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Diversified Asset Management, Inc.

1113 Spruce Street, Boulder, CO 80302

phone: 303-440-2906

# Higher Taxes In 2013? Roth Conversion To The Rescue

If Paul Revere were around today, he might be warning the public that "Higher income taxes are coming, higher income taxes are coming. . . ." Because that is exactly what will happen in 2013, barring action by Congress to head off scheduled increases. And considering how polarized legislators are during this election year, there's virtually no chance of compromise before the November vote, and it's uncertain which tax breaks, if any, might be preserved during a post-election lame duck session of Congress. In the meantime, though, there is something you can do to reduce the impact of the likely tax hikes. Converting a traditional IRA to a Roth IRA in 2012 could save you money in several ways.


There are three key provisions that could boost your tax bill next year.

**1. Higher income tax rates.** Current tax brackets carry rates ranging from a low of 10% to a high of 35%. Unless Congress decides differently, tax rates on all brackets will rise next year, topping out at 36% and 39.6% (compared with 33% and 35%, respectively under current rules).

**2. Steeper levies on investment income.** In 2012, both long-term capital gains and qualified dividends are taxed at a maximum rate of 15%. But those provisions are scheduled to expire in 2013, and the new rules call for a top rate of 20% on long-term capital gains. Dividends will be taxed as ordinary income at next year's steeper rates.

**3. A new 3.8% Medicare surtax on high earners.** If you trigger this tax, it will apply to a portion of your net investment income, which includes investment interest, dividends, royalties, rents, gains from sales of property, and passive activity income. Tax-free interest payments from municipal bonds and distributions from 401(k)s, IRAs, and other retirement plans are excluded.

Taken together, these provisions could result in a much heavier tax burden for many people, and tax experts have been busy coming up with ideas for reducing the impact of higher rates. For example, taking capital gains on appreciated stock positions this year rather than in 2013 could help, as could shifting some future income into the current tax year. But converting a traditional IRA to a Roth could be particularly advantageous.

Prior to 2010, you couldn't make a Roth IRA conversion in a year in which your modified adjusted gross income (MAGI) exceeded $100,000. But that limit no longer applies, and though you must pay income tax on the amount you convert, doing that this year rather than next year could save you a lot of money.

To do a Roth IRA conversion, you arrange to transfer part or all of the funds in your traditional IRAs to a Roth that you set up. You pay income tax on the converted amount, minus any after-tax contributions that you had

*(Continued on page 4)*

## *More Celebration: Congress Extends Payroll Tax Holiday*

Get out the party hats and streamers: After an acrimonious debate in Congress, our nation's lawmakers have extended the "payroll tax holiday" for the remainder of 2012.

The tax cut was first enacted as a one-shot deal for 2011. Under a provision in the 2010 Tax Relief Act, the usual 6.2% Social Security tax rate for employees was reduced by two percentage points to an effective 4.2% rate on wages up to the Social Security ceiling ($106,800 in 2011). The self-employed got a comparable tax break. The usual 1.45% Medicare portion of the payroll tax (2.9% for the self-employed) continued to apply to all wages.

In a last-ditch effort at the end of 2011, Congress enacted compromise legislation that kept the payroll tax holiday in effect through February 2012. And now, after weeks of wrangling and political grandstanding, Congress has approved a further extension through the end of the year on amounts up to this year's wage base of $110,100.

For example, if earn $100,000 in 2012, you will save $2,000 in payroll tax (2% of $100,000). The maximum tax savings is $2,202 (2% of $110,100).

Glad to have more money in your pocket? Don't squander your tax savings on frivolities or extravagances you don't really need. A better move is to use this extra cash for a sound investment or to bolster your retirement savings.

*Robert J. Pyle, CFP, CFA*

# Getting A Life Insurance Check-Up

Do you need to update your life insurance protection? You may be surprised to learn that your existing policies are no longer sufficient to meet your needs.

If you're like many people, you probably took care of your life insurance years ago. You bought as much coverage as you felt you needed, and then you stashed the contract in a drawer or safe somewhere and pretty much forgot about it. But it would be unusual if your family financial situation hadn't changed significantly since then. For example, you might now have too little insurance if you've added another child or two to your brood. But it could also work the other way. If your children have left the family nest or you've retired, you may be able to cut the amount of your coverage.

Now is as good a time as any to dust off that old policy and review it. You may find it doesn't reflect one or several major life events you've experienced since you acquired the coverage. Those might include:

- You have married, divorced, or separated;
- There has been a birth, death, disability, marriage, or divorce involving someone else in your family;
- One or more of your children has completed college or graduate school;
- You bought or sold your principal residence, a vacation home, or investment real estate;
- You switched jobs, started your own business, or retired; or

There has been a big shift in your financial or business circumstances.

Other family changes could also have an impact. For instance, you may have taken on the care of an elderly or disabled relative, thus adding to your financial commitments and increasing the amount of replacement income that would be needed if you died. Meanwhile, if you've paid off your mortgage, you may be able to reduce your coverage.

