College of William & Mary Law School
William & Mary Law School Scholarship Repository

William & Mary Annual Tax Conference | Conferences, Events, and Lectures

2010

Roth IRAs Planning for 2010...And Beyond

Mitchell A. Drossman

Lester B. Law

Repository Citation
Drossman, Mitchell A. and Law, Lester B., "Roth IRAs Planning for 2010...And Beyond" (2010). *William & Mary Annual Tax Conference.* Paper 14.
http://scholarship.law.wm.edu/tax/14

Copyright c 2010 by the authors. This article is brought to you by the William & Mary Law School Scholarship Repository.
http://scholarship.law.wm.edu/tax

U.S. TRUST
Bank of America Private Wealth Management

Roth IRAs
Planning for 2010
... And Beyond

November 2010

Presented by:

____

U.S. Trust, Bank of America Private Wealth Management

Materials written by:
Mitchell A. Drossman, Managing Director
Lester B. Law, Senior Vice President
National Wealth Planning Strategies Group
U.S. Trust, Bank of America Private Wealth Management

I. Historical Perspective

A. Individual Retirement Accounts ("IRAs") were originally introduced in the Nixon Administration and the law governing IRAs was enacted under ERISA in 1974.[1]

1. In 1997, the Roth IRA was introduced as a new type of IRA.[2]
2. In general, Roth IRAs[3] are similar to Traditional IRAs.[4] If there is no rule under IRC § 408A (or the Treasury's Regulations thereunder) for a Roth IRA, then the Traditional IRA rules under IRC § 408 apply.[5]
3. From its inception in 1997 through 2009 the use of Roth IRAs as retirement vehicles had little application for the higher-income and higher-net worth individuals, primarily because of the limitations.
   a. There were two limitations that applied:
      i. Limits on "*regular contributions*"[6]; and
      ii. Limit on "*conversions*".[7]
   b. Limits for *regular contributions* and *conversions* are discussed below in detail in Sections IV and V.G, respectively.
4. As of January 1, 2010, the higher-income earner and higher-net worth individual, as a result of the changes under TIPRA,[8] will be able to use Roth IRAs because there will be **no** limitations on *conversions*. However, limits on *regular contributions* will still exist.[9]

---

[1] Employment Retirement Income Security Act of 1974 ("ERISA") PL 93-406.

[2] Taxpayer Relief Act of 1997 ("TRA 97") PL 105-34.

[3] "Roth IRAs" will be referred to as IRAs governed under Section 408A of the Internal Revenue Code of 1986 (hereinafter, sometimes referred to as "IRC §" or "Code §", as such sections are in existence as of the date of this outline).

[4] "Traditional IRAs" will be referred to IRAs governed under IRC § 408.

[5] IRC §408A(a); Treas. Reg. §1.408A-1, Q&A-1(a) and (b); and Rev. Proc 98-59, 1998-2 CB 727

[6] Code § 408A(d)(4)(B)(ii) defines the annual or regular contributions as "contributions **other than** qualified rollover contributions to which section 408A(d)(3) applies (which the author defines as "*conversions*"). For purposes of this outline, the author uses the term 'regular contribution' (which is also sometimes used in the Treasury's regulations) to mean contributions other than 'conversions'. Additionally, for purposes of this outline, generally, we will assume that there are only two ways to fund the Roth IRA: (a) *regular contributions*; and (b) *conversions* (see Footnote 7 below).

[7] The term "*conversions*" will be used in this outline to mean "qualified rollover contributions to a Roth IRA from an individual retirement plan (or eligible retirement plan) other than a Roth IRA" as such term is defined in Code § 408A(d)(3).

[8] Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA") PL 109-222.

[9] Section 512(a) of TIPRA only removed the limitations for *conversions*, not *contributions*, by striking Code § 408A(c)(3)(B) (as it existed before TIPRA) and re-designating Section 408A(c)(3)(C) and (D) (as new) (B) and (C) and slightly modifying the new provisions. These changes eliminated the filing status and MAGI limitations that existed since 1997. Code § 408A(c)(3)(A) applies the rules related to *contributions*; this code section was **not** changed. As a practical matter, this is a case where the exception has swallowed the rule. For instance, if the taxpayer exceeds the Roth IRA income limitations for contributions, the taxpayer could make a non-deductible contribution to a Traditional IRA and thereafter convert that Traditional IRA to a Roth IRA. Some practitioners indicate that one may want to have a "waiting period" between the contribution to the Traditional IRA and conversion to the Roth IRA. It should be noted, at the time of writing this outline there is no statutory, regulatory or other pronouncements by the IRS which requires a waiting period; so, technically, one could contribute and

II. Overview

A. The three most cited benefits of Roth IRAs are:

a. Minimum required distributions for the participant are not required.[10] This translates to greater after-tax accumulation after one would have reached his or her required beginning date (i.e., the year in which one turns 70 ½).

b. Tax-free distributions (if they are "qualified distributions" (defined below));[11] and

c. No maximum age for making contributions[12] (whether *regular contributions* or *conversions*.[13]

B. For individuals whose estates may be subject to estate tax, converting a Traditional IRA to a Roth IRA may allow them to pass more assets to descendants and loved ones. The analysis requires "running the numbers", using reasonable expectations, variables and common sense. The factors to be considered and the analysis are discussed below.

C. Additionally, in light of the changes to the Roth IRA rules, it appears that conventional advice of "leaving one's Traditional IRA to charity" may not yield as good a result as converting one's Traditional IRA to a Roth IRA and leaving other assets to charity. See our discussion and analysis below.

D. Creation of a Roth IRA is relatively easy; it may be formed as a trust account, custodial account or annuity contract account.[14]

1. There are three (3) major ways to fund a Roth IRA:

a. Direct contributions;

b. Rollover from a Traditional IRA; or

c. Rollover from a designated Roth account.[15]

2. When there is a rollover from a Traditional IRA (or eligible qualified plan[16]), it is treated as a distribution from the Traditional IRA and a contribution to the Roth IRA.[17]

---

convert on the same day. We take no position on whether this is recommended. Please seek the advice of your tax advisor.

10 IRC §408A(c)(5), provides that the mandatory distribution rules under IRC § 401(a)(9)(A) (also known as the minimum required distribution (or "MRD") rules) do not apply to a Roth IRA during the life of the participant. For purposes of this rule, when a surviving spouse inherits a Roth IRA (from the decedent spouse) and if the surviving spouse ("SS") elects to treat the IRA as SS's own, then for purposes of the MRD rules, one treats the SS as if the SS is the participant. (See, Treas. Reg. §§ 1.408A-2, Q&A 2, and 1.408A-8, Q&A 5(b)). Further, if the participant dies and leaves the IRA to a designated beneficiary, who is (a) someone other than the SS, or (b) the SS, and the SS elects to treat the Roth IRA as an inherited Roth IRA (and **not** as his or her own), then the MRD rules under Code § 401(a)(9)(B) would apply. After the participant's death, according to Treas. Reg. §1.408A-6, Q&A 14(b), the RMD rules would apply to the Roth IRA as though the participant (regardless of his or her age at death) had not reached his or her Required Beginning Date.

11 See discussion below at section VI, below on page 10 of this outline.

12 Generally the author will use the term "contribution" (which is not *italicized*) to have the generic meaning given to it under the Code.

13 Code §§ 408A (c)(2)(A) and (c)(4).

14 Code §§408A (b) and 7701(a)(37).

15 Treas. Reg. § 1.408A-2, Q&A 2, and Treas. Reg. § 1.408A-4, Q&A 1(b)(1), (2) and (3).

III. Establishing a Roth IRA

A. In general

1. A Roth IRA can be funded in two ways:
   a. *Regular contributions* (i.e., depositing cash into a Roth IRA); and
   b. Qualified rollover contributions[18] (called "*conversions*" for purposes of this outline).[19]
2. The focus of this outline will be on *conversions*.

B. Traditionally, *regular contributions* and *conversions* are limited by a taxpayer's filing status and modified adjusted gross income ("MAGI").[20] After 2010, the filing status and MAGI limitations are removed for *conversions*, but not for *regular contributions*.[21]

C. Roth IRAs are for individuals.[22]

1. Individuals can establish Roth IRAs for themselves.
2. Parents of minor children are permitted to establish Roth IRAs on behalf of minor children. However, some institutions may not allow this. It should be noted that under NASD rules, a minor is not allowed to create a brokerage account for him or herself. It does not, however, preclude a parent from creating a custodial account for a minor.

IV. Regular Contributions

A. There are limits on *regular contributions* to a Roth IRA. Under current law these limits will not change in 2010; thus, they will still be in effect for the foreseeable future.[23]

1. There are two limitations:
   a. Dollar Limitation; and[24]
   b. MAGI Limitation.[25]
2. Dollar Limitation

---

16 Section 824 of the Pension Protection Act of 2006 ("PPA") (PL 109-280) provided for the inclusion of converting eligible retirement plans (defined under Code §402(c)(8)(B)) along with Traditional IRAs after December 31, 2007. Thus, from 2008 forward generally qualified retirement plans can be converted directly to a Roth IRA. *See*, PPA Section 824(b)(1).

17 Treas. Reg. § 1.408A-4, Q&A 1(c).

18 Technically, a rollover from a Roth IRA to another Roth IRA is a "qualified rollover contribution". For our purposes of this outline, since rollovers from one Roth to another Roth has no impact, and since we are discussing the benefits and burdens of conversions from a Traditional IRA, eligible plan, § 403(b) or § 457 plan to a Roth IRA, we will simply ignore rollovers from one Roth IRA to another Roth IRA.

