



Asset Management Resources, LLC

One Sentry Plaza
1185 Falmouth Rd, Ste 101A
Centerville, MA 02632
508-771-8900
Toll 866-771-8901
info@amrfinancial.com
www.AMRfinancial.com

Hi Everyone,
Christi and I recently attended the Estate Planning Council of Cape Cod's Spring Event. It highlighted the importance of planning to ensure that your assets are protected from creditors and taxes. When was the last time you reviewed your estate plan? So much has changed in the last few years, you may wish to review your plan. If you don't have a plan now is the right time to do something about it. Feel free to call us and we can point you in the right direction.

Sincerely,
Chris Boyd

VOLUME IV, 2012

Cape Cod Summer is Here!
Pay Down Debt or Save and Invest?
Of Taxes Past, Present, and Future
Can I convert my traditional IRA to a Roth IRA in 2012?



eResources Review

Asset Management Resources' E-mail Newsletter

Cape Cod Summer is Here!

Cape Cod offers a wide range of activities for all ages. For the long boaters, there are races and regattas along the way. For the family, there are beaches and parks that make it easy to enjoy the outdoors. For the avid fisherman, there are fishing spots and boat rentals. For the movie lover, there are drive-in theaters. For the water soaker, there are water parks and camps. For the kid, there are water parks, a week of summer camp, visiting one of the islands, and most important, free time without school!

As for your portfolio, the question remains will the markets heat up or slow down this summer? In our recent conference call we shared many of the potential catalysts for market movement both positive and negative. For a copy of the recorded call, email Jenn@AMRfinancial.com. In recent months, we have seen the economy slowing, both in the US, and broadly around the world. In Europe, ongoing economic struggles continue to be an issue. On a positive note Greek elections imply more stability for markets as Greece attempts to balance its budget. In Spain, European bailout funds have been made available to stabilize the banking industry to avoid bank runs. Worries remain that the bailouts are insufficient to address the problem. Concerns appear to be building in other Euro zone countries, too. Obviously, developments in Europe could have a significant impact on stock prices, as the region struggles to meet their economic challenges.

The Fed recently announced that it is not undertaking a new "quantitative easing" program but will extend the "twist" program which attempts to lower long-term interest rates and bolster borrowing. The Supreme Court decision on the constitutionality of the 2010 health care reform law is expected soon. The decision could impact health care and related industry stocks.

In the months ahead, Congress will wrestle with a number of issues that could have a significant impact on the economy, the markets and possibly your portfolio. They will again battle over the debt ceiling threshold. Last year this

led to a stock market decline. In November, the election results could impact the market. Without action from Washington, existing law will lead to increases in the income tax rates, capital gain tax rates, and taxes on qualifying stock dividends. Additionally, the Alternative Minimum Tax (AMT) patch ends, so it will impact many more people. The payroll tax holiday will end increasing payroll taxes by 2% in 2013. Estate taxes rates go up and thresholds on who will be taxed go down. Also, the spending cuts mandated by last year's debt ceiling legislation take effect in January. If these issues are not addressed by those in Washington, the non-partisan Congressional Budget Office (CBO) calculates that a recession is likely.

Ultimately, stocks appear inexpensive in many respects, and as challenging as the near-term is, the long-term view is encouraging. Because of the recent challenges around the world, the dollar continues to strengthen. This, in addition to the global economic slowdown, has driven commodity prices lower. This may reverse when economic data improves or international worries diminish.

Bonds have been a benefactor of recent conditions, particularly longer-term U.S. Treasury bonds. As demand and prices rise on these and other high quality debt instruments, rates have been declining. Higher risk bond offerings have been less appealing in this environment, and short-term bonds have remained steady, with very modest returns.

Of our AMR strategies, the low risk investors remain attracted to the AMR 3070 Preservation strategies, while those open to some risks have been more excited about our AMR 5050 Dividend strategies providing a solid dividend income from both stocks and bonds. We discussed expected reactions by various AMR strategies to potent market conditions in our conference call, so please listen if interested.

