

What to do for clients now and next year

With higher rates looming, it's time to consider Roths, GRATs and loss harvesting

By Robert N. Gordon

November 8, 2009

The following is an edited transcript of an Oct. 20 webcast, Tax planning: What to do for clients now and in 2010. InvestmentNews Editor Jim Pavia and Deputy Editor Frederick P. Gabriel Jr. were the moderators.

InvestmentNews: With taxes front and center in everyone's minds, what should advisers be telling their clients?

Mr. Gordon: Let's be clear that the increasing tax rates that everybody has been talking about actually wouldn't kick in until 2011, whether it be the 39% top tax rate or the 20% long-term gains rate. And I think there is some confusion in the marketplace about that. Once we know what's going to be happening with the tax rates, 2010 is really a very big year to be making some decisions on whether you should be accelerating your income or deferring income. Then there is a whole new group of clients that are allowed to do Roth conversions, so there are issues around whether they should be doing it and what the math is.

InvestmentNews: A lot of people are skeptical of Roth conversions, aren't they?



Mr. Horn: Since we don't know what the tax rate is going to be in the future, people say, "Well, my rates are going to be lower" am I going to gain any benefit on this? Maybe Congress will defer required minimum distributions for another few years for people who already are taking them.

So there are a lot of questions about whether it's worth it to pay a big tax bill upfront. What we're telling people to do is, unless you can pay the tax out of other funds, meaning not the money that's in the IRA, it probably isn't going to make sense.

Mr. Gordon: If you had a \$1 million IRA, and you turned it into a Roth and paid the \$350,000 tax out of the regular IRA, mathematically, if tax rates stay where they are, you get absolutely nowhere. It would all work out to the same number.

If you took the money out of your own pocket, the government would say, "You have a \$1 million IRA that, after taxes, is \$650,000. We are giving you the opportunity to throw \$350,000 into a Roth IRA that will be totally tax-free."

The real opportunity is to throw an extra \$350,000 into that Roth. Not taking advantage of that is giving up one of the largest benefits. Paying the money out of your own pocket, if you believe tax rates will be up in the future, would be an advantage.

InvestmentNews: If you do a Roth conversion in 2010, can you claim some of the income in 2010 and also split the remainder in 2011 and 2012?

Mr. Neuschwander: By default, if you do the conversion in 2010, it will be split fifty/fifty in 2011 and 2012. You can elect to pay all of the tax on a conversion in 2010.

Mr. Horn: This is the first that we've heard of somebody suggesting that if you did two separate conversions, you might be able to pay one in 2010 and defer the other one to 2011 and 2012.

Mr. Gordon: But for each conversion, you either have to choose 2010, or half in 2011 and half in 2012. Let's just talk about the math of that. I think most people might be better off choosing 2010, believing that in 2011 there's going to be tax of 39.6%.

If you do the math, if you didn't pay the tax in 2010, you would have 35 cents of every dollar to invest for another year.

Now you say, "But if I hold on to that money for another year, my tax goes from 35% to 39.6%." So I think the 4.96 [percentage points] of the extra tax, and divided by the 35 I get to keep, tells me I'm going to make 14% on my money. I don't think anybody is planning on making 14% on their money. So I think that the average person is going to be better off taking it in 2010, even though the natural behavior would be to put it off as far as you could.

Mr. Horn: One more key thing you need to look at on this is the state tax consequences. In New York, we now have this millionaire's tax, where at a certain level you lose the graduated benefit, you lose your itemized deductions, and you're paying just a flat rate of 9% statewide and close to 5% in the city. So in that case, it may make more sense to split it over the two years, if it keeps you below a state bracket. With respect to your 14%, you might only need to make 7% when you take the state tax effect in.

InvestmentNews: Can a Roth conversion be done for a client past the age of 70 1/2 with no earned income?

Mr. Horn: To the best of my knowledge, there is no age limitation in starting.

Mr. Gordon: Just to make it clear, this is an action for 2010, but it's got to be dealt with now because the optimum moment to do the Roth conversion would be the first day of the year. I think some people aren't familiar with this concept of re-characterization, but if you had a \$1 million IRA and you turned it into a Roth IRA, and you were ready to pay the \$350,000 in taxes, but somehow you only had

\$400,000 left in your Roth, you might say, "This is crazy. I am paying a big tax that's only worth \$400,000."