When you review your policy, examine it as if you were buying life insurance for the first time. It's your projections for the future that are the crucial factors—not the way things were a few years earlier. And don't forget to review all of your life insurance policies, including any group coverage you get through your employer (or your spouse's employer), taking into account recent estate tax law changes.

The amount of coverage you need is likely to drop as you get older, and you may eventually decide you can do without life insurance, though it could also play a role in your estate plan. Also, consider the return you may receive on cash value, especially with whole life policies. What's certain is that your financial situation will continue to evolve, so it makes sense to make an insurance review a regular event—if you mark it on your calendar each year, you won't forget to conduct this important checkup. ●

# Six Disability Facts To Consider

You probably already understand the importance of having life insurance. The proceeds from a life policy can help cover your family's current expenses and may provide a cushion for the future if you die prematurely. But another kind of coverage—disability income (DI) insurance—is often ignored or neglected. And that's a mistake, because DI insurance can be even more vital than life insurance in maintaining a family's financial well-being. A new white paper from the Council for Disability Awareness, an independent nonprofit group, provides these six startling facts.

1. More than one in four of today's 20-year-olds will become disabled before they retire. (Source: Social Security Administration, Fact Sheet, March 18, 2011)

2. Some 8.5 million disabled U.S. wage earners were receiving Social Security Disability Insurance (SSDI) benefits at the end of September 2011. (Source: Social Security Administration, Office of Disability and Income Security Programs)

3. Ninety percent of new long-term disability claims are the result of an illness, not an accident, and fewer than 5% of claims are work-related. (Source: 2011 Council for Disability Awareness Long-Term Disability Claims Study)

4. The average long-term disability claim lasts 31.2 months. (Source: 2010 GenRe Disability Fact Book)

5. New applications for Social Security Disability Insurance (SSDI) benefits increased 27% from 2008 to 2010. (Source: Social Security Administration, Office of Disability and Income Security Programs)

6. About 100 million workers lack private disability income insurance. (Source: Social Security Administration, Fact Sheet, March 18, 2011)

If you don't have DI insurance, either through a policy from your

# 6 Ways To Improve Your Business Credibility

"The truth is the truth is the truth," says Doug Carter. "And yet there are times when the believability of the truth is determined by factors other than the content of the message." In other words, simply telling the truth may not be sufficient if a listener doesn't trust you or knows from experience that you're not always reliable. Carter is the founder and owner of Carter International Training Company, a firm specializing in business training and development. He believes that for executives and business owners, establishing and maintaining credibility is crucial for success, and he has zeroed in on six ways to convince people that you'll always be as good as your word.

**1. Tell the truth.** The fastest way to be believed is to be trustworthy, and that means telling the truth, the whole truth, and nothing but the truth. Carter suggests agreeing only to things you know you're absolutely going to do. For instance, if you realize you'll be late to an appointment, say so, rather than making up an excuse after the fact. Act as if your word means exactly what you say.

**2. Avoid overstatement; use understatement.** Carter sees no virtue in embellishing the facts. "You only have to exaggerate once before people begin questioning the accuracy of your statements," he says. "Even if you're saying something half in jest you may create doubt with a statement such as, 'I've told you a million times.' Everyone knows it hasn't been a million times and likely understands you're just trying to make your point. But the fact of the matter is, you lied!'" People may ask themselves what else you might exaggerate about that wouldn't be as noticeable, and they could end up wondering when they can actually believe what you say.

On the other hand, understatement—saying that something is less than it really is—can create a foundation for credibility. To generate an understatement, first say what your product, service, or idea won't do. Then state what it will do.

**3. Be specific.** Specificity can make the truth more believable. For example, "61.93%" may carry more weight than "about 60%," and "there are seven steps to take" is better than "there are several things we can do." If you know the exact number right down to the second decimal place, you'll likely be looked upon as a credible source of information.

**4. Present evidence.** This can come in many forms, and it's important to remember that different people may value some types of evidence more than they do others. Among the possibilities are:

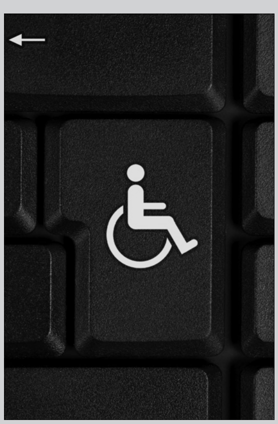
- Statistics: A quantitative fact or number.
- Facts: Anything that can be verified as being true.
- Truisms: Something likely to be accepted as true. For example, "I was just sitting here thinking about you" isn't something the other person can prove but it probably won't be questioned, either.
- Testimonials: A statement of support from a third party.
- Demonstrations: Actually showing how something works.

**5. Be concise.** Carter's research and personal experience suggest that the person who feels least in control or authority will use the most "filler words"—words and phrases such as "and," "so," "but," "you know," and "ah." He cites the example of a physician who isn't likely to use filler words when giving a diagnosis but who might hem and haw if pulled over for speeding. Carter says that people who are not certain tend to explain and then re-explain their opinions and answers, and that can sow doubts in the minds of listeners. It's better to say what you need to say as clearly and concisely as you can.

