

Welcome to FPA's Virtual Learning

We will begin today's program at 2:00 PM Eastern.

Advanced Roth Conversions in 2010

If you have joined this event early, we invite you to sit back, relax and learn about other upcoming FPA Educational Opportunities.

Thank you for your continued support of FPA and the Virtual Learning Center.

We hope you enjoy today's program.

About Today's Program:

While many professional advisers know about the basic rules of Roth IRAs, they do not understand the economic/tax intricacies associated with them. Unfortunately, the failure to understand the mathematical fundamentals of Roth IRAs can lead to making disastrous decisions. However, with a good working knowledge of the quantitative "forces" which drive Roth IRA conversions, professional advisers will be able to give cogent, straightforward advice to their clients.

Learn About

- Reasons for converting to a Roth IRA
- Mathematics of Roth IRA conversions
- Super advanced recharacterization plan
- "Stretch" Roth IRAs
- Using insurance to preserve post-death "stretch-out"
- Estate planning for Roth IRAs
- "Surtax Bubble" planning

Join FPA for these Upcoming VLC Events!

- Wednesday, July 14, 2010 (2-3 pm ET)

Resolving Legal and Financial Issues in Elder Care

Presented by: Chris Cooper, CFP®

VLC Track: Technical Knowledge

CFP CE: 1.0

- Thursday, July 22, 2010 (2-3 pm ET)

Fiduciary Ethos – The Link to Leadership Behaviors

Presented by: Don Trone

VLC Track: Sponsored Education / Practice Management

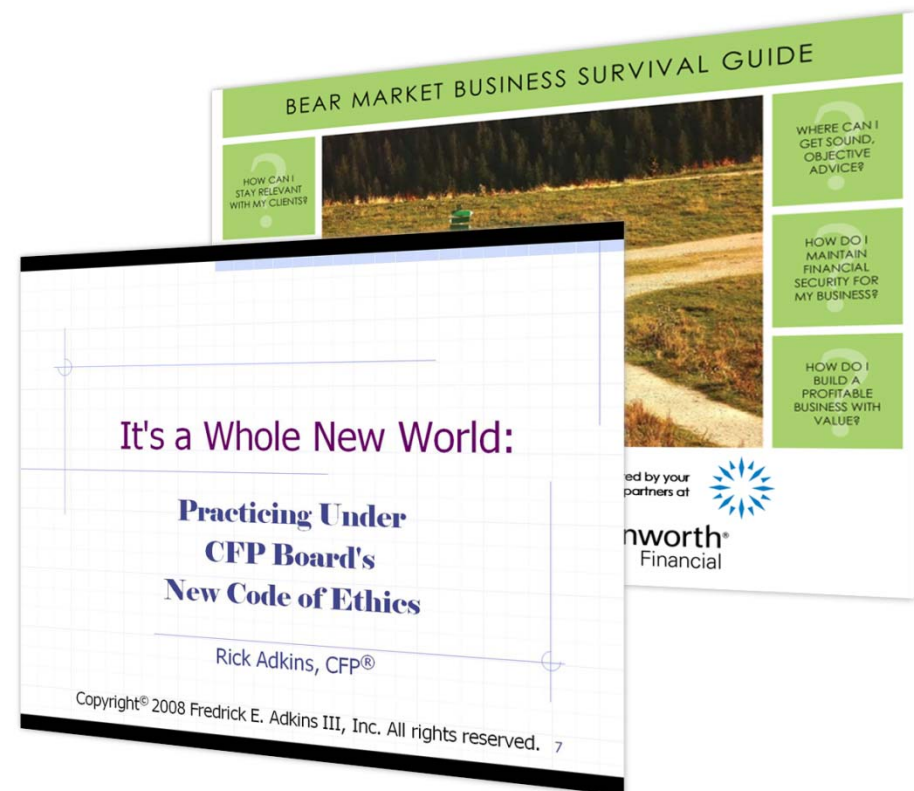
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Understanding Roth IRA Conversions in 2010

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Advanced Roth IRA Conversion Strategies

Overview



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- > ABCs of Roth IRAs
- > Reasons for converting to a Roth IRA
- > Mathematics of Roth IRA conversions
- > Recharacterizations
- > “Stretch” Roth IRAs
- > Using insurance to preserve post-death “stretch-out”
- > Integrating the estate tax
- > Integrating AMT
- > Integrating the new 3.8% health care surtax

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ABCs of Roth IRAs



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- > Starting in 2010, the \$100,000 Modified Adjusted Gross Income (MAGI) limitation no longer applies
 - > The taxable income recognized on a Roth IRA conversion in 2010 may be spread over the following two tax years (i.e. 2011 and 2012)
- > Married Filing Separately taxpayers can convert to a Roth IRA

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ABCs of Roth IRAs



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Convertible accounts

- > Traditional IRAs
- > 401(k) plans
- > Profit sharing plans
- > 403(b) annuity plans
- > 457 plans
- > “Inherited” 401(k) plans (see Notice 2008-30)

Non-convertible accounts

- > “Inherited” IRAs
- > Education IRAs

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Reasons to Convert to a Roth IRA



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- 1) Taxpayers have special favorable tax attributes including charitable deduction carry-forwards, investment tax credits, net operating losses (NOLs), high basis non-deductible traditional IRAs, etc.
- 2) Suspension of the minimum distribution rules at age 70½ provides a considerable advantage to the Roth IRA holder.
- 3) Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax.

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Reasons to Convert to a Roth IRA



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- 4) Taxpayers who can pay the income tax on the IRA from non IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields.
- 5) Taxpayers who need to use IRA assets to fund their Unified Credit bypass trust are well advised to consider making a Roth IRA election for that portion of their overall IRA funds.
- 6) Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates.

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Reasons to Convert to a Roth IRA



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- 7) Because federal tax brackets are more favorable for married couples filing joint returns than for single individuals, Roth IRA distributions won't cause an increase in tax rates for the surviving spouse when one spouse is deceased because the distributions are tax-free.
- 8) Post-death distributions to beneficiaries are tax-free.
- 9) Tax rates are expected to increase in the near future.
- 10) The new 3.8% Medicare surtax.

Advanced Roth IRA Conversion Strategies

“Missing” IRC §691(c) Deduction - Example



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| | <u>Traditional IRA</u> | <u>Roth IRA</u> |
|---|----------------------------|-------------------------|
| Gross estate | \$1,000,000 | \$1,000,000 |
| Less: Federal income tax on Roth IRA conversion @ 35% | - 0 | - 350,000 |
| Less: State income tax on Roth IRA conversion @ 5% | - 0 | - 50,000 |
| Taxable estate | \$1,000,000 | \$600,000 |
| | | |
| Federal estate tax @ 45% | \$450,000 | \$270,000 |
| State estate tax @ 10% | <u>100,000</u> | <u>60,000</u> |
| Total estate taxes | \$550,000 | \$330,000 |
| | | |
| Traditional IRA balance | \$1,000,000 | |
| Less: IRC Section 691(c) deduction | <u>- 450,000</u> | |
| Net taxable IRA balance | \$550,000 | |
| | | |
| Federal income tax IRA withdrawals @ 35% | \$192,500 | |
| State income tax on IRA withdrawals @ 5% | <u>27,500</u> | |
| Total income taxes on IRA withdrawals | \$220,000 | |
| | | |
| Net after-tax IRA balance to beneficiaries | <u>\$230,000</u> | <u>\$270,000</u> |

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Advanced Roth IRA Conversion Strategies

“Fading” IRC §691(c) Deduction – Example



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| | No Planning | Roth IRA Conversion @ Death |
|-------------------------------------|-------------------------|-----------------------------------|
| IRA balance @ death | \$1,000,000 | \$1,000,000 |
| Less: IRC Section 691(c) deduction | - 450,000 | - 450,000 |
| Net taxable Roth IRA conversion | <u>\$550,000</u> | <u>\$550,000</u> |
| | | |
| Federal income tax @ 35% | \$192,500 | \$192,500 |
| State income tax @ 5% | <u>27,500</u> | <u>27,500</u> |
| Total income tax | \$220,000 | \$220,000 |
| | | |
| Net to beneficiaries @ death | <u>\$780,000</u> | <u>\$780,000</u> |

Advanced Roth IRA Conversion Strategies

“Fading” IRC §691(c) Deduction – Example (cont.)