19 Treas. Reg. § 1,408A-3, Q&A 1.

20 Modified Adjusted Gross Income ("MAGI") is defined under Code § 408A(c)(3). The Code references Code § 219(g), which generally provides that the participant's adjusted gross income is increased or decreased for the conversion income, the traditional IRA deduction, student loan interest expense, foreign earned income tax exclusion, and other miscellaneous exclusions and deductions. Note: Since there will be no MAGI limitation after 2010, the author will not detail the actual mechanics of how MAGI is computed for *conversions*.

21 *See* Note 9 *supra*.

22 Treas. Reg. § 1.408A-2, Q&A 1.

23 *See* Note 9, *supra*.

24 Code § 219(b)(1)(B), by reference from Code § 408A(c)(2)(A); Treas. Reg. § 1.408A-3, Q&A 3.

25 Code § 408A(c)(3)(A); Code § 219(g)(3)(A).

a. The amount of the *regular contribution* is limited to 100% of the individual's compensation, reduced by contributions to all other individual retirement plans for the individual's benefit.[26]
b. This limit applies equally to Traditional and Roth IRAs; however, the non-deductibility of *regular contributions* for individuals over the age of 70 ½ and the AGI phase-out for active participants is disregarded for Traditional IRAs.[27]
c. The maximum *regular contribution* is as follows:
   i. 2010 - $5,000[28]
   ii. 2009 - $5,000
   iii. 2008 - $5,000
   iv. 2007 - $4,000
d. The participant may make an additional $1,000 contribution for 2010, 2009, 2008 and 2007, if he or she is 50 years or older on or before year end. For years prior to 2007, the addition was $500.[29]
e. Note: There are different dollar limitations for other qualified plan participants.[30] For instance, there is no limitation for Roth 401k plans.

3. MAGI Limitation
   a. The "dollar limitation" is phased out based upon the individuals:
      i. AGI (or modified AGI);[31] and
      ii. Filing status.[32]
   b. MAGI is determined as set forth under Code § 219(g)(3)(A).

B. Filing Status
   1. There are different limitations based upon filing status, as follows:
      a. Single Persons
      b. Married Filing Jointly
      c. Married Filing Separately
      d. Combined Rule
         i. For 2010

	Phased out with MAGI between the following Amounts
Single	105,000 - $120,000
Married Filing Jointly	167,000 - $177,000
Married Filing Separately	$0 - $10,000

26 Code § 219(b)(1)(B), by reference from Code § 408A(c)(2)(A); Treas. Reg. § 1.408A-3, Q&A 3.
27 Code §408A(c)(2)(A).
28 Each year, the amount may be increased for cost of living adjustments (COLA). Based on IRS projections, there will be no increase for 2010, see IRS Notice 2009-94.
29 Code § 219(b)(1)(B).
30 Code § 219(b)(5)(C).
31 Code § 408A(c)(3)(A).
32 Code § 408A(c)(3).

ii. For 2009

	Phased out with MAGI between the following Amounts
Single	105,000 - $120,000
Married Filing Jointly	166,000 - $176,000
Married Filing Separately	$0 - $10,000

2. A person who files separately can make *regular contributions* to a Roth IRA (subject to the MAGI of $10,000); however, a married person filing separately[33] cannot *convert* his or her Traditional IRA to a Roth IRA.
3. Examples: See, Treas. Reg. §1.408A-3 Q&A 3(c) for more details and examples of these rules.[34]

---

[33] *See infra* Note 57 (discussing the special rule for married persons filing separately for IRAs).

[34] Treas. Reg. § 1.408A-3, Q&A 3 provides the rules regarding the contribution limitations, as follows:

***"Q-3.** What is the maximum aggregate amount of regular contributions an individual is eligible to contribute to a Roth IRA for a taxable year?*

***A-3.** (a) The maximum aggregate amount that an individual is eligible to contribute to all his or her Roth IRAs as a regular contribution for a taxable year is the same as the maximum for traditional IRAs: $2,000 or, if less, that individual's compensation for the year. (Author's note: The $2,000 is currently $5,000)*

(b) For Roth IRAs, the maximum amount described in paragraph (a) of this A-3 is phased out between certain levels of modified AGI. For an individual who is not married, the dollar amount is phased out ratably between modified AGI of $95,000 and $110,000 (Author's Note: This amount is $105,000 to $120,000 for 2010); for a married individual filing a joint return, between modified AGI of $150,000 and $160,000 (Author's Note: This amount is $167,000 and $177,000 for 2010); and for a married individual filing separately, between modified AGI of $0 and $10,000. This does not change for 2010). For this purpose, a married individual who has lived apart from his or her spouse for the entire taxable year and who files separately is treated as not married. Under section 408A(c)(3)(A), in applying the phase-out, the maximum amount is rounded up to the next higher multiple of $10 and is not reduced below $200 until completely phased out.

(c) If an individual makes regular contributions to both traditional IRAs and Roth IRAs for a taxable year, the maximum limit for the Roth IRA is the lesser of—

(1) The amount described in paragraph (a) of this A-3 reduced by the amount contributed to traditional IRAs for the taxable year; and

(2) The amount described in paragraph (b) of this A-3. Employer contributions, including elective deferrals, made under a SEP or SIMPLE IRA Plan on behalf of an individual (including a self-employed individual) do not reduce the amount of the individual's maximum regular contribution.

(d) The rules in this A-3 are illustrated by the following examples:

Example (1). In 1998, unmarried, calendar-year taxpayer B, age 60, has modified AGI of $40,000 and compensation of $5,000. For 1998, B can contribute a maximum of $2,000 to a traditional IRA, a Roth IRA or a combination of traditional and Roth IRAs.

Example (2). The facts are the same as in Example 1. However, assume that B violates the maximum regular contribution limit by contributing $2,000 to a traditional IRA and $2,000 to a Roth IRA for 1998. The $2,000 to B's Roth IRA would be an

C. Rule Swallow's the Exception

1. As detailed in Footnote 9, this may be the case where the "exception swallows the rule.
2. As set forth above, by removing the income and marital status limitations for conversion, a suggested strategy is to simply make a non-deductible contribution to a Traditional IRA and at some future point convert that non-deductible contribution to a Roth IRA. As stated in Footnote 9, some planners suggest that no waiting period is necessary (a literal reading of the Code and Treasury Regulations) and some would suggest some waiting period (i.e., converting in the year after the contribution).[35]

V. Conversions (Qualified Rollover Contributions)

A. Definition of Qualified Rollover Contributions

1. The ability for an individual to "rollover" his/her Traditional IRA, or other eligible plans (e.g., 401(k), 403(b), and/or 457 plans) to a Roth IRA.[36]
2. The ability for an individual to "rollover" a Roth IRA to another Roth IRA.[37] A qualified rollover contribution may also be from a designated Roth 401(a) or 403(b) to a Roth IRA. However, no amount distributed from a Roth IRA may be rolled over or transferred to a designated Roth account under 401(a) or 403(b) (i.e., the one way street rule).[38] This is true even if the Roth IRA

---

excess contribution to B's Roth IRA for 1998 because an individual's contributions are applied first to a traditional IRA, then to a Roth IRA.

Example (3). The facts are the same as in Example 1, except that B's compensation is $900. The maximum amount B can contribute to either a traditional IRA or a Roth (or a combination of the two) for 1998 is $900.

Example (4). In 1998, unmarried, calendar-year taxpayer C, age 60, has modified AGI of $100,000 and compensation of $5,000. For 1998, C contributes $800 to a traditional IRA and $1,200 to a Roth IRA. Because C's $1,200 Roth IRA contribution does not exceed the phased- out maximum Roth IRA contribution of $1,340 and because C's total IRA contributions do not exceed $2,000, C's Roth IRA contribution does not exceed the maximum permissible contribution.

The author encourages the initiated to read and study these examples; they are very good in explaining how the rules for *regular contributions* are applied.

[35] If one waits, then any appreciation would be taxed as ordinary income on the conversion.

[36] Code § 408A(e)(1)(A); Treas. Reg. § 1.408A-5, Q&A 1. Note, the Treasury Regulations were written before the recent change under PL 109-208 where, prior to 2008, only contributions from Traditional IRAs could be rolled-over to Roth IRAs. Stated differently, eligible retirement plans (under Code § 401(a), 403(a), 403(b), and 457 plans) could not have been *converted* to a Roth IRA prior to 2008. Although a qualified rollover contribution to a Roth IRA could not have been directly rolled-over, it did not preclude a rollover from the qualified plan to a Traditional IRA and then a conversion from the Traditional IRA to a Roth IRA. Presumably, the regulations would apply equally to qualified rollover contributions from qualified plans, as they apply to Traditional IRAs, and, therefore, Q&A 5 of Treas. Reg. § 1.408A-5 is obsolete. Note: Treas. Reg. § 1.408A-5, Q&A 1, states that "*the Roth IRA must satisfy the definition of a qualified rollover contribution in section 408A(e) (i.e., it must satisfy the requirements for a rollover contribution as defined in section 408(d)(3), except that the one-rollover-per-year limitation in* [Code] *section 408(d)(3)(B) does not apply).*" It should also be noted that the term is first used in Section 408A(d)(3)(A)(i), where it sets forth the rule that conversions are includible in ordinary income.

[37] Code § 408A(e)(1)(A).

[38] *See*, Treas. Reg. §1.408A-10 – Q&A 1 and 2.

was originally funded from the designated Roth account under 401(a) or 403(b).

3. A SEP IRAs can be *converted* to a Roth IRA.[39] However, the Code did not create an IRA called a "designated Roth SEP IRA"; thus, a SEP IRA cannot be converted to a "designated Roth SEP IRA" (because it does not exist). Stated otherwise, a SEP IRA may not be a "designated Roth IRA".[40]
4. A SIMPLE IRA can be *converted* to a Roth IRA,[41] however, only after the 2 year period (i.e., from date of contribution for 2 years) has expired. As with SEP IRAs, there is no IRA called a "designated Roth SIMPLE IRA."

