Conversion of an IRA to a Roth IRA Needs Careful Study

Right now, anyone with an adjusted gross income of less than $100,000 a year can convert a traditional IRA account to a Roth IRA. However, higher-income Americans were just given a gift – if the next Administration doesn't repeal it – in the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), which passed in May. Starting in 2010, the income limitation on Roth IRA conversions will be removed, and for conversions done in 2010, taxpayers can spread their taxes on that conversion over tax years 2011 and 2012.

The conversion issue is a potentially attractive retirement and estate-planning idea for wealthier Americans who want to make sure they maximize the assets they can pass to heirs tax-free. But anyone considering such a move – regardless of his or her income status -- should first review their current retirement asset strategy with a tax or financial adviser.

Issues to consider:

What's the difference between a traditional IRA and a Roth IRA? Traditional IRAs allow certain individuals to save money tax-deferred with deductible contributions until they're ready to begin withdrawals anytime between age 59 ½ and 70 ½. Roth IRAs don't allow tax-deductible contributions, but they allow tax-free withdrawal of funds with no mandatory distribution age and allow these assets to pass to heirs tax-free as well. Contributions to a Roth IRA aren't deductible, but if you leave your savings in the Roth for at least five years and wait until you're 59 ½ to take withdrawals, you'll never pay taxes on the gains. You can convert a traditional IRA to a Roth, but you must pay taxes on any pre-tax contributions, plus any gains.

Does time to retirement matter? Always. If you have more than five years until you plan to withdraw your retirement funds, conversion of traditional IRA assets to a Roth IRA might make sense. Generally, the longer the time span where earnings can grow tax deferred, the greater the benefit of being able to withdraw those earnings without paying tax on them.

Do you expect your tax rate to drop significantly when you retire? This is a very important question since certain individuals – particularly business owners who may be paying taxes at a fairly low rate – might face higher rates in retirement, which will make the tax-free nature of Roth withdrawals all the more valuable.

What does a Roth conversion cost? It can be a pretty big tax hit. You'll have to pay taxes on contributions that you previously deducted, as well as taxes on the accumulated earnings. Also, you need to be aware that conversion could push you into a higher tax bracket, especially if you've accumulated sizeable earnings over the years. This is why a conversion should be a planned event. A solution could be partial conversions of the funds over a period of time to avoid the lump-sum tax hit or the creation of a fund to pay those taxes before you make the move. If you can avoid it, don't withdraw existing traditional IRA retirement funds to cover the taxes – you'll diminish your savings and be hit with a 10 percent penalty for early withdrawal under age 59 ½.

-more-

What are the contribution limits for both types of IRAs? If you are eligible, you can contribute up to $4,000 annually — $8,000 for married couples for 2006. You can still contribute to a regular IRA, but your combined total IRA contributions cannot exceed $4,000 per person. Ask your tax adviser first. For 2006, you can contribute $5,000 to a Roth IRA if you are age 50 or older at year-end, or $10,000 for a married couple if both spouses are age 50 or older.

My retirement funds are all over the place. What should I do? The good part about settling the IRA-to-Roth issue is that it should force you to start thinking not only about what you have, but how you'll draw on your retirement assets once you retire. Getting help now will not only give you a status report on how well you've done up to this point, but how you'll withdraw the money most sensibly in the future.

- 30 -

July 2006 - This column is provided by the Financial Planning Association® (FPA®) of San Diego, the membership organization that connects those who need, support and deliver financial planning. We believe that everyone is entitled to objective advice from a competent, ethical financial planner to make smart financial decisions. Please credit FPA of San Diego if you use this column in whole or in part.

The Financial Planning Association is the owner of trademark, service mark and collective membership mark rights in: FPA, FPA/Logo and FINANCIAL PLANNING ASSOCIATION. The marks may not be used without written permission from the Financial Planning Association.

Getting the Kids Involved in Saving for College

The World War II generation got a taste of higher education through the G.I. Bill and made it a point to supplement or pay their kids' tuition. It was a struggle, but a far more manageable one than it is in this day and age. Figures from the University of Texas last year showed that since the 1960s, the price of a public higher education has risen from about 5 percent of median family income to more than 17 percent today.

Based on the current pace, that number could rise to 30 percent of median family income by 2020. Private universities could approach 50 percent.

Scary numbers indeed. That's why it makes sense for families to make college affordability a family effort - with both parents *and* kids pitching in. That's a big change in 40 years, where parents considered it a badge of honor to put their kids through school with no debt.

But there's a bright side to involving your child in the process of saving for college. They'll get an early education in money decisions that will have a direct impact on their future. Here are ways to make sure you're well informed about the college savings process and how to involve your child:

Get advice as early as possible. Even if your child has only a short time until high school graduation, get advice tailored to your own situation from a trained expert such as a financial planner. Parents often forget that their first financial goal is retirement planning, not college saving, so they need to start with the following points:

- What parents will need to support their retirement;
- What they can contribute to their child's college fund based on time to retirement and to freshman year;
- The best savings strategies for parent and child based on the tax situation for both;
- A primer on college financial aid in all its forms. Depending on the child's need for financial aid, parents need to know what kind of assets they should hold in their child's name and in what types of accounts for the best chance of securing financial aid if it's needed.

Involve your child in the discussion. Armed with knowledge from the financial planning process or your own research, start talking with your child about their financial contribution through money from part-time jobs, savings or, as a last resort, debt after college. Parents might decide to schedule two advisory meetings with a planner – one for themselves, and a second one with the child.