You are actually allowed to say, "I made a mistake. I want to re-characterize it and put it back to a regular IRA like nothing ever happened." What's odd about that is the government gives you until you file your tax return for that year. So in a perfect world, if you converted on Jan. 3, and you extended your tax return in 2011, you'd actually have until Oct. 15, 2011, to look back, see how it was doing and re-characterize it or not.

If you converted the Roth on Dec. 15, then you turned the 20-month window into a nine-month window.

Mr. Neuschwander: I completely agree.

Practitioners do a disservice to their clients if in the year that there is a Roth conversion, that tax return for that particular year is not extended all the way to Oct. 15.

That is malpractice in my view, just because it does give you all the way to Oct. 15 to consider the re-characterization.

The thing that needs to be made known about that is, even though you file an extension, you still have to make a decision by April 15 on how you're actually going to pay the tax. If you're going to pay all the tax in 2010, you're going to have that hard discussion with your CPA around April 15, so you can make sure that you pay a proper amount of tax. If you make that decision as of Oct. 15, you could find yourself paying some interest and penalties.

Mr. Gordon: There are certain places in the tax code where they don't give you 12 months, they give you the calendar year, and this is one of those situations.

The other one involves clients that exercise incentive stock options. They have an alternative-minimum tax to pay unless they dispose of the stock that they purchased in the same calendar year. So it's the same thing. The only day to exercise an incentive stock option is Jan. 3. It gives you the full year to say, "Gee, the stocks are down. I'm going to get rid of it and not get hit with the AMT."

We all know the horror stories of the secretary of some Silicon Valley executive who wound up having an alternative-minimum tax that was worth more than the stock and had to declare bankruptcy.

It can be prevented, but it has to do with timing. We've updated our list of what you do on Jan. 3, from not only exercising [incentive stock options] if you're going to exercise them that year, to doing the Roth conversion.

Mr. Horn: The talk about re-characterization reminds me of clients who might have had a required minimum distribution taken out, perhaps automatically.

The IRS has given people until the later of either Nov. 30 or 60 days after it has been taken out to put it back in without any consequence this year. Some people have had it automatically come out, and they really don't need the money and they'd like to not have to pay the tax. So that's something that you can be looking at with your clients who are over 70 1/2.

InvestmentNews: So what is the key consideration in deciding whether to convert to a Roth?

Mr. Gordon: It's very important to be able to pay the tax out of your pocket, not depleting the IRA.

Mr. Neuschwander: I agree completely. The second point is, what tax bracket you're in now and what crystal ball you have to anticipate what tax bracket you're going to be in when you need to pull the money out. Those two go hand in hand.

If you look at where tax rates were and where they are now when I started working, investment income was taxed at 70% and it had just come down from 90%.

Although that sounds absolutely impossible to people you might speak to today, those really were the rates, and one wonders why anybody would continue to live in United States with a 90% tax rate. Now taxes are as low as they've ever been. Add on the reality that we're printing money to fix all these problems and sooner or later, it's got to come back.

Maybe it will be in the mid-50s, but I don't think there's going to be a time in my life that the tax rates are going to be much lower than they are now.

InvestmentNews: Do you think they are ever going to be as high as 90% again?

Mr. Gordon: There certainly seems to be a political push to tax the rich, and I don't think there is any sympathy given there, so who knows?

Mr. Horn: On the 90%, I don't think we're going to see that, but when you throw in Social Security taxes and state taxes and things like that and the effective sales tax, I think we can be looking at 75% or 80% total tax rates in some of the high-tax states in the next few years. As far as the Roth IRA conversion, the question isn't, "Should somebody be doing it?" but, "How much of their IRA should be doing it?"

InvestmentNews: They can do portions, right?

Mr. Horn: Yes. For some people, it may make sense just to do 10% or 15%, just to get a little bit of that money put aside. Besides the benefit of it growing, there's the benefit of that money, when your heirs inherit it, being tax-free to them as well.