B. How to convert?

1. There are three methods outlined in the Regulations explaining how to convert from a Traditional IRA (including qualified plans) to a Roth IRA.
   a. A distribution from Traditional IRA (or other eligible account) followed by a contribution to Roth IRA (within 60 days of the distribution).[42]
   b. A transfer from the Trustee of a Traditional IRA (or qualified plan) to the Trustee of a Roth IRA (the so-called "Trustee-to-Trustee" transfer).[43]
   c. Re-designating (or re-naming) the Traditional IRA account to a Roth IRA account.[44]
2. All three methods are treated as if there was a distribution from the Traditional IRA (or plan) account and a contribution to the new Roth IRA account.[45]
3. A transaction that is treated as a failed conversion[46] is **not** treated as a *conversion*.[47]
4. Planning Note: The author believes that it is best to first create a new Roth IRA account (or accounts). Then, transfer the assets from the Traditional IRA to the new Roth IRA utilizing the Trustee to Trustee transfer. The rationale behind this lies in the planning opportunities set forth utilizing the re-characterization rules. See discussion on "re-characterization" below in Section VII, beginning on page 20, of this outline.

---

39 Treas. Reg. §1.408A-1 Q&A – 4(a). Under Treas. Reg. §1.408A-1 Q&A – 4(c), once the SEP IRA (or the SIMPLE IRA) has been *converted*, no further SEP IRA or SIMPLE IRA contributions can be made to those IRAs. The apparent rationale is that tax vehicles called Roth SEP IRA or a Roth SIMPLE IRA do not exist. After *converting* the SEP or SIMPLE IRA to a Roth IRA and the SEP and SIMPLE IRA contributions are not possible.

40 Code § 408A(f).

41 Treas. Reg. §1.408A-1 Q&A – 4(a). *See,* Note 39 *supra*.

42 Treas. Reg. § 1.408A-4 Q&A – 1(b)(1). It should be noted that with the 60-day rollover, one could literally withdraw funds from the Traditional IRA in year 1 and fund the Roth IRA in year 2 (if the withdrawal date is less than 60 days from Year 1's end of year (i.e., after November 2, of Year 1). If this is the case, the rollover is deemed to apply to Year 1 (and not Year 2).

43 Treas. Reg. § 1.408A-4, Q&A–1(b)(2).

44 Treas. Reg. § 1.408A-4, Q&A–1(b)(3). Note: See discussion below on recharacterizations, which require a "trustee to trustee" distribution from the Roth IRA back to a Tradition IRA or to a new Traditional IRA. See generally Section 21 of this outline.

45 Treas. Reg. § 1.408A-4, Q&A–1(c).

46 A "failed conversion" is defined under Treas. Reg. §1.408A-5 – Q&A -9(a)(1).

47 Treas. Reg. §1.408A-4, Q&A–1(d).

C. Valuation

1. Valuation is typically not an issue. The value is generally deemed to be fair market value on the date of the contribution to the Roth IRA.
2. However, when dealing with "annuity contracts" the issue of valuation becomes a bit more involved.[48] Valuation issues are beyond the scope of this outline.

D. Cost of conversion

1. *Conversion* requires one to recognize income. [49]
2. Income will be ordinary income.[50]
3. Income will be equal to the value of the assets on the date of *conversion* (as adjusted for the adjusted basis inside of a Traditional IRA (i.e., from non-deductible contributions)).[51]

E. Section 72(t) - 10% Penalty

1. Generally the 10% early distribution penalty under section 72 does not apply to *conversions*.[52]
2. Note: A *conversion* from a Traditional IRA (or other qualified plan) should not be confused with a later distribution from the Roth IRA. If there is a later distribution from the Roth IRA, the distribution rules (discussed below in Section VI of this outline) would apply. For instance, if a distribution from the Roth IRA is made within 5 years of *conversion*, then the 10% penalty for an early distribution may apply.[53]

---

[48] *See*, Treas. Reg. §1.408A-4, Q&A-14(b) (based on gift tax regulation's valuation theory for value of annuities); *see also*, Rev. Proc 2006-13 (based on accumulation of premium theory of valuation).

[49] Code § 408A(d)(3)(A)(i); Treas. Reg. § 1.408A-4, Q&A 1(c) provides that converted amounts are "*treated as a distribution from the traditional IRA and a qualified rollover contribution to the Roth IRA for purposes of section 408 and section 408A, even if the conversion is accomplished by means of a trustee-to-trustee transfer or a transfer between IRAs of the same trustee.*" Code §408A(c)(7) refers to Code §219(f)(3) which states that "*a taxpayer shall be deemed to have made a contribution to an individual retirement plan on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).*"

[50] Code § 408A(d)(3)(A)(i) and (d)(3)(B). Treas. Reg. § 1.408A-4, Q&A-7, also provides that an amount converted to a Roth IRA is includible in gross income as a distribution under the rules of Code § 408(d)(1) and (2) for "*the taxable year in which the amount is distributed from the traditional IRA.*" Thus, the important date is the "date of distribution" and **not** the date of receipt by the Roth IRA (i.e., for those 60-day distributions and the trustee to trustee transfers that cannot be accomplished in one day the value to use is the value on date of distribution). Thus, if a *conversion* is contemplated for 2010, one should not distribute funds in 2009, and then deposit the funds in 2010. If that occurs, the *conversion* will be deemed to have been made in 2009 and the 2009 rules on *conversions* would apply. Treas. Reg. § 1.408A-4, Q&A-1(c) also provides that under Code §§ 408(d)(1) and 72, generally, distributions from IRAs generate ordinary income. A special rule exists when non-deductible contributions are included in the Traditional IRA that is *converted* to a Roth IRA, whereby part of the amount *converted* (i.e., the amount attributable to the non-deductible contribution as a ratio to the value of all Traditional IRAs) will be excluded from income under Code § 72. Additionally, under Code §408(d)(2) all IRA accounts are to be aggregated. Thus, one cannot simply "pick and chose" which IRA accounts to include in this calculation. *See* discussion *infra* in Section X, beginning on page 29, of this outline. *See also*, The Joint Committee Staff Technical Explanation (JCX-38-06) of the Pension Protection Act (PL 109-280) which provides that *conversion* income will not include amounts that represented after-tax (i.e., non-deductible) contributions.

[51] Treas. Reg. § 1.408A-4, Q&A-7(a).

[52] Code § 408A(d)(3)(A)(ii); *see also*, IRS Notice 2008-30, Q&A-3; Treas. Reg. § 1.408A-4, Q&A–7(b).

[53] *See generally*, Code § 408A(d) and Treas. Reg. § 1.408A-6. And, *see also e.g.,* IRS Notice 2008-30, Q&A-3.

F. Limitations on *Conversions*

1. Certain limits for tax years before January 1, 2010.[54]
2. No limits for tax years after December 31, 2009.[55]

G. Pre-2010[56]

1. MAGI limitation
   a. For 2009
      i. One can *convert* his or her Traditional IRA to a Roth IRA, if his or her MAGI is less than $100,000; and
      ii. One is NOT married filing separately.[57]
2. 2010 and Beyond …[58]
   a. Beginning on January 1, 2010, there are no limits. This effectively gives the higher-income earner and the higher net worth individual a great opportunity to take advantage of *conversion*.
   b. However, as of January 1, 2010, the limits on *regular contributions* will be the same as they were in prior years.[59]
      i. Thus, future *regular contributions* are limited based on MAGI and filing status limitations.
      ii. Planning Pointer: A strategy to fund future amounts (albeit smaller amounts) is for the taxpayer to make non-deductible *regular contributions* to a Traditional IRA, then after the *regular contributions* are made, to "*convert*" the non-deductible IRA to a Roth IRA.
   c. See discussion below for the specific rules related to *conversions* after December 31, 2009.[60]

VI. Distributions from a Roth IRA

A. In General:

1. Distribution rules for Roth IRAs are analogous to Traditional IRAs – they are not simple and are fraught with many general rules, exceptions and exceptions to exceptions. The author's goal is to try to simplify the rules.
2. In the big picture there are five issues to understand:
   a. Ordering rules for distributions from a Roth IRA;
   b. Distributions that are subject to (and not subject to) the ordering rules;
   c. Conventions that are to be applied for distributions from Roth IRAs;
   d. The definition of a "qualified distribution"; and
   e. Income tax recognition rules and penalty rules for distributions from Roth IRAs.

B. The Ordering Rules:

1. In general,

---

[54] *See*, Notes 8 and 9, *supra*.

[55] *See*, Notes 8 and 9, *supra*.

[56] *See*, Notes 8 and 9, *supra*.

[57] Married spouses filing separately that live apart for the year (i.e., not living together in the same household for one year) are not considered married filing separately for this rule. *See*, Treas. Reg. § 1.408A-4, Q&A 2(b).

[58] *See*, Notes 8 and 9, *supra*.

[59] *See*, Note 9, *supra*.

[60] *See*, section **Error! Reference source not found.** of this outline, beginning on page 27.

a. The "ordering rules" are fairly simple, the Code and Regulations establish that distributions are to be made in the following order:
   i. From *regular contributions* (i.e., what the Code calls "annual contributions");[61]
   ii. From *conversions* (i.e., what the Code calls "qualified rollover contributions"); [62] and
   iii. From earnings. [63]

b. Each category of the ordering rules must be exhausted before the next category can be utilized; it is important to keep track of the cumulative effect of all distributions.[64]

c. The difficult part is to determine if the ordering rules apply to the distribution scheme and all of the rules to apply.

2. Thus, one should first determine if the distribution is subject to or exempt from the ordering rules. If the distribution is subject to the ordering rules, then the next issue to determine is whether the distribution will be subject to income tax (and/or a 10% penalty).