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| | No Planning | Roth IRA Conversion @ Death |
|---|---------------------------|-----------------------------------|
| IRA balance in 20 years | \$2,000,000 | \$1,560,000 |
| Less: IRC Section 691(c) deduction | - 450,000 | 0 |
| Net taxable IRA distribution | \$1,550,000 | \$1,560,000 |
| | | |
| Federal income tax @ 35% | \$542,500 | |
| State income tax @ 5% | 77,500 | |
| Total income tax | \$620,000 | |
| | | |
| Net to beneficiaries in 20 years | <u>\$1,380,000</u> | <u>\$1,560,000</u> |

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Advanced Roth IRA Conversion Strategies

Mathematics of Roth IRA Conversions



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In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:

- > The annual growth rates are the same
- > The tax rate in the conversion year is the same as the tax rate during the withdrawal years (i.e. $A \times B \times C = D$; $A \times C \times B = D$)

Advanced Roth IRA Conversion Strategies

Mathematics of Roth IRA Conversions



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| | <u>Traditional IRA</u> | <u>Roth IRA</u> | <u>Life Insurance</u> |
|--------------------------------------|------------------------|---------------------|-----------------------|
| 2010 Account Balance | \$ 1,000,000 | \$ 1,000,000 | \$ 1,000,000 |
| Less: Income Taxes @ 40% | - | (400,000) | (400,000) |
| Net Balance | \$ 1,000,000 | \$ 600,000 | \$ 600,000 |
| | | | |
| Growth Until Death | 200.00% | 200.00% | 200.00% |
| | | | |
| Account Balance @ Death | \$ 3,000,000 | \$ 1,800,000 | \$ 1,800,000 |
| Less: Income Taxes @ 40% | (1,200,000) | - | - |
| Net Account Balance to Family | \$ 1,800,000 | \$ 1,800,000 | \$ 1,800,000 |

Advanced Roth IRA Conversion Strategies

Mathematics of Roth IRA Conversions



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Critical decision factors

- > Tax rate differential (year of conversion vs. withdrawal years)
- > Use of “outside funds” to pay the income tax liability
- > Need for IRA funds to meet annual living expenses
- > Time horizon

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Mathematics of Roth IRA Conversions



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The key to successful Roth IRA conversions is to keep as much of the conversion income as possible in the current marginal tax bracket

- > However, there are times when it may make sense to convert more and go into higher tax brackets
- > Need to take into consideration the new 3.8% Medicare “surtax”
- > Need to take into consideration the impact of AMT

Advanced Roth IRA Conversion Strategies

Mathematics of Roth IRA Conversions



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2010 Tax Brackets

| | Single | Married Filing Jointly | Head of Household |
|-----|-------------|---------------------------|----------------------|
| 10% | \$8,375 | \$16,750 | \$11,950 |
| 15% | \$34,000 | \$68,000 | \$45,500 |
| 25% | \$82,400 | \$137,300 | \$117,650 |
| 28% | \$171,850 | \$209,250 | \$190,550 |
| 33% | \$373,650 | \$373,650 | \$373,650 |
| 35% | > \$373,650 | > \$373,650 | > \$373,650 |

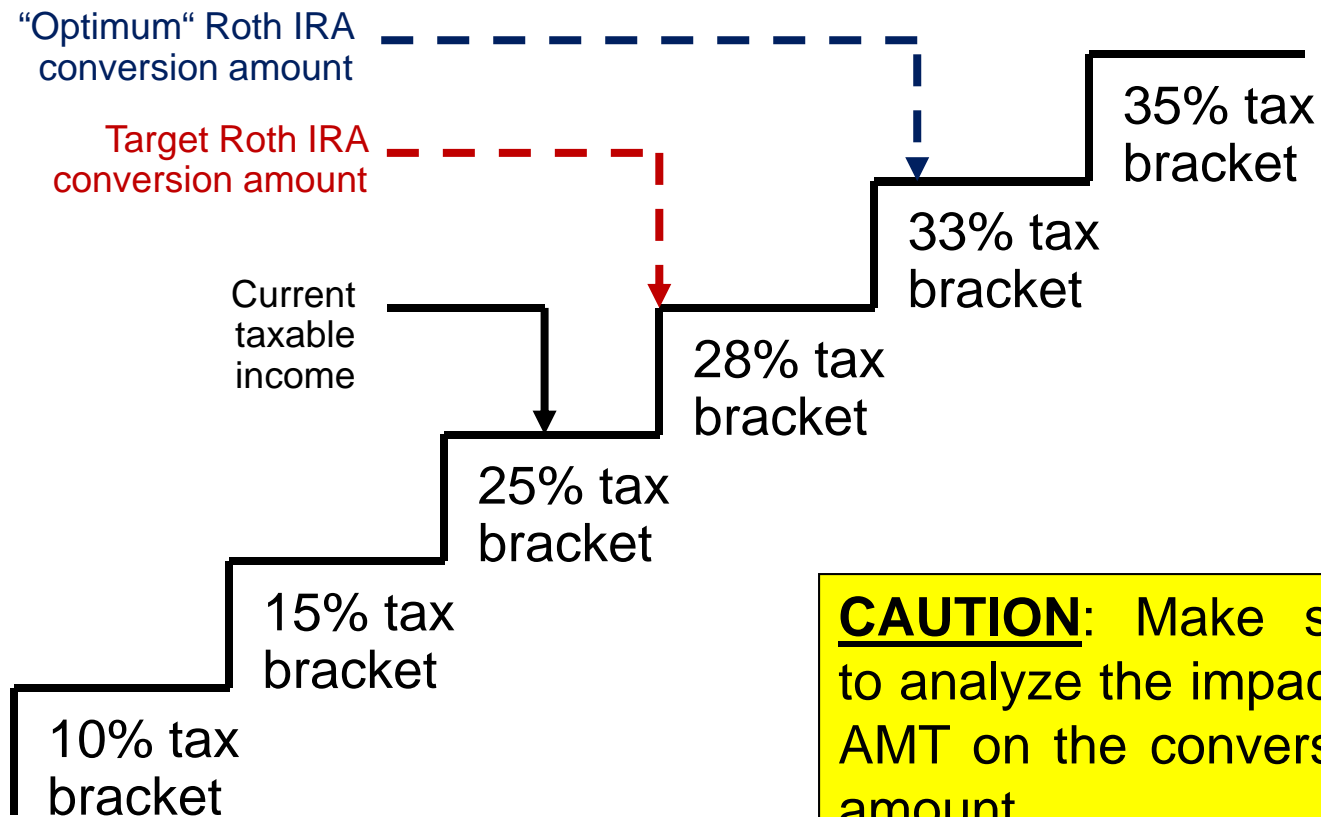
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Mathematics of Roth IRA Conversions



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CAUTION: Make sure to analyze the impact of AMT on the conversion amount

Advanced Roth IRA Conversion Strategies

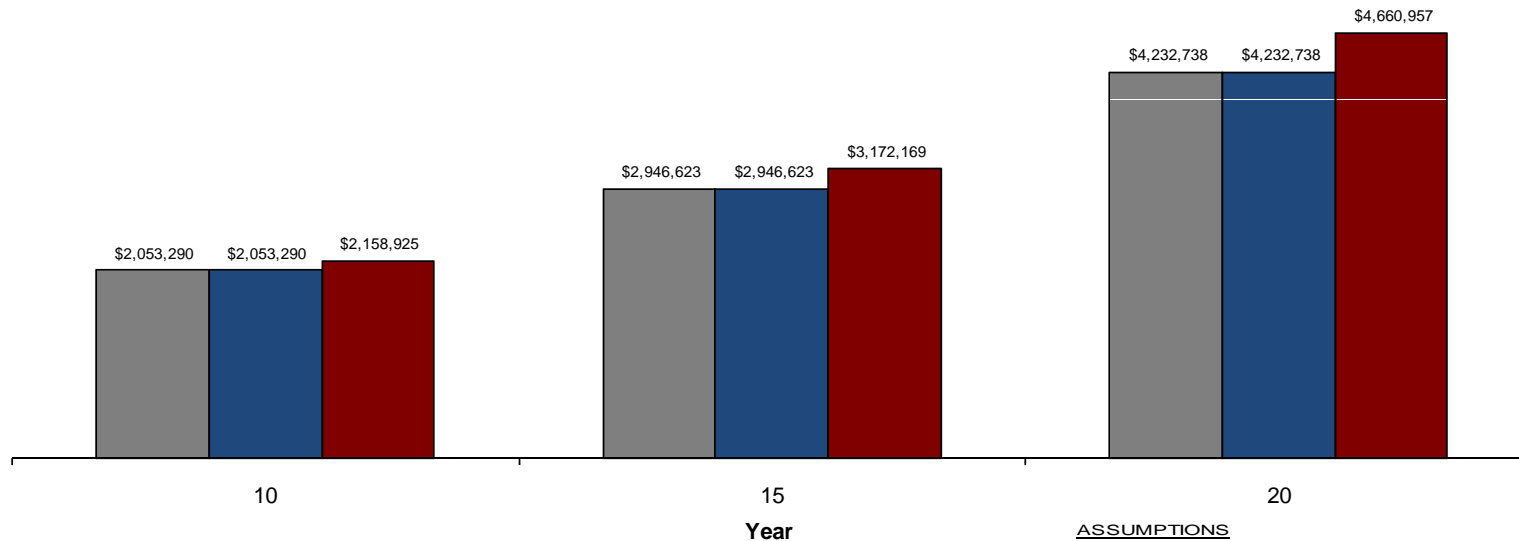
Mathematics of Roth IRA Conversions

Example #1 – 50-Year-Old IRA Owner



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After-Tax Investment Balance
(Tax Rates Remain the Same)



- Traditional IRA
- Roth IRA Conversion (Pay Tax w/Roth IRA)
- Roth IRA Conversion (Pay Tax w/Outside Account)

ASSUMPTIONS

| | |
|-----------------------------------|--------------|
| IRA Owner's Age | 50 |
| IRA Balance | \$ 1,000,000 |
| Outside Account Balance | \$ 400,000 |
| Yield Rate | 2.00% |
| Growth Rate | 6.00% |
| Total Return (Pre-Tax) | 8.00% |
| Less: Income Tax on Yield @ 40% | -0.80% |
| Less: Income Tax on Growth @ 20%* | -0.60% |
| Total Return (After-Tax) | 6.60% |
| Tax Rate - Current Year | 40.00% |
| Tax Rate - Future Years | 40.00% |

* Assumes 50% annual turnover on growth

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Advanced Roth IRA Conversion Strategies