Mr. Gordon: The main issue is that the money should come out of your own pocket, not out of the IRA. The next question is, are you well-off enough that you're going to die holding the Roth IRA. If you are, then there are great estate tax benefits, because using the \$1 million IRA example from before the \$350,000 you paid in tax reduced your estate, so you just reduced how much you have to pay in estate taxes. Then whatever that's in the Roth actually gets passed through to the kids tax-free and without any estate tax.

Mr. Neuschwander: In terms of taking the money out of the IRA to actually pay for the tax, you also have to look at the age of the taxpayer. If that taxpayer is under the age of 59½ and they don't have the cash to pay it and it's going to come out of the IRA, they also have to pay the 10% early-withdrawal penalty, so that even makes that scenario even worse.

InvestmentNews: Can you convert a Keogh to a Roth IRA?

Mr. Horn: I'm pretty sure that the new rules let you convert any kind of retirement account to an IRA, as long as the plan documents allow it.

Mr. Neuschwander: It used to be that you had to go from a 401(k) to a traditional to a Roth, but that's been changed wherein now you can go straight from a 401(k) to a Roth, so I don't see any issue in doing that.

InvestmentNews: Where can people get more information about Roth IRA conversions, either to read about it or online?

Mr. Gordon: There is a lawyer in Pittsburgh named James Lange who seems to spend a lot of time with this.

One of the ideas I got from looking at his information was this concept of multiple Roths. If you literally were going to buy, let's say, five different stocks and put them in one Roth, and at the end you broke even, that's not horrible. But if you put it into five different Roth IRAs, and you left the Roth IRAs that went up converted, and you re-characterized the ones that went down, it's a great opportunity.

When you come up to January of the next year, you could actually reconvert the ones that you re-characterized. I think that it was there that I saw this idea. Just as if you were going to do a grantor retained annuity trust, you would be better off having multiple GRATs. That same concept is here. I think James Lange has some of the best information out there. The other person that I've relied on a lot is Bob Keebler. He is at a firm in Milwaukee called Baker Tilly. These are the guys that I find to be the thought leaders in this space.

InvestmentNews: There was an article in The Wall Street Journal about Roth conversions, which had links to a couple of online calculators that can help you start to try to run some numbers for your clients.

Mr. Gordon: Right, but the calculators aren't going to deal with what it does to your state taxes. Or, as an example, miscellaneous itemized deductions are only deductible if they are more than 3% of your adjusted gross income. So, how does increasing your adjusted gross income affect that?

Mr. Neuschwander: Another plus for doing the conversion comes when you need to take the money out at retirement.

As of right now, with the traditional IRA, when you take the money out, it's taxable. But taking that money out can actually result in some of your Social Security distribution becoming taxable at up to 85%. But if you do a Roth, you never pay tax on it again. Therefore you don't have any potential other taxable income, so your Social Security is not taxable either.

InvestmentNews: If a client obtains his or her stock from a mutual fund company that went public with a zero basis, can it be sold in 2009 or 2010 without tax consequences if the client is in the 15%-or-lower tax bracket?

Mr. Gordon: Yes.

InvestmentNews: What are the other big issues in tax planning right now, besides Roth conversions?



Robert Gordon

Mr. Gordon: We are in the season where people should be looking at loss harvesting.

Look at your portfolio, look at what stocks are underwater on an unrealized basis. A large body of knowledge tells you that taking those losses, whether you use them currently or bank them for the future, makes a lot of sense. What we think is the “as close to perfect transaction” is a double-up transaction.

Because of the way the dates and the rules work, that trade actually has to be made before Thanksgiving, so you have 31 days in this year before you take your loss. Unfortunately, most people don't focus on loss harvesting until December something. It's sort of too late to do the optimum trade. Either you don't do anything, or you do something that isn't perfect. Again, it's one more thing to focus on now, to act in the window that you need. Our preferred strategy for harvesting losses is a doubling-up type strategy. What happens is that if you had a loss of a thousand shares, you are buying another thousand shares representing that. Then you have to hold both of those to 31 days and then sell one for a loss.

