CALL SUMMARY
DECEMBER 2009

INSIDE:

BRADWAY FINANCIAL
Plan First, Then Invest

We'll Help You Make the Right Roth Choice

The next time we meet to review your financial plan we will be faced with a decision about converting your traditional IRAs to Roth IRAs.

We'd like you to understand the benefits and drawbacks of converting, so we hope you will take the time to read this background information before your next review.

Decisions about converting need to be made on a case-by-case basis.

This presentation covers the basics of what can be a very complicated topic. As you read about Roth IRA conversions, keep in mind that decisions about converting need to be made on a case-by-case basis.

What is right for one client may not be right for another. We'll help you arrive at the right decision after conducting a thorough review of how a Roth IRA conversion would fit your particular situation.

As we head into 2010 there's likely to be a media buzz about the Roth IRA conversion window.

You will no doubt see Roth conversion stories in the financial media, as well as the mainstream media, since this is likely to be one of the top

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A Roth IRA Conversion May Help You Keep More Money in Your Pocket

In 2010, some of the long-established restrictions on Roth IRAs will be lifted, enabling anyone to convert a traditional IRA to a Roth IRA.

Converting or partially converting a traditional IRA to a Roth IRA may be advantageous if taxes increase. The main benefits are:

Potential reductions in future tax payments, leaving you with more money in retirement.

More freedom on withdrawals.

The ability to leave an income tax-free legacy for your heirs.

And for 2010 only – the so-called Roth IRA conversion window – the ability to defer conversion taxes for a year and then spread the payments over two years.

Before we delve into the conversion details, let's compare traditional IRAs and Roth IRAs. Both accounts offer tax advantages and are good ways to save for retirement. But the similarities end there.

Contributions to traditional IRAs typically are tax-deductible, and you pay taxes only upon making withdrawals from the account in retirement. Roth IRAs work in reverse: You pay taxes on your contributions and can then watch your money grow and be withdrawn free from income taxes.

There are other differences in the way contributions and withdrawals are treated. In a traditional IRA, you generally can contribute only until age 70½ and can't begin withdrawing money without penalty until you turn 59½. In a Roth, there are no age restrictions on contributions, and you can withdraw your principal tax-free and penalty-free as long as you've held the account for five years.

Another major difference between traditional and Roth IRAs is forced withdrawals. With a traditional IRA, tax rules force you to begin making withdrawals, often called required minimum distributions, in the year after you turn 70½. With a Roth IRA, there are no withdrawal requirements. You can choose whether to withdraw money or leave it in your Roth account, where it can continue to grow tax-free.

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Next Review

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personal finance topics next year.

We'd like to introduce you to the topic now to ensure that you have the correct information as you consider converting your traditional IRAs to Roth IRAs.

We'd like to introduce you to the topic now to ensure that you have the correct information as you consider converting your traditional IRAs to Roth IRAs.

If you wind up having Roth IRA conversations at work or with relatives or friends, feel free to pass this summary along, or point them to our Web site, so that they can have the facts in front of them, too.

And please don't hesitate to refer relatives or friends to us. We'll be happy to review their individual situations and make recommendations.

We look forward to discussing Roth IRAs with you at our next meeting.

If you'd like to meet sooner, rather than later, please contact us.

Meanwhile, we offer our best wishes for the holidays and wish you peace and prosperity in the new year.

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Conversion Basics

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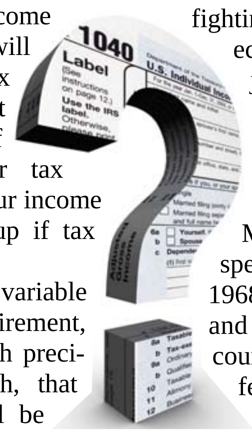
Roths were created in 1997 and came with a host of restrictions. If your gross income is above $176,000, for example, you can't establish or contribute to a Roth IRA. And if your gross income is above $100,000 you can't convert a traditional IRA to a Roth IRA.

