA

Converting a regular IRA to a Roth IRA brings a host of benefits. Unlike a traditional IRA, which requires you to begin withdrawing money from the account after you turn 70½, a Roth has no mandatory distributions. If you don't need the money, you can leave it to compound for the rest of your days. Even better, if you're at least 59½, any money you do take out—assuming it has been in the account five years or more—is tax-free. In contrast, withdrawals from a regular IRA are taxed as regular income.

> If you are in your 60s and have a low income and big tax deductions, a Roth conversion can be almost painless.

So why doesn't everyone convert to a Roth? One reason is the current $100,000 income limit for conversions. The other problem is taxes; to convert to a Roth, you must first take money out of your traditional IRA, and that means paying income tax. However, if you are in your 60s and have a low income and big tax deductions, a Roth conversion can be almost painless. You can make the switch without creating a huge tax bill, avoid paying taxes on much of your retirement income, and provide tax-free income for your heirs as well.

To see how this would work, consider Frank and Sylvia, a fairly typical couple on the verge of retirement. He is 61 and a hospital administrator; she's a 55-year-old homemaker. They have managed to sock away $600,000 in Frank's pension plan and $400,000 in regular IRAs. They have another $600,000 invested in tax-free municipal bonds.

Frank wants to retire this year, and it turns out that he and Sylvia are in an ideal situation to convert some of their IRA assets to a Roth. Not only are they far under the $100,000 income threshold, but also, like many people their age, they can control how much income they receive in a particular year. For instance, Frank can choose to delay receiving Social Security until age 65, and also can defer payments from his pension. Keeping your income down when you're converting to a Roth IRA means that the money you pull out of the regular IRA will be taxed at a low rate or may not be taxed at all.

Apart from interest and dividends flowing from a savings account and investments in a few mutual funds, almost all the income Frank and Sylvia will receive after he leaves his job will be from their tax-free municipal bonds. They will have less than $10,000 of taxable income, and once their exemptions are figured in, that figure will drop to almost zero.

Meanwhile, the mortgage interest and property taxes Frank and Sylvia pay on their primary residence and vacation

(Continued on page 4)

Don't Be Confused By Wall Street's Advertising Blitz

Independent firms like ours don't spend money on TV advertising. And that's a shame because consumers deserve to know the difference between those giant Wall Street firms and our business.

The Wall Street giants, stung by scandals for giving advice that was tainted by self interest, have in the last couple of years launched ad campaigns selling their advice and saying they work on a fee-basis free of conflicts of interest. They are doing this because small firms like ours have had growing success in recent years by offering investment advice on a fee basis and acting as fiduciaries.

Whether or not the titanic Wall Street companies that were prosecuted just a few years ago for giving conflicted advice have completely changed their ways is a dubious proposition.

Our firm is a Registered Investment Advisor. By law, we must disclose all conflicts of interest and act in your best interest. Because we are a small firm, we can offer you personal advice and a personal relationship. We can tailor solutions to your needs. We have no hidden agenda, no gimmicks, and no TV ads.

So don't be confused by Wall Street's advertising blitz as firms try to repair their bad reputations. When it comes to personal financial planning, an independent fiduciary is the real gold standard.

Steven L. Kane, CPA/PFS, CFP®

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 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. ●

When Your Financial Advisor Accepts The Role Of Fiduciary,

In the world of financial advisors there are myriad labels, certifications, registrations, and other terms that tend to be meaningful only to industry insiders. But one distinction could be crucial: An advisor bound by contract or law to serve as a "fiduciary" is obligated to act solely in your best interest. That's different from others who may seem to work for you but in fact owe primary allegiance to the companies that pay them.

With other professionals, such as lawyers and CPAs, there's typically a fiduciary responsibility that requires them to act in clients' best interests. But for financial advisors, fiduciary status is not yet standardized or guaranteed. So while you may think your stockbroker offers unbiased advice, he or she is probably receiving a commission for selling you products. To complicate matters, even a fee-based advisor who charges for advice may not be acting solely in your interest.

Not surprisingly, there's widespread confusion among consumers on this point. According to a recent survey by a major financial services firm:

- More than half of the investors interviewed believed both stockbrokers and Registered Investment Advisors (RIAs) have an obligation to act in the client's best interests.
- Three out of four investors didn't realize that only independent RIAs have a fiduciary duty to their clients.

RIAs must inform clients of potential conflicts of interest, and they're legally obligated to act as a fiduciary. They have a fiduciary duty to act in their clients' interest at all times. Stockbrokers don't have the same obligation. Brokers must make recommendations that are suitable but are not required to adhere to the higher standard of care—to always do what's in your best interest—as a fiduciary.