**6. Pace existence.** This is the process of describing things in such a way that others will clearly understand that you understand them. You can "pace existence" by mentally putting yourself in the other person's place and answering the question, "What would I be thinking and feeling if I were in this situation?" Begin by simply observing your audience. Are your listeners excited or do they look bored? Are they nodding and involved in your presentation or are they uninvolved? If you were sitting the way they're sitting, observing what they're observing, and doing what they're doing, how would you be feeling?

Doug Carter uses these six instructions to help his clients make the truth more believable. Adopting these ideas may not always make everyone trust you, but using these effectively could indeed help you become more credible. ●

employer or one you've bought on your own, you can choose from among a wide array of products whose costs and benefits vary widely. Here are several factors you'll need to take into account.



- How a policy defines "disability" is crucial. The best policies pay benefits if you can't work in your chosen profession, and they don't consider the nature of an injury.
- DI insurance policies generally require a waiting period before paying benefits, and a shorter waiting period normally translates into higher premiums.
- Typically, a policy will state how long and under what circumstances it will pay disability income benefits. It could, for example, provide benefits only until you qualify to receive Social Security retirement benefits.
- If you opt for a noncancellable policy, the insurer can't drop you off its rolls if your health declines.

Finally, don't be seduced by the low costs of a fly-by-night operation. You'll be better off opting for an experienced company with a good reputation. ●

# Give Away Gifts With No Gift Tax

It may be better to give than to receive, but not if your giving results in a big bill for estate or gift taxes. Still, there are plenty of strategies for avoiding those levies. Making generous gifts now, while favorable rules are in effect, could be an especially effective way to transfer wealth to the next generation.

One way to make tax-free gifts is by using the annual gift tax exclusion. This provision in the tax code lets you avoid taxation on gifts of up to $13,000 to as many recipients as you choose. If your spouse joins you, the limit rises to $26,000.

Suppose you have two adult children and three grandchildren. If you and your spouse make gifts of the maximum amount to each of those five people, together you can give away $130,000 (5 x $26,000), completely free of gift tax. And you can continue to provide that amount year in and year out without owing taxes on the transfers.

Meanwhile, you could also help family members by paying tuition or medical expenses on their behalf without tax liability, and those payments don't count against the annual exclusion.

By making a series of lifetime gifts, you could remove substantial assets from your taxable estate, thus reducing potential estate tax liability for your heirs. Also, if younger family members are in a lower income tax bracket than you are, this strategy may provide additional tax savings if they subsequently sell the property you give away. (One complication here is that investment income received by young children may trigger the "kiddie tax," with much of the income taxed at parents' rates. Even then, however, making gifts to children is likely to result in a net tax benefit.)

To further sweeten the pot, current law enables you to transfer up to $5 million of assets (indexed to $5.12 million for 2012) to family members, either through gifts during your lifetime or through a bequest in your will. This $5 million exemption, which is doubled to $10 million for married couples (indexed to $10.24 million for 2012), is scheduled to revert to $1 million after 2012 unless Congress intervenes. So now is a particularly good time to make large transfers.

There are, however, a few potential downsides to consider. First, when you give away property, you no longer have control over it, and that could be a concern if you're putting money in the hands of those who may be too young to handle it responsibly. Moreover, using part or all of the $5 million exemption to shelter lifetime gifts reduces the amount that could be used to offset future estate taxes.

Planning how best to transfer money to children and grandchildren can be part of your overall financial strategy. We can work with you and your tax and legal advisors to find an approach that fits your situation. ●

## Higher Taxes in 2013?

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made to the traditional accounts. Suppose you convert $500,000, and the entire amount is taxed at 2012's top rate of 35%. You'll owe $175,000—or $23,000 less than if the converted amount had been subject to the top rate of 39.6% scheduled to take effect in 2013.

Future distributions from the Roth IRA won't be taxed at all, as long as the account has been in existence at least five years and you're older than age 59½. If you had left the money in a traditional account, all withdrawals would have been taxed as income at those higher future rates. Moreover, with a traditional IRA, you are required to begin distributions the year after you reach age 70½. Roth IRAs don't have that requirement, and can be effective vehicles for passing along tax-free income to your heirs.

Because the tax on a Roth conversion is determined by the value of the converted assets on the date of the transfer, a subsequent market plunge could leave you paying tax on money you no longer have. In that case, though, you would have the option of "recharacterizing" the Roth—undoing the conversion so that the money would remain in your traditional IRA and you wouldn't owe any tax. The deadline for a re-characterization is the due date for your tax return plus any extensions. That means you could take until October 15, 2013 to undo a 2012 Roth conversion. (You can change your mind again and convert to a Roth IRA, but generally not before the start of the following tax year or after 30 days, whichever is later.)


Depending on your situation, a Roth IRA conversion might make sense even if tax rates don't rise. But if rates do head skyward, the advantages could multiply. We can help you determine whether a conversion would pay off for you. ●

**Robert J. Pyle** **Diversified Asset Management, Inc.** **1113 Spruce Street, Boulder, CO 80302**
**Phone: (303) 440-2906** **Fax: (303) 539-9880** **E-mail: rpyle@diversifiedassetmanagement.com** **www.DiversifiedAssetManagement.com**