In 2010, the conversion limits will be eliminated. This makes it possible for anyone, regardless of income, to convert a traditional IRA to a Roth. You do have to pay taxes on the amount you convert from a traditional IRA to a Roth IRA. During the 2010 conversion window, you can spread those tax payments out. And down the road your withdrawals from the Roth account are always free from income taxes. (The contribution restrictions remain in force, so if you earn more than $176,000 as a married couple you still can't contribute to a Roth.)

Converting may not be the right choice for you, but it makes sense for everyone with an IRA to at least consider converting it, or part of it, to a Roth. Conversion decisions must be made while taking into account what may happen in the future.

A LOOK AHEAD

The only thing we can say for certain about the future is that it's uncertain. We don't know for sure what future tax rates will look like. People usually assume that when they retire, and their income is reduced, that they will drop down to a lower tax bracket and tax rate. But we can't be sure. Even if you drop to a lower tax bracket in retirement, your income tax bill could still go up if tax rates increase enough.



Inflation is another variable that will affect your retirement, but we can't predict with precision. It's likely, though, that your income needs will be much higher in the future when measured by today's dollars. Prices tend to double every 18 years, meaning that 18 years from now you'll need $200,000 of annual income to enjoy the same standard of living you do today with $100,000.

Your Roth IRA conversion decision may hinge on what you think tax rates will look like in the future. Mark Twain noted that if history doesn't repeat, it certainly rhymes. Although we have seen tax increases in the past decade, income tax rates are still at some of the lowest levels since the 1920s. The highest income tax brackets stayed above 80 percent – and often topped 90 percent – in the 1940s, 50s and 60s. Although you might be in a different bracket, not necessarily the highest one, it's important to remember that the rates tend to move up and down together. An increase in the highest level generally trickles down to lower brackets and affects the majority of people with above-average incomes. So while we don't know what future tax rates will be, we do know that they have been much, much higher than they are now.

We also know that the federal budget is under increasing pressure. Deficits are at a record high, we're fighting two wars, stimulating the economy and trying to create jobs and improve education and infrastructure. On top of that, Congress is debating massive new spending on health care.

Meanwhile, entitlement spending has skyrocketed. In 1968, Social Security, Medicare and Medicaid spending accounted for 17 percent of the federal budget. In 2008, those

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Conversion Basics

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three programs alone accounted for 41 percent of federal spending. And as Baby Boomers retire, problems with Social Security will mount. Without changes, the Social Security Trust Fund estimates that its reserves will be exhausted by 2037, and that there will be enough money to pay only 76 cents on the dollar of scheduled benefits.

When you consider all these factors – relatively low current tax rates, mounting deficits, rising government spending and problems with Social Security – it's probably a pretty good bet that Congress will have to raise taxes, cut programs or consider some combination of both tax increases and cuts to popular programs.

If taxes increase, it may make sense to prepay some of your retirement taxes now, at lower rates, through Roth IRA conversions.

TAX RATE SCENARIOS

Let's look at three different conversion scenarios. In each case, we're converting a $100,000 traditional IRA into a Roth IRA. We're using 33 percent tax rate because that's the current rate if your income falls between roughly $209,000 and $373,000. It would also be your rate if you convert a $100,000 traditional IRA into a Roth and your ordinary income is between $109,000 and $273,000. In that case, you'd temporarily bump up to the 33 percent bracket because you would have to declare the $100,000 conversion as income.

Let's walk through the first table. The traditional IRA has a value of $100,000. It grows to about $492,000 over 20 years. After 20 years, you take a lump sum withdrawal at the 33 percent rate. Your net income, after paying income taxes, is a shade over $330,000. When converting to a Roth, you would deduct $33,000 from your $100,000 IRA to pay the taxes at the 33 percent rate. This puts the starting value of your Roth IRA at $67,000, assuming that you withdrew the funds from your IRA to pay the conversion tax. The remaining $67,000 grows tax free. And since it grew at the same rate as the traditional IRA, the ending value of just over $330,000 is identical. This highlights the fact that there is no advantage to converting if your income tax rate remains the same or decreases by the time you're ready to tap your retirement accounts.