As summer heats up, we hope you have a fun time with all of your summer traditions and "must do's". We'll be watching markets and



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Pay Down Debt or Save and Invest?



Should you pay off debt or should you save and invest? To find out, compare what rate of return you can earn on your investments versus the interest rate on the debt. There may be other factors that you should consider as well.

There are certainly a variety of strategies for paying off debt, many of which can reduce how long it will take to pay off the debt and the total interest paid. But should you pay off the debt? Or should you save and invest? To find out, compare what rate of return you can earn on your investments versus the interest rate on the debt. There may be other factors that you should consider as well.

Rate of return on investments versus interest rate on debt

Probably the most common factor used to decide whether to pay off debt or to make investments is to consider whether you could earn a higher after-tax rate of return on the investments than the after-tax interest rate on the debt if you were to invest your money instead of using it to pay off the debt.

For example, say you have a credit card with a \$10,000 balance on which you pay nondeductible interest of 18%. You would generally need to earn an after-tax rate of return greater than 18% to consider making an investment rather than paying off the debt. So, if you have \$10,000 available to invest or pay off debt and the outlook for earning an after-tax rate of return greater than 18% isn't good, it may be better to pay off the debt than to make an investment.

On the other hand, say you have a mortgage with a \$10,000 balance on which you pay deductible interest of 6%. If your income tax rate is 28%, your after-tax cost for the mortgage is only 4.32% ($6\% \times (1 - 28\%)$). You would generally need to earn an after-tax rate of return greater than 4.32% to consider making an investment rather than paying off the debt. So, if you have \$10,000 available to invest or pay off debt and the outlook for earning an after-tax rate of return greater than 4.32% is good, it may be better to invest the \$10,000 rather than using it to pay off the debt.

Of course, it isn't an all-or-nothing choice. It may be useful to apply a strategy of paying off debts with high interest rates first, and then investing when you have a good opportunity to make investments that may earn a higher after-tax rate of return than the after-tax interest rate on the debts remaining.

Say, for example, you have a credit card with a \$10,000 balance on which you pay 18% nondeductible interest. You also have a mortgage with a \$10,000 balance on which you

pay deductible interest of 6%, and your tax rate is 28%. So, if you have \$20,000 available to invest or pay off debt, it may make sense to pay off the credit card with \$10,000 and invest the remaining \$10,000.

When investing, keep in mind that, in general, the higher the rate of return, the greater the risk, which can include the loss of principal. If you make investments rather than pay off debt and your investments incur losses, you may still have debts to pay, but will you have the money needed to pay them?

Some other considerations

When deciding whether to pay down debt or to save and invest, you might also consider the following.

- What are the terms of your debt? Are there any penalties for prepayment?
- Do you actually have money that you could invest? Most debts have minimum payments that must be paid each month. Failure to make the minimum payment can result in penalties, increased interest rates, and default. Are your funds needed to make those payments?
- How much debt do you have? Is it a problem? How do you feel about debt? Is it something you can easily live with or does it make you uncomfortable?
- If you say you will save the money, will you really invest it or will you spend it? If you pay off the debt, you will have assured instant savings by eliminating the need to come up with the money needed to pay the interest on the debt.
- Would you be able to borrow an additional amount, if needed, and at what interest rate, if you paid off current debt? Do you have an emergency fund, or other source of funds, that could be used if you lose your job or have a medical emergency, or would you have to borrow?
- If your employer matches your contributions in a 401(k) plan, you should generally invest in the 401(k) to get the matching contribution. For example, if your employer matches 50% of your contributions up to 6% in a 401(k) plan, getting the 50% match is like getting an instant 50% return on your contribution. In addition, there are tax advantages to investing in a 401(k) plan.

Of Taxes Past, Present, and Future



Qualified charitable distributions

A popular provision allowing individuals age 70½ or older to make qualified charitable distributions of up to \$100,000 from an IRA directly to a qualified charity expired at the end of 2011. These charitable distributions were excluded from income, and counted towards satisfying any required minimum distributions that you would have had to take from your IRA for the year.

Return of the "marriage penalty"?

