

Making the Most of the Roth Conversion

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Have you heard of the 2010 Roth Conversion opportunity yet? If you have been keeping up with financial media over the past couple of months you are bound to have run across this tool. It is a great opportunity for a large number of people. However, when you convert dollars in a traditional retirement account to a Roth IRA, the Federal Government requires that you also make a gift of “social capital” (aka, pay federal income taxes on the balance converted). If you are thinking about converting to a Roth IRA, you should know that it is possible to redirect that “social capital” to organizations you love while reducing income taxes upon the conversion. At the same time, you will be planning for your retirement and eventual wealth transfer. One option for achieving this is utilizing a Charitable Remainder Trust in the same year that retirement funds are converted to a Roth IRA account.

2010 Roth Conversion

Some benefits of the 2010 Roth Conversion opportunity:

- The income limits to be eligible for a conversion have been removed. ANYONE, NO MATTER YOUR TAXABLE INCOME, CAN CONVERT.
- The opportunity to pay taxes now at potentially much lower rates than future years.
- Tax Free growth for you and your heirs.
- Pay no taxes on distribution
- No REQUIRED MINIMUM DISTRIBUTIONS
- An option to defer payment of taxes due from conversion until 2011 and 2012

Charitable Remainder Trust (CRT)

Some benefits of utilizing a Charitable Remainder Trust

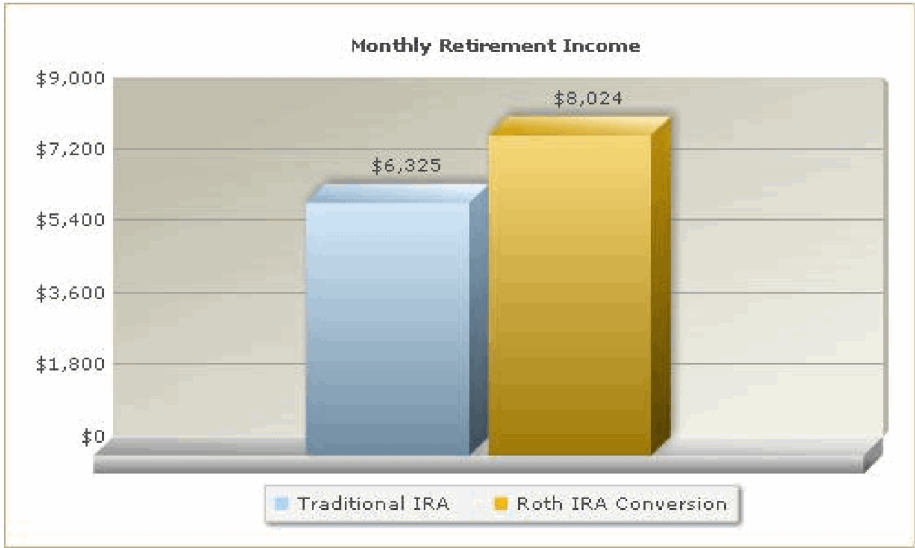
- Income tax deduction in the year trust is funded (could help offset Roth conversion income)
- Income stream back to donor for a term of years or their lifetime
- Value in CRT will not be included in their taxable estate upon their death
- Can be funded with appreciated assets allowing the deferral of capital gains taxes
- Allows one to direct their “social capital” to organizations they truly care about.

Roth Conversion example:

Jimmy Watson is 66 years old and has a Traditional IRA worth \$800,000 that was rolled over from his employer retirement plan upon retirement. Jimmy has not yet begun required minimum distributions, since he has not yet “achieved” the age of 70 ½. Currently, Jimmy is in the 25% tax bracket but expects that the Federal Government will be raising tax rates. He believes he will be paying taxes at a level around 40% in the future. On the following page you will see a calculator from CalcXML that shows how Jimmy could realize about \$1,650 more per month in retirement by utilizing a Roth Conversion in 2010.

Based on the assumptions you provided, your current traditional IRA account might generate a monthly income of \$6,325, converting your Traditional IRA to a Roth IRA you might generate a monthly income of \$8,024.

IRA Conversion Analysis		
Conversion Phase	Traditional IRA	Roth IRA
Current IRA balance: (deductible)	\$800,000	n/a
Current IRA Balance: (non-deductible)	\$0	n/a
Side account	\$200,000	n/a
Roth conversion amount: (before-taxes)	n/a	\$800,000
Less conversion tax liability	n/a	n/a
Plus investment savings for delayed tax payments	\$14,716	n/a
Adjusted beginning comparison balance	\$1,014,716	\$800,000
Accumulation Phase	Traditional IRA	Roth IRA
Estimated IRA balance: (deductible)	\$1,122,042	n/a
Estimated IRA balance: (non-deductible)	\$0	n/a
Estimated side account	\$277,316	n/a
Estimated Roth IRA balance	n/a	\$1,122,042
Estimated value at retirement: (before-taxes)	\$1,399,358	\$1,122,042
Distribution Phase	Traditional IRA	Roth IRA
Yearly income: (deductible)	\$57,770	n/a
Yearly income: (non-deductible)	\$0	n/a
Side account income	\$18,129	n/a
Roth IRA income	n/a	\$96,283
Annual after-tax income	\$75,899	\$96,283
Monthly after-tax income	\$6,325	\$8,024