But what happens if taxes increase? In the middle table, your income tax rate climbs to 38 percent in 20 years, when you are ready to withdraw money from the traditional IRA. After making your income tax payment, your net income after taxes drops to about $305,000. On the Roth conversion side, you paid your conversion taxes 20 years earlier at the 33 percent rate. So in this scenario you're nearly $25,000 ahead by converting.

The third scenario uses a future income tax rate of 48 percent. While that may sound high, it's not high in a historical context. Remember that the top marginal tax rate was above 80 percent for several decades in the

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IF TAX RATES REMAIN THE SAME

	Traditional IRA	Roth IRA Conversion
Initial Value	$100,000	$67,000
Value After 20 Years at 8%	$492,680	$330,096
Taxes at 33%	*-$162,584	**-$33,000
Total	**$330,096**	**$330,096**

*Paid upon lump-sum withdrawal
**Paid from account at inception

IF TAX RATES RISE TO 38%

	Traditional IRA	Roth IRA Conversion
Initial Value	$100,000	$67,000
Value After 20 Years at 8%	$492,680	$330,096
Taxes: 33% now, 38% later	*-$187,218	**-$33,000
Total	**$305,461**	**$330,096**
Roth Advantage		**$24,635**

*38% rate paid upon lump-sum withdrawal
**33% rate paid from account at inception

IF TAX RATES RISE TO 48%

	Traditional IRA	Roth IRA Conversion
Initial Value	$100,000	$67,000
Value After 20 Years at 8%	$492,680	$330,096
Taxes: 33% now, 48% later	*-$236,486	**-$33,000
Total	**$256,194**	**$330,096**
Roth Advantage		**$73,902**

*48% rate paid upon lump-sum withdrawal
**33% rate paid from account at inception

Conversion Basics

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20th century. Look at what happens when the income tax rate climbs to 48 percent by the time you're ready to withdraw money from your traditional IRA in 20 years. After making your tax payment, your net income drops to about $256,000. Now look at the Roth IRA. Since you paid your Roth taxes 20 years earlier at the 33 percent rate, you're nearly $74,000 ahead by converting.

Please keep in mind that these are hypothetical examples and they are just that: hypothetical.

We are all aware that there are other scenarios under which you could be withdrawing money from your IRA, such as taking the money annually or as an income stream, for example. And you also could pay your conversion taxes out-of-pocket. (Using an out-of-pocket example can be misleading because the scenario would not account for the potential return you would earn if you instead kept the money and invested it for 20 years.)

In any case, these examples illustrate that if tax rates go up, Roth IRAs make a lot of sense because they allow you to pay taxes now, at lower rates, and keep more money in your pocket when you begin making withdrawals.

ONE-TIME TAX INCENTIVE

The 2010 conversion window also has an added tax incentive. On conversions made next year – and only next year – you will be allowed to spread out your tax payments. In 2011, this window will close and you'll have to pay conversion taxes in one lump sum.

But let's say you convert a $100,000 traditional IRA to a Roth in 2010. You could declare the $100,000 as extra income on your 2010 return and pay your taxes in one lump sum. Or you could choose to defer the taxes for 2010 and split the extra income between your 2011 and 2012 returns. This would push payment off to calendar years 2012 and 2013.

If a Roth IRA conversion makes sense for you, it may or may not make sense for you to take advantage of this ability to spread taxes over the 2011 and 2012 tax years. These decisions must be made on a case-by-case basis, and we'll walk each of you through it during your next review. But we do want you to be aware of this beforehand.