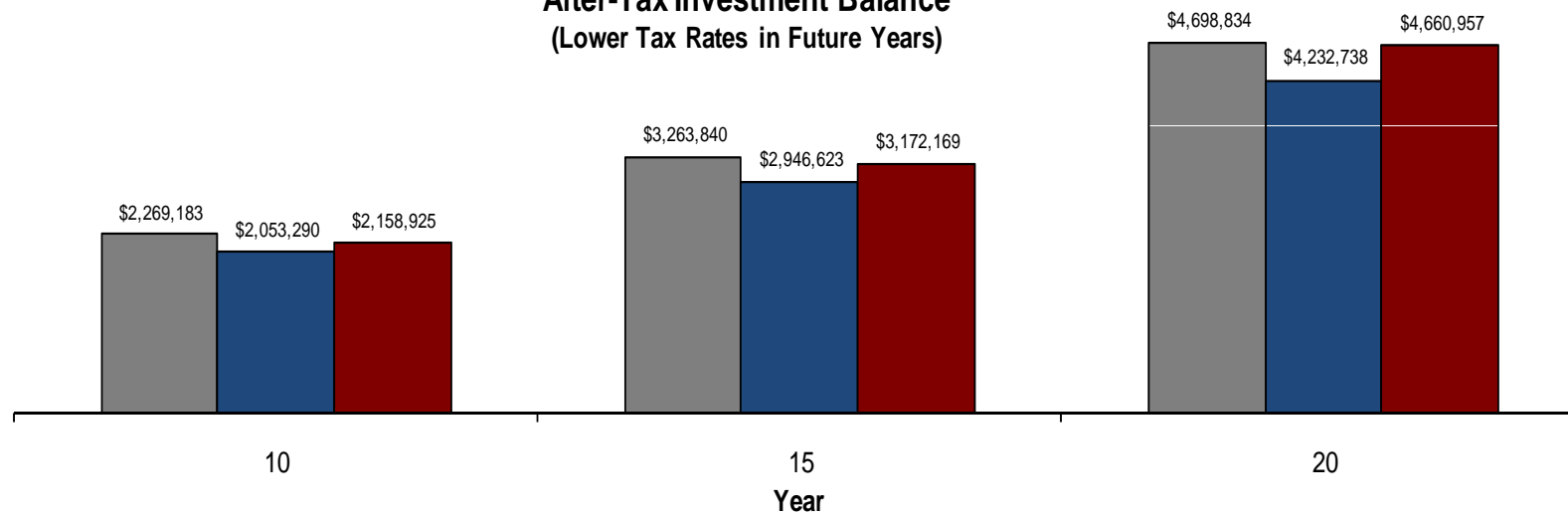
Mathematics of Roth IRA Conversions

Example #2 – 50-Year-Old IRA Owner



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**After-Tax Investment Balance
(Lower Tax Rates in Future Years)**



- Traditional IRA
- Roth IRA Conversion (Pay Tax w/Roth IRA)
- Roth IRA Conversion (Pay Tax w/Outside Account)

ASSUMPTIONS

| | |
|-----------------------------------|--------------|
| IRA Owner's Age | 50 |
| IRA Balance | \$ 1,000,000 |
| Outside Account Balance | \$ 400,000 |
| Yield Rate | 2.00% |
| Growth Rate | 6.00% |
| Total Return (Pre-Tax) | 8.00% |
| Less: Income Tax on Yield @ 40% | -0.80% |
| Less: Income Tax on Growth @ 20%* | -0.60% |
| Total Return (After-Tax) | 6.60% |
| Tax Rate - Current Year | 40.00% |
| Tax Rate - Future Years | 30.00% |

* Assumes 50% annual turnover on growth

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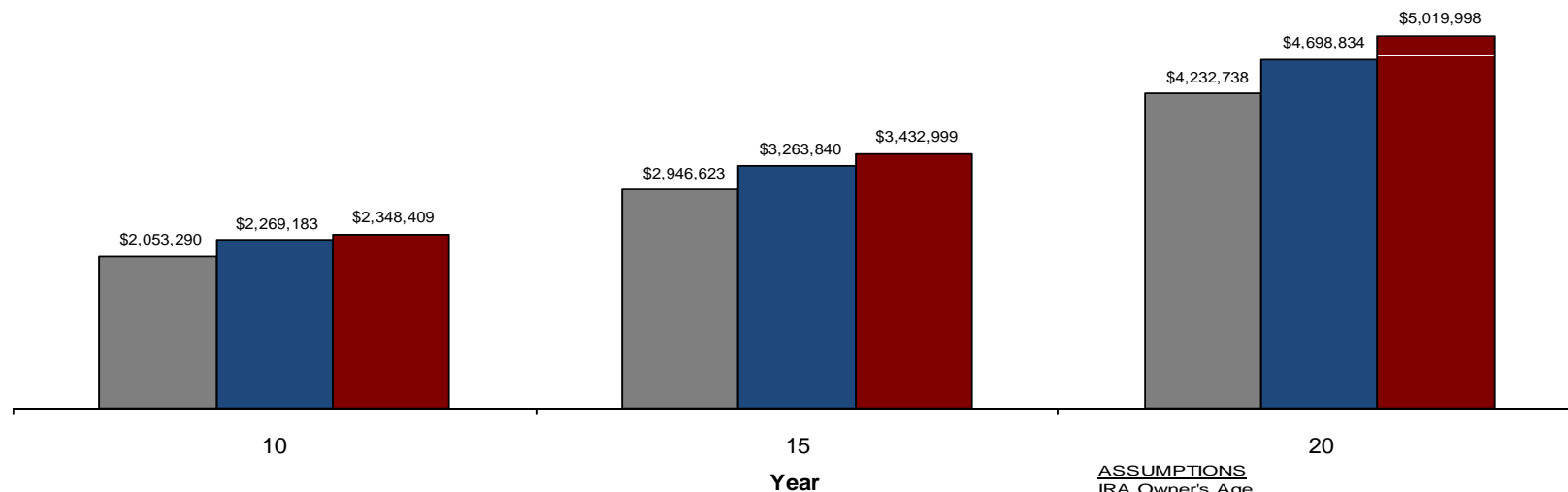
Mathematics of Roth IRA Conversions

Example #3 – 50-Year-Old IRA Owner



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After-Tax Investment Balance
(Higher Tax Rates in Future Years)



- Traditional IRA
- Roth IRA Conversion (Pay Tax w/Roth IRA)
- Roth IRA Conversion (Pay Tax w/Outside Account)

ASSUMPTIONS
IRA Owner's Age

| | |
|-----------------------------------|--------------|
| IRA Owner's Age | 50 |
| IRA Balance | \$ 1,000,000 |
| Outside Account Balance | \$ 400,000 |
| Yield Rate | 2.00% |
| Growth Rate | 6.00% |
| Total Return (Pre-Tax) | 8.00% |
| Less: Income Tax on Yield @ 40% | -0.80% |
| Less: Income Tax on Growth @ 20%* | -0.60% |
| Total Return (After-Tax) | 6.60% |
| Tax Rate - Current Year | 30.00% |
| Tax Rate - Future Years | 40.00% |

* Assumes 50% annual turnover on growth

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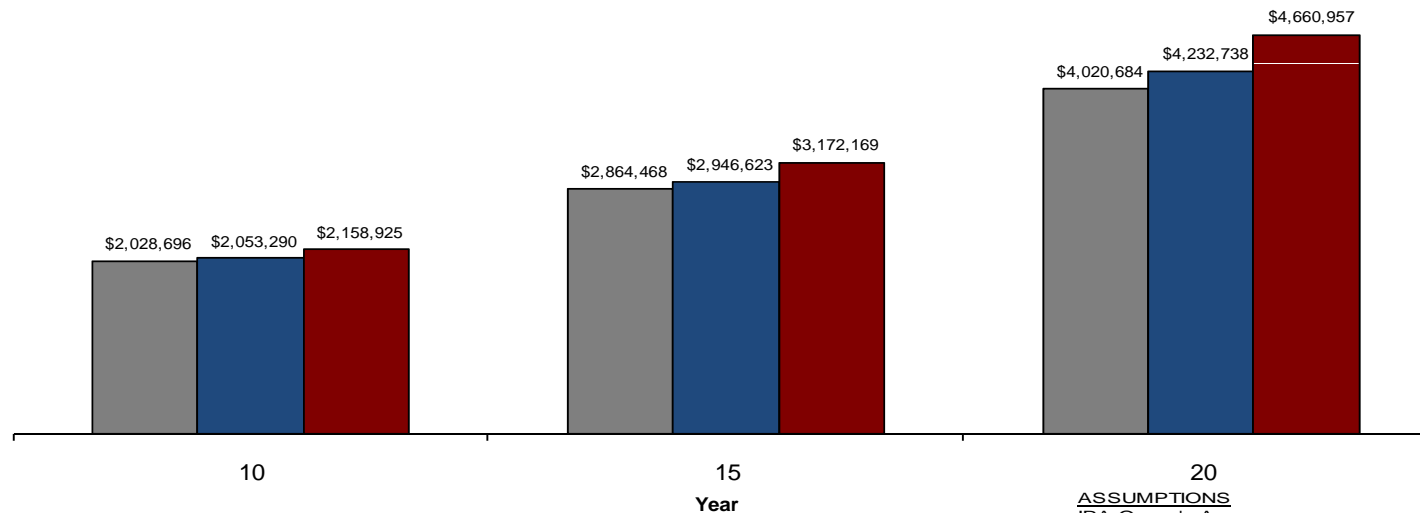
Mathematics of Roth IRA Conversions