Mr. Neuschwander: Bob is referring to wash-sale rules that apply to positions sold at a loss that were acquired 30 days before or 30 days after. It's just to remind everyone of [IRS Revenue Ruling] 2008-5. Now you've got to really look at your positions that you are buying in your IRAs, because you could actually have a deferred wash sale if you were to buy that substantial identical security instead of your IRA.

Mr. Horn: People have such large losses carried forward from last year that some of them are asking me, “Does it make sense to take some short-term gains based on the market run-up now, lock those gains in without any tax consequences, and then just re-buy the stock?” And, of course, they can do it the same day.

Another issue right now that people don't normally stop to think about is the state tax consequences on things. This year, every day, I am getting notices from every state that they've raised their rates, they've increased their taxes, they are taxing new things, and decoupling from the federal.

California has decoupled on a couple of things in the last couple of weeks. When people are making decisions, everyone looks at the federal consequences. You need to really look at your state consequences as well, more than ever.

Mr. Gordon: Someone mentioned New York state earlier. Until now, if you made more than [\$500,000] a year, half-year deductions were thrown out the window.

But New York state passed this law that not only kicked the tax rate up but said if you made more than a \$1 million a year, none of your deductions are deductible in the state.

Mr. Horn: Actually, you get to keep half of your charitable.

Mr. Gordon: But the problem is that it compounds. If you wind up paying a giant state tax because of these issues, then you wind up in the AMT because you pay the giant state tax.

Mr. Horn: It's a state AMT that feeds to your federal AMT, and you get into a circle.

Mr. Gordon: So it's important to manage yourself. Let's say this year, you made more than a million, and next year, you made less than a million. Or if you thought you were going to do the conversion next year, and that is going to put you over the level, then somehow you stop taking income this year and push it into next year and make sure you are below one of those levels this year.

InvestmentNews: Is there any case for changing the composition of the IRA because it's a Roth?

Mr. Gordon: Beyond having multiple Roths that may move in different directions and would give you some advantage in terms of re-characterizing or not, I would think that earning behind the tax shield is the same whether it's deferred or tax-free in the future.

I've always felt that asset allocation is something to be looked at. Fixed income that has a reliable stream of income that takes advantage of the tax shield makes more sense to have in your own name than the equivalent of growth stocks.

If you are in a growth stock and you make money, and it's your own name, it's a long-term gain. If it were in your IRA, it would be taxable as ordinary income. If you had a growth stock and you lost money and it was in your own name, you would get a capital loss. If it were in your IRA or your Roth, you would get no benefit for the loss.

So speculative or volatile investments should be in your own name, and things that are throwing off a constant stream of taxable income should be taking advantage of a tax shield.

InvestmentNews: Is there any possibility that legislation will be put into place to allow people to defer taking their required minimum distribution another year, into 2011, and how likely is it that this legislation would pass?

Mr. Horn: I am going to say a 25% chance. It's an easier political decision, given the fact that there is no [cost-of-living adjustment] on Social Security. It would be looked at as, "Gee, we've got to do something for the seniors, so let's do this."

Mr. Neuschwander: That may be a little high. I don't see as much of a political need to do it as Jonathan does.

Mr. Gordon: I think the economic situation will probably dictate it more than anything.

InvestmentNews: What is going on in terms of legislation that is affecting tax planning today?

Mr. Gordon: There are two things that I think are really important. One is that the president's Green Book of proposed tax changes has this concept that deductions shouldn't be worth more to a rich person than to a lower-income person. And therefore, all deductions are going to be worth a maximum of 28 cents on the dollar.

So if that does go through, that's a new concept. I would think that people would be working as hard as they could to get as many deductions as they could get next year at 35%. Then the 28% is going to come after that.

The other thing that we are watching very closely is the health bill. The Senate health bill pays for itself through taxing what they are calling Cadillac health plans. The health plan still has this 5.4% surtax on rich people. And that would make a big difference because, on a proportion basis, it would really affect long-term gains and intercorporate dividends. If it were your ordinary income, it would go from 39.6% to 45%, which is not great, but is not a giant difference. So if that surtax went in, no one would be happy about it. It's really going to affect the people that get long-term gains and intercorporate dividends more than those who are just earning salary.