CONVERSION FLEXIBILITY

What if you convert your traditional IRA or 401k into a Roth, and then change your mind? Perhaps it winds up being a bad year for the extra tax burden. Or perhaps the Roth loses value, leaving you with the same tax bill but on an account with a much lower value. In the example below, you convert a $100,000 IRA into a Roth and will have to declare the $100,000 as income. At the 28 percent tax rate, you must pay $28,000 in taxes on the conversion.

But suppose the market crashes and the value of the account drops significantly.

It wouldn't make much sense to pay $28,000 in taxes on an account now valued at $50,000. The new rules give you until Oct. 15, 2011 to change your mind, or recharacterize your Roth back into a traditional IRA without penalty. In this scenario, you would avoid the $28,000 tax bill because it would be as if you never converted in the first place. Keep in mind that now that the IRA is once again a traditional IRA, taxes will be paid when you start making withdrawals.

The new provisions also give you the flexibility of flip-flopping. Although you just undid your conversion,

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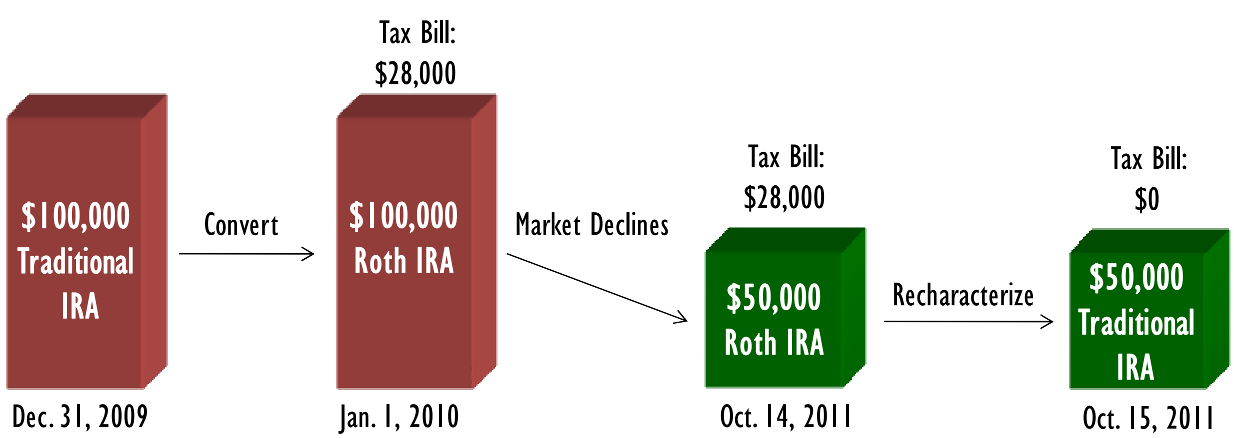
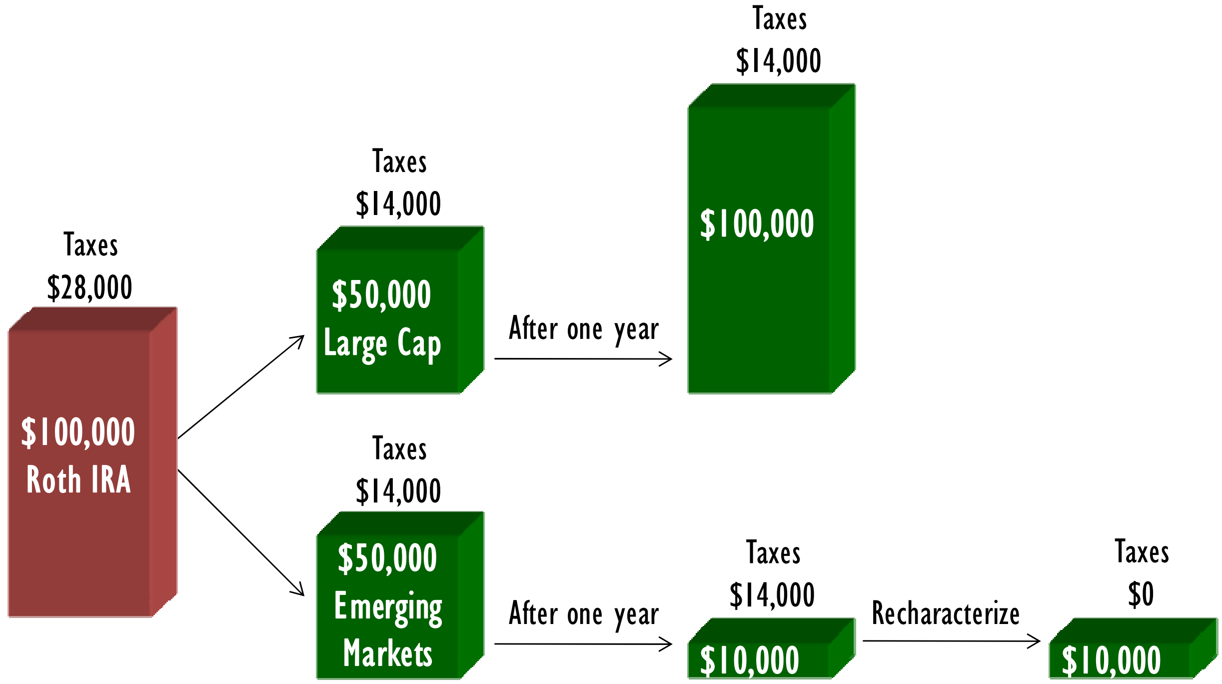
YOU CAN CHANGE YOUR MIND



