

ROTH IRAs & PERSONAL INCOME TAX CREDITS

A review of the 2010 Roth Conversion rules and
personal income tax credits currently available



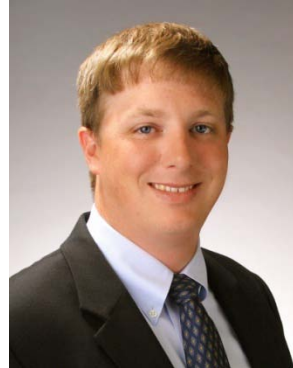
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General Concepts – Roth IRA

- 100% of growth is tax free
- No required minimum distributions (RMD) at age 70½
- \$100,000 Modified Adjusted Gross Income (MAGI) limitation to convert
- For 2010 only, the \$100,000 MAGI limitation no longer applies
 - Taxable income recognized on a 2010 Roth IRA conversion may be spread over the following two tax years (i.e., 2011 and 2012)

□ □ □ □ Convertible Accounts

- Traditional IRAs
- 401(k) plans
- Profit-sharing plans
- 403(b) annuity plans
- 457 plans
- “Inherited” 401(k) plans/IRA’s

Rollover Chart

| | | Roll To | | | | | | | |
|------------------|--|------------------------------------|----------------------|------------|----------------------|----------------------------------|---------------------------------------|----------------------|--|
| | | Roth IRA ¹ | IRA (traditional) | SIMPLE IRA | SEP-IRA | 457(b) | Qualified Plan ⁴ (pre-tax) | 403(b) (pre-tax) | Designated Roth Account (401(k) or 403(b)) |
| Roll From | Roth IRA | YES | NO | NO | NO | NO | NO | NO | NO |
| | IRA (traditional) | YES ² | YES | NO | YES | YES | YES | YES | NO |
| | SIMPLE IRA | YES ² , after two years | YES, after two years | YES | YES, after two years | YES ³ after two years | YES, after two years | YES, after two years | NO |
| | SEP-IRA | YES ² | YES | NO | YES | YES ³ | YES | YES | NO |
| | 457(b) | YES ² , after 12/31/07 | YES | NO | YES | YES | YES | YES | NO |
| | Qualified Plan⁴ (pre-tax) | YES ² , after 12/31/07 | YES | NO | YES | YES ³ | YES | YES | NO |
| | 403(b) (pre-tax) | YES ² , after 12/31/07 | YES | NO | YES | YES ³ | YES | YES | NO |
| | Designated Roth Account (401(k) or 403(b)) | YES | NO | NO | NO | NO | NO | NO | Yes, if a direct trustee to trustee transfer |

¹Subject to [income limits](#) until December 31, 2009

²Must include in income

³Must have separate accounts

⁴Qualified Plans include, for example, Profit-Sharing, 401(k), Money Purchase, Defined Benefit plans

□ □ □ □ Taxation of Roth Distributions

- Qualified distributions are not subject to income tax
 - All growth is 100% tax free
- Non-qualified distributions will be subject to income tax
 - Basis can be withdrawn tax free

Reasons to Convert...

- Higher income tax rates or bracket in future
- Favorable tax attributes
 - Charitable deduction carry-forwards, tax credits, net operating losses, etc.
- Suspension of the RMD rules at age 70½ provides a considerable advantage to the Roth IRA holder.

Reasons to Convert

- Taxpayers benefit from paying income tax before estate tax
 - Removes IRD (income in respect of a decedent) & lowers estate taxes
- Taxpayers who can pay the income tax on the Roth IRA conversion from non IRA funds benefit as a result of greater tax-free yields.

IRA Basis

- If you made non-deductible contributions, not all of the conversion will be taxable
- Must look at all IRA values when calculating non-taxable portion

| | |
|----------------|--------|
| FMV IRA #1 | 70,000 |
| FMV IRA #2 | 30,000 |
| Basis IRA #2 | 10,000 |
| Taxable Income | 90,000 |

Critical Decision Factors

- Tax rate differential
 - conversion vs. withdrawal years
 - pay less tax today than in the future
- Use of “outside funds” to pay the income tax liability
 - avoid penalties and secure more after tax \$ for tax free growth
- Need for IRA funds to meet annual living expenses
- Time horizon

□ □ □ □ Tax Rate Differential

- Key to successful Roth conversions is to keep as much conversion income as possible in current marginal tax bracket
 - However, it may make sense to convert more and go into higher tax brackets

Married Filing Joint Tax Brackets

- Tax rates are projected to increase in 2011. The highest tax bracket will increase from 35% to 39.6%

