



Stephen Molyneaux

UNCERTAINTY IN THE U.S. TAX CODE

A Roth IRA Conversion May Limit Future Tax Risk

We last visited the topic of converting a traditional IRA to a Roth IRA in our spring 2009 newsletter (see the full article at hanoveradvisorsinc.com). At the time of that publication, we emphasized the point that with the stock market having suffered such a significant loss in the Great Recession, we felt the timing may be advantageous for certain investors to explore the possibility of converting part or all of their traditional IRA to a Roth IRA while stock prices were so low and hence the tax advantages could be quite substantial. And while markets have rebounded from the lows of last spring, we still feel that a full or partial conversion to a Roth IRA is a very favorable maneuver for certain investors to consider at this time. Also, there has been a significant change in the tax code for 2010 which removes prohibitions on permitting higher income taxpayers to qualify for a Roth conversion. For 2010, all taxpayers may convert a traditional IRA into a Roth IRA regardless of their modified adjusted gross income (MAGI). In addition, taxpayers are allowed to roll over assets from a previous employer's retirement plan, such as a 401(k) to a Roth IRA regardless of their income level. Remember, *these changes are only available in 2010. Investors will have to complete their conversion by December 31st 2010.* To determine whether or not a Roth conversion may be right for you, keep in mind the greatest difference

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Laurence Bumette, CFP

TERM LIFE INSURANCE

How Much Death Benefit Coverage and For How Long?

You may have read recently that term life insurance rates are at historic lows and that now is a good time to buy. But before considering whether or not term life insurance is appropriate for you, it may be worthwhile to review some of the basics of term life insurance.

Term life insurance policies are offered with a variety of fixed annual premium periods. The death benefit coverage as stated in the policy is guaranteed for as long as the premiums are paid and the policy is kept in force. A term life policy is normally underwritten as renewable with a fixed level premium for time periods ranging from one to thirty years in length. When applying for term life insurance one chooses both the actual death benefit amount and the level premium time period. Usually the one, ten, or twenty year level premium periods are the most common.

The determination of which coverage period is most appropriate for an individual is dependent on many personal variables which will need to be discussed with your financial advisor or insurance agent. Generally speaking, term life insurance is the most inexpensive way to purchase substantial death benefits.

In deciding what type of life insurance is right for you and your family, remember that your current and ongoing death benefit needs are the priority.

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But the first point is to decide whether or not you need life insurance. People without dependents generally do not need to have life insurance, while people with spouses and families generally do require some degree of coverage.

The primary point of life insurance is to replace income if a breadwinner dies. A financial planner can help you determine the right insurance products to buy based on your needs. Better still, he or she can help shape your insurance purchases as part of an overall estate plan. A planner can help a buyer decide how much life insurance to buy and over how long a period. Some critical questions that should be asked before purchasing insurance:

- 1. How much income would your spouse and your children need to replace your income over a period of years based on your current age?***
- 2. Will your spouse or guardian need to provide childcare support?***
- 3. Is there a mortgage to pay off?***
- 4. Are there substantial short-term debts, like credit cards or auto loans, to pay off?***
- 5. What are estimated college expenses for children and spouses, and when will those expenses start?***
- 6. How much will burial expenses be?***
- 7. Do you have any other life insurance – such as work related group term life?***
- 8. Are there anticipated expenses for care giving for elderly relatives or children or family members with special needs?***
- 9. Do you anticipate substantial estate taxes when you die?***
- 10. Do you have any other assets that can be liquidated sensibly or will bring in income?***

Many online life insurance calculators found at various personal finance websites can help you address questions 1-8. The last two questions require a bit more strategic thinking in terms of what you and your family have done with overall estate planning. Keep in mind, your age and health will also be factors in how much insurance you can afford to purchase. Also, remember that life insurance companies will investigate all suspicious claims, so be honest about the facts you provide.

Many term life policies are both "renewable" and "convertible." Renewable means you can renew your coverage without a medical exam. The latter allows you to convert your term life policy into an equivalent cash value permanent policy from the same carrier. Another consideration is the accelerated death benefit payout option in case of terminal illness. Again, the kind of coverage you choose should depend on your own personal needs and a financial planner can help you determine what those are.

Also, as you check various companies, it is critical to find the most financially sound carrier. Insure.com provides free ratings from Standard & Poor's on various insurers, and many public libraries have subscriptions to ratings from *A.M. Best*.

Once you purchase a term life policy do not just put it away and forget about it. Make sure every few years you review the insurance policy as part of your overall financial plan. Circumstances change in life – incomes rise and fall and family size often changes. Insurance holdings should accurately reflect a policyholder's needs and conditions.