DIVIDE AND CONQUER CONVERSION



Conversion Basics

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as long as you wait until the next calendar year, you can reconvert it to a Roth. This time your converted amount would be the $50,000 value of the account, and your tax bill would be a more manageable $14,000.

DIVIDE AND CONQUER

Another strategy that builds off of this recharacterization concept is a "divide and conquer" conversion. We may be crossing the line from something you need to know to something that's nice to know, but we want you to be exposed to some of the ideas you may wind up reading or hearing about.

The new rules allow you to create several different converted Roth accounts, each containing a different component of your portfolio. In the above example, you put just large cap growth stocks into one Roth and emerging markets investments in another Roth.

Now suppose that the two accounts perform quite differently over the next year. The large cap growth account doubles in value, reaching $100,000. The emerging markets account does not do well. Its value falls to $10,000. Because both accounts started at $50,000, the tax bill would be identical for both, $14,000. While paying $14,000 on a $100,000 is a good deal, paying $14,000 in taxes on an account that's now worth only $10,000 makes no sense.

The rules allow you to recharacterize the emerging markets Roth back into a traditional IRA. This will eliminate your tax bill on that account for now, saving you $14,000. Down the road, of course, you'd have to pay taxes on this traditional IRA when you begin making withdrawals in retirement. But you'd keep the large cap growth IRA as a Roth, and pay the $14,000 in taxes on that account.

These strategies are examples of some of the complexities regarding the Roth conversion window, and highlight how important it is for people to get professional advice.

LEAVING A LEGACY

Now let's look at Roth IRAs from an estate planning perspective.

If you determine that you do not need the money in your Roth IRA, you can leave it in the account and pass the money along to your children or grandchildren. Unlike a traditional IRA, you don't have to make withdrawals after age 70½. And you never have to pay taxes on any withdrawals. This would leave a much larger account for you to pass on to your heirs because you didn't have to pay

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Conversion Basics

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taxes or make withdrawals. If your grandson inherits your traditional IRA, he would have to pay income taxes whether he takes a lump-sum payment or uses the IRA as an income stream. But if your grandson inherits your Roth IRA, the money is income tax-free, period. Your grandson could potentially have a lifelong income stream that is free from income taxes.