C. Distributions that are (a) subject to and (b) **not** subject to the ordering rules

1. The following distributions are **not** subject to the ordering rules:
   a. Qualified rollover contributions (which are basically distributions from one Roth IRA to another Roth IRA).[65]
   b. Contributions that are in excess of the annual contribution limit (of $5,000 or $6,000) (i.e., called "excess contributions"), where such excess contributions (including income attributable thereto) are distributed from the Roth IRA.[66]
   c. Re-characterizations (including income thereon).[67]

2. All other distributions are subject to the ordering rules.

D. Conventions applied to distributions

---

[61] Code § 408A(d)(4)(B)(ii)(I); Treas. Reg. § 1.408A-6, Q&A 8.

[62] Code § 408A(d)(4)(B)(ii)(II); Treas. Reg. § 1.408A-6, Q&A 8. Note, the Code requires that in ordering the distributions, first the taxable conversion contributions and then the non-taxable conversion contributions are distributed.

[63] Treas. Reg. § 1.408A-6, Q&A-8.

[64] Code § 408A(d)(4)(B)(i).

[65] Code § 408A(e); Code § 408A(d)(1); Code § 408A(d)(3)(A)(i) and (ii); Code § 408A(d)(3)(B); Code § 408A(d)(4)(B)(ii)(I); Treas. Reg. § 1.408A-6, Q&A 1(c). Basically, distributions between Roth IRA accounts are disregarded.

[66] Code § 408A(c)(2); Treas. Reg. § 1.408A-3, Q&A-7. This situation occurs when the taxpayer inadvertently makes an annual contribution that is in excess of the amount allowable.

[67] Re-characterizations are permitted under Code § 408A(d)(6)(A). The authors call this special provision in the Roth IRA section of the Code, the "oops" provision. What Code § 408A(d)(6)(A) provides is that if the participant made a mistake (e.g., inadvertently converted to a Roth IRA when he or she was ineligible, invested in a manner where asset values decreased after conversion, did not have sufficient funds to pay the tax on conversion, or any other reason) then if, within the time for filing the income tax return for the year of conversion, the taxpayer may "undo" his or her original conversion (i.e., he or she can simply say "oops" I did not mean to do that, and undo it). It should be noted that Code § 408A(d)(6)(B) provides that if you undo the "oops" you have to take any income attributable to the amount contributed that the participant wishes to re-characterize. See generally, Treas. Reg. § 1.408A-5 for the rules on re-characterizations. See also the discussion in this outline in Section VII beginning on page 21, below.

1. The following conventions are then to applied to those distributions which are subject to the ordering rules:
   a. First, distributions are aggregated during the year, and must be analyzed at the end of the year.[68]
   b. Second, all *regular contributions* from the current and prior years are to be aggregated.
   c. Third, all *conversions* from prior years are to be identified by the year in which they were contributed.[69]
2. After applying the conventions, the planner must understand whether the distribution is a so-called "qualified distribution".

E. Qualified Distributions

1. In the big picture, the reader is asked to digress in order to understand the concept of "qualified distributions" (or "QD") discussed in Code § 408A(d)(2). Even if the ordering rules apply to a distribution, it will **not** be included in gross income if the distribution is characterized as a QD.[70]
2. Specifically, Code § 408A(d) provides as follows:

> *408A(d)(2) QUALIFIED DISTRIBUTION. -- For purposes of this subsection --*
>
> *(A) IN GENERAL. --The term "qualified distribution" means any payment or distribution --*
>
> *(i) made on or after the date on which the individual attains age 59 ½ ,*
>
> *(ii) made to a beneficiary (or to the estate of the individual) on or after the death of the individual,*
>
> *(iii) attributable to the individual's being disabled (within the meaning of section 72(m)(7)), or*
>
> *(iv) which is a qualified special purpose distribution.*
>
> *(B) DISTRIBUTIONS WITHIN NONEXCLUSION PERIOD. -- A payment or distribution from a Roth IRA shall not be treated as a qualified distribution under subparagraph (A) if such payment or distribution is made within the 5-taxable year period beginning with the 1st taxable year for which the individual made a contribution to a Roth IRA (or such individual's spouse made a contribution to a Roth IRA) established for such individual.*

3. Analyzing QD's
   a. What does Code § 408A(d)(2) mean?

---

[68] *See*, Treas. Reg. § 1.408A-6, Q&A-1(c) and (d). This year-end analysis rule is a logical rule that allows the taxpayer to "wait-and-see" which distributions are subject to the ordering rules. For instance, since re-characterizations may be accomplished after year-end, one could not determine which distributions are and are not subject to the ordering rules until after that time period (for electing to re-characterize) has passed.

[69] Thus, one must keep an accounting of *conversions* for each year *converted*. This is important in applying the 5-year rule for so-called, qualified distributions, as explained in Section VI.E, beginning on page12 of this outline. The reason for keeping track of the *conversions* on an year-to-year basis, is because the Code § 72(t) - 10% penalty is applied to *conversions* basis looking back on a first-in, first-out basis at each *conversion* separately, on a 5-year look-back basis.

[70] Code § 408A(d)(1).

i. The regulations help to explain the Code, somewhat. Treasury Regulation § 1.408A-6, Q&A 1[71], provides that any distribution will not be taxed, if it meets **both** tests. If it fails either one of the tests, then it is **not** a QD, which generally means that it may be taxed and may be subject to the 10% penalty.

ii. The first test is the so-called "5-year test". There are actually two different 5-year tests.

    I. Recall, Code § 408A(d)(2)(B) provides in part that the distribution will not be a QD "*if such payment or distribution is made within the 5-taxable year period beginning with the 1st taxable year for which the individual made a contribution to a Roth IRA …*"

    II. This Code section must be read in tandem with the ordering rules of Code § 408A(d)(4), specifically the "first-in, first-out" rules applicable to *conversions*.[72]

        1. The first 5-year period applies to situations where the participant first made a contribution (any contribution, whether a *regular contribution* or a *conversion*) to the Roth IRA. This first 5-year rule expires upon the fifth year from the first contribution.[73]

        2. The second 5-year period applies when examining *conversions* (i.e., the second tier of the ordering rules) for purposes of those rules.[74] Simply put, after the first tier is

---

[71] Treas. Reg. § 1.408A-6, Q&A 1 provides in part, as follows:

> *"Q-1. How are distributions from Roth IRAs taxed?*
>
> ***A-1.*** *(a) The taxability of a distribution from a Roth IRA generally depends on whether or not the distribution is a qualified distribution. This A-1 provides rules for qualified distributions and certain other nontaxable distributions. A-4 of this section provides rules for the taxability of distributions that are not qualified distributions.*
>
> *(b) A distribution from a Roth IRA is not includible in the owner's gross income if it is a qualified distribution or to the extent that it is a return of the owner's contributions to the Roth IRA (determined in accordance with A-8 of this section). A qualified distribution is one that is both—*
>
> > *(1) Made after a 5-taxable-year period (defined in A-2 of this section); and*
> >
> > *(2) Made on or after the date on which the owner attains age 591/2 , made to a beneficiary or the estate of the owner on or after the date of the owner's death, attributable to the owner's being disabled within the meaning of section 72(m)(7), or to which section 72(t)(2)(F) applies (exception for first-time home purchase)…"*

[72] *See*, Code § 408A(d)(4)(B)(ii)(II).

[73] Treas. Reg. § 1.408A-6, Q&A-2 and -5(b) and (c).

[74] Treas. Reg. § 1.408A-6, Q&A 5, makes it clear that one must keep track of this second 5-year period. The question posed in that Q&A is: "*Will the additional tax under 72(t) apply to the amount of a distribution that is not a qualified distribution?*" It is the response in A-5(b) that clearly illustrates that there is a second 5-year period that applies on an ongoing basis. Specifically, A-5(b) states, "*The 10-percent additional tax under section 72(t) also applies to a nonqualified distribution, even if it is not then includible in gross income, to the extent it is allocable to a conversion contribution, if the distribution is made within the 5-taxable-year period beginning with the first day of the individual's taxable year in which the conversion contribution was made*" and A-5(c) then goes on to say, "[t]*he 5-taxable-year period described in this A-5 for purposes of determining whether section 72(t) applies to a distribution allocable to a conversion contribution is separately determined for each conversion contribution, and*

exhausted (i.e., when the distribution has used up the *regular contributions*) in examining the second tier (i.e., the *conversions*), the planner examines the year in which year taxpayer made the *conversion* to the Roth IRA. That is the reason for applying the convention in SectionVI.D.1.c of this outline. If the distribution is deemed made from a *conversion* that was made within the 5-year period, then the distribution is **not** a QD.[75] Accordingly, one must always keep track of *conversions* made in different years separate and apart from other such *conversions*. This allows one to keep track of the 2nd 5-year period rule. The second 5-year rule will become inapplicable when the participant turns 59 ½, so it has limited applicability if the participant has reached that age.[76]

III. A few words on how to calculate the "5 years"

1. Treas. Reg. §1.408A-6, Q&A-2 is helpful. It states that the 5 year period:
   a. Begins on 1st day of the taxable year (January 1 for most individual taxpayers) of:
      i. first annual (or *regular*, as the regulations call it) *contribution* for which the contribution applies, or
      ii. if earlier, the first *conversion* contribution for which the contribution applies.
   b. Ends on last day (December 31 for most taxpayers) of 5th consecutive taxable year (beginning with the year of the earlier of the 1st *regular contribution* or the 1st *conversion*.
2. Examples:
   i. *Example 1*: Wife contributes funds between January 1, 2006 and April 15, 2007 that apply to

---

need not be the same as the 5-taxable-year period used for purposes of determining whether a distribution is a qualified distribution under A-1(b) of this section."