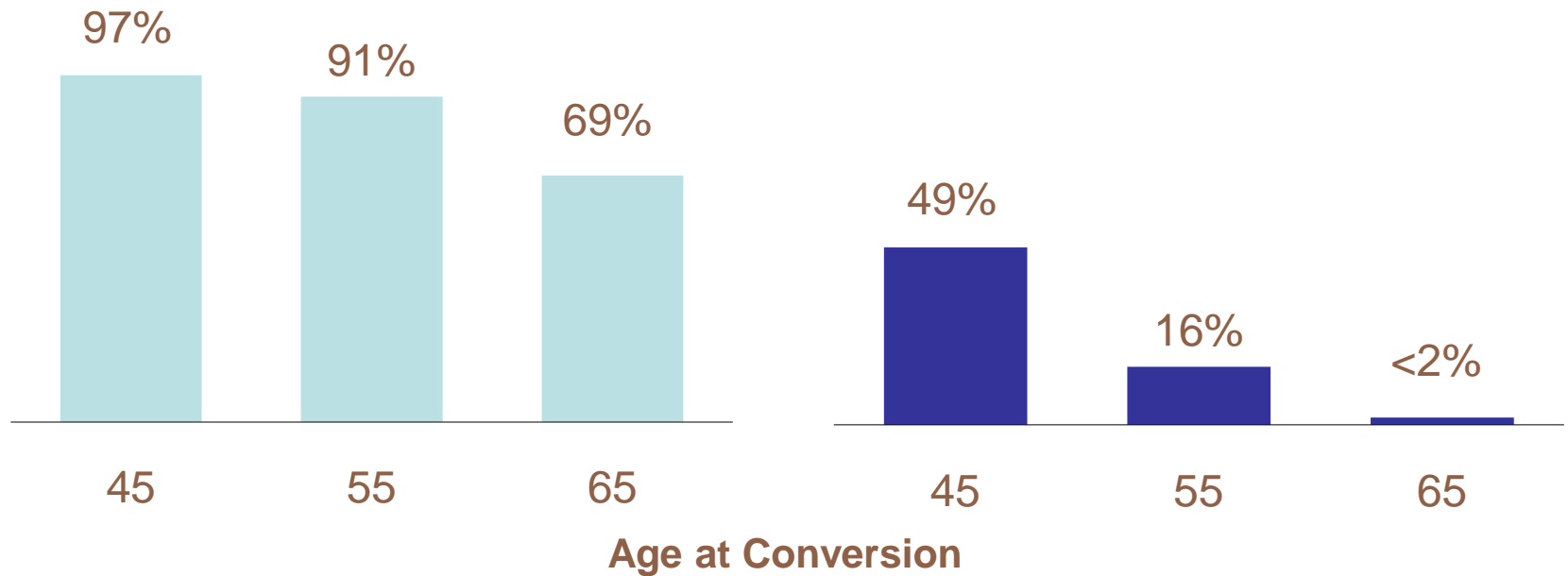
| 2010 | | | | 2011 (PROJECTED) | | | |
|---------|---|---------|-------|------------------|---|---------|-------|
| 0 | | 16,750 | 10.0% | | | | |
| 16,750 | - | 68,000 | 15.0% | 0 | - | 70,040 | 15.0% |
| 68,000 | - | 137,300 | 25.0% | 70,040 | - | 141,419 | 28.0% |
| 137,300 | - | 209,250 | 28.0% | 141,419 | - | 215,528 | 31.0% |
| 209,250 | - | 373,650 | 33.0% | 215,528 | - | 384,860 | 36.0% |
| 373,650 | - | Above | 35.0% | 384,860 | - | Above | 39.6% |

Time Horizon

Probability of Roth Conversion Winning—to Age 85 \$1 Million IRA, Plus \$450,000 Taxable Account (60/40)