Tax changes that were originally made to address a perceived "marriage penalty" expire at the end of 2012. If you're married and file a joint return with your spouse, you'll see the effect in the form of a reduced 2013 standard deduction amount, as well as in lower 2013 tax bracket thresholds in the tax rate tables (i.e., couples move into higher rate brackets at lower levels of income).

With the 2011 tax filing season behind us, much attention is being paid to the expiring "Bush tax cuts"--the reduced federal income tax rates, and benefits, that will expire at the end of 2012 unless additional legislation is passed. In fact, though, several important federal income tax provisions already expired at the end of 2011. Here's a quick rundown of where things stand today.

What's already expired?

A series of temporary legislative "patches" over the last several years has prevented a dramatic increase in the number of individuals subject to the alternative minimum tax (AMT)--essentially a parallel federal income tax system with its own rates and rules. The last such patch expired at the end of 2011. Unless new legislation is passed, your odds of being caught in the AMT net greatly increase in 2012, because AMT exemption amounts will be significantly lower, and you won't be able to offset the AMT with most nonrefundable personal tax credits.

Other provisions that have already expired:

- **Bonus depreciation and IRC Section 179 expense limits**-- If you're a small business owner or self-employed individual, you were allowed a first-year depreciation deduction of 100% of the cost of qualifying property acquired and placed in service during 2011; this "bonus" depreciation drops to 50% for property acquired and placed in service during 2012, and disappears altogether in 2013. For 2011, the maximum amount that you could expense under IRC Section 179 was \$500,000; in 2012, the maximum is \$139,000; and in 2013, the maximum will be \$25,000.
- **State and local sales tax**-- If you itemize your deductions, 2011 was the last tax year for which you could elect to deduct state and local general sales tax in lieu of state and local income tax.
- **Education deductions**-- The above-the-line deduction (maximum \$4,000 deduction) for qualified higher education expenses, and the above-the-line deduction for up to \$250 of out-of-pocket classroom expenses paid by education professionals both expired at the end of 2011.

What's expiring at the end of 2012?

After December 31, 2012, we're scheduled to go from six federal tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) to five (15%, 28%, 31%, 36%, and 39.6%). The rates that apply to long-term capital gains and dividends will change as well. Currently, long-term capital

gains are generally taxed at a maximum rate of 15%. And, if you're in the 10% or 15% marginal income tax bracket, a special 0% rate generally applies. Starting in 2013, however, the maximum rate on long-term capital gains will generally increase to 20%, with a 10% rate applying to those in the lowest (15%) tax bracket (though slightly lower rates might apply to qualifying property held for five or more years). And while the current lower long-term capital gain rates now apply to qualifying dividends, starting in 2013, dividends will be taxed at ordinary income tax rates.

Other provisions expiring at the end of the year:

- **2% payroll tax reduction**-- The recently extended 2% reduction in the Social Security portion of the Federal Insurance Contributions Act (FICA) payroll tax expires at the end of 2012.
- **Itemized deductions and personal exemptions**-- Beginning in 2013, itemized deductions and personal and dependency exemptions will once again be phased out for individuals with high adjusted gross incomes (AGIs).
- **Tax credits and deductions**-- The earned income tax credit, the child tax credit, and the American Opportunity (Hope) tax credit revert to old, lower limits and (less generous) rules of application. Also gone in 2013 is the ability to deduct interest on student loans after the first 60 months of repayment.

New Medicare taxes in 2013

New Medicare taxes created by the health-care reform legislation passed in 2010 take effect in just a few short months. Beginning in 2013, the hospital insurance (HI) portion of the payroll tax--commonly referred to as the Medicare portion--increases by 0.9% for high-wage individuals. Also beginning in 2013, a new 3.8% Medicare contribution tax is imposed on the unearned income of high-income individuals.

Who is affected? The 0.9% payroll tax increase affects those with wages exceeding \$200,000 (\$250,000 for married couples filing a joint federal income tax return, and \$125,000 for married individuals filing separately). The 3.8% contribution tax on unearned income generally applies to the net investment income of individuals with modified adjusted gross income that exceeds \$200,000 (\$250,000 for married couples filing a joint federal income tax return, and \$125,000 for married individuals filing separately).

