



Eliminating Taxes on Future IRA Growth by Converting to Roth IRA

Before this year, high income taxpayers could not contribute to a Roth IRA. Nor could high income earners make deductible contributions to a traditional IRA. While nondeductible contributions to a traditional IRA were feasible, the associated tax benefits were limited (i.e., no current deduction, the taxes on the IRA earnings were deferred rather than eliminated, and minimum distributions were required after a certain age).

Now, for tax years beginning 2010 and later, a conversion from a traditional to a Roth IRA can be made without regard to income level. Therefore, even though you have adjusted gross income of more than \$100,000, you are no longer ineligible to make a Roth IRA conversion. The elimination of the rules related to IRA conversions may provide you with a unique tax planning opportunity.

The income limitation on Roth IRA conversions has now been permanently repealed. And there is a special tax treatment available for 2010 conversions only. Conversion income in 2010 is recognized half in 2011 and half in 2012, unless you make an election to recognize all of the income in 2010.

There are several valid reasons why you may want to take advantage of the opportunity to convert to a Roth IRA. Withdrawals from a Roth-IRA are tax free forever. Moreover, unlike a traditional IRA, you are no longer mandated to take out required minimum distributions over life after reaching age 70 ½. Then there is the 2008-2009 Wall Street meltdown that caused many IRAs to decline significantly in value (which shrinks the taxes upon conversion), the prospect of hedging against future tax rate increases by choosing to report taxable income now rather than later, and perhaps even the possibility of offsetting the conversion income with a possible current year net operating loss.

The following key factors generally need to be identified and addressed in order to best

analyze a Roth IRA conversion:

- Asset mix (i.e., qualified versus nonqualified, liquid versus illiquid)
- Traditional IRA fair market value
- Time horizon
- Current and future cash flow needs
- Current marginal tax rate versus projected future marginal tax rate
- The ability to pay the income tax on a conversion with nonqualified funds
- Estate planning objectives

As you can see, whether a traditional IRA should be converted to a Roth IRA is a complex issue. One other issue to consider is that Georgia law does not protect Roth IRA assets from creditors. Georgia law states that distributions from a traditional IRA (not Roth) are exempt from bankruptcy only to the extent necessary for the support of the debtor and any dependent.

Example: Virginia has a traditional IRA that was worth \$300,000 in 2007, but is worth only \$200,000 today. If the IRA goes up to \$500,000 in value, Virginia would ultimately owe about \$225,000 in Federal income taxes (assuming her Federal marginal tax rate goes up to 45% in the future) when she withdraws all the money out of the account. By converting today, Virginia would owe only \$70,000 in Federal income taxes, and she could elect to pay half of it in 2011 and the other half in 2012. She would actually save \$155,000 in taxes (perhaps even more if tax rates go up over 45%)! Yes, Virginia, there is a Santa Claus!

What happens if you convert to a Roth IRA and the account value continues to go down? Well, it turns out that, like Santa Claus, the Tooth Fairy really does exist, and you can undo the conversion without any tax consequences! You can make this happen any time up until October 15, 2011.

If you have a traditional IRA (or know someone who does), please call our office to discuss the conversion strategies available to maximize your tax benefits.

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