10% Drop in Tax Rate

20% Drop in Tax Rate

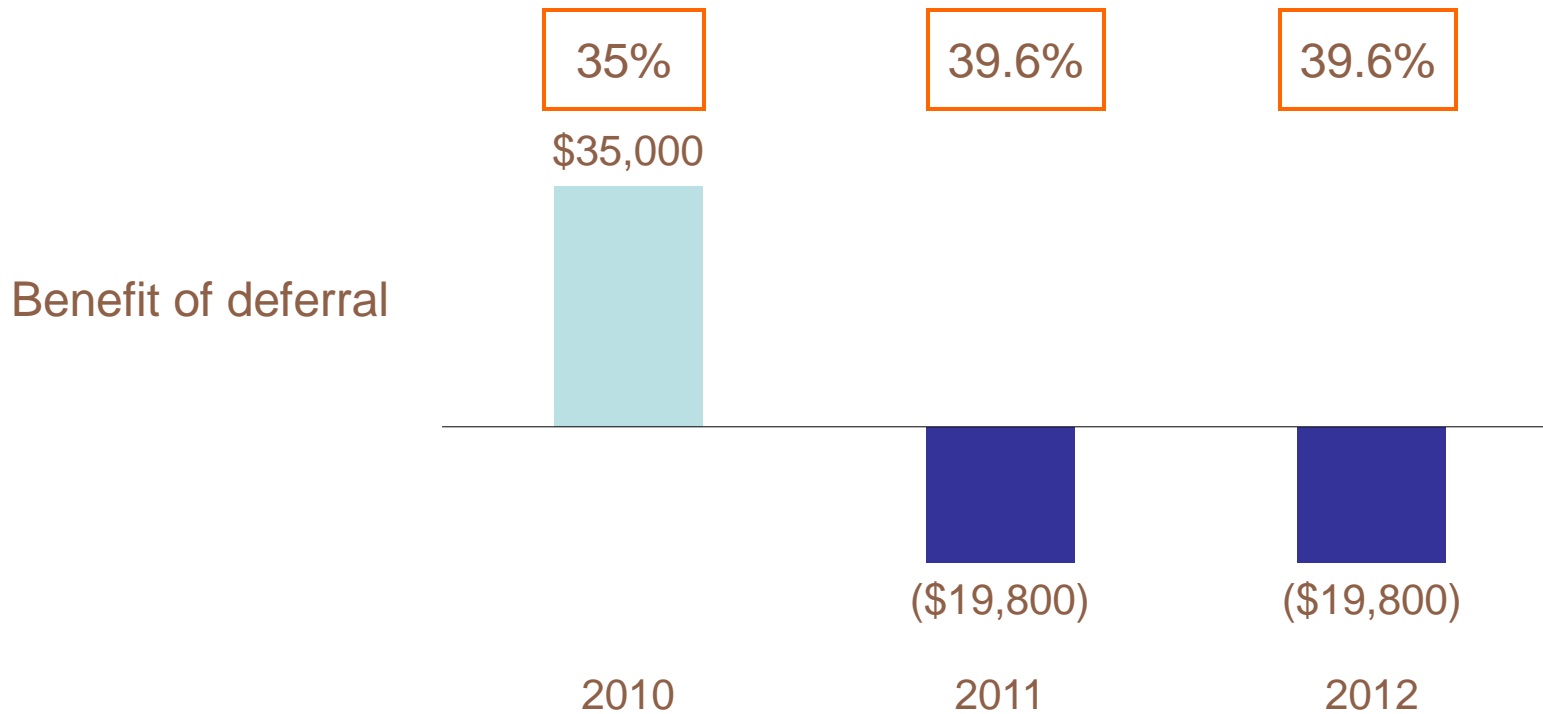


Tactical Considerations...

- Unused charitable contribution carryovers
- Current-year ordinary losses
- Net Operating Loss (NOL) carryovers from prior years
- Alternative Minimum Tax (AMT)
- Credit carryovers

Tactical Considerations

With Income Split Between 2011 and 2012
Converting \$100,000 of an IRA



\$35K *not* paid in 2010 would have to compound at 8.6% per year to “break even”

□ □ □ □ Estate Planning...

- Roth conversions become very beneficial with a stretch
 - Time Horizon plays a large role in determining if a conversion is appropriate
- Not subject to IRD (Income in Respect of a Decedent)
- Reduce taxable estate by paying tax up front on conversion
- Estate Tax Exclusion in 2009 is \$3.5M

Estate Planning

| | Traditional | Roth |
|---------------------------------|----------------|----------------|
| Total Value of IRA in Estate | 1,000,000 | 1,000,000 |
| Gross Federal Estate Tax | (450,000) | (450,000) |
| Taxable IRA Value (IRD) | 550,000 | 550,000 |
| IRD Tax (40%) | (220,000) | - |
| Net IRA to Beneficiaries | 330,000 | 550,000 |
| Total IRA Lost to Taxes | 670,000 | 450,000 |

Recharacterizations...

