

THE COMPASS CHRONICLE

Highlighting important wealth management issues

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COMPASS Wealth Management, LLC



Louis E. Conrad II, CFA

President

P.O. Box 250

Lexington, MA 02420

Telephone: 978.828.5681

E-mail: info@compassinvest.com

Web Site: www.compassinvest.com

A client-focused wealth management firm dedicated to providing objective advice to individuals, families, and corporate retirement plans.

Our wealth management services include:

- ◆ Investment Management and Consulting
- ◆ Retirement Planning
- ◆ Education Funding
- ◆ Gift Planning

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The Great Conversion Opportunity

Roth IRA Conversions in 2010

For those who qualify for making a contribution to a Roth IRA, they can be a great retirement vehicle.¹ Though contributions are made with after-tax money and are not tax deductible, a Roth IRA provides:

1. tax-free growth of earnings and income.
2. tax-free withdrawals.
3. no required minimum distributions (RMDs) after 70½.
4. the ability to make contributions after reaching 70½.

Conversely, contributions to a Traditional IRA may or may not be tax deductible depending on your circumstances and offer tax-deferred growth only until assets are withdrawn. With a Traditional IRA, you are required to begin withdrawing a certain amount from your IRA (RMDs) after reaching 70½ and incurring income taxes, whether you need the cash or not.

What's Changing?

While Roth IRAs are an attractive retirement account, you may contribute only if your income is below the limitations set by the IRS. Thus, for those with higher income, a *contribution* to a Roth IRA has been impossible. ***Though the income limitation for contributions is not changing, those who heretofore have been unable to contribute to Roth IRAs will be allowed, beginning in 2010, to convert their non-Roth IRAs to Roth IRAs.*** The income limitation that has existed for conversions will be removed in 2010 (prior to 2010, your MAGI has had to be less than \$100,000, whether married or single, to convert your IRA to a Roth IRA).

A conversion is a process the IRS allows with

1. the completion of paperwork from your custodian and
2. the payment of income taxes on the taxable portion of the conversion

to transfer your non-Roth IRA assets into a Roth IRA account. ***For conversions occurring in 2010 only, you may elect to evenly split the income tax that is due from the conversion in your 2011 and 2012 tax years, effectively deferring the tax by up to 2 years.*** Income taxes will be due on previously untaxed amounts; that is, federal and state income tax will be due on tax deductible contributions and earnings, and earnings on nondeductible contributions (your contributions have already been taxed in this case). Once converted, your holdings thereafter will be free from income tax.

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¹ A married couple, filing jointly can make the maximum allowed contribution if their modified adjusted gross income (MAGI) is below \$166,000 in 2009, whereas someone filing single can make a full Roth IRA contribution if their MAGI is below \$105,000.

The Great Conversion Opportunity

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Should You Convert?

Whether you should convert is highly dependent on your individual situation and the assumptions that you use. Two specific assumptions that need to be made are:

1. whether the income tax rates that apply to you will be higher or lower in retirement than they are today and
2. whether you will need the assets you convert for your retirement and, if so, how many years will pass before those assets are used.

Though the decision to convert is specific to your circumstances, we can provide you with rules of thumb for when a conversion may or may not make sense. The accounts that can be converted include Traditional IRAs, Rollover IRAs, SEP-IRAs, SIMPLE-IRAs, and 401(k)s, 403(b)s, and 457(b)s from a former employer or if in-service distributions are allowed. Thus, higher earners can circumvent the income contribution limits that exist for Roths by contributing to a non-Roth IRA and then converting it to a Roth beginning in 2010. Further, you do not need to convert all of your non-Roth IRA assets.

Factors Supporting Conversion

1. **Income Tax Rate**—if your tax rate will be the same or higher in retirement than it is today.
2. **Age**—if you are young and/or will not need the assets that are converted during your retirement.
3. **Depressed values**—the lower the value of your non-Roth IRA account(s), the lower your taxes will be on conversion.
4. **Cash**—the cash to pay the tax incurred from the conversion will not come from your IRA.

Factors Not Supporting Conversion

1. **Income Tax Rate**—if your tax rate will be lower in retirement than it is today.
2. **Age**—if you are older and/or will need the assets that are converted during your retirement.
3. **Cash**—you do not have the cash to pay the tax incurred from the conversion.

If you decide to convert, pay the income taxes incurred, and then the value of your Roth IRA declines, the IRS allows for a *recharacterization* of your conversion (basically a “do over”). While specific steps need to be followed in a recharacterization, the process allows you to receive a refund of any taxes you paid upon conversion and then reconvert at a later date.

Before pursuing a conversion, COMPASS Wealth Management, LLC strongly encourages you to speak with your tax preparer as the applicable IRS rules are complex and not all of the technical aspects have been reviewed here. Further, your tax preparer can run projections for you, including the impact of converting on your taxable income, tax bracket, and other tax items that are sensitive to the level of your adjusted gross income.

Your Credit Score

Fair Isaac, the company that created the FICO credit score, recently introduced a new version of its landmark credit scoring method that might have serious consequences for you if you are planning on borrowing for a home or establishing any other new credit.