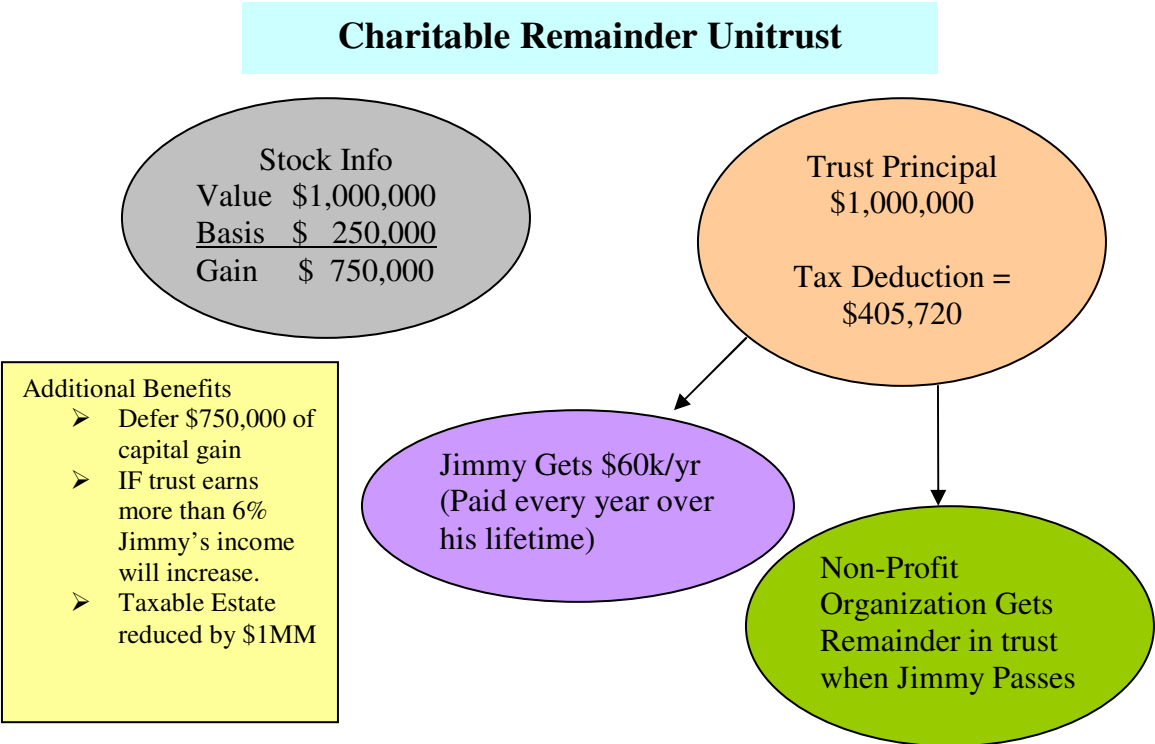
*CalcXML Financial Calculators (Roth Conversion Analysis)
 *Fidelity's proprietary Roth Conversion Evaluator
 *Crescendo Software online "Charitable Unitrust" calculator

Charitable Remainder Unitrust (CRUT) Example:

Now that Jimmy has decided to convert to a Roth IRA, he has started to think about ways to reduce his tax bill for 2010. After all, he will pay tax on the full conversion. If he does nothing, he will write a check to the IRS for an additional \$200,000 over his normal tax bill. Jimmy is a philanthropist and would like to leave some money to charity. However, he is concerned that giving away too much would negatively affect the funds he is counting on for an income stream in retirement. Therefore, he is considering contributing company stock that he has accumulated for many years to a Charitable Remainder Unitrust (CRUT). This trust can pay him an income stream over his lifetime and, after he passes, the principal will be distributed to his favorite non-profit organization. Here are the details:

Current Value of Company Stock:	\$1,000,000
Basis of Company Stock:	\$ 250,000
Payout Rate from Trust:	6%

If Jimmy funds the CRUT with the entire balance of the company stock he could reduce his income tax by about \$100,000 (from Roth Conversion) and receive an income of at least \$60,000 per year from the trust. He would also be able to diversify his concentrated stock holding after contributing to the trust and defer the capital gains from the sale until income was paid from the trust. As an additional benefit, the \$1,000,000 would be removed from his taxable estate. Review the example below:



ALL TOGETHER NOW!

Hopefully you can see how combining the two strategies benefits Jimmy. Here is a “before and after” look.

<p><u>Before Planning</u></p> <ul style="list-style-type: none"> ➤ Jimmy would begin Required Minimum Distributions (RMDs) on the IRA account. ➤ Jimmy’s tax rate would increase when RMDs begin providing a lower monthly income in retirement. ➤ Jimmy has a concentrated stock position with large capital gain impact if sold. ➤ All assets are included in Jimmy’s taxable estate. 	<p><u>After Planning</u></p> <ul style="list-style-type: none"> ➤ The Roth Conversion would allow Jimmy to avoid RMDs on converted dollars. ➤ Money in the Roth would see the benefit of tax free growth and distribution for Jimmy and heirs. ➤ Jimmy would see higher income in retirement from both the Roth IRA and the Charitable Remainder Unitrust (CRUT) ➤ By combining the Roth with the CRUT Jimmy will save an additional \$100k in taxes ➤ Jimmy reduces taxable estate
<p>GOVERNMENT GETS MORE!</p>	<p>Jimmy and Non-Profit get more!!!</p>

Does this make sense for your personal situation? A Thompson & Associates representative can help you sort through some of these issues to help you come up with ideas and possibilities to help you formulate a plan. Then, they can help you work with your professional advisors to work out the best solution for you.

Sources:
 *Personal Notes from Fidelity 2010 Conversion Opportunity Conference Call
 *CalcXML Financial Calculators (Roth Conversion Analysis)
 *Fidelity's proprietary Roth Conversion Evaluator
 *Crescendo Software online “Charitable Unitrust” calculator