

2010 Roth Conversion Regulations

As you may already know in 2010 you are now able to convert your pre-tax retirement accounts without regard to income limitations. There is a special option for paying taxes on a 2010 Roth IRA Conversion. While 2010 is the actual year that you will be able to convert, the income to be claimed can be deferred until 2011 and 2012. While initially this tax break sounds appealing you need to review the pros and cons prior to the conversion. Expecting a vast majority to take advantage of this, the IRS has set up special provision on how the tax will be paid. The IRS has granted you the option to claim 50% of the conversion amount as income in 2011 and the remaining 50% in 2012. Keep in mind that this is **only in 2010**. After 2010 the taxes will all be paid in full the following year going forward.

If you elect to pay the tax over the two year period, keep in mind that the tax rate is determined for that year only. Keep in mind that your income could increase and the tax rates could go up as well causing you to increase your tax liability.

Traditional IRA to Roth IRA Conversion Hypothetical Tax Liability

Converting in 2010 can be extremely tricky because when it comes to converting an IRA, the IRS will look at all your IRA's as one. What makes it even more complicated is if you have a combination of pre-tax / after-tax contributions. Let's take a look at multiple accounts with both pre-tax & after-tax contributions.

Client A has a SEP IRA, a Traditional IRA, and a Roth IRA totaling **\$430,000**. Let's breakdown the pre and post tax contributions of each.

- **SEP IRA:** Consists entirely of pre-tax contributions. Total value is **\$90,000** with pre-tax contributions of **\$15,000**.
- **Traditional IRA:** Consists entirely of after-tax contributions. Total value is **\$300,000** with after-tax contributions of **\$60,000**.
- **Roth IRA:** All after tax contributions. Total value is **\$40,000** with total contributions of **\$8,000**.

Client A would like to only convert **\$180,000** in his SEP and Traditional IRA's to the Roth IRA. What amount will be added to his taxable income in 2011 and 2012?

Quick Summary

There is \$60,000 total after-tax contributions to non-Roth IRA's. The total non-Roth IRA balance is **\$390,000**. The total amount that is desired to be converted is **\$180,000**.

Step 1: Calculate non-taxable portion of total Non-Roth IRA's

Total after-tax contributions / Total Non-Roth IRA Balance = Non-Taxable %
 $\$60,000 / \$390,000 = 15.38\%$

Step 2: Calculate the non-taxable amount by converting the result to Step 1 into dollars

$15.38\% \times \$180,000 = \$27,692.31$

Step 3: Calculate the amount that will be added to your taxable income

$\$180,000 - \$27,692.31 = \$152,307.69$

In this scenario, Client A will owe ordinary income tax on **\$152,307.69**.

Conclusion

While a conversion does finally allow many high-income investors the opportunity to have a Roth, it's important that you analyze your situation and are comfortable with your decision. Below you will find a short list of situations where you may benefit from a Roth conversion. The final decision will depend on many factors such as the current tax as well as future factors that are unknown at this point.

- Expect taxes (combined federal, state, and local) to be higher in retirement.
- Are able to use non-retirement assets to pay the conversion taxes.
- Expect to have a lower than usual taxable income in the 2010 year.
- Desire more flexibility on when and how to take future retirement distributions.
- Have IRA assets consisting mostly of pre-tax contributions.
- Plan to bequeath a majority of your retirement assets to your beneficiaries.
- Don't plan on taking any retirement distributions for at least 10-15 years.

Each situation needs to be evaluated on a case-by-case basis. Take a close look at your own situation and, if it makes sense, consider taking advantage of these rule changes. Remember that tax laws are subject to change, so stay current at www.irs.gov. Please note that SPAHR FINANCIAL GROUP, LLC does not provide accounting and/or legal advice and highly recommends you use consult your accountant to determine if a conversion is right for you.

For additional information about the current 2010 year contributions go to: <http://spahrfinancial.com/> and under the Advance Planning Data link you will find the *Pension Plan Limitations*.

ROTH CONVERSION CALCULATOR

<http://personal.fidelity.com/accounts/services/content/convertinga.shtml.cvsr>

Disclosures:

Traditional IRA aggregation rule: If you have made nondeductible contributions to your traditional IRA in the past (hopefully, tracked all along on [IRS Form 8606](#)), you can't pick and choose which portion of the traditional IRA money you want to convert to a Roth. The IRS looks at all traditional IRAs as one when it comes to distributions, including Roth conversions. Traditional IRA balances are aggregated so that the amount converted consists of a prorated portion of taxable and nontaxable money. For more on the aggregation rule, see [IRS Publication 590](#).

Converting non-deductible IRA contributions to a Roth: Starting in 2010, high earners otherwise not eligible to make Roth contributions could make nondeductible contributions to a traditional IRA and then convert those amounts to a Roth. This process could be repeated every year. Don't be surprised, though, if Congress changes the law to eliminate this option.

Multi-year tax payment: Being able to split the conversion income between 2011 and 2012 for 2010 conversions (only) is a potential benefit only if your tax rate doesn't rise. But higher rates in 2011 and 2012 vs. 2010 are almost a certainty for top earners.

Eligibility for a Roth conversion in 2010 doesn't automatically make it a good idea. In fact, the very high-earning taxpayers who will become eligible for Roth conversion in 2010 are the least likely to benefit because they are already in the highest brackets. If a Roth conversion didn't make sense for income tax purposes before 2010, it probably won't afterwards. That said, in the right circumstances, converting to a Roth IRA can potentially have significant benefits. Conversion for estate-planning purposes may also add value.

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