75 If the distribution of a *conversion* is not a QD, then it may be subject to the 10% early distribution penalty under Code § 72. Specifically, Code § 408A(d)(3)(F) states that if any portion of a distribution from a Roth IRA is allocable to the *conversion*, and the distribution is made with the 5-taxable year beginning in the year of the *conversion*, then the penalty tax under Code § 72(t) will be applied ***as if*** the *conversion* (was once again) included in gross income. Thus, if an exception under Code § 72(t) would apply to the distribution, then no penalty would apply. Importantly, for instance, if any part of the original *conversion* was not subject to tax on the conversion (i.e., if part of the *conversion* from an IRA was made with non-deductible IRAs), that portion that is non-deductible, will not be considered in applying the rules under Code § 72(t).

76 Code § 408A(d)(3)(F) provides that Code § 72 (in particular Code §72(t) which applies the 10% penalty) would apply to the distribution. However, an exception to the 10% penalty rule is the participant's attaining age 59 ½, thus, once the participant attains that age, notwithstanding that the penalty would be applicable, the exception would come into play and thus, none would be applied. Another exception under the 10% penalty rules is that distributions made to those who inherit would not be subject to the penalty. Thus, once the participant turns 59 ½, whether the participant a subsequent owner (through inheritance) takes a distribution, no penalty will be applied.

2006.[77] The 5-year period **begins** on January 1, 2006 and **ends** on December 31, 2010. Thus, any distribution made on or before December 31, 2010, would **not** be a QD. This rule applies to all Roth IRAs (because all of the participant's Roth IRAs are deemed to be one big Roth IRA).

ii. *Example 2:* Same as *Example 1*, except that Wife dies and leaves IRA to husband. Husband treats IRA as his own (i.e., spousal rollover). In testing of the 5-year rule, look to when Husband had the first contribution to his other Roth IRAs. If the first contribution was the rollover from deceased Wife, then the 5-year period begins at Wife's death. If Husband did **not** treat the inherited Roth IRA as his own, then he would look back to the Wife's first contribution and use her 5-year period.

IV. This gets tricky – especially with Qualified Roth Contribution ("QRC") programs under 401(k) and 403(b) plans ("QRCPs").

1. QRCPs are treated separately from Roth IRA.[78]
2. Examples:
   a. *Example 3*. John makes contributions to QRCP in 2006. John, who is over age 59 ½, takes a distribution from his QRCP in 2008, prior to the end of the 5-taxable-year period of participation used to determine qualified distributions from a QRC. The distribution is an eligible rollover distribution and John properly rolls it to his Roth IRA (meeting tests under Code §§ 402(c) and 402A(c)(3)), which was established in 2003. Any subsequent distribution from the Roth IRA of the amount rolled in, plus earnings thereon, would not be includible in gross income (because it would be a qualified distribution within the meaning of Code § 408A(d)(2)).
   b. *Example 4***.** The facts are the same as in *Example 3*, except that the Roth IRA is John's first Roth IRA and is established with the rollover in 2008, which is the **only** contribution made to the Roth IRA. If a distribution is made from the Roth IRA prior to the end of the 5-taxable-year period used to determine qualified distributions from a Roth IRA (which begins in 2008, the year of the rollover which established the Roth IRA) the distribution would not be a qualified

[77] Code §408A(c)(7) by reference to Code §218(f)(3) permits one to make a contribution after year end (until the day for filing a tax return for the prior year, which is generally April 15).

[78] *See generally*, Treas. Reg. §1.408A-10 Q&A 4. It is beyond the scope of this outline to explain this in detail. The examples, however, are very illustrative of the rules.

distribution within the meaning of Code §408A(d)(2), and any amount of the distribution that exceeded the portion of the rollover contribution that consisted of investment in the contract is includible in John's gross income.

c. *Example 5*. The facts are the same as in *Example 4*, except that the distributions from the QRCP and the rollover to the Roth IRA occur in 2011 (after the end of the 5- year period of participation used to determine qualified distributions from a QRCP). If a distribution is made from the Roth IRA prior to the expiration of the 5-year period used to determine qualified distributions from a Roth IRA, the distribution would not be a qualified distribution within the meaning of Code §408A(d)(2), and any amount of the distribution that exceeded the amount rolled in is includible in John's gross income. Thus, John has to wait until January 1, 2016 (or later).

iii. Even if the distribution qualifies under both of the 5-year tests, then the conversion must still pass the "purpose" or "(d)(2)(A)" test,[79] in that such distribution must be distributed:

I. On or after the individual attained age 59 ½;[80]

II. Made to a beneficiary (or the estate of the individual) on or after the individual's death; [81]

III. To the individual who is disabled (within the meaning of Code §72(m)(7); [82] or

IV. For the qualified purchase of a residence (within the meaning of Code § 72(t)(2)(F)). [83]

b. If that part of a distribution (or all of the distribution, as the case may be) meets both of Code § 408A(d)(2) tests (i.e., the (d)(2)(B) 5-year test and the (d)(2)(A) purpose test), then that part of the distribution is a QD, and is not subject to income tax and also not subject to any 10% penalty.

F. Income Tax Recognition Rules:

1. Those transactions that are not considered distributions for the ordering rules are not subject to income tax under Code § 408A, these include:

a. Qualified rollover contributions.[84]

b. Excess annual contributions (including income attributable thereto). [85]

---

79 Code § 408A(d)(2)(B)

80 Code § 408A(d)(2)(A)(i)

81 Code § 408A(d)(2)(A)(ii)

82 Code § 408A(d)(2)(A)(iii)

83 Code § 408A(d)(2)(A)(iv)

84 *See*, section VI.C.1.a of this outline and footnote 65 above. Technically, the reason for not being subject to any income tax is that when the amounts were originally contributed to the transferring Roth IRA, such contributions were subject to income tax; thus, to merely change from one Roth to another would not be a taxable event. See also, Code § 408A(d)(3)(ii); Code § 408A(d)(3)(F), by negative implication; Code § 408A(e); Code § 408A(d)(1); Code § 408A(d)(3)(A)(i) and (ii); Code § 408A(d)(3)(B); and Treas. Reg. § 1.408A-6, Q&A 1(c).

c. Re-characterizations (including income thereon).[86]
It should be noted that even thought these transactions are not taxed under Code § 408A, they may otherwise be caught under Code § 72, § 408, or some other income tax provision. For instance, if the excess contribution and income therefrom is distributed from the Roth IRA, the excess contribution and income therefrom will be subject to regular income tax (albeit, not under the provisions of Code § 408A).

2. As stated in Section VI.C.2, one looks to the total amount of the payments from the Roth IRA and categorizes them as *regular contributions*, *conversion*s and earnings (in that order). The following describes the taxability (and possible imposition of penalties) on the payments:[87]
   a. Distributions of *regular contributions* are:
      i. Income Tax. Not subject to income tax on distribution;[88] and
      ii. 10% Penalty. Not subject to the 10% penalty under Section 72(t).[89]
      iii. Example (adapted from Treas. Reg. § 1.408A-6, Q&A 10, Example 1).
         I. *Example 6.* In 2010, individual B converts $80,000 in his traditional IRA to a Roth IRA. B has a basis of $20,000 in the conversion amount and so must include the remaining $60,000 in gross income. He decides to spread the $60,000 income by including $30,000 in each of the 2 years 2011 and 2012. B also makes a regular contribution of $5,000 in 2010. If a distribution of $5,000 is made to B anytime in 2010, it will be treated as made entirely from the *regular contributions*, so there will be no Federal income tax consequences as a result of the distribution.
   b. Distributions of *conversions* are:
      i. Income Tax. Not subject to income tax.
      ii. 10% Penalty.

---

85 *See*, section VI.C.1.b of this outline and Note 66 *supra*. An excess contribution is any amount contributed to a Roth IRA in excess of the maximum allowed to be contributed under Code § 408A(c)(2). The Code provides a mechanism that allows one to make a distribution of the excess amount back to the participant. If this is done, then any income allocable to that contribution must also be distributed back to the participant. Treas. Reg. § 1.408A-3, Q&A-7. Note, that if the excess contributions are not removed, Treas. Reg. § 1.408A-3, A-7, provides a methodology of how the excess contributions that are not distributed from the Roth IRA are taxed (i.e., the 6% penalty tax under Code §4973) and how they are treated in future years. It is beyond the scope of this outline to explain this. The reader is encouraged to read Q&A-7.

86 *See*, section VI.C.1.cVI.C.1.a of this outline and Note 67 *supra*. *See also*, Code § 408A(d)(6)(A) and (B); Treas. Reg. § 1.408A-5, Q&A-1 and -2.

87 A more complete explanation of "qualified distributions" and "non-qualified distributions" and the attendant income tax and potential penalties is discussed below.

88 Treas. Reg. § 1.408A-6, Q&A 1(b). The A-1(b) in part states, "[a] *distribution from a Roth IRA is not includible in the owner's gross income … to the extent that it is a return of the owner's contributions to the Roth IRA (determined in accordance with A-8 of this section). See also*, *Example 1* of Treas. Reg. § 1.408A-6, Q&A 10.

89 Treas. Reg. § 1.408A-6, Q&A 5. The regulations state that the 10% tax will apply "*to any distribution from a Roth IRA includible in gross income.*" Because *regular contributions* are not included in gross income, the 10% penalty would not apply. *See also*, *Example 1* of Treas. Reg. § 1.408A-6, Q&A 10.