- “I changed my mind....”
- Taxpayers may “recharacterize” (i.e., undo) a 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 October 15 in the year following year of conversion
- Taxpayers may choose to “reconvert”
 - Reconversion may only take place at the later of (1) Tax year following the original conversion or (2) 30 days after the recharacterization

Recharacterizations

Conversion Period

Recharacterization Period



1/1/2010
First day
conversion can
take place

12/31/2010
Last day
conversion
can take place

4/15/2011
Normal filing
date for 2010
tax return

12/31/2011

10/15/2011
Latest filing date
for 2010 tax
return/last day
to recharacterize
2010 Roth IRA
conversion

Recharacterization Planning

- Taxpayers cannot recharacterize a portion of a Roth conversion by “cherry picking” only assets that decline in value
 - All gains and losses to the entire Roth IRA must be pro-rated
- Bypass this by setting up multiple Roth IRA’s by asset class/holdings/etc.

The Case for Account Segregation

| 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|--------------------------------|-------------------------------|------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|--------------------------------|--------------------------------|--------------------------------|-------------------------------|-------------------------------|------------------------------|-------------------------------|-------------------------------|--------------------------------|-------------------------------|
| BONDS 9.16% | SMALL GROWTH STOCKS 51.19% | SMALL VALUE STOCKS 29.14% | FOREIGN STOCKS 32.95% | FOREIGN STOCKS 8.06% | LARGE VALUE STOCKS 38.35% | REAL ESTATE STOCKS 37.04% | LARGE VALUE STOCKS 35.18% | LARGE GROWTH STOCKS 38.71% | SMALL GROWTH STOCKS 43.09% | REAL ESTATE STOCKS 31.04% | SMALL VALUE STOCKS 14.02% | BONDS 9.82% | SMALL GROWTH STOCKS 48.56% | REAL ESTATE STOCKS 31.49% | REAL ESTATE STOCKS 14.00% | REAL ESTATE STOCKS 35.97% | LARGE GROWTH STOCKS 11.81% | BONDS 5.70% | MID CAP STOCKS 32.63% |
| LARGE GROWTH STOCKS -0.26% | SMALL VALUE STOCKS 41.70% | MID CAP STOCKS 16.34% | SMALL VALUE STOCKS 23.85% | LARGE GROWTH STOCKS 2.67% | LARGE STOCKS 37.58% | LARGE GROWTH STOCKS 23.12% | LARGE STOCKS 33.36% | LARGE STOCKS 28.58% | LARGE GROWTH STOCKS 33.16% | SMALL VALUE STOCKS 22.83% | REAL ESTATE STOCKS 12.25% | REAL ESTATE STOCKS 3.60% | SMALL VALUE STOCKS 46.07% | SMALL VALUE STOCKS 22.25% | FOREIGN STOCKS 13.54% | FOREIGN STOCKS 26.35% | FOREIGN STOCKS 11.17% | SMALL VALUE STOCKS -28.92% | SMALL GROWTH STOCKS 29.21% |
| LARGE STOCKS -3.11% | MID CAP STOCKS 41.51% | REAL ESTATE STOCKS 15.13% | LARGE VALUE STOCKS 18.12% | REAL ESTATE STOCKS 2.66% | LARGE GROWTH STOCKS 37.19% | LARGE STOCKS 22.96% | SMALL VALUE STOCKS 31.79% | FOREIGN STOCKS 20.33% | FOREIGN STOCKS 27.30% | BONDS 10.10% | BONDS 8.96% | SMALL VALUE STOCKS -11.42% | MID CAP STOCKS 40.11% | FOREIGN STOCKS 20.66% | MID CAP STOCKS 12.65% | SMALL VALUE STOCKS 23.48% | BONDS 7.39% | LARGE VALUE -36.85% | FOREIGN STOCKS 28.97% |
| LARGE VALUE STOCKS -8.08% | LARGE GROWTH STOCKS 41.16% | LARGE VALUE STOCKS 13.81% | REAL ESTATE STOCKS 15.14% | LARGE STOCKS 1.32% | MID CAP STOCKS 34.45% | LARGE VALUE STOCKS 21.64% | LARGE GROWTH STOCKS 30.49% | LARGE VALUE STOCKS 15.63% | LARGE STOCKS 21.05% | MID CAP STOCKS 8.25% | LARGE VALUE STOCKS -5.59% | LARGE VALUE STOCKS -15.52% | FOREIGN STOCKS 39.67% | MID CAP STOCKS 20.19% | LARGE VALUE STOCKS 7.05% | LARGE VALUE STOCKS 22.25% | SMALL GROWTH STOCKS 7.05% | LARGE STOCKS -37.00% | LARGE GROWTH STOCKS 27.11% |