Mr. Horn: I'd add that qualified dividends may go away completely. That's a big revenue raiser that they are looking at.

In the Senate health bill, there is also the raising of the floor on medical from 7.5% to 10%, which would lower your itemized deductions even more.

And then there are the estate tax issues. Right now, estate tax goes away in 2010.

Although the odds of that happening are probably pretty small, something will get passed. Most likely, there will be a one-year extension, and Congress will just delay and delay again. But as part of that, Congress has started to take a look now at the GRATs, the grantor-retained annuity trusts, because they've become so popular with interest rates so low. It is looking at maybe limiting them. It's a gift tax. That's something you may want to be talking about getting set up now, while they are still available.

Mr. Gordon: I do a monthly column for InvestmentNews, and my last column said that if you are going to have to do a GRAT, do it now. One is because of the 3.2% rate, which is extremely low. In a GRAT, remember that everything you earn above that hurdle rate is what you move to the kids. The lower the hurdle rate, the better off you are. But in the president's Green Book is the proposal to stretch GRATs out to 10 years. Right now, they are usually two or three years, so that would severely impact their benefit as well.

So the message is, if you are ever going to do a GRAT, now is the time.

InvestmentNews: Do long-term stock option leaps qualify for long-term capital gains?

Mr. Gordon: Yes. Let's say that you were bearish on the market. The only thing I know that would get you a long-term gain is something you own, and the only thing you could own that's bearish is a put. So if you bought a 13-month put and you held it for the whole 13 months and it was profitable, it's a long-term gain. That's as long as it was not what is called the Section 1256 contract.

I think that's where a lot of people get caught up. An option on the S&P 500 index is actually mark-to-market at the end of the year under Section 1256. And that's not bad, because there is a tax trade-off for that. Right now, it would be a 23% tax rate, but you would not get long-term.

In our view, we think an option on an S&P 500 exchange-traded fund is taxed short-term and long-term. We think an S&P 500 option on the index is a Section 1256 contract. It's mark-to-market at the end of

year. So if you were going to speculate in the market for less than a year, I wouldn't buy the option on the index and get taxed at 23%. If I were going to buy an option and plan on holding it for more than a year, then I would buy it on the S&P 500 ETF in order to get a long-term gain.

It makes no sense that an option on the S&P 500 ETF and an option on the S&P 500 index are taxed differently, but they are.

Mr. Neuschwander: My firm has done the research on that as well, and I concur with your conclusion that there is a position for options on ETFs to get Section 1256.

Mr. Gordon: So to answer the question, a put on the S&P 500 index would not get long-term-gain [treatment] “these are just mark-to-market “ but one on the S&P 500 ETF would.

InvestmentNews: Can a non-spouse beneficiary convert an inherited IRA to a Roth IRA?



Jonathan Horn, CPA

Mr. Horn: I am not a 100% certain on it, but generally, you are extremely limited on what you can do with a non-spouse beneficiary.

Mr. Gordon: On the Jim Lange site, I believe I saw something that said that if you died and you hadn't done the conversion yet, that the heirs can elect to make the conversion. That's secondhand knowledge, but I believe that's what it said, and they were suggesting that you actually put it in your will.

InvestmentNews: An adviser writes, “I have a client who is required to take required minimum distributions from his 401(k) this year. His money is now in an IRA. Can he put that money back into the IRA by Nov. 30?”

Mr. Horn: If you've taken a required minimum distribution for 2009 that you are not required to take, because of the exemption this year, you can put it back by Nov. 30.

Mr. Neuschwander: I am not sure if that question was for a required minimum distribution, but there is the 60-day window, and if you take money out of an IRA, you can in essence put it back within 60 days of the distribution, and that's not a taxable event.

Mr. Horn: Right. And that applies in all cases.

InvestmentNews: If you want to convert a portion of an IRA into a Roth IRA, how do you decide what that portion is?

Mr. Gordon: I would think you don't just use one data point. Even if you wanted to convert the whole thing, it might make sense to do one-third of it for three years just to use three different entry points in the marketplace.

But I think trying to see what proportion is appropriate or not appropriate has something to do with whether you are going to leave this money to the kids or going to spend it, and how quickly it is going to go.