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Can I convert my traditional IRA to a Roth IRA in 2012?

It may be an excellent time to consider converting your traditional IRA to a Roth IRA. As a result of market volatility, some investors have seen a

reduction in the value of their traditional IRAs, meaning that the tax cost of converting may have dropped significantly. Also, federal income tax rates are scheduled to increase in 2013, so converting this year may be "cheaper" than converting next year.

Anyone can convert a traditional IRA to a Roth IRA in 2012. There are no longer any income limits, or restrictions based on your tax filing status. You generally have to include the amount you convert in your gross income for the year of conversion, but any nondeductible contributions you've made to your traditional IRA won't be taxed when you convert. (You can also convert SEP IRAs, and SIMPLE IRAs that are at least two years old, to Roth IRAs.)

Converting is easy. You simply notify your existing IRA provider that you want to convert all or part of your traditional IRA to a Roth IRA, and they'll provide you with the necessary paperwork to complete. You can also transfer or roll your traditional IRA assets over to a new

IRA provider, and complete the conversion there.

If a conversion ends up not making sense (for example, the value of your Roth IRA declines after the conversion), you'll have until October 15, 2013, to "recharacterize" (i.e., undo) the conversion. You'll be treated for federal income tax purposes as if the conversion never occurred, and you'll avoid paying taxes on the value of IRA assets that no longer exist.

The conversion rules can also be used to allow you to contribute to a Roth IRA in 2012 if you wouldn't otherwise be able to make a regular annual contribution because of the income limits. (In 2012, you can't contribute to a Roth IRA if you earn \$183,000 or more and are married filing jointly, or if you're single and earn \$125,000 or more.) You can simply make a nondeductible contribution to a traditional IRA, and then convert that traditional IRA to a Roth IRA. (Keep in mind, however, that you'll need to aggregate the value of all your traditional IRAs when you calculate the tax on the conversion.) You can contribute up to \$5,000 to an IRA in 2012, \$6,000 if you're 50 or older.



Can I undo my Roth IRA conversion?

When you convert a traditional IRA to a Roth IRA, you include the value of your traditional IRA, reduced by any nondeductible contributions

you've made, in income for federal tax purposes in the year of the conversion. But what happens if the value of your Roth IRA subsequently declines, making the conversion a bad deal from a tax perspective? No problem. The IRS lets you recharacterize (undo) a conversion, if you act in a timely fashion.

For example, assume you convert a fully taxable traditional IRA worth \$50,000 to a Roth IRA in 2012. You include \$50,000 in income on your 2012 federal income tax return. But shortly after the conversion, the value of your Roth IRA declines to \$25,000. Now you're suddenly faced with the proposition of paying taxes on \$50,000, while your Roth IRA is worth only \$25,000.

All is not lost—because of the recharacterization rules, you have until your tax return due date (including extensions) to undo all or part of a conversion if it no longer makes good financial sense. So in this example, you have until October 15, 2013, to recharacterize. (Similarly,

if your conversion occurred in 2011, you have until October 15, 2012, to undo the conversion.)

When you recharacterize, you need to withdraw the amount you originally converted, plus any earnings, out of the Roth IRA and transfer it back to a traditional IRA. To simplify the calculation of earnings if you decide to recharacterize, you should consider using a new Roth IRA for each conversion. You might also consider using a different Roth IRA for each separate investment, or class of investments, you plan to make—this way, if one investment goes down but another goes up, you can recharacterize only the Roth IRA that declined in value (you don't need to aggregate your Roth IRAs for this purpose). If you wish, you can always combine Roth IRAs later after the recharacterization deadline passes.

If you convert a traditional IRA to a Roth IRA in 2012 and then recharacterize, you'll have to wait until January 1, 2013, to reconvert those same dollars (and any earnings) to a Roth (or, if later, the 31st day following the recharacterization). However, any other traditional IRA dollars you have can be converted to a Roth IRA without restriction.