Lack of money isn't the only reason kids may be asked to contribute or shoulder debt. Blended families with ex-spouses who either don't want to make a contribution or haven't agreed to pay tuition as part of a divorce settlement can be a sticking point. Whatever the reason may be it needs to be presented honestly to the child.

-more-

Tackle the FAFSA first. The dreaded Free Application for Federal Student Aid (FAFSA) is a necessity for all parents who believe there will be some shortfall in paying for college after savings, grants and scholarships. It's a good idea to fill it out even if your needs aren't immediate; family finances can change for the worse. Your child won't qualify for federal student loans until you fill out this form. To speed the process, get your taxes done as early as possible in the year your child will need the funds. Colleges typically dole out money on a first-come, first-served basis, so you'll need your income documentation in order.

Once the FAFSA is processed, the Department of Education determines financial need and the parent's EFC, or the expected financial contribution. If parents can't cover the EFC, the student has to come up with a way to close the gap. There's a way to rough out what your EFC might be – go to http://finaid.org/calculators/quickefc.phtml.

Start looking for free money. On the community level, you might find corporations, associations and other groups that offer scholarships and grants for local students, particularly those going off to state or local schools. Students can generally find out about local opportunities through their high school guidance counselor. If the student works for a company on a part-time basis, there might be college support there. Also, the College Board (www.collegeboard.com) Web site features a good online clearinghouse for scholarships, grants, internships and loans, as well as www.fastweb.com.

- 30 -

July 2006 - This column is provided by the Financial Planning Association® (FPA®) of San Diego, the membership organization that connects those who need, support and deliver financial planning. We believe that everyone is entitled to objective advice from a competent, ethical financial planner to make smart financial decisions. Please credit FPA of San Diego if you use this column in whole or in part.

The Financial Planning Association is the owner of trademark, service mark and collective membership mark rights in: FPA, FPA/Logo and FINANCIAL PLANNING ASSOCIATION. The marks may not be used without written permission from the Financial Planning Association.

Start a New Summer Tradition: the Mid-year Financial Checkup

No, it's not exactly like a day at the beach, but a midyear review of your tax situation, retirement and spending issues can be far more valuable than the rushed attempt most people make at the end of the year.

Summer is a great time to review finances because things at work and home may be slower and if you've fallen behind on savings or haven't checked your spending habits in a while, you can work to correct the problem during the second half of the year. Here are the big issues to tackle:

Taxes: If you got a sizable refund in April or found it necessary to dig between the seat cushions to pay Uncle Sam, it's definitely time to reassess what you'll owe at tax time next year. Part of that might include harvesting losses in your investment portfolio and using them to shelter gains that may result from necessary rebalancing.

Retirement savings: If you are maxed out on your company retirement plan, that's great, but experts stress you may need other resources to retire comfortably. Check your existing IRAs and other accounts to see if you can deposit the maximum by the end of the year. Also see if a Roth IRA is right for you.

Health and health insurance: Increasingly, what we pay for health insurance will be tied to the state of our health. While the weather is good, commit to a plan to walk, bike, pick up a tennis racquet or hit the gym a specific number of hours a week. Also, check with your benefits expert at work or independent agent and look for ways to lower your premiums. Many insurers reset premiums at mid-year in a rising cost environment, so make sure you're ready to switch plans or negotiate different coverage if necessary. There are some great tips and learning tools on the Plan for Your Health Web site at www.planforyourhealth.com.

Check your spending: For people who use financial tracking software budgeting is generally pretty easy to figure out. And it shouldn't matter whether you're tracking your spending with a keystroke or shoebox full of receipts – take the time to figure out where your money's going. A look at the last six months of spending may reveal opportunities to reduce spending and redirect money toward more necessary goals. Also, take a look at such things as club memberships, magazines that are piled up and luxury coffee. If you're paying without really thinking about these things, you can probably live without them.

Reserve fund: Most financial experts encourage you to have between three to six months of living expenses in an emergency fund. If you don't have that minimum, go back to your spending review and see where you can start building.

College savings: If you are saving for your child's education or your own, check to see if you're on track with the savings goals you made for the year, and better yet, take some time to read the latest news on financial aid. Schools change their financial aid policies in subtle ways each year, and it's best to study the concept of college saving and financial aid early in the process rather than try to make up for lost knowledge late in the game.

-more-

Reset special goals: If you are going to need to replace your car, see if you can direct more money into your down payment fund so you don't have to take out a huge loan at purchase. If there's a vacation you want to take by the end of the year or a special household purchase you want to make, focus on the cash you'll set aside to make that happen. Also, do yourself a favor and make sure you have small, more affordable goals on the list – you need goals you can reach quickly, too.

The review process: Dealing with all of the above – particularly if it's your first attempt – can't be done in a day or week. Make it a lifelong thing. If you're willing to try computerized tracking of your personal finances, take the time you'll need to understand it. If your current physical filing system is a frightening mess, allot yourself proper time to get it straightened out. And don't forget that you can get help – bring a financial adviser into the process if necessary.

- 30 -

July 2006 - This column is provided by the Financial Planning Association® (FPA®) of San Diego, the membership organization that connects those who need, support and deliver financial planning. We believe that everyone is entitled to objective advice from a competent, ethical financial planner to make smart financial decisions. Please credit FPA of San Diego if you use this column in whole or in part.

The Financial Planning Association is the owner of trademark, service mark and collective membership mark rights in: FPA, FPA/Logo and FINANCIAL PLANNING ASSOCIATION. The marks may not be used without written permission from the Financial Planning Association.