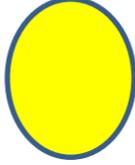


# Robert S. Keebler, CPA, MST: The Roth IRA Conversion Decision

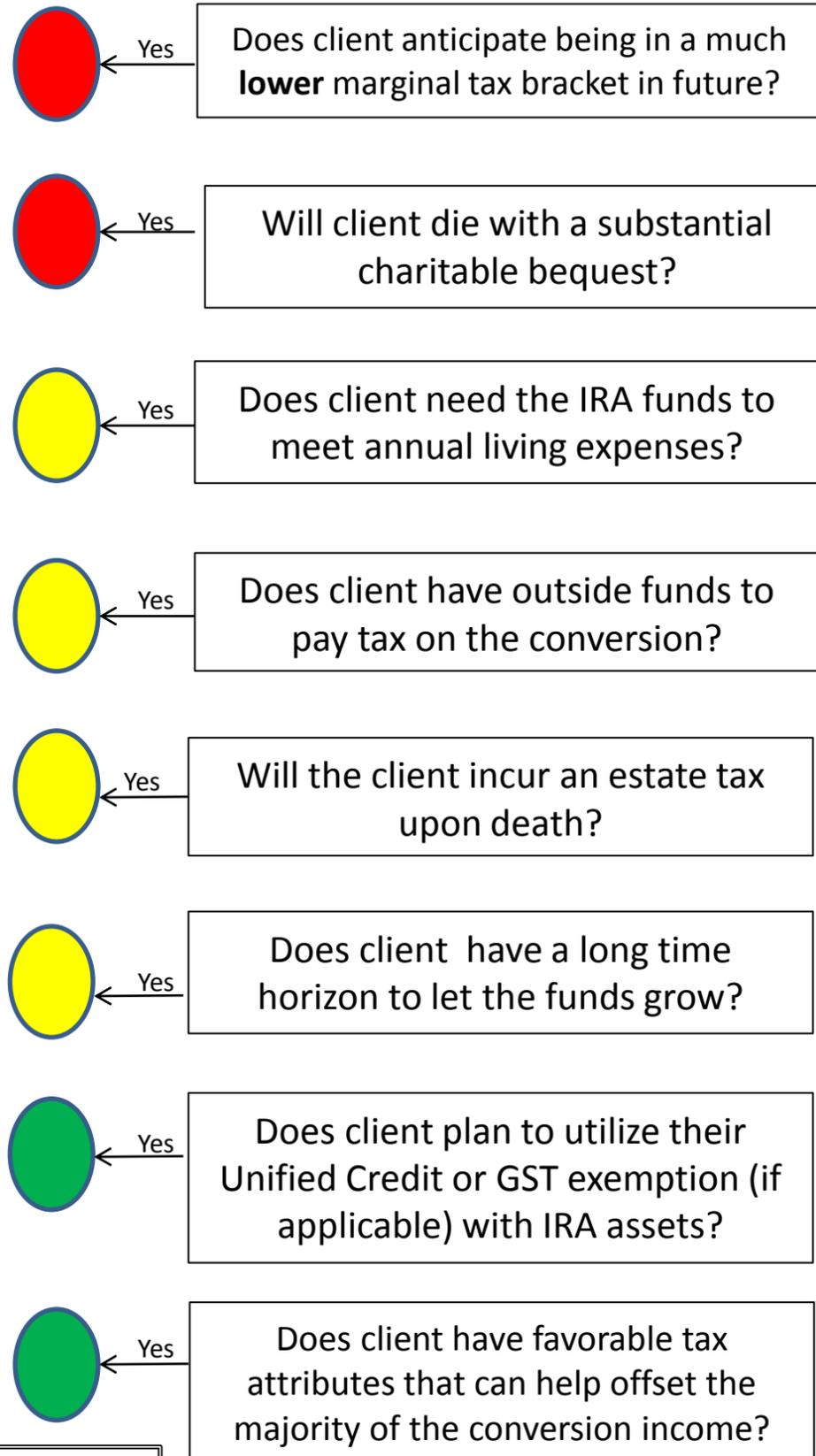
## Should a client convert to a Roth IRA?

## 11 Reasons to Convert to a Roth IRA<sup>SM</sup>

 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.



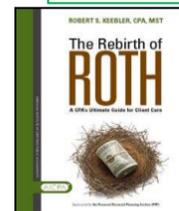
### Bob's Roth Conversion Observations<sup>SM</sup>

1. After determining the "optimum" conversion amount, additional amounts converted may be detrimental in that they increase the effective tax rate on the conversion.
2. Always convert more than the initial numbers suggest and recharacterize if warranted.
3. Recharacterize depressed accounts in November of the year of conversion and reconvert in January.
4. The Roth IRA is the most powerful asset with which to fund a GST exempt trust.
5. 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.
6. Partial conversions generally provide a better quantitative result than 100% conversions.

