

## 2010 Roth IRA Conversion Changes

Starting in 2010, the world of Roth IRA planning will experience significant change. Due to the Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA") previously disqualified taxpayers will now have the opportunity to convert their Traditional IRA(s) into a Roth IRA.

### What Changed?

Currently, an individual's eligibility to perform a Roth IRA conversion is dependent upon their modified adjusted gross income ("MAGI") and their federal income tax filing status. In 2010, TIPRA will enable anyone to convert to a Roth IRA by eliminating the filing status and \$100,000 MAGI limitations. Furthermore, conversions performed in 2010 will receive special tax treatment in that the taxable income, and therefore the resultant income tax, incurred on the Roth conversion may be spread over the 2011 and 2012 tax years.

### Why is this Significant?

These changes mark a monumental opportunity in the field of Roth conversion planning for you and your clients. For the first time since the introduction of the Roth IRA everyone will be eligible to convert to a Roth IRA. This is significant because a Roth conversion will allow for future IRA growth to be received tax-free, which may increase retirement funds and enable more wealth to be transferred to future generations.

### Example

Assume Matt, age 45, has \$150,000 in a Traditional IRA account. He is considering converting the entire balance to a Roth IRA. Assume further that Matt's current marginal tax rate is 30% and that his expected future marginal income tax rate is 40%. Additionally, assume that both the Traditional IRA and the Roth IRA will earn a 7% pre-tax growth rate and that Matt is eligible to make a Roth conversion. The following table illustrates the increased wealth Matt would realize by executing the Roth IRA conversion.

	<u>Traditional IRA</u>	<u>Roth IRA Conversion</u>
Current Value	\$150,000	\$150,000
Less tax on conversion at 30%	0	(45,000)
Net after conversion	<u>\$150,000</u>	<u>\$105,000</u>
Balance in 25 years (7% pre-tax growth rate)	\$814,115	\$569,880
Less tax on distributions at 40%	(325,646)	0
Net to family before taxes:	<u>\$488,469</u>	<u>\$569,880</u>
Increased wealth due to Roth IRA conversion:		<b>\$81,411</b>

As the table indicates, in twenty-five years, Matt would amass approximately \$81,400 more wealth by performing the Roth IRA conversion.

### Reasons for Converting

Although a cost-benefit analysis will need to be prepared for each individual to determine the potential benefits of executing a Roth conversion, there are generally seven reasons why the Roth IRA conversion may be a promising option:

- 1) To take advantage of favorable tax attributes (such as charitable deduction, Net Operating Loss carryforwards, etc...)
- 2) Suspension of the lifetime required minimum distribution rules
- 3) The payment of income tax prior to the imposition of estate tax allows for greater wealth to be transferred to future generations
- 4) Greater growth potential, to the extent that outside sources (i.e. taxable brokerage account) are used to pay for the taxes due on the Roth IRA conversion
- 5) To better utilize an IRA owner's Unified Credit
- 6) To effectively reduce the taxable estate of the IRA owner
- 7) To hedge against the projected increase in tax rates when the first spouse dies.

TIPRA is going to provide great planning opportunities for many clients in 2010, but clients must consult with their CPAs to make sure the correct plan is devised to accomplish their goals.

For more information on this topic, please contact your Virchow Krause advisor or a member of the Strategic Tax Team.

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