Example #4 – 70-Year-Old IRA Owner



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After-Tax Investment Balance
(Tax Rates Remain the Same)



- Traditional IRA
- Roth IRA Conversion (Pay Tax w/Roth IRA)
- Roth IRA Conversion (Pay Tax w/Outside Account)

| <u>ASSUMPTIONS</u> | |
|-----------------------------------|--------------|
| IRA Owner's Age | 70 |
| IRA Balance | \$ 1,000,000 |
| Outside Account Balance | \$ 400,000 |
| Yield Rate | 2.00% |
| Growth Rate | 6.00% |
| Total Return (Pre-Tax) | 8.00% |
| Less: Income Tax on Yield @ 40% | -0.80% |
| Less: Income Tax on Growth @ 20%* | -0.60% |
| Total Return (After-Tax) | 6.60% |
| Tax Rate - Current Year | 40.00% |
| Tax Rate - Future Years | 40.00% |

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* Assumes 50% annual turnover on growth

Advanced Roth IRA Conversion Strategies

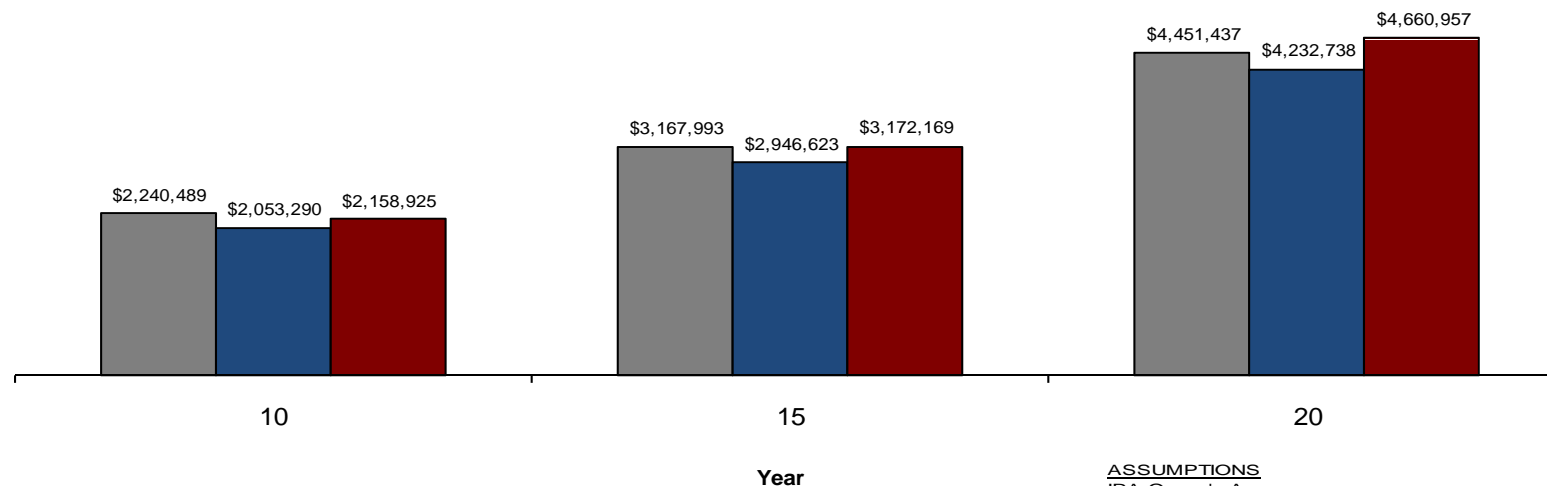
Mathematics of Roth IRA Conversions

Example #5 – 70-Year-Old IRA Owner



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After-Tax Investment Balance
(Lower Tax Rates in Future Years)



- Traditional IRA
- Roth IRA Conversion (Pay Tax w/Roth IRA)
- Roth IRA Conversion (Pay Tax w/Outside Account)

ASSUMPTIONS

| | |
|-----------------------------------|--------------|
| IRA Owner's Age | 70 |
| IRA Balance | \$ 1,000,000 |
| Outside Account Balance | \$ 400,000 |
| Yield Rate | 2.00% |
| Growth Rate | 6.00% |
| Total Return (Pre-Tax) | 8.00% |
| Less: Income Tax on Yield @ 40% | -0.80% |
| Less: Income Tax on Growth @ 20%* | -0.60% |
| Total Return (After-Tax) | 6.60% |
| Tax Rate - Current Year | 40.00% |
| Tax Rate - Future Years | 30.00% |

* Assumes 50% annual turnover on growth

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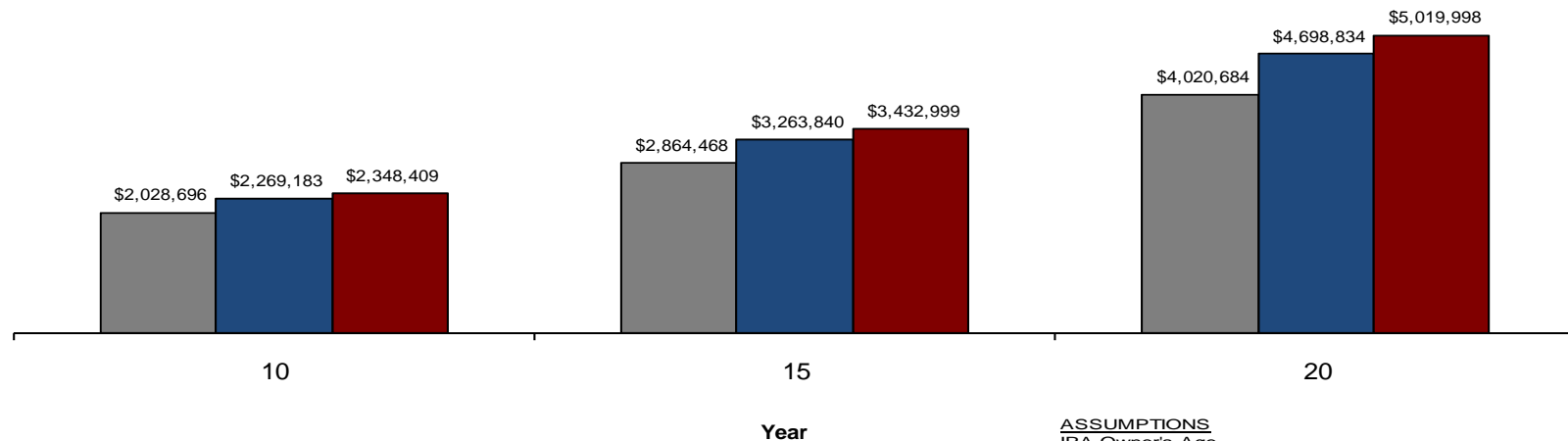
Mathematics of Roth IRA Conversions

Example #6 – 70-Year-Old IRA Owner



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After-Tax Investment Balance
(Higher Tax Rates in Future Years)



- Traditional IRA
- Roth IRA Conversion (Pay Tax w/Roth IRA)
- Roth IRA Conversion (Pay Tax w/Outside Account)

ASSUMPTIONS

| | |
|-----------------------------------|--------------|
| IRA Owner's Age | 70 |
| IRA Balance | \$ 1,000,000 |
| Outside Account Balance | \$ 400,000 |
| Yield Rate | 2.00% |
| Growth Rate | 6.00% |
| Total Return (Pre-Tax) | 8.00% |
| Less: Income Tax on Yield @ 40% | -0.80% |
| Less: Income Tax on Growth @ 20%* | -0.60% |
| Total Return (After-Tax) | 6.60% |
| Tax Rate - Current Year | 30.00% |
| Tax Rate - Future Years | 40.00% |

* Assumes 50% annual turnover on growth

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Recharacterizations



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Taxpayers may “recharacterize” (i.e. undo) the Roth IRA conversion in current year or by the filing date of the current year’s tax return

- > Recharacterization can take place as late as 10/15 in the year following the year of conversion