1. 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.*
2. 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.*
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. *This is because the IRC § 691(c) deduction is inefficient.*
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. *This is because of the ability to move funds from a "taxable" to a "tax-free" tax asset class.*
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. *This is because the exemption is funded on an after-tax basis.*
6. Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates.
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. *(See chart on page two.)*
8. Post-death distributions to beneficiaries are tax-free. *This is possibly the most advantageous aspect of a Roth IRA conversion.*
9. 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.*
10. 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".*
11. 3.8% Surtax. *A conversion will be beneficial for taxpayers.*

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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 and chose the 2 year tax spread passes away before the income has been claimed on his/her tax return, the 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 conversions was made, that person has the ability to elect to continue the deferral of the two year spread (§408A(d)(3)(E)(ii)(II)).

### 2012 Single vs. Married Rates

	Single	Married Filing Jointly
10%	\$8,700	\$17,400
15%	\$35,350	\$70,700
25%	\$85,650	\$142,700
28%	\$178,650	\$217,450
33%	\$388,350	\$388,350
35%	> \$388,350	> \$388,350

### 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

### 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.

### 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.

### The Small Business Jobs and Credit Act of 2010

- Allows the conversion of 401(k), 403(b) and governmental 457(b) plans to Roth accounts.
- Keeping the retirement funds in a Roth 401(k) rather than converting to a Roth IRA can be beneficial from an asset protection standpoint.
- However, the recharacterization option is not available under this provision as it would be if account were converted to a Roth IRA.

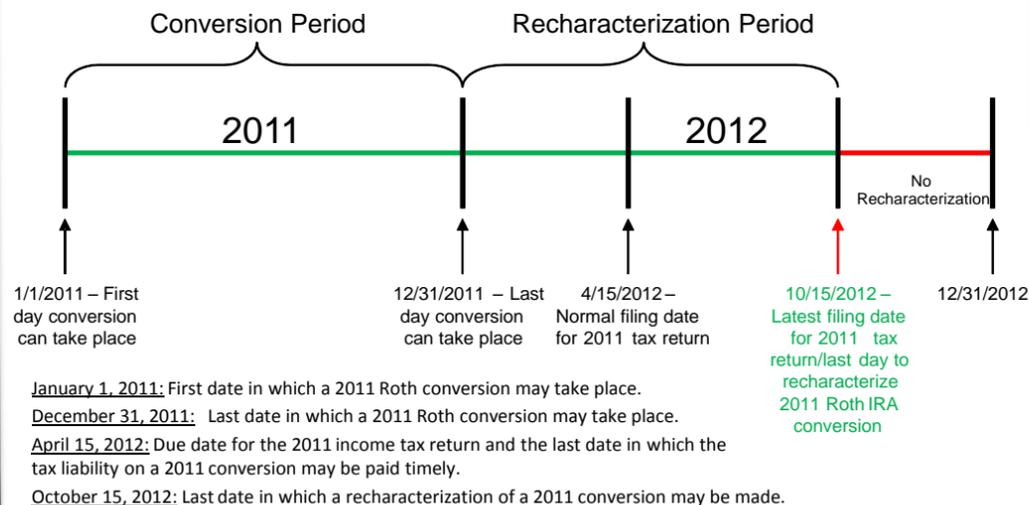
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# Important Financial Considerations

## 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



	1/1/11	Action	11/30/11	Action	1/1/12	Action	4/15/12	Action	10/15/12	Action	11/30/12	Action	1/1/13	Action
A	\$100,000	Original Conversion 1/1/11	\$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 1/1/11	\$100,000	Hold	\$100,000	Hold	\$95,000	Recharacterize 4/15/12	\$80,000	Reconvert 5/16/12	\$85,000	Hold	\$90,000	Hold
C	\$100,000	Original Conversion 1/1/11	\$75,000	Recharacterize 11/30/11	\$80,000	Reconvert 1/1/12	\$85,000	Hold	\$85,000	Hold	\$90,000	Hold	\$95,000	Hold
D	\$100,000	Original Conversion 1/1/11	\$75,000	Recharacterize 11/30/11	\$90,000	Reconvert 1/1/12	\$85,000	Hold	\$90,000	Hold	\$75,000	Recharacterize 11/30/12	\$80,000	Reconvert 1/1/13

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, 2011. In the case of asset class A, the account increases in value to \$125,000 as of November 30, 2011. Due to the increase in value, there is no reason to recharacterize. The deadline for recharacterization of the January 1, 2011 conversion is October 15, 2012, 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, 2012 and it is recharacterized. On May 16, 2012 (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 16<sup>th</sup>, it will be held. Asset class C decreases in value to \$75,000 as of November 30, 2011. It is recharacterized. On January 1, 2012 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, 2011 and is recharacterized. When the value is \$90,000 on January 1, 2012, the account is reconverted. On April 15 and October 15, 2012 the account is held; however, when the account decreases in value to \$75,000 on November 30, 2012, it is recharacterized. (This is possible because the account was reconverted on January 1, 2012. Technically, the account could be recharacterized as late as October 15, 2013.) At a value of \$80,000 the account is (again) reconverted on January 1, 2013.

# 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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