| MID CAP STOCKS -11.50% | LARGE STOCKS 30.47% | SMALL GROWTH STOCKS 7.77% | MID CAP STOCKS 14.30% | SMALL VALUE STOCKS -1.55% | SMALL GROWTH STOCKS 31.04% | SMALL VALUE STOCKS 21.37% | MID CAP STOCKS 29.00% | MID CAP STOCKS 10.10% | MID CAP STOCKS 18.23% | LARGE VALUE STOCKS 7.01% | MID CAP STOCKS -5.62% | FOREIGN STOCKS -15.94% | REAL ESTATE STOCKS 37.06% | LARGE VALUE STOCKS 16.48% | LARGE GROWTH STOCKS 5.26% | LARGE STOCKS 15.79% | MID CAP STOCKS 5.60% | LARGE GROWTH STOCKS -38.44% | LARGE STOCKS 19.26% |
| SMALL GROWTH STOCKS -17.41% | LARGE VALUE STOCKS 24.61% | LARGE STOCKS 7.62% | SMALL GROWTH STOCKS 13.36% | BONDS -1.93% | SMALL VALUE STOCKS 25.75% | MID CAP STOCKS 18.99% | REAL ESTATE STOCKS 19.67% | BONDS 8.42% | LARGE VALUE STOCKS 7.35% | LARGE STOCKS -9.11% | SMALL GROWTH STOCKS -9.23% | MID CAP STOCKS -16.19% | LARGE VALUE STOCKS 30.03% | SMALL GROWTH STOCKS 14.30% | LARGE STOCKS 4.91% | MID CAP STOCKS 15.28% | LARGE STOCKS 5.49% | SMALL GROWTH STOCKS -38.54% | REAL ESTATE STOCKS 17.65% |
| SMALL VALUE STOCKS -21.78% | REAL ESTATE STOCKS 23.84% | BONDS 7.17% | LARGE STOCKS 10.08% | LARGE VALUE STOCKS -1.99% | BONDS 15.31% | SMALL GROWTH STOCKS 11.26% | SMALL GROWTH STOCKS 12.95% | SMALL GROWTH STOCKS 1.23% | BONDS 0.39% | FOREIGN STOCKS -13.96% | LARGE STOCKS -11.76% | LARGE STOCKS -22.09% | LARGE GROWTH STOCKS 29.77% | LARGE STOCKS 10.88% | SMALL VALUE STOCKS 4.71% | SMALL GROWTH STOCKS 13.35% | LARGE VALUE STOCKS -0.17% | REAL ESTATE STOCKS -39.20% | SMALL VALUE STOCKS 16.36% |
| FOREIGN STOCKS -23.20% | BONDS 14.60% | LARGE GROWTH STOCKS 5.00% | BONDS 8.78% | MID CAP STOCKS -2.09% | REAL ESTATE STOCKS 12.24% | FOREIGN STOCKS 6.36% | BONDS 7.87% | SMALL VALUE STOCKS -6.45% | SMALL VALUE STOCKS -1.49% | LARGE GROWTH STOCKS -22.42% | LARGE GROWTH STOCKS -20.42% | LARGE GROWTH STOCKS -27.89% | LARGE STOCKS 28.72% | LARGE GROWTH STOCKS 6.29% | SMALL GROWTH STOCKS 4.15% | LARGE GROWTH STOCKS 9.07% | SMALL VALUE STOCKS -9.78% | MID CAP STOCKS -41.46% | LARGE VALUE 14.85% |
| REAL ESTATE STOCKS -23.44% | FOREIGN STOCKS 12.50% | FOREIGN STOCKS -11.85% | LARGE GROWTH STOCKS 2.90% | SMALL GROWTH STOCKS -2.43% | FOREIGN STOCKS 11.55% | BONDS 4.06% | FOREIGN STOCKS 2.06% | REAL ESTATE STOCKS -17.00% | REAL ESTATE STOCKS -2.57% | SMALL GROWTH STOCKS -22.43% | FOREIGN STOCKS -23.27% | SMALL GROWTH STOCKS -30.27% | BONDS 4.30% | BONDS 4.19% | BONDS 1.58% | BONDS 4.41% | REAL ESTATE STOCKS -17.56% | FOREIGN STOCKS -43.38% | BONDS 5.72% |

*Performance through 09/30/2009

Large Value Stocks are represented by the Russell 1000 Value Index.
 Large Growth Stocks are represented by the Russell 1000 Growth Index.
 Large Stocks are represented by the S&P 500 Index.
 Mid Cap Stocks are represented by the Russell Mid Cap Index.
 Small Value Stocks are represented by the Russell 2000 Value Index.
 Small Growth Stocks are represented by the Russell 2000 Growth Index.
 Foreign Stocks are represented by the MSCI EAFE Index.
 Real Estate Stocks are represented by the Dow Jones US Select REIT Index.
 Bonds are represented by the Lehman Brothers Intermediate Gov/Credit Index.