Taxpayers may choose to “reconvert” their recharacterization

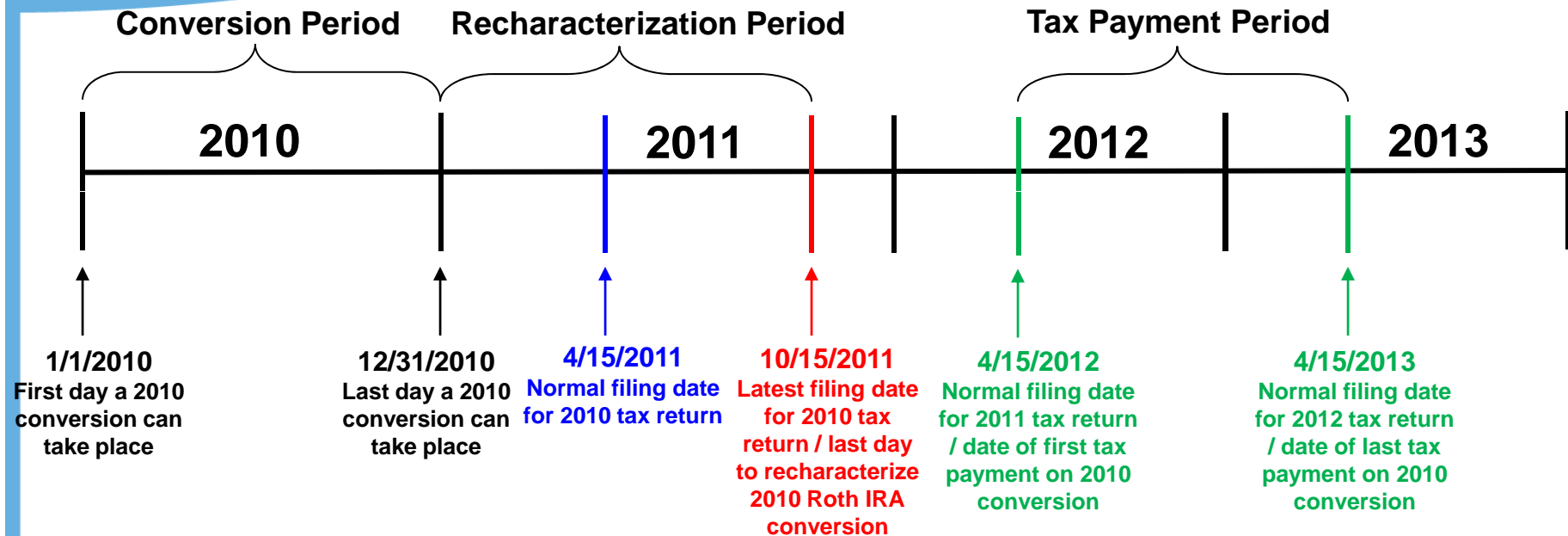
- > Reconversion may only take place at the later of the following two dates:
 - (1) The tax year following the original conversion OR
 - (2) 30 days after the recharacterization

Advanced Roth IRA Conversion Strategies

Recharacterizations



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CAVEAT: Because of adverse market conditions that could occur from the end of the “recharacterization period” to the end of the “tax payment period” (i.e. 10/15/2011 – 4/15/2013), serious consideration should be given to investing in highly-secure liquid investments (e.g. certificates of deposit) to reserve for the tax liability due on the 2010 Roth IRA conversion.

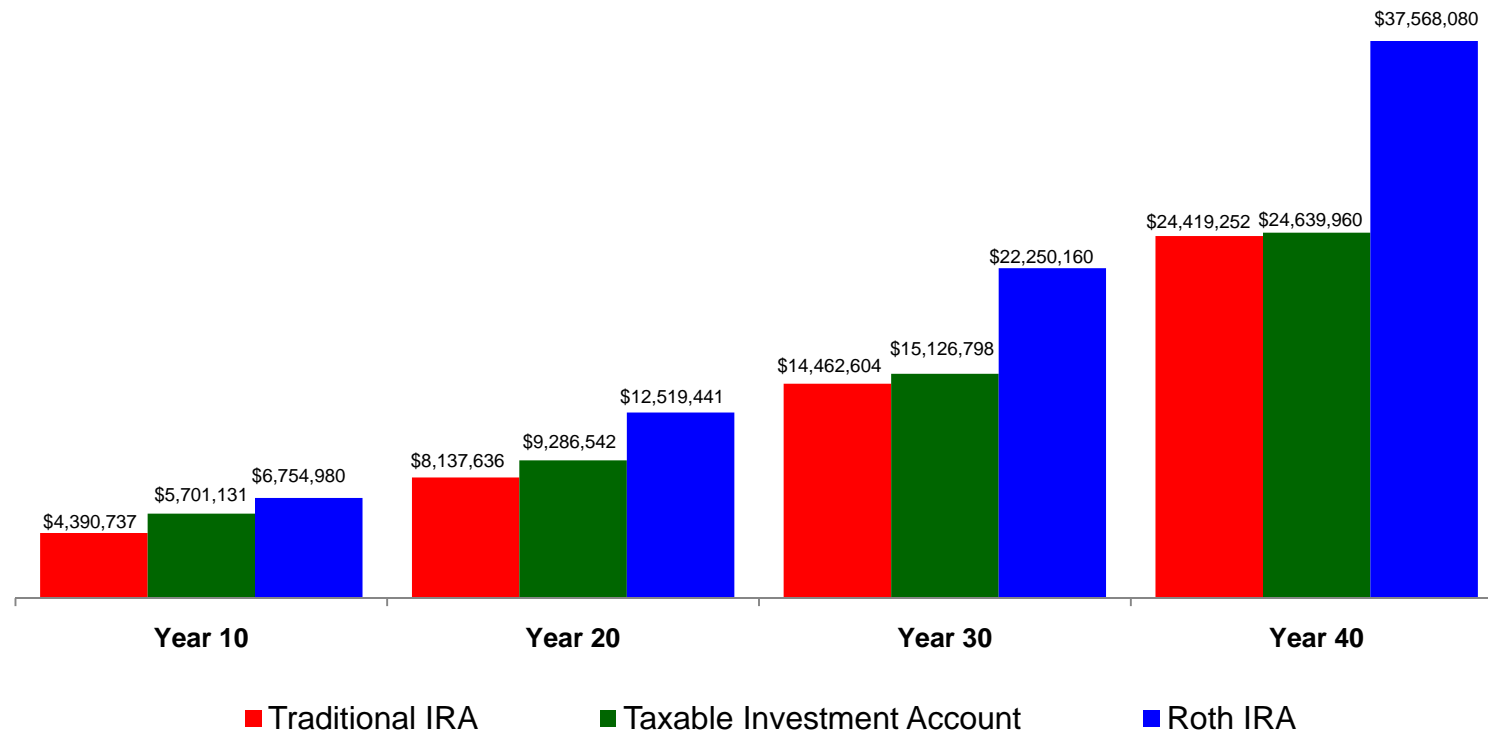
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Comparison of Using Roth IRA vs. Traditional IRA to Fund a Bypass Trust



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Advanced Roth IRA Conversion Strategies

“Stretch” Roth IRAs



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Objective: Prolong IRA payments over longest possible period of time, thus increasing wealth to future generations

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“Stretch” Roth IRAs



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Scenarios

- > Immediate distribution
- > Roth IRA payable to non-qualified beneficiary (five-year rule)
- > Roth IRA payable to surviving spouse (spousal rollover)
- > Roth IRA payable to child

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“Stretch” Roth IRAs Comprehensive Example



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Assumptions

- > IRA owner's age - 68
- > Spouse's age – 62
- > Child's age – 35

- > Roth IRA balance - \$500,000
- > Taxable investment account balance - \$0

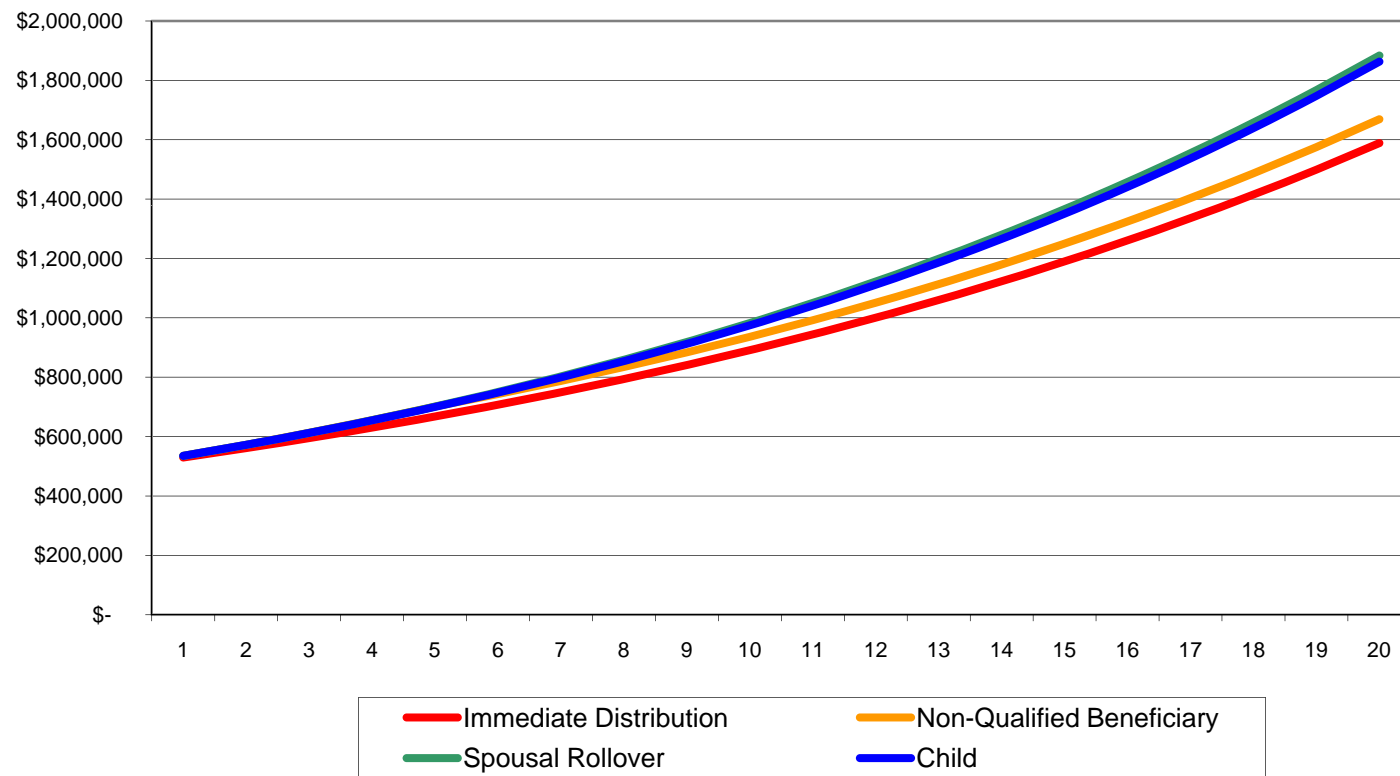
- > Pre-tax growth rate – 7%
- > After-tax growth rate – 6%