Working Longer To Fix The Retirement Mess

Are you willing to postpone retirement by two to four years? If you want to enjoy a secure, prosperous retirement, delaying it may be the best way to get there, according to a new book published by the Brookings Institution Press. *Working Longer: The Solution to the Retirement Income Challenge* offers a sobering yet hopeful message to Americans approaching retirement age at a time of soaring health care costs, declining pensions, severely weakened retirement accounts, and shaky prospects for Social Security.

Authors Alicia H. Munnell, professor of management sciences at Boston College, and Steven A. Sass, associate director of the Center for Retirement Research at Boston College, argue that raising the average retirement age from 63 to 66 would solve many of the financial problems retirees are facing. “The key is to avoid drawing on your Social Security benefits or 401(k) plan until age 67,” says Sass. Allowing your retirement assets to grow just a few years longer can significantly boost your assets, and delaying retirement means a shorter period during which you’ll have to depend on retirement savings.

The nice thing about this strategy is that it won’t necessarily mean enjoying fewer years of post-work life. Because life expectancy has soared while the average age of retirement has fallen, merely moving back the start could still afford you decades of doing whatever you have planned. Consider these numbers:

- The average life expectancy for a 55-year-old man in 1965 was 20 years; by 2005, it had risen to 25 years.
- For women at 55, life expectancy rose from 25 years in 1965 to 29 years in 2005.
- About 19% of men and 33% of women who survive to age 65 today will live to age 90 or older.

Meanwhile, the average retirement age for Americans fell from 65 in the mid-1960s to 63 in the 1980s, where it remains today. A major reason is that workers may start receiving Social Security benefits at age 62, even though beginning then, rather than waiting until full retirement age, reduces the amount of the monthly payments you’ll receive. And while Social Security’s official retirement age is gradually rising from 66 to 67, the government has opted to leave the earliest eligibility age (EEA) at 62. Sass and Munnell believe the government should push back the EEA to age 64 to encourage people to remain in the work force longer.

The declining U.S. savings rate is another strong argument for staying on the job a few additional years, suggests Sass. “For baby boomers, it’s getting a little late to save.” They don’t have that much money in their 401(k) plans. Working longer is probably the best option.”

Sass notes that the amount of your Social Security benefit is calculated using the 35 highest-paid years of your working life. “By delaying retirement, very often you’ll replace a zero- or low-earnings year and actually increase your benefit level,” he says. Moreover, each year you wait before starting Social Security payments will boost the amount. Work four years longer, Sass estimates, and you’ll increase your monthly check by a third.

Consider a man who made an average of $150,000 a year during his highest-paid 35 years at work. If, rather than retiring at age 62, he keeps going four more years at that same average salary, his benefits will go up more than 30% compared with what he would have received at 62, not taking inflation into account, Sass says.

If the same man had earned an average of $150,000 but had worked only 31 years, his 35-year Social Security average would be lower. (The exact figure is calculated based on the Social Security wage base limit, which changes annually and stands at $106,800 in 2009.) Retiring at age 66 instead of 62 would add four more years to the average (at the wage base limit), thus increasing his benefits somewhat more than the automatic 30%.

For a person earning an average salary of $40,000 a year, adding four more years to a 31-year average would make the increase in benefits rise from 30% to 45%, according to Sass. For higher earners to receive a similar extra boost, the wage base limit would have to be increased significantly above the $106,800 level.

The recent meltdown in the stock market just adds one more reason to think about delaying retirement by a few years. Most nest eggs have suffered, and to begin withdrawals from a beaten-down retirement account may sharply reduce the size of annual distributions that can be taken without depleting the account during a long retirement. We can revisit your retirement plan with you and help you choose a retirement age that will support your goal of a long and comfortable life after work. ●

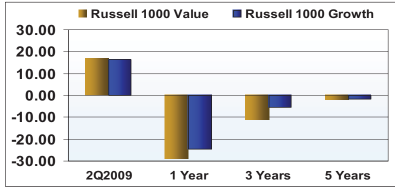
You Have A Foundation For Trust

The distinction between an advisor who is a fiduciary and one who is not could be critical when weighing an advisor’s recommendations. There may be a hidden agenda—for example, if an advisor is receiving better commissions for selling you one mutual fund instead of another.

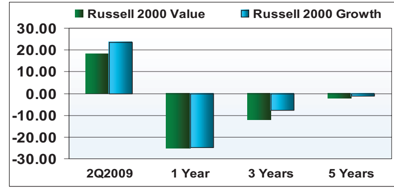
Rules recently clarified by the Securities & Exchange Commission permit brokers to give you investment advice on a fee basis and not act as a fiduciary. In these instances, a broker can only give you advice about one or two issues—such as your retirement plan or investing. If a broker wishes to give you comprehensive financial advice that spans insurance, taxation, college planning and estate planning as well as investing and retirement planning, the broker must accept his or her role as a fiduciary to you. He must disclose that he will begin giving you advice as a fiduciary and then tell you when he has stopped acting as a fiduciary and reverted back to his role as your stockbroker.