This column is provided by Laurence C. Burnette, CFP, a member of the Financial Planning Association.

between a traditional IRA and a Roth IRA is in how they are taxed. Traditional IRAs are taxed when you take the distribution from your IRA at the time of your retirement, but the money you contribute to your traditional IRA during your working years is tax-exempt. With a Roth IRA, there is no tax exemption for the money you contribute each year, but when you retire and begin to withdraw the funds – the money is tax free. While a large part of the equation when considering whether or not to do a Roth conversion involves comparing your current tax bracket versus what bracket you foresee in your retirement, the complete math equation is much more complicated. Avoid listening to those “personal finance” gurus who claim, “you should only do a conversion if you anticipate being in a higher tax bracket in retirement” – nothing could be further from the truth. First, attempting to predict future tax rates for years or decades ahead is impossible. One study reports that on average, the U.S. tax code undergoes a major shift every four years. Beyond not knowing what future tax rates may be when you retire, there are an entire range of other tax and estate issues which must be considered before making a decision. If an investor is only comparing tax rates now and at their retirement age it is akin to looking at a slice of a pie while ignoring the rest of the entire pie.



There Are Many Possible Benefits To A Post-Retirement Roth IRA Conversion

Keep in mind when considering a Roth conversion - it is not an all or nothing proposition. A tax expert may find the best situation for you personally is to convert a portion of your existing traditional IRA to a Roth IRA. An informal survey of CPAs discovered that many accountants thought a partial conversion is what worked best for most of their clients. One accountant said it may be best to think of a Roth conversion as a hedge against major changes in the tax code. In essence, the investor is diversifying their overall future tax risk by having a percentage of their retirement funds in a Roth vehicle.

For investors approaching or at retirement age, they may want to consider some of the possible benefits to a post-retirement Roth conversion:

- *A conversion may reduce your estate tax by paying income tax on your IRA before you die.*
- *Roth conversions may reduce or eliminate taxes on your social security benefits.*
- *A conversion may cause the money in your converted IRA to be taxed at a lower rate than if your children inherited a traditional IRA.*
- *Roth conversions will allow investors to have a larger dollar amount invested in a tax-free retirement vehicle if they use other savings to pay the tax on the rollover.*
- *Investors can remain invested in a tax-free vehicle for a longer period of time with a Roth conversion by avoiding required distributions at a specified age.*

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Hanover Advisors is pleased to announce a blog is now available on our website. The blog will be updated on a regular basis with pertinent, up-to-date investment commentary regarding portfolio adjustments and unfolding events in the financial markets. Please visit our website at www.hanoveradvisorsinc.com to view our newest feature.

While it appears certain that some taxes will be increasing in the very near future, no one is certain as to the exact specifics or how they will impact the overall tax picture. The Presidential Debt Commission will issue its recommendations in December, 2010 and while not binding, it will probably work as a guideline for future tax increases and spending cuts.

The Bush-era tax cuts will expire in December, 2010 and when combined with the new 3.8% Medicare surtax it will move the highest marginal rate from 35% to 43.4%. There is talk in Washington of higher tax rates across the board - a VAT tax, targeted tax proposals, energy taxes, specific surtaxes, and numerous other tax measures. Unfortunately, at the present time, investors have very little concrete information to guide them through the tax maze. It may very well be that it is all this uncertainty swirling around the future of the tax code that makes the strongest argument for considering a Roth IRA conversion now. Prudent investors may want to seriously look at a conversion as a means to diversify their tax risk.

We can not stress strongly enough the importance of consulting a tax pro (CPA, tax attorney, or financial planner) to determine if a Roth IRA conversion is the correct move for a particular investor. The tax implications of a Roth conversion are potentially very significant. For certain individuals a conversion can offer great benefits, but for others it can create enormous tax liabilities. There are a myriad of tax consequences involved in making the final determination regarding a conversion: federal income tax rates, state tax laws, the alternative minimum tax, the newly imposed 3.8% Medicare surtax, and the estate tax and post-mortem distribution issues. Investors need a tax professional who can analyze and evaluate all the various tax regulations and make the best decision for their specific circumstances.



Hanover Advisors Is Pleased To Announce

Laurence C. Burnette, CFP has recently completed the required course study and passed the final exam to earn his professional designation of CRPSSM (Chartered Retirement Plan Specialist). The CRPSSM program is sponsored and administered by the College for Financial Planning and is specifically designed for professionals involved with retirement plan design, installation, and maintenance for companies and small business owners. This achievement will enhance Hanover Advisors' ability to offer innovative and flexible retirement plan solutions tailored to the needs of the business community.

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