I saw a paper I thought was fairly interesting which said that if you converted to a Roth, one of the worst things that could happen would be to die soon after you couldn't re-characterize it anymore, because you paid upfront to be able to earn money tax-free over the years. This was from someone who actually got a patent; believe it or not, on coming up with the amount of life insurance you should buy in order to negate that risk.

Mr. Horn: You have to look at the question of how much, if you convert X amount, it is going to move you into another tax bracket.

Mr. Gordon: To the average person, it's going to make sense to convert all of it.

The only reason I'd step into it in smaller pieces is just so that you are not making one big decision at one moment.

InvestmentNews: Are clients nervous about this conversion? Are you finding resistance among clients when you recommend it to them?

Mr. Gordon: If I could say to the client, "Would you like to put \$350,000 away and never pay tax on it and have all the earnings tax-free, and pass through to your heirs tax-free?" then the answer is yes. And that's what the government is offering you.

The government is offering you the ability to stick more money into the Roth IRA from your taxable account.

Mr. Neuschwander: Well, here is the thing. That's what they are offering today. That may not be what they are offering in the future, and that's what some of the clients are unsure of. I can't make that guarantee, and no one can.

Mr. Gordon: There are people who say, "Gee, when I take the money out, maybe the government is going to be in so much trouble, they're going to decide it is taxable."

Mr. Neuschwander: Look at what happened to Social Security. That is a pretty good example of it.

Mr. Gordon: Right. So I don't know. I don't think anybody has a proper response to that.

InvestmentNews: How do you get past that argument with the client?

Mr. Gordon: Everybody keeps doing it believing they have a compact with the government, and they are not going to change the game halfway through.

Mr. Horn: One of the answers is, it's an investment decision you are making and it's no different than 10 years ago if you bought [General Motors Co.] stock and sold [Citigroup Inc.]. You don't know what's going to happen.

InvestmentNews: It's got to be a harder sell, especially after what we've just gone through. A lot of the people are a lot less wealthy than they were a few years ago.

Mr. Gordon: Right. But I think the point was that they did sort of change the deal on Social Security.

I would think making this stuff taxable later, after they made you pay taxes, sounds almost impossible. But as I said, anything is possible. If they've got enough of a budget deficit, I would be more than happy to bet anyone that tax rates are not going to be any lower during my lifetime.

Mr. Horn: What we just went through with the market is part of the argument why the Roth conversion makes sense now. It's just a lucky confluence that the ability to do it, no matter what your income, comes at a time when the assets are at their lowest level, or close to their lowest level, in years. So the tax is going to be the lowest it's going to be.

Mr. Gordon: That's why the people in the high-net-worth area like to look at GRATs. It's the exact same thing with multiple GRATs fund them when the things are low. All that same thinking just transfers right to the Roth conversion.

InvestmentNews: Do Treasury investment-protected securities make more sense in a Roth than they do in deferred accounts?

Mr. Gordon: I would think it's just six of one, half dozen of the other. In other words, TIPS are a pain because you've got to take this whole accrual thing. So having them in something that's tax-sheltered so you don't have to take in all that accrual is exactly the right place for them, beyond the fact that they are throwing off this predictable stream of taxable income that takes advantage of the tax shield.

I think they are just as attractive to both.

InvestmentNews: We've all been saying that taxes are going to increase. Where are those tax increases likely to come from?

Mr. Gordon: Ten years from now, when you are going to take the money out, there is a rate of return that you have to earn to make it worthwhile, because you're going to pay tax now at 35%, or you can pay tax then at 40% or 50% or whatever the number is. If you believe that a 50% number is reasonable 10 years from now, you'll see that you need about a 15% return on your money to have made that deferral worthwhile. And this is assuming no friction costs, no commissions, no insurance, no nothing just straight math.

So that's pretty scary. I don't think anybody wants to depend on a 15% earning rate, whereas a 50% tax rate sounds pretty reasonable.

You can go the other way and say, "Gee, I think I can make 8% a year or 10% a year" and then say, "OK, what kind of tax rate could it take?" It only takes about a 45% tax rate.