I. Not subject to the 10% penalty, if the distribution is deemed to be a "QD". [90]

II. Are potentially subject to the 10% penalty, if the distribution is not a QD. [91] But, not subject to penalty, if it meets one of the four exceptions under Code §408A(d)(2))(A) (i.e., participant is 59 ½ , participant is disabled, first $10,000 is used by the participant for a first home purchase, or the beneficiary is the withdrawer).

iii. Example – (adapted from Treas. Reg. § 1.408A-6, Q&A 10, Example 2)

I. *Example 7*. The facts are the same as in *Example 6*, except that the distribution made in 2010 is $12,000. The distribution is treated as made from $5,000 of *regular contributions* and $7,000 of *conversions* that were includible in gross income. As a result, B must include $12,000 in gross income for 2010: $7,000 as a result of the acceleration of amounts that otherwise would have been included in 2012 under the 2-year-spread rule. In addition, because the $7,000 is allocable to a *conversion* made within the 5-years period, the 10-percent additional tax under section 72(t) would apply to this $7,000 distribution for 2010, unless an exception under section 72(t) applies (e.g., participant was over the age of 59 ½ at the time of the withdrawal). Under the 2-year-spread rule, B would report $30,000 in 2011 and $23,000 for 2012 (because $7,000 was accelerated in 2010).

c. Distributions from earnings are:

i. Income Tax

I. Not subject to income tax if they are considered QDs.[92]

---

[90] Treas. Reg. § 1.408A-6, Q&A 5. The regulations state that "[t]*he 10-percent additional tax under section 72(t) will apply (unless the distribution is excepted under section 72(t)) to any distribution from a Roth IRA includible in gross income.*" Code § 408A(d)(3)(F) provides the rules of applying Code § 72 to distributions of *conversions*. Specifically, it says that if the 10% penalty under Code § 72(t) will be applied only to the extent that the distribution of the *conversion* is **not** a qualified distribution.

[91] *See*, Note75, *infra.*

[92] Code § 408A(d)(2)(B) provides that if the payment is made within the 5-taxable year period beginning with the 1st taxable year for which the individual made any contribution (whether a conversion contribution or an annual contribution) to a Roth IRA, then the payment would not be a "qualified distribution"). Stated otherwise, the payment is a nonqualified distribution. Treas. Reg. § 1.408A-6, Q&A-4, provides that non-qualifed distributions that are effectively treated as earnings are *"includible in the owner's gross income*". Treas. Reg. § 1.406A-6, Q&A-4 states as follows:

> "*A distribution that is not a qualified distribution, and is neither contributed to another Roth IRA in a qualified rollover contribution nor constitutes a corrective distribution, is includible in the owner's gross income to the extent that the amount of the distribution, when added to the amount of all prior distributions from the owner's Roth IRAs (whether or not they were qualified distributions) and reduced by the amount of those prior distributions previously includible in gross income, exceeds the owner's contributions to all his or her Roth IRAs. For purposes of this A-4, any amount distributed as a corrective distribution is treated as if it was never contributed.*"

In deciphering the clause:

II. Subject to income tax if not QDs.[93]

ii. 10% Penalty

I. Not subject to penalty if considered QDs.[94]

II. Are subject to the 10% penalty, if the distribution is not a QD and there is no other exception under Code § 72(t).[95] Thus, if the distribution qualifies under one of the four exceptions under Code §408A(d)(2)(A) then there is no penalty).

iii. Example:

I. Adapted from Example 3 of Treas. Reg. § 1.408A-6, Q&A-10.

II. *Example 8.* The facts are the same as in *Example 6*, except that B makes an additional $5,000 *regular contribution* in 2011 and he does not take a distribution in 2010. In 2011, the entire balance in the account, $98,000 ($90,000 of contributions and $8,000 of earnings), is distributed to B. The distribution is treated as made from $10,000 of regular contributions, $60,000 of *conversions* that were includible in gross income, $20,000 of *conversions* that were not includible in gross income, and $8,000 of earnings. Because a distribution has been made within the 2-year spread period, B must accelerate the income inclusion under the 2-year spread rule and must include in gross income the $30,000 remaining under the 2-year-spread rule in addition to the $8,000 of

---

"*to the extent that the amount of the distribution, when added to the amount of all prior distributions from the owner's Roth IRAs (whether or not they were qualified distributions) and reduced by the amount of those prior distributions previously includible in gross income, exceeds the owner's contributions to all his or her Roth IRAs.*"

This means "earnings", as such term is used in Treas. Reg. § 408A-6, Q&A-8(c). Thus, to the extent that the distribution is deemed a qualified distribution, regardless of whether it is earnings, then it is not to be included in income. And, to the extent that the distribution is not a qualified distribution, and it is earnings, then it will be included in gross income (provided it is not: (a) contributed to another Roth IRA, (b) a corrective distribution, or (c) a re-characterization).

[93] See Footnote 92, above.

[94] By definition, the distribution tests under Code § 408A(d)(2)(A)(i) through (iv), inclusive, are exceptions under Code § 72(t). The following table illustrates the correlation:

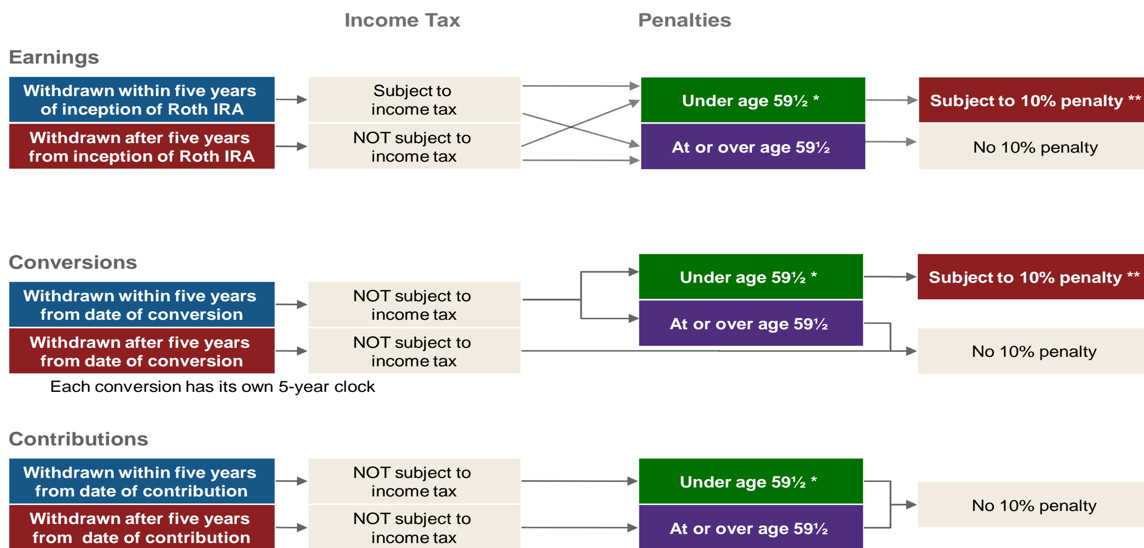
Section 72(t)		Section 408A(d)(2)(A)	
(2)(A)(i)	59 ½ age requirement	(i)	59 ½ age requirement
(2)(A)(ii)	Distribution to beneficiary	(ii)	Distribution to beneficiary
(2)(A)(iii)	Attributable to being disabled	(iii)	Attributable to being disabled
(2)(F)	Purchase of house	(iv)	Purchase of house

Accordingly, if a distribution is a qualified distribution, it would automatically qualify as an exception to the 10% penalty tax under section 72(t).

[95] Treas. Reg. § 1.408A-6, Q&A-5. The regulations state that "[t]*he 10-percent additional tax under section 72(t) will apply (unless the distribution is excepted under section 72(t)) to any distribution from a Roth IRA includible in gross income.*"

earnings. Because $60,000 of the distribution is allocable to a *conversion* made within the 5-year period, it is subject to the 10% additional tax under section 72(t) as if it were includible in gross income for 2011 unless an exception applies (under section 72(t)). The $8,000 allocable to earnings would be subject to the tax and penalty under section 72(t), unless an exception applies.

The following chart, taken from presentation materials prepared by the authors may be helpful:



VII. Contribution Re-characterizations

A. Re-characterizations Defined

1. Re-characterizations are actually 're-characterizations of contributions' that the contributor to the Roth IRA (or his or her personal representative, as the case may be) wishes not to treat as a contribution or conversion. One can re-characterize either a *regular contribution* or a *conversion*.
2. This provision, as set forth above, allows the contributor to change his or her mind, for any reason, and not treat the contribution as a contribution. As one can imagine there are numerous rules that apply. The re-characterization provision may be a very useful planning tool.

B. What is the authority for a "re-characterization"?

1. Code §408A(d)(6)(B) and Treas. Reg. §1.408A-5 provide the authority for re-characterizations, and the specific provisions when a re-characterization can occur.

a. The re-characterization must be made on or before the due date (including extensions) for any taxable year for which the contribution was made;[96]
b. The transfer of the re-characterized amount must **only** be done by a trustee-to-trustee transfer to another individual retirement plan; [97]
c. The re-characterized amount must include income attributable thereto (calculated on a proportional basis). [98]
d. Cannot re-characterize amounts not included in income on a conversion. Thus, if one converts a non-deductible IRA, the non-deductible amount cannot be re-characterized.[99]

C. What is necessary if you wish to re-characterize?
1. Notify Trustees.[100]
2. Identify type and amount of contribution. [101]
3. Calculate and identify net income allocable to the transfer. [102]
4. May be made by an executor of an estate on behalf of the deceased. [103]

D. Re-characterization, like contributions, is **not** treated as a rollover for the 1 year rollover rule.[104]

E. Can the participant "re-convert" assets that were "re-characterized"?
1. Yes, however there is a waiting period.
a. If a taxpayer *converts* his or her Traditional IRA to a Roth IRA during the year (Year 1) and then re-characterizes that amount, he or she may not re-convert until the later of:
i. January 1 of the year following the original conversion; or
ii. Thirty (30) days after the re-characterization (regardless of whether the re-characterization occurs during the taxable year in which the amount was converted to a Roth IRA or the following taxable year).[105]
b. Examples:
i. *Example 9*. On January 5, 2010, Mary *converts* her Traditional IRA to a Roth IRA (assume she met all of the statutory requirements for conversion). Mary changes her mind and then re-characterizes the *converted* IRA by a trustee-to-trustee transfer on November 10, 2010. Mary can "reconvert" her IRA to a Roth IRA at the later of (a)