Advanced Roth IRA Conversion Strategies

“Stretch” Roth IRAs Comprehensive Example



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Using Insurance to Preserve “Stretch” Roth IRA



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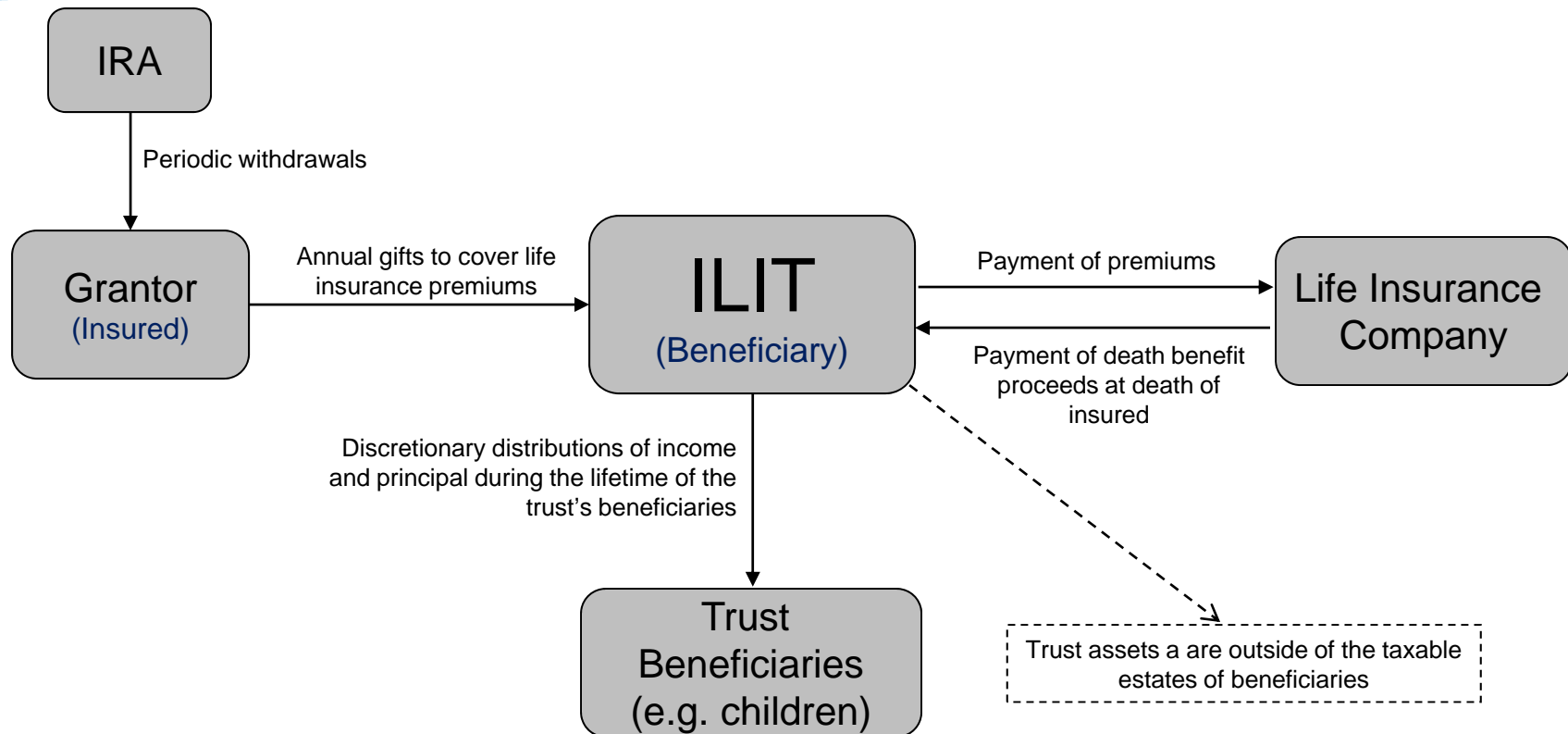
In situations where IRAs and/or other qualified retirement plans make up the majority of a decedent's taxable estate, approximately 60% to 80% of the value of these assets could be lost to taxes.

Advanced Roth IRA Conversion Strategies

Using Insurance to Preserve “Stretch” Roth IRA



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Advanced Roth IRA Conversion Strategies

Using Insurance to Preserve “Stretch” Roth IRA



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- > Use of second-to-die to avoid having to liquidate a large IRA or Roth IRA
- > Use of insurance to facilitate spousal post-mortem Roth IRA conversions
- > Use of insurance to facilitate non-spousal post-mortem Roth IRA conversions
 - > Only applies to post-mortem conversions from qualified retirement plans (e.g. 401(k) plans)
- > Purchase of annuity within IRA to pay life insurance premiums

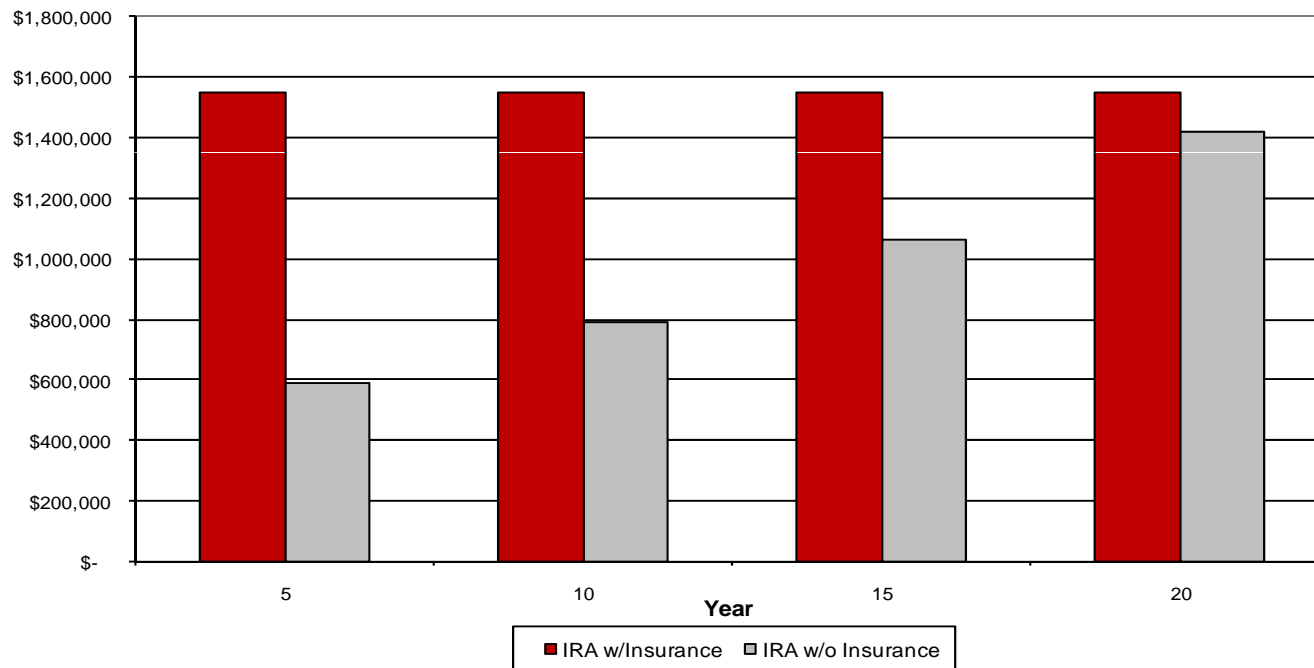
Advanced Roth IRA Conversion Strategies

Using Insurance to Preserve “Stretch” Roth IRA



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Net IRA Balance to Family



ASSUMPTIONS

| | | |
|--------------------------------------|----|-----------|
| IRA Balance | \$ | 1,000,000 |
| Life Insurance Death Benefit | \$ | 1,000,000 |
| Annual Premium | \$ | 45,000 |
| Growth Rate | | 6.00% |
| Income Tax Rate - Annual Withdrawals | | 25.00% |
| Income Tax Rate - Lump-Sum | | 35.00% |
| Estate Tax Rate | | 45.00% |

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Advanced Roth IRA Conversion Strategies

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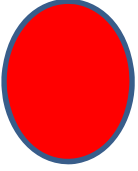
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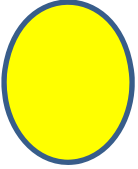
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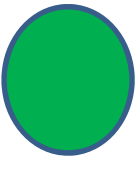
Robert S. Keebler, CPA, MST: The Roth IRA Conversion Decision