HIGHLIGHTS

The 2010 Roth conversion window makes it possible for anyone to convert a traditional IRA to a Roth IRA. For 2010 only, you can convert and spread tax payments out over two years. Compared to traditional IRAs, Roth IRAs have tax advantages if taxes increase. They also have withdrawal flexibility and can be passed on to your heirs free from income taxes. In certain cases, a Roth IRA can be a valuable estate planning tool for providing a legacy.

At your next review session, we'll help you arrive at a conversion strategy that makes sense for you, whether that means converting, partially converting or not converting. And we'll help you deal with the tax implications as well.

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Retirement Account Basics

IRA, SEP IRA, 401k and 403b
all offer tax advantages now

BENEFITS
Pre-tax contributions
Tax deferral

DRAWBACKS
Low maximum contributions
Withdrawal penalties until age 59½
Required minimum withdrawals
Typically must end contributions at 70½
Legacy subject to income tax

Roth IRAs offer tax advantages
if tax rates rise

BENEFITS
Grow your money tax-free
Withdraw principal tax- and penalty-free
No mandated withdrawals
Make contributions at any age
Pay no taxes on withdrawals
Legacy free from income tax

DRAWBACKS
Income limits on contributions
Contributions are taxed

Question & Answer Session

The following is a summary of the question and answer session.

Q. Suppose you were to keep your traditional IRA, reach age 70½ and then start making withdrawals. If you don't need the money, can you take your withdrawals from the traditional IRA and then contribute it to a Roth?

A. If you were still working, yes, you could. But unless you have earned income, you are not going to be able to make Roth contributions in the scenario you just described.

Q. And Social Security is not earned income, right?

A. That's correct. Good question.

Q. In your IRA conversion scenarios, you are paying the conversion taxes out of the account. Is that what you are recommending, or can you use funds outside the account? I wish you had used an example where you pay the taxes from another source.

A. We tried very hard to come up with an example that would allow us to make an apples-to-apples comparison. Taking the money out of the account was a way to do that because then you don't have to factor in the time value of money. In other words, if you paid the conversion tax out-of-pocket, the scenario would not easily depict the fact that you could have chosen to invest the $33,000 for 20 years instead of using it to pay taxes. If you use that as an example, it makes it very difficult to have an apples-to-apples comparison. Nonetheless, below is a fourth scenario, under which you pay the conversion tax out-of-pocket at the 33 percent rate, preserving the initial account value of $100,000. As you can see, the Roth advantage appears to be $154,218 if taxes climb to 38 percent. But, again, that doesn't account for the fact that you could have invested that $33,000 tax payment for 20 years instead. We didn't want to use an example that would ignore the time value of money and inflate the advantage of converting to a Roth.

PAY ROTH TAXES OUT-OF-POCKET

	Traditional IRA	Roth IRA Conversion
Initial Value	$100,000	$100,000
Value After 20 Years at 8%	$492,680	$492,680
Taxes: 33% now, 38% later	-$187,218*	-$33,000**
Total	**$305,462**	**$459,680**
Roth Advantage		**$154,218**

*38% rate paid upon lump-sum withdrawal
**33% rate paid out-of-pocket at inception

Q. Your presentation referred mostly to people who are still contributing to their retirement accounts and are under age 59. Your situation changes a lot when you retire and you depend on your retirement accounts. What's your view on conversions for retired people?

A. If you believe that tax rates are going up, even in the shorter term, then even a partial conversion would still make sense because you're going to have to pay the taxes either for the conversion or as you are living off your traditional IRA withdrawals. Either way, there's a tax bill to be paid on some amount of the money that's coming out of your regular IRA. If you believe we're looking at slightly higher, or worse, much higher tax rates, then you don't really need a lot of time to accumulate from the time you paid the taxes to the time you made the withdrawal. Also, you have the ability to recharacterize. Suppose in January you do a full or partial conversion. We can get deeply into 2011 before we have to decide whether we want to live with that conversion or not. This gives us the ability to look at tax rates almost two years after we convert before we decide for sure whether to remain converted.