---

[96] Code § 408A(d)(6)(A); Treas. Reg. § 1.408A-5, Q&A-1. This is generally October 15, but may be the 16th if the 15th falls on a Sunday or the 17th if the 15th falls on a Saturday
[97] Code § 408A(d)(6)(A); Treas. Reg. § 1.408A-5, Q&A-1. An amount cannot be re-characterized by making a distribution under the 60-day rule. Additionally, the transfer must be made to an IRA account. Even if the distribution came from a 401k account originally, the recharacterization must be to an IRA account, at least initially. If permitted by the 401k agreement, the funds recharacterized to a Traditional IRA account could later be transferred back to the 401k (i.e., in a 2-step process).
[98] Code § 408A(d)(6)(b); Treas. Reg. § 1.408A-5, Q&A-1 and -2.
[99] Treas. Reg. § 1.408A-5, Q&A-4.
[100] Treas. Reg. § 1.408A-5, Q&A-6(a).
[101] Treas. Reg. § 1.408A-5, Q&A-6(b).
[102] Treas. Reg. § 1.408A-5, Q&A-6(b).
[103] Treas. Reg. § 1.408A-5, Q&A-6(c).
[104] Treas. Reg. §1.408A-5 Q&A-8.
[105] Treas. Reg. § 1.408A-5, Q&A-9(a)(1).

January 1, 2011, or (b) December 10, 2010. In this case, it would be January 1, 2011.

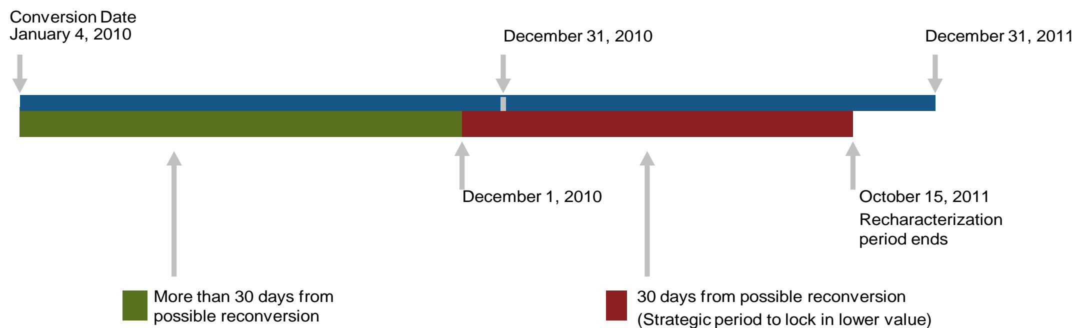
ii. *Example 10*. Assume the same facts as *Example 9*, however, assume that before filing her income tax return for 2010 (on April 4, 2011), Mary re-characterizes her Roth IRA back to a Traditional IRA. In this case Mary can *convert* at the earliest on the later of (a) January 1, 2011, or (b) May 4, 2011. In this case it would be May 4, 2010.

The following chart may also be helpful, which was also prepared by the authors for other presentations:

Strategies applicable to reconversion after recharacterization

Planning for reconversion after recharacterization

Look for the drops in value when recharacterization is possible, particularly when reconversion is possible 30 days thereafter (to lock in lower values for income tax purposes). Of course, consider other factors such as possible higher rates in the reconversion tax year and the impact of deductions and credits.



32

2. Failed re-conversions

   a. Any attempt to "re-convert" before the "beginning of following year" or "30-day" time period would be a failed or ineligible conversion.[106]

VIII. Required Minimum Distributions ("RMD") Rules for Roth IRAs

A. Traditional IRAs and Roth IRAs.

1. The rules for Traditional IRAs apply equally to Roth IRAs, except as provided in the Code (and regulations thereunder).[107] This is true for the RMD rules, too.

2. There are a few differences in the RMD rules for Roth IRAs and Traditional IRAs, as follows:

---

106 Treas. Reg. § 1.408A-5, Q&A 9(a)(1); *see also,* Treas. Reg. § 1.408A-4, Q&A-3.

107 Code § 408A(a).

a. Lifetime of the Participant –

   i. Traditional IRA – The general rule for Traditional IRAs is that in the year that the participant turns age 70 ½ he or she is said to have reached his or her required beginning date ("RBD").[108] And, upon reaching that date, in that year, or until April 1 of the year following the year in which the participant reached his or her RBD, he or she is to begin taking his or her RMD.[109]

   ii. Roth IRA – There is no RMD for the participant of a Roth IRA during his or her lifetime. The participant is deemed to never reach his or her RBD during life.[110]

b. Death of Participant

   i. The Roth IRA RMD rules apply the same way as Traditional IRA, *as if* the participant died before his or her RBD.[111]

   ii. Note: In 2009, there was no RMD.[112]

B. There are generally four (4) RMD rules that apply upon the death of the participant, as follows:

1. Five-year distribution rule.[113]
2. Beneficiary life expectancy rule.[114]
3. Pre-RBD spousal life expectancy rule.[115]
4. Spousal rollover rule.[116]

C. Five-Year Distribution Rule.

1. The default rule for RMDs is the 5-Year Rule, which provides that the entire amount of the inherited Roth IRA must be distributed by December 31st of the fifth year after participant's death.
2. Examples:

   a. *Example 11*: The participant, Dad, dies on October 2, 2011, leaving his Roth IRA to a charity. Since charity is not a "designated beneficiary" (or "DB"), as explained below, the Roth IRA must be fully distributed to the charity by December 31, 2016.

   b. *Example 12*: Same facts as in *Example 11*, except that the beneficiary is Dad's son, Bob. In this case Bob is a DB, so he has two options he could

---

[108] Treas. Reg. §1.408-8, Q&A-3.

[109] Code § 408(a)(6) and (b)(3); Code § 401(a)(9); Treas. Reg. §§ 1.401(a)(9)-1 through -9. Note, if the participant dies between his RBD and April 1 of the year following the year of his or her RBD, and such participant did not take his or her RMD, he or she does not need to take it. This is an exception to the rule.

[110] Code §408A(c)(5); Treas. Reg. § 1.408A-6, Q&A-14 and -15.

[111] Treas. Reg. § 1.408A-6; Q&A-14.

[112] Code §401(a)(9)(H) (added by P.L. 110-458).

[113] Code §401(a)(9)(B)(ii); Treas. Reg. §1.401(a)(9)-3, Q&A-2 and -4; Treas. Reg. § 1.408A-6, Q&A-14(b). Note: because there is no RMD in 2009, if one is within the 5-year period, the time period is extended for 1 additional year. See also, Notice 2009-82 for clarification of a number of issues that arose as a result of the addition of new Code §401(a)(9) under the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA), PL 110-458.

[114] Code §401(a)(9)(B)(ii); Treas. Reg. §10401(a)(9)-3 Q&A-2 and -4; Treas. Reg. § 1.408A-6, Q&A-14(b).

[115] Code §401(a)(9)(B)(ii); Treas. Reg. §10401(a)(9)-3 Q&A-2 and -4; Treas. Reg. § 1.408A-6, Q&A-14(b).

[116] Code §401(a)(9)(B)(ii); Treas. Reg. §10401(a)(9)-3 Q&A-2 and -4; Treas. Reg. § 1.408A-6, Q&A-14(b).

elect[117] to use the 5-Year Rule or the Life Expectancy Rule, explained below. If he elects the 5-Year Rule, the Roth IRA must be fully distributed to Bob by December 31, 2016.

3. **Note**: If the 5-Year Rule applies, no distributions are necessary until December 31st of the fifth year following the participant's death. In the above examples, that would be December 31, 2016.
4. If the 5-year rule applies during 2009, there is a one year extension (i.e., by December 31 of the sixth year following death). [118]
5. It may be permissible for "non-spouse" DB's only if the Roth IRA (or plan) allows this as an alternative.

D. Beneficiary Life Expectancy Rule.

1. The major exception to the 5-Year Rule is the Life Expectancy Rule, which permits withdrawals over the beneficiary's "life expectancy" based upon the IRS' Uniform Tables from the IRA on or before December 31st following the year of the participant's death.
   a. Example
      i. *Example 13*: Assume the same facts as *Example 12*, and that the IRA Agreement provides for the Life Expectancy Rule option. In this case, if the son, Bob, who is a DB, elects to use the Life Expectancy Rule, son must begin taking the required distributions on or before December 31, 2012 and continue to do so during his life.
2. The Beneficiary Life Expectancy rule can only be used by a "designated beneficiary" ("DB").[119]
3. If the DB elects[120] to use the Life Expectancy Rule, then the DB must begin taking the DB's RMDs.
4. This rule generally applies for all "non-spouse" DBs. If there are multiple beneficiaries, it may be possible to have separate shares. If not, then use age of oldest DB. Roth IRAs must be distributed to the DB beginning the year after the decedent's death. RMDs must be taken by December 31 (starting the year after the decedent's death). The Single Life Table must be used in calculating the RMD. In determining the age of the beneficiary, use the owner's age in the year after the death of the original owner (assume that beneficiary will live through the year and that his or her birthday is January 1 of the year after participant's death), and Life factor (i.e., the divisor) is reduced by 1 each year (i.e., not recalculating).[121]

---

[117] It is important to review the Roth IRA Agreement to ensure that it allows the DB to "elect" or to take advantage of the more tax efficient and beneficial Life Expectancy Rule. Note, see, Notice 2009-82, Q&A-2 for clarification on the election process for IRAs where the election is to be made in 2009.