Payment Timeliness

The new version of FICO is focused not only on your payment history, but on your balances too. Reports have indicated that the FICO revision is actually more lenient on a late payment, which might affect more consumers due to the economic downturn. Obviously, this will not rectify a history of late payments, but being late once or twice will not have the same impact as in earlier FICO versions.

Credit Utilization

Consequently, your top priority under this new scoring system should be to reduce your level of debt. Credit utilization—the amount of credit that you tap relative to your credit limit—is more important under the new FICO scoring scheme, especially so as higher balances are more prevalent right now. From a lender’s perspective, high balances combined with a tough economy leads to a higher risk of default among customers.

So what is a good target utilization rate for all of your revolving credit accounts? You should target a rate of less than 50 percent of your credit limit for each revolving account. If you are not below the 50 percent threshold, you may want to defer applying for new credit or refinancing if you are able to. The lower your credit utilization, the better your FICO score.

Credit Scores and Reports

The best interest rates and terms from lenders are reserved for those with credit scores of at least 740 (850 is the best possible score). You can purchase your FICO score from either TransUnion or Equifax at www.MyFICO.com for \$15.95.

You have the right to obtain all three of your credit reports—from Experian, TransUnion, and Equifax—once a year for free (go to www.AnnualCreditReport.com to order a report). You may not want to order all three at the same time, though. By staggering receipt of each of your credit reports, you will get a continuous picture of how your credit picture looks because the three bureaus feed each other the latest information. Reviewing your credit report on a regular basis will (1) allow you to rectify any errors that appear that could otherwise reduce your credit score and (2) assist you in spotting identity theft.

As perverse as it may seem, once you have paid off a revolving credit account, you may not want to close the account because in the world of credit scoring, closing an account, even one that has not had a balance for years, may reduce your credit score. Why? Lenders prefer to see a long record of credit management even if some accounts have been dormant.

Losing A Loved One

Losing a loved one is an emotionally difficult time, but it can also be very trying for those left to sort out the deceased's financial and legal affairs. What follows is a checklist that you can use if you are responsible for this task.

Perhaps the most important initial step is to seek professional advice to assist you. As needed, you should consult with a team of professionals, including an estate planning attorney, financial advisor, tax preparer, and insurance agent. An estate planning attorney can review the decedent's legal documents and outline a plan of action to pursue.

To pursue several of the steps below you will need to supply a certified copy of the decedent's death certificate. Thus, you will probably want to obtain several copies.

As executor, you will also need to gain access to the decedent's safe deposit box, if applicable, where important documents like those listed below and small personal assets may be held.

❑ Assemble Important Documents

- ❑ **Wills and Trusts**—verify who the executor is for an estate with a will and who the trustees or successor trustees are for a trust.
- ❑ **Tax Returns**—tax returns for the past few years may be able to assist in determining the assets that are held.
- ❑ **Bank Statements**
- ❑ **Investment Statements**—including employer-based retirement accounts, such as 401(k)s, 403(b)s, and 457(b)s.
- ❑ **Insurance Policies**—life insurance, property and casualty policies, and annuity accounts.
- ❑ **Assets**—real estate deed, automobile title, and a listing of personal property.

❑ Notifications

- ❑ **Executor and Trustees**—as indicated in the will and trusts, as applicable.
- ❑ **U.S. Postal Service**—forward mail if appropriate.
- ❑ **Social Security**—if the deceased was receiving benefits. If you are a surviving spouse, then you should apply for the lump sum death benefit.
- ❑ **Veterans Administration**—for burial benefits if decedent was a veteran.
- ❑ **Insurance Companies**—for potential life insurance and annuity proceeds and to cancel insurance coverage as necessary.
- ❑ **Creditors**—mortgage and credit card companies, as well as other creditors; cancel cards.

- ❑ **Employer (or former employer(s))**—for applicable life insurance, pension, health care, and any other benefits.
- ❑ **Other Organizations**—wherever life insurance may have been held, including trade and professional associations.

- ❑ **Filing With Probate Court**—when a will exists, the named executor should decide whether to file the will for probate. It is usually not necessary to probate a will unless there is property in the name of the decedent that needs to be transferred, so if all of the assets are held in joint names with a surviving spouse or surviving children, there may be nothing to pass under the will. Ultimately, the executor will need to ensure that the decedent's bills and taxes are paid and assets are distributed.

If no will exists, but property in the name of the decedent needs to be transferred, a surviving spouse or child will need to open a probate estate in the applicable probate court. The court will name an administrator who will then ensure the decedent's bills and taxes are paid and assets are distributed.

The passing of one close to you is emotionally trying, but with assistance from a team of legal and financial professionals, the process of managing the deceased's estate does not have to add to your challenges. COMPASS Wealth Management can assist in this process, even acting as a quarterback to coordinate the activities of the parties involved.

Adapted from Dennis Sullivan & Associates' piece "Where To Begin When You Lose a Loved One" and from other sources. Used with permission.

Did You Know?

COMPASS Wealth Management, LLC not only provides wealth management services to individuals and families, but we also oversee corporate retirement plans, including recommending and monitoring the mutual funds offered. If you know someone who could benefit from our wealth management services or a company that needs assistance with its retirement plan, please forward this copy of our newsletter to them (or direct them to our Web site). Thank you!

Written and edited by Louis E. Conrad II, CFA.

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