Home Buyer Credits...

- ❑ 1st time home buyer credit
 - \$8,000 refundable credit (10% of purchase price, if less)
 - No prior home ownership for 3 years
 - Binding contract by 4/30/2010, close by 6/30/2010
 - Can claim credit for 2010 purchase on 2009 tax return
 - Phase-out \$150K (\$225K @ 11/7/2009) of AGI for couples
 - Effective 11/7/2009, purchase price limited to \$800K and settlement statement must be attached to the return
 - Recapture if not principal residence during first 36 months
 - 2008 “credit” was \$7,500 with 15 year payback
- ❑ Extended ownership credit (effective 11/7/2009)
 - \$6,500 (10% if less) refundable credit on new home purchase
 - Primary residence 5 consecutive out of last 8 years
 - Same as above for contract dates, phase-outs, and return attachments

Home Buyer Credits

□ Georgia

- Lesser of \$1,800 or 1.2% of purchase price
- Credit is spread over 3 years
- Home must be listed for sale on or before May 11, 2009, or
- Bought from the lender out of foreclosure, or
- Owner-occupied with acquisition indebtedness in default on or before March 1, 2009
- Home must have been purchased between June 1 and November 30, 2009
- Limited to state tax liability, can carry forward but not back
- Form IND-CR, Part 9
- Supporting documentation required

Energy Credits

- ❑ Personal residence energy credit
 - 2009 and 2010
 - 30% up to \$1,500 (over 2-yr period) ($\$5,000 \times 30\% = \$1,500$)
 - Insulation, exterior doors, windows, furnace, heat pump, water heater, central air conditioner, certain metal roofs
 - Nonrefundable credit
- ❑ Personal residence green credit (Res. Energy Efficient Prop. Cr.)
 - 2006 Through 2016
 - 30% of the cost of qualified property
 - Solar water heating, geothermal heat, wind and solar electric property
 - Nonrefundable credit, but can carry forward indefinitely

Alternative Motor Vehicle Credits

- ❑ Qualified Hybrid Vehicles
 - Current maximum is \$3,400
 - Toyota, Lexus, and Honda have already expired
 - Ford and Mercury will expire after March 31, 2010
 - Nonrefundable
- ❑ Advanced Lean-Burn Technology Motor Vehicle Credit
 - German diesel sedans
 - Current maximum is \$1,800
- ❑ Plug-in Electric Motor Drive Vehicle Credit
 - Public road use (includes golf cart on steroids)
 - Minimum credit is \$2,500
 - Maximum credit is \$15,000 (weight & battery capacity)
 - Will phase out after 200,000 units sold, per manufacturer

Education Credits

❑ American Opportunity Credit

- Formerly Hope Credit
- \$2,500 (100% of first \$2,000, 25% of next \$2,000)
- Enrolled in a degree program
- Up to four years undergraduate, per student
- Books and supplies are qualified expenses
- Partially refundable (40%)

❑ Lifetime Learning Credit

- \$2,000 (20% of \$10,000) includes graduate
- Limit is per return, not per student
- Books and supplies only if required as condition of enrollment
- Nonrefundable

❑ Strategy

- If parents can not benefit due to phase-outs, may be claimed on student's tax return if no one claims the dependency exemption for the student

Cancellation of Debt Income

- ❑ Residential cancellation of debt income (CODI)
 - Exclude up to \$2 mil CODI (\$1 mil single)
 - Qualified principal residence indebtedness (2 of last 5 years)
 - 2007 to 2012
- ❑ Cancellation of business debt income – QRPBI
 - Exclude CODI down to FMV of asset, also reduce basis
 - Generated from foreclosure or debt modification
 - Sale versus CODI
 - Recourse debt = part sale @ FMV, part CODI @ debt balance
 - Nonrecourse debt = sale @ debt balance
 - Insolvency exclusions may be able to shelter CODI [Section 108(a)]
 - CODI deferral available to 2014, then 5 year spread on qualified indebtedness income (election is irrevocable) [Section 108(i)]