We could be there in 2011 if they stick in this 5.4% surtax or at least start taking in estate taxes. So I think the realization that taxes are going nowhere but up should really be making a major dent in deferred-annuity sales.

Mr. Horn: The good news is, I don't think that we're going to be talking about AMT as much in five years.

The bad news is, we're not going to be doing it, because your top brackets, not just the top two; I think the top three brackets are going to be all going up.

You're going to be losing your itemized deductions more and more. They're going to be reducing them either with the 25% cap or just taking them away.

So absolutely, rates are going up. Even if your bottom rates go up between earned-income credit, child tax credit and all these other credits, we're still going to be in a position where the lower 50% of the country is going to be paying zero tax. Will they be getting money back as many of them are now? Probably not, or not as much.

InvestmentNews: Can you claim a loss on a Section 529 plan if you close it?

Mr. Neuschwander: That's an itemized deduction subject to 2% of your adjusted gross income, but you may be subject to AMTs. Can you claim it? Yes. Will you actually receive benefit for it? Probably not.

InvestmentNews: If a client takes the loss with tax harvesting, could that then pay for a Roth IRA conversion if the client has less than \$100,000?

Mr. Gordon: No, capital losses don't go against ordinary income.

InvestmentNews: What steps can investors take now to position themselves for a better 2010?

Mr. Gordon: Analyzing all of the actions that you're going to have to make next year, and starting to talk about that right now, is the way to go.

The health bill is probably going to be the sooner part, so we'll know whether the 5.4% is happening or not. And then you've got to decide what you want to do with the Roth. And then next year, you've got to watch closely what happens with the tax rules.

Everybody thinks we're going to be 39.6% on the top rate and 20% on long-term gains. It could get worse. But I don't think anybody thinks it's going to get better. So I think you've got to sit down and say, "Gee, maybe there are things I want to sell and take my gain."

On the other hand, you've got to remember that right now, anyway, all gains are forgiven at death. So for a 40-year-old to take the gain might make sense.

For an 80-year-old to take the gain, it's not a matter of "pay the tax now or pay the tax later" it's "pay the tax now or hold it until you die and never pay the tax." These are all really big issues. And a lot of it is just math and understanding what the rules are.



Mr. Neuschwander: I think the key is for investors to use an investment adviser who also has a business relationship with a CPA. It's imperative for those two professionals to talk to each other with all the potential changes.

That investment adviser needs to know what's going on with that client's overall tax position. For example, that client may also be an owner of a closely held business that may be generating losses. If you've got a business that's generating ordinary losses, then that's a net operating loss potentially.

Darren Neuschwander, CPA

But you could use that loss to offset the tax that could potentially result from a conversion on a Roth IRA.

So it's imperative, with all of the potential changes that are going to take effect, that the adviser speak to the CPA and make sure that both of them are doing what's best for the client, who is the most important individual.

InvestmentNews: Is there often a disconnect between the adviser and the CPA in what they're telling their client?

Mr. Neuschwander: It's not necessarily a disconnect; it's just one's going one way and thinking this is the best strategy, which in turn has an adverse effect for something else that the CPA is planning. If the two just had a brief conversation, they could have done what's best overall for the client.

Mr. Horn: I'd like to really emphasize what Darren is talking about that the adviser and the CPA talking on a regular basis is so important.

Clearly, there are things that may be coming down the pike. Bob referred to the step-up at death on assets that's something that's actually being talked about as being eliminated in the estate tax provision. And that would make a huge difference in whether you are harvesting now or not.

Also, if you're in a limited-liability partnership that has a loss, even though you're a limited partner, you can take that loss now. It's not considered a passive loss anymore. You can take it against regular income. So that's a whole new place that you can get some losses to offset your income.

The big thing is, there are so many moving parts that you really have to look at each individual investment and know what you're going to do with that investment if X happened, if Y happened, if capital gain rates go up, if we go to 39.5%.

Because what you do with an appreciated stock, what you do with a stock that's paying high dividends, what you do with a bond that's maturing in three years or 20 years, it's going to be different for every single investment.

And that's where an adviser and a CPA can talk and the client can talk, and really make a plan now for each item.