

Roth IRA Conversion Opportunity Begins January 1st, 2010

The rapidly approaching New Year brings an opportunity for higher income earners to convert some or all of their existing Traditional Individual Retirement Accounts (IRAs) to Roth IRAs for the first time.

BACKGROUND

As part of the Tax Increase Prevention and Reconciliation Act of 2005, Congress eliminated the Adjusted Gross Income limit on conversions of traditional IRAs to Roth IRAs beginning 1 January 2010. The limit had the result that higher income earners were effectively unable to either contribute to (AGI phase out begins at \$150,000 for joint filers) or convert to (modified AGI of \$100,000) Roth IRAs.

In less than 3 months, this is no longer the case and the legislation provides incentives to convert in 2010 by spreading the income recognition, and corresponding tax liability, over tax years 2011 and 2012 (50/50 split).

WHY WOULD I WANT TO CONVERT AND PAY TAXES AT ALL?

The reality of a Traditional IRA is that somewhere between 25% and 40% of the balance is really the Government's tax claim on the account. This makes the question *when* do I want to pay that tax, not *if*.

Roth IRAs have several advantages over Traditional IRAs for high net worth individuals.

- First, there are no required minimum distributions for the account owner upon reaching age 70 ½ so you do not have to draw down this account but instead can use it as a legacy asset for your spouse and family.
- Second, any distributions you do take come out tax free as long as you have met the five year holding period (another good reason to convert in 2010 and start the clock on this requirement).
- Third, if you have earned income after age 70 ½, you can continue to contribute to the Roth IRA but are not permitted to do so to a Traditional IRA.
- Fourth, *inherited* Roth IRAs do have minimum required distributions for *non-spouse* beneficiaries but those distributions are received tax free as well (provided the five year holding period has been met).

ONCE I CONVERT, CAN I CHANGE MY MIND?

Yes. Roth IRA conversions are one of the few tax code items that allows you to perform a “recharacterization” which essentially sets your accounts back as if you never converted at all. You have until October 15th of the year following the year of conversion to recharacterize without penalty.

MUST I CONVERT MY ENTIRE TRADITIONAL IRA?

No, conversions are not all or nothing. You can pick the amount of the Traditional IRA that you want to convert in 2010, spread the tax bill over 2011 and 2012, start the five year holding period AND keep your traditional IRA open with the remainder of the funds. The advantage to performing a partial conversion is that you may want to convert sufficient funds to maximize the conversion without the income forcing you to the next higher tax bracket. This process could be repeated in 2011 and beyond but remember that the deferral in taxes ONLY applies to conversions in 2010.

KEY DECISION CRITERIA TO CONSIDER

- Will I need this money to live on or is it truly a legacy asset?
- Do I have non-IRA funds available to pay the taxes?
- Do I want to pay the tax in 2010 (known rates from 2001 tax law) OR spread it over 2011-2012 with the potential for paying higher tax rates?
- What is my life expectancy? My spouse’s life expectancy?
- Do I have children and grandchildren that would permit me to stretch the Roth payout period over a long number of years?

PRAETORIAN GUARD’S RECOMMENDATION

Be ready to convert in the first quarter of 2010, at least partially. Work with your advisory team (Praetorian and your CPA) to project your income for the year and where you will reach the breakpoint for the next higher Federal Tax Bracket.

Pay the taxes due out of non-IRA funds so that you convert the maximum amount from the Traditional IRA to the Roth IRA to keep growing tax deferred and to eliminate the need for required distributions upon reaching age 70 ½.

We are happy to help with the analysis of your particular situation so that you can make an informed decision regarding this opportunity.