Working with someone who is a fiduciary, or will sign an agreement to act as a fiduciary, doesn’t guarantee you’ll profit from the advisor’s recommendations. But it does give you a greater assurance that you’re both sitting on the same side of the table.●

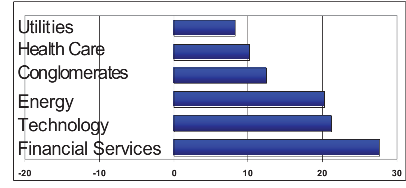
Market Data Bank: 2nd Quarter 2009



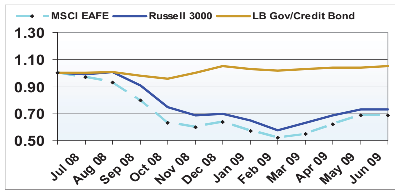
LARGE VALUE VS. LARGE GROWTH
The rally that began in March gathered momentum well into the second quarter, leaving large-cap shares up over 16% in 2Q09. On the value side, battered banks rebounded; on the growth side, investors remained bullish on technology.



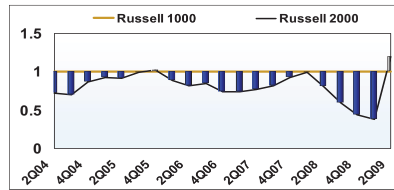
SMALL VALUE VS. SMALL GROWTH
Hope that smaller companies would be among the first beneficiaries of an eventual economic recovery gave small-cap shares an even bigger boost. Small value gained 18% in 2Q09; small growth surged 23.38%.



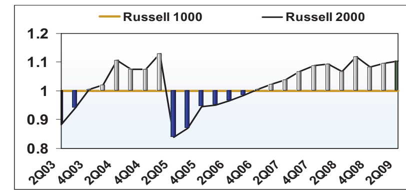
THREE BEST AND WORST SECTORS
All major industries ended the quarter in positive territory. Traditionally defensive utilities and health care shares delivered relatively mild gains. Technology soared. The battered finance sector bounced 27.61% as the credit crunch eased.



FOREIGN, US STOCKS & US BONDS
Despite the quarter's gains, equities around the world still have ground left to recapture after the 2008 bear market. Bonds, on the other hand, ended 2Q09 up 5% on a year-over-year basis.



LARGE VS. SMALL STOCK EARNINGS
Corporate profits actively declined for the first time since 2002 as both large and small companies found it impossible to preserve their margins in the worst economic environment in decades.



PRICE-TO-EARNINGS RATIO
Excluding those reporting outright losses, stocks became slightly cheaper on an earnings basis. Investors paid $15.90 for every $1 in large-cap profit, versus $17 for every $1 small companies earned.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capital International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a • xed rate of return while stocks will • uctuate. Indices are unmanaged and do not represent **Source: Rus-**

Switch To Roth IRA

(Continued from page 1)

home provide a $40,000 annual deduction for the next several years. The perfect use for that deduction, which would otherwise go to waste, is to offset $40,000 a year in income from IRA withdrawals which can then go into a Roth IRA. If they do this for four years, until Frank reaches 65 and must start receiving income from Social Security and his pension, they'll salt away $160,000 in the Roth IRA.

To give them the $85,000 a year they need to live on in the meantime, Frank and Sylvia can tap the principal from their $600,000 muni-bond account. Spending investment principal is psychologically difficult for some retirees, but in many situations it makes good financial sense.

In this case, selling some of their munis now helps Frank and Sylvia avoid taxes later.

Once he reaches 65 and starts receiving Social Security and his pension, they are likely to be in the 28% tax bracket or higher. Money they take out from a regular IRA would be taxed at that rate, and after age 70½ annual withdrawals would be mandatory. That won't be a problem with the assets they've moved into the Roth IRA; they won't have to make withdrawals, but funds they do pull out are tax-free.

In addition, if Frank names his children beneficiaries of the Roth IRA, they will inherit a stream of tax-free income. According to Roth IRA rules, they can stretch out tax-free payments for the rest of their lives.

Future tax breaks: The $100,000 dollar cap for Roth IRA conversions is scheduled to be removed beginning in 2010. What's more, for a conversion occurring in 2010, you can elect to spread out the resulting tax liability over the following two years. ●

Steven L. Kane, CPA/PFS, CFP® Kane Company, P.C. 5526 N.W. 86th Street, Suite A, Johnston, Iowa 50131
phone: (515) 270-2727 fax: (515) 270-1509 email: KaneCompany@mchsi.com

Articles are written by a journalist hired by Kane Company, P.C., and are general information not intended as advice to individuals.

©2009 API