
SMITH DENLINGER & CO., INC

Certified Public Accountants

Conversions to Roth IRA for 2010 and after

For years 2010 and after, you will be able to roll over amounts in regular IRAs and qualified employer sponsored retirement plan accounts, such as 401(k)s and profit sharing plans, into Roth IRAs, regardless of your adjusted gross income (AGI) or filing status. Previously, individuals with more than \$100,000 of adjusted gross income or married filing separately were barred from making such rollovers.

What's so attractive about a Roth IRA? Here's a summary:

- Earnings within the account are tax-sheltered (as they are with a regular qualified employer plan or IRA).
- Unlike a regular qualified employer plan or IRA, withdrawals from a Roth IRA aren't taxed if they are "qualified distributions". A "qualified distribution" is one which is made more than five years after a Roth was established **and** after the individual attains age 59 ½, made to a beneficiary after the individual's death, the individual becomes disabled, or the withdrawal was used to pay for qualified first-time homebuyer expenses.
- A Roth IRA owner does not have to take required minimum distributions (RMDs) after he or she reaches age 70 1/2 as is generally the case with regular qualified employer plans or IRAs.
- Beneficiaries of Roth IRAs also enjoy tax-sheltered earnings (as with a regular qualified employer plan or IRA) and tax-free withdrawals (unlike with a regular qualified employer plan or IRA). They do, however, have to commence regular withdrawals from a Roth IRA after the account owner dies.

Sounds too good to be true doesn't it? So what's the catch? Yes, there is a catch, and it's a big one. The rollover amount will be fully taxed. All of the earnings and all of the contributions that were deductible when contributed to the IRA or employer sponsored retirement plan are taxable when rolled over. Only the dollars that were not deductible, if any, when contributed are not taxable. For example, if you are in the 28% federal tax bracket and roll over \$100,000 from a regular IRA funded entirely with deductible dollars to a Roth IRA, you'll owe \$28,000 of federal tax (plus state tax if you are the resident of a state with a state income tax). So you'll be paying tax now for the future privilege of tax-free withdrawals, and freedom from the required minimum distribution rules.

Should you consider making the rollover to a Roth IRA? The answer may be "yes" if:

- ... You can pay the tax hit on the rollover with non-retirement-plan funds. Keep in mind that if you use retirement plan funds to pay the tax on the rollover, you'll have less money building up tax-free within the account.
- ... You anticipate paying taxes at a higher tax rate in the future than you are paying now. Many observers believe that tax rates for upper middle income and high income individuals will trend higher in future years.

... You have a number of years to go before you (or your beneficiaries) might have to tap into the Roth IRA. This will give you a chance to recoup (via tax-deferred earnings and tax-deferred payouts) the tax hit you absorb on the rollover.

... You are willing to pay a tax price now for the opportunity to pass on a source of tax-free income to your beneficiaries.

... If you have a taxable estate, your estate tax may be lowered by the amount of taxes paid now on the retirement income.

You also should know that Roth rollovers made in 2010 represent a novel tax deferral opportunity and a novel choice. If you make a rollover to a Roth IRA in 2010, the tax that you'll owe as a result of the rollover will be payable half in 2011 and half in 2012, unless you elect to pay the entire tax bill in 2010.

Why on earth would you choose to pay a tax bill in 2010 instead of deferring it to 2011 and 2012? Keep in mind that absent Congressional action, after 2010 the tax brackets above the 15% bracket will revert to their higher pre-2001 levels. That means the top four brackets will be 39.6%, 36%, 31%, and 28%, instead of the current top four brackets of 35%, 33%, 28%, and 25%. The Administration has proposed to increase taxes only for those making \$250,000, but it is difficult to predict who will get hit by higher rates. What's more, there's a health reform proposal before the House of Representatives right now that would help finance healthcare reform with a surtax on higher-income individuals.

So if you believe there's a strong chance your tax rates will go up after 2010, you may want to consider paying the tax on the Roth rollover in 2010.

There are many reasons to exercise great caution and to make your decision with due diligence. This decision is based on the tax laws as we know them today. No tax law is permanent and there is a possibility that your decision would be different if the tax laws change in the future. For example, the assumption that Roth IRAs will never be taxed could change in the future and some or all of the Roth IRA would be taxable, even if you comply with all of the rules in effect today.

This letter is written as a general description of the opportunity available. Please contact us so that we can review your specific situation and advise you accordingly.