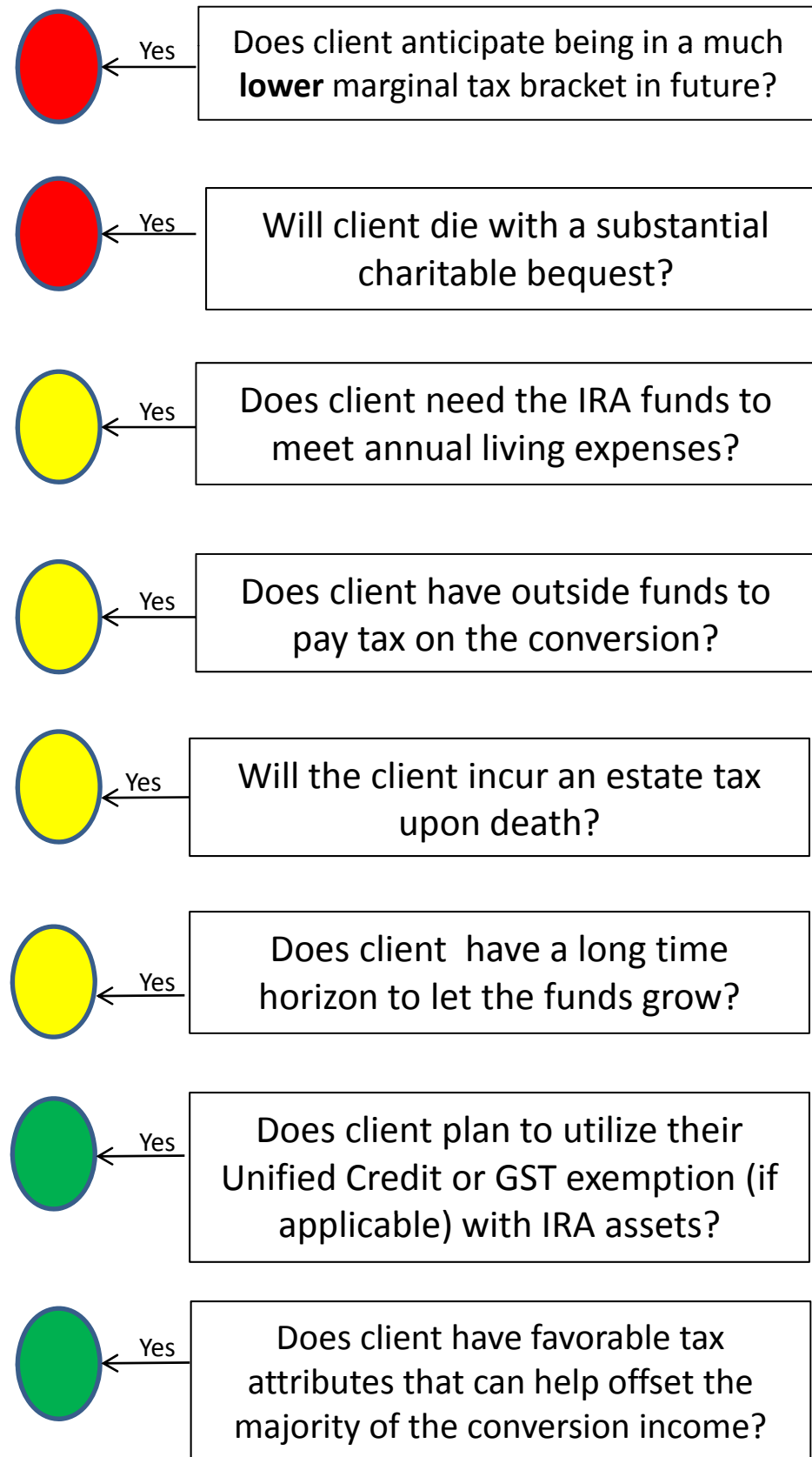
Should a client convert to a Roth IRA?

11 Reasons to Convert to a Roth IRASM

 A Roth conversion likely not beneficial. Run the numbers.

 A Roth conversion could be beneficial – Run the numbers.

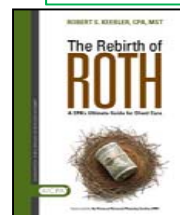
 A Roth conversion will most likely be beneficial. Run the numbers.



Bob's Roth Conversion ObservationsSM

- After determining the "optimum" conversion amount, additional amounts converted may be detrimental in that they increase the effective tax rate on the conversion.
- Always convert more than the initial numbers suggest and recharacterize if warranted.
- Recharacterize depressed accounts in November of the year of conversion and reconvert in January.
- The Roth IRA is the most powerful asset with which to fund a GST exempt trust.
- There is no bright line rule or "optimum" conversion amount for all individuals, considering that each individual's financial, income tax, and wealth situations are different. If several of the ten reasons are met, it is likely the individual is a good candidate for a Roth IRA conversion.
- Partial conversions generally provide a better quantitative result than 100% conversions.

- Taxpayers have special favorable tax attributes, including a high basis ratio, charitable deduction carry-forwards, investment tax credits, net operating losses (NOLs), etc. *This is because these attributes reduce the effective tax rate of the conversion.*
- Suspension of the minimum distribution rules at age 70½ provides a considerable advantage to the Roth IRA holder. *This allows for additional tax-free deferral.*
- Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax. *This is because the IRC § 691(c) deduction is inefficient.*
- Taxpayers who can pay the income tax on the IRA from non IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields. *This is because of the ability to move funds from a "taxable" to a "tax-free" tax asset class.*
- Taxpayers who need to use IRA assets to fund their Unified Credit bypass trust are well advised to consider making a Roth IRA election for that portion of their overall IRA funds. *This is because the exemption is funded on an after-tax basis.*
- Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates.
- Because federal tax brackets are more favorable for married couples filing joint returns than for single individuals, Roth IRA distributions won't cause an increase in tax rates for the surviving spouse when one spouse is deceased because the distributions are tax-free. *(See chart on page two.)*
- Post-death distributions to beneficiaries are tax-free. *This is possibly the most advantageous aspect of a Roth IRA conversion.*
- Tax rates are expected to increase in the very near future. *Higher tax rates in the future means more tax will be paid on taxable IRA distributions than the tax that would be paid on a conversion at a lower rate.*
- The ability to recharacterize allows the taxpayer 20/20 "hindsight", effectively allowing them to "undo" conversions that were not advantageous. *This allows the client to create a powerful "heads you win, tails you tie" opportunity that protects against adverse market swings. Later recharacterized funds can be "reconverted".*
- 3.8% Surtax. *A conversion will be beneficial for taxpayers.*



FOR MORE INFORMATION ABOUT THESE RESOURCES:

100+ Roth IRA Examples & Flowcharts call 800-809-0015.

CCH's Roth IRA Conversion ExpertSM software call 888-224-7377.

The Rebirth of Roth: A CPA's Guide for Client Care by Robert Keebler call 888-777-7077.

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Important Tax Law Considerations

CPA's Checklist

CPA's Checklist

- Analyze Tax Rates
- Consider Tax Attributes
- Determine Amount to Convert
- Convert by Asset Class
- Determine Tax Estimates
- Monitor Alternative Minimum Tax
- Monitor Taxation of Social Security Benefits and Increases in Medicare Premiums
- Monitor Recharacterization(s)
- Monitor Reconversion(s)
- 3.8% Surtax planning
- Consider oil and gas investment

Roth Conversion Before Death

- If an individual who converts to a Roth in 2010 passes away before all income has been claimed on his/her tax return, all remaining income will be claimed on his/her final 1040 (\$408A(d)(3)(E)(ii)(I)).
- Exception:** If a surviving spouse receives the 100% interest in the Roth IRA into which the 2010 conversion was made, that person has the ability to elect to continue the deferral of the two year spread (\$408A(d)(3)(E)(ii)(II)).

Death & Married Rates

- If death of a married taxpayer is imminent, it may be more advantageous to convert to a Roth IRA while the taxpayer is still alive in order to utilize the preferential married filing jointly tax rates.
- Post-death distributions are tax-free

2010 Single vs. Married Rates

| | Single | Married Filing Jointly |
|-----|-------------|------------------------|
| 10% | \$8,375 | \$16,750 |
| 15% | \$34,000 | \$68,000 |
| 25% | \$82,400 | \$137,300 |
| 28% | \$171,850 | \$209,250 |
| 33% | \$373,650 | \$373,650 |
| 35% | > \$373,650 | > \$373,650 |

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Two Year Tax Trap

- Protecting the Roth IRA from a catastrophic decline in value during the two year spread.
 - The main problem here is that the Roth IRA could decline to a value lower than the tax liability owed on the 2010 Roth IRA conversion.
- Need to compare deferring the taxable income over 2011 and 2012 and paying income tax at higher rates against paying the income tax in 2010 at lower income tax rates.

Two Year Tax Trap Example

Assume that Jackie converts \$1,000,000 of her traditional IRA to a Roth IRA in 2010.

- If Jackie pays the tax over 2011 and 2012 and is in the highest tax bracket in both years (i.e. 39.6%), her total tax liability will be \$396,000.
- Thus, Jackie will want to pay a "protective" estimate in 2011 based on her 2010 tax liability (unless her 2011 tax liability will be lower) and pay the remainder of the tax when she files her 2011 tax return. For 2012, Jackie will need to pay a "protective" estimate based on her 2011 tax liability (unless her 2012 tax liability will be lower).

- If the Roth IRA declines in value to below \$396,000 after October 15, 2011, Jackie will still be responsible for paying the entire tax liability.

- Thus, it will be important for Jackie to create a "reserve" (e.g. buy put options, invest in CDs, buy annuities with a guaranteed floor, etc.) in her Roth IRA to protect against a catastrophic decline in value.

- NOTE:** If the account declines significantly before October 15, 2011, Jackie should recharacterize the Roth IRA conversion (thereby eliminating the tax liability).

Estimated Payments

- Be cognizant of setting up "protective" quarterly tax estimates for 2011 and 2012.
- Although 2010 income may be lower due to the spreading of income over the following two years, this does not bar you from having to make estimated tax payments for 2011 and 2012 tax years.
- Monitor state estimates.

Pension Protection Act of 2006

- Non-spousal beneficiaries are permitted to roll over a qualified retirement plan (e.g. 401(k) plan), via trustee-to-trustee transfer, into an inherited IRA effective for tax years beginning after December 31, 2006.

Best Practices

Extend 2010 income tax returns (6 months)

- Provides benefit of being able to weigh the options of the two year spread and electing to pay the applicable tax in 2010.
- Allows for more time to see how the market will perform.
- Allows the taxpayer the benefit of making their final decision on recharacterization up to the extended due date of the 2010 income tax return.

Alternative Minimum Tax

- If the taxpayer is close to being exposed to AMT prior to the implementation of a Roth conversion, the practitioner must be aware of the effects of state and local taxes.
- Although federal income taxes may be offset by an applicable deduction, state and local taxes that typically tag along are not deductible for AMT purposes under §56(b)(1)(A)(ii).

State Taxes

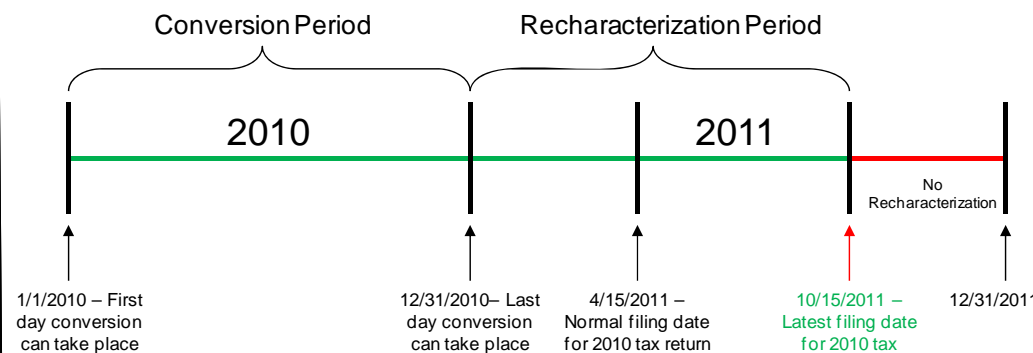
- Roth conversions may be treated differently from state to state.
- Consider local tax implications.

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Important Financial Considerations

Financial Advisor's Checklist

- Work collaboratively with CPA to determine the value of the Roth Conversion including the surtax
- Ensure estate liquidity by considering purchasing life insurance in an ILIT
- Convert by Asset Class (i.e. Roth IRA Conversion Segregation Strategy)
 - Taxpayers cannot recharacterize a portion of a Roth conversion by "cherry picking" only those stocks that decline in value (IRS Notice 2000-39).
 - All gains and losses to the entire Roth IRA, regardless of the actual stock or fund re-characterized, must be pro-rated.
- Monitor Recharacterization(s)
 - Taxpayers may "recharacterize" (i.e. undo) the Roth IRA conversion in current year or by the filing date of the current year's tax return.
 - Recharacterization can take place as late as 10/15 in the year following the year of conversion.
- Monitor Reconversion(s)
 - Taxpayers may choose to "reconvert" their recharacterization.
 - Reconversion may only take place at the later of the following two dates:
 - The tax year following the original conversion OR
 - 30 days after the recharacterization



- January 1, 2010:** First date in which a 2010 Roth conversion may take place.
- December 31, 2010:** Last date in which a 2010 Roth conversion may take place.
- April 15, 2011:** Due date for the 2010 income tax return and the last date in which the tax liability on a 2010 conversion may be paid timely if the taxpayer elects out of the two-year spread.
- October 15, 2011:** Last date in which a recharacterization of a 2010 conversion may be made.
- October 15, 2011 falls on a Saturday:** recharacterizations can be performed as late as October 17, 2011.

| | 1/1/10 | Action | 11/30/10 | Action | 1/1/11 | Action | 4/15/11 | Action | 10/15/11 | Action | 11/30/11 | Action | 1/1/12 | Action |
|---|-----------|----------------------------|-----------|-------------------------|-----------|------------------|-----------|------------------------|-----------|-------------------|-----------|-------------------------|-----------|------------------|
| A | \$100,000 | Original Conversion 1/1/10 | \$125,000 | Hold | \$130,000 | Hold | \$130,000 | Hold | \$135,000 | Hold | \$130,000 | N/A | \$130,000 | N/A |
| B | \$100,000 | Original Conversion 1/1/10 | \$100,000 | Hold | \$100,000 | Hold | \$95,000 | Recharacterize 4/15/11 | \$80,000 | Reconvert 5/16/11 | \$85,000 | Hold | \$90,000 | Hold |
| C | \$100,000 | Original Conversion 1/1/10 | \$75,000 | Recharacterize 11/30/10 | \$80,000 | Reconvert 1/1/11 | \$85,000 | Hold | \$85,000 | Hold | \$90,000 | Hold | \$95,000 | Hold |
| D | \$100,000 | Original Conversion 1/1/10 | \$75,000 | Recharacterize 11/30/10 | \$90,000 | Reconvert 1/1/11 | \$85,000 | Hold | \$90,000 | Hold | \$75,000 | Recharacterize 11/30/11 | \$80,000 | Reconvert 1/1/12 |

In the chart above, the conversion of four different asset classes (referred to as A through D) is analyzed. All four asset classes are converted to (4) Roth IRAs on January 1, 2010. In the case of asset class A, the account increases in value to \$125,000 as of November 30, 2010. Due to the increase in value, there is no reason to recharacterize. The deadline for recharacterization of the January 1, 2010 conversion is October 15, 2011, and at that time the value of A is \$135,000, meaning it will, of course, be held. Asset class B decreases in value to \$95,000 as of April 15, 2011 and it is recharacterized. On May 16, 2011 (31 days after the recharacterization) the value of B is \$80,000, and the account is reconverted to a Roth IRA (the reason for this is the advantage afforded by paying income tax on \$80,000 instead of \$100,000). Because the account increases in value after May 16th, it will be held. Asset class C decreases in value to \$75,000 as of November 30, 2010. It is recharacterized. On January 1, 2011 the value of the account is \$80,000 and it is reconverted. Subsequently, the value increases and the account is held. Asset class D decreases in value to \$75,000 as of November 30, 2010 and is recharacterized. When the value is \$90,000 on January 1, 2011, the account is reconverted. On April 15 and October 15, 2011 the account is held; however, when the account decreases in value to \$75,000 on November 30, 2011, it is recharacterized. (This is possible because the account was reconverted on January 1, 2011. Technically, the account could be recharacterized as late as October 15, 2012.) At a value of \$80,000 the account is (again) reconverted on January 1, 2012.

Important Estate Planning and Asset Protection Considerations

Lawyer's Checklist

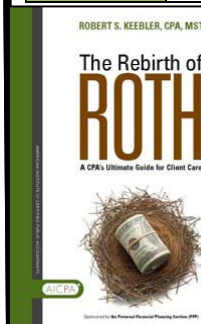
Estate Planning Considerations

- Ensure that beneficiary designation forms are updated to seamlessly integrate the Roth IRA into the overall estate plan.
- Consider that post-death qualified distributions are tax free.
- Consider utilizing a Roth IRA to fund unified credit trust and/or a generation skipping transfer tax exempt trust (if applicable).
- Ensure that appropriate tax apportionment clauses are addressed in planning documents. Estate taxes should generally be apportioned away from the Roth IRA asset thereby enabling the Roth IRA to continue to grow on an income tax-free basis.
- Consider utilizing a charitable split interest trust as a tool in minimizing income tax in the year of a Roth IRA conversion.
- Ensure that an individual's durable power of attorney will provide the attorney-in-fact with the right to make any and all tax elections, including an election to recharacterize the Roth IRA.
- Because the ability to recharacterize extends beyond an individual's death and is transferred to the individual's personal representative following death, ensure that both an individual's IRA trust and last will and testament provides for the recharacterization power.

Asset Protection Considerations

- Consider implications on bankruptcy and creditor protection under federal and applicable state law before converting a qualified plan or traditional IRA to a Roth IRA.
- Consider utilizing a standalone IRA Trust to be beneficiary of the Roth IRA for asset protection purposes.

| DISTRIBUTIONS TO BENEFICIARY UNDER IRC § 401(a)(9) | | | |
|--|---|--|--|
| ROTH IRAS | | | |
| Beneficiary | | Beneficiary | |
| Spouse - Inherited IRA (No rollover) | Spouse may defer required distributions until the year the owner would have reached age 70 1/2. In this year and for each succeeding year, the RMD is calculated based upon spouse's life expectancy by referencing her attained age for the year of distribution based on the Single Life Table. | Designated Beneficiary Trust | RMDs calculated using the oldest beneficiary's age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this factor is reduced by one. If the trust is designed properly and the beneficiary designation form is filed properly, then each primary beneficiary may utilize his or her own age in calculating RMDs. |
| Spouse - Rollover | No RMDs required during spouse's life. | Non-Spouse Individual Designated Beneficiary | RMDs calculated based upon corresponding life expectancy factor for the beneficiary's age in the year of the first distribution by reference to the Single Life Table. For succeeding years, this factor is reduced by one. If multiple beneficiaries are named, as long as the account is segregated prior to December 31st of the year following death, each beneficiary may independently calculate RMDs. |



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