[118] Code §401(a)(9)(H) added by P.L. 110-458

[119] It is beyond the scope of this outline to explain designated beneficiaries. For a few good resources, see Choate, *Life and Death Planning for Retirement Benefits* (6th Ed.), Lesser, Levy and Ward, *Quick Reference to IRAs*, Aspen Publishers, and Kennedy, 367 T.M., IRAs.

[120] This assumes that the IRA Agreement provides for the beneficial Life Expectancy Rule option.

[121] These rules are generally covered in Code §401(a)(9)(B)(iii); Treas. Reg. §1.401(a)(9)-5, Q&A 5(c)(1); and Treas. Reg. §1.401(a)(9)-3 Q&A 1.

5. Calculating the RMD –
   a. First Year: In the first year following the year of death of the participant, the RMD is calculated using the following formula:

$$\frac{\text{Value of Roth IRA as of December 31st of the year of the Participant's death}}{\text{Life expectancy of the DB (in terms of years using the Uniform Table) in the year following the Participant's death}}$$

   b. For Succeeding Years: For the years following the first year after the death of the participant, the same formula would be used, except that:
      i. For the numerator, the value of the inherited Roth IRA would be its value as of December 31st of the preceding year, and
      ii. For the denominator, the life expectancy factor is reduced by 1 year.
   c. Example:
      i. *Example 14*: Assume the same facts as *Example 13*, and add to the facts that son, Bob, would turn 57 years of age in 2012 (i.e., the year following Dad's death). Based on these facts, using the IRS' Uniform Life Tables, Bob's life expectancy would be as follows for the following years:

Year	Denominator
2011	27.9
2012	26.9
2013	25.9
Future	prior year's number minus 1

   d. After a designated beneficiary's death, the person who inherits the Roth IRA from the DB is allowed to continue using the formula above and take the RMD over the original DB's life expectancy.
      i. Example
         I. *Example 15*: Let's assume the same facts as in *Example 14*, (i.e., that son, Bob, inherits the Roth IRA from Dad when Bob is 57 years of age and elects to take the RMD over his life). Let's further assume that that Bob dies in 2028 taking his RMD for that year (i.e., 16 years after the year after Dad's death). Let's further assume that Bob leaves the Roth IRA to his only daughter, Sue. In computing Sue's RMD in 2029 (i.e., the year after Bob's death), she would use 11.9 (i.e., 27.9 minus 16 years) as the denominator, and thereafter reduce the denominator by 1 each of the following 11 years (i.e., until the Roth IRA is fully distributed).

e. It is important to note that the fraction for the RMD is not then recalculated when the first beneficiary (i.e., Bob in our examples) dies. The second beneficiary (i.e., Sue) simply steps into the shoes of the first beneficiary and continues to use the divisors (as adjusted by 1 each year) as if the first beneficiary (i.e., Bob) had survived.

6. Special Rule for 2009 – No RMD. In 2010, the Life factor is reduced by 1 from what the 2009 Life Factor would have been (or 2 from the 2008 Life Factor). [122]

E. Pre-RBD Spousal Life Expectancy Rule

1. This is only available to surviving spouses. [123] The spouse may elect to "inherit" the Roth IRA and keep it in name of deceased spouse participant. Under the separate share rules, if spouse is one of many beneficiaries, the IRA can be a separate share and thus it is now easy to make the spouse the only DB of the Roth IRA.
2. The RMDs begin the **later of**:
   a. December 31 in year following the participant spouse's death;[124] or
   b. December 31 in the year in which the original owner would have reached 70½.[125]
3. The surviving spouse must use Single Life Table for the life factor, which is "recalculated" each year based on spouse's age. Thus, the factor changes each year, instead of being reduced by 1 each year. Generally means a longer life expectancy and longer ability to distribute property.
4. Remember, in 2009 there are no RMDs.[126]

F. Spousal Rollover.

1. Spouse treats Roth IRA as his or her own.[127]
2. When the spouse elects to treat the Roth IRA as the surviving spouse's own IRA, then the lifetime distribution rules apply (i.e., no RMD during surviving spouse's lifetime).[128]

IX. *Converting* in 2010 (and beyond) …

A. Income tax ramifications

1. A special rule applies only for 2010 *conversions*. If the taxpayer *converts* the Traditional IRA in 2010, the default rule under the Code is that *conversion* income will automatically be deferred equally over 2011 and 2012.[129] As a result, the taxpayer will have to pay taxes on that deferred income at tax rates in effect in 2011 and 2012. It should be noted that the taxpayer may elect to **opt out** of this deferral and recognize the conversion income in 2010 (and

---

[122] Code § 401(a)(9)(H) added by P.L. 110-458. See also, Notice 2009-82

[123] Treas. Reg. §1.401(a)(9)-8, Q&A 2. Remember, whether the spouse is the sole beneficiary is determined on or before September 30 in the year following year of death of participant spouse.

[124] Code § 401(a)(9)(B)(iv)(I); Treas. Reg. § 1.401(a)(9)-3 Q&A 3; Treas. Reg. § 1.408A-6 Q&A 14

[125] Code § 401(a)(9)(B)(iv)(I); Treas. Reg. § 1.401(a)(9)-3 Q&A 3.

[126] Code § 401(a)(9)(H) added by P.L. 110-458. See also, Notice 2009-82.

[127] Treas. Reg. §1.408A-6 – Q&A 14; Treas. Reg. §1.408-8 Q&A-5.

[128] *See*, Section VIII.A.2.a.ii, beginning on page 24, of this outline.

[129] Code §408A(d)(3)(A)(iii)

pay the taxes in 2010 based on 2010 tax rates).[130] Importantly, the participant must realize that if the "income" is deferred (i.e., the participant did not 'opt out'), the participant's tax liability would be calculated based on income tax rates applicable to the deferred years (i.e., 2011 and 2012)

2. Note: If there is a distribution from the Roth IRA that is not a "qualified distribution",[131] then there is a recapture of earlier income.[132]
3. With increasing income tax rates, this "beneficial" deferral may not be so beneficial. The following two examples help to explain this concept:
   a. *Example 16*: Let's assume Bill has a Traditional IRA valued at $1 million. Bill has no tax basis in the Traditional IRA. Bill converts all of his Traditional IRA to a Roth IRA in January 2010. Assume that income tax rates for 2010, 2011 and 2012 will be 35%. In 2010, Bill has the option of (1) recognizing one-half of the income ($500,000) in each of 2011 and 2012, or (2) electing to recognize the $1 million of income in 2010. Based on these tax rates, it appears that deferral would make the most sense, because under both scenarios, Bill would pay $350,000, however, Bill would pay $350,000 in 2011, versus paying $175,000 in each of 2012 and 2013. Thus, conventional wisdom is that deferral of income tax is better -- the assumption being that income tax rates will stay relatively static.
   b. *Example 17*: Let's assume the same facts in *Example 16* and further assume instead that the marginal income tax rates are as follows:

Year	Tax Rate
2010	35%
2011	42%
2012	42%

If Bill defers recognizing the income, the conversion tax will be $210,000 in each of 2011 and 2012 (i.e., 42% of $500,000), totaling $420,000. On the other hand, if Bill elects to recognize the income in 2010, the conversion tax will be $350,000. Thus, by deferring payment into the future, it will cost Bill an additional $70,000. To make an "apples-to-apples" comparison, Bill would need to have a 13.1% after tax return to make him indifferent to paying $350,000 in 2011, versus paying $210,000 in each of 2012 and 2013. Thus, depending upon future tax rates, it may **not** be prudent to defer the recognition of income for conversions done in 2010.

130 Code §408A(d)(3)(A)(iii)

131 Discussed in section VI.E, beginning on page 12, of this outline.

132 Code § 408A(d)(3)(E).

B. If the participant *converts* in 2010, what are the important dates to remember:

January 1, 2010	first day to *convert*
December 31, 2010	last day to *convert* taking advantage of the possible deferral provision
April 15, 2011	100% of conversion tax is due, to avoid late payment penalty
October 15, 2011	last day to make re-characterize 2010 conversion, including extensions
April 15, 2012	50% of resulting conversion tax liability, if deferral is elected
April 15, 2013	remaining 50% of resulting conversion tax liability, if deferral is elected

X. *Converting* IRAs with Basis

A. A participant may *convert* any portion or all of any Traditional IRA (or qualified plan). It may be the case that the participant has a Traditional IRA with basis (generally because of non-deductible contributions) and a Traditional IRA without basis. To minimize the income tax on the *conversion*, the participant may try to *convert* the IRA with basis.[133] The rules provide that the IRAs must be aggregated, and any distribution from the Traditional IRA is deemed to be a distribution from all IRAs and the basis in the Traditional IRA will be allocated to all IRAs, so that on *conversion*, the amount converted is deemed to come from all the IRAs. This is best explained in the following example:

1. *Example 18*. John has two IRAs. Traditional IRA #1 is valued at $20,000, and has tax basis of $10,000 (from non-deductible contributions). IRA #2 is valued at $80,000 and has no basis. In determining the amount of the tax-free amount on *conversion*, the following fraction is to be obtained:

$$\frac{\text{Total Amount of Basis in All IRAs}}{\text{Total Value of All IRAs}}$$

In this case, the ratio would be $10,000 / $100,000, or (10%). Thus, of every dollar that is *converted*, 10% would not be included in income. So, if John converts IRA #1, it is treated as if 90% is included in income and 10% is excluded. Thus, $18,000 would be included in income and $2,000 would be excluded. After the *conversion*, Traditional IRA #2 would have a tax basis of 10% or $8,000.

B. Planning with Non-Deductible IRAs. In certain circumstances, one may be able to plan around the non-deductible IRA issue. This occurs, for instance, in the circumstance where one has a Traditional IRA which was originally rolled-over from one's 401k plan.

---

[133] As set forth in Section V.D.3

1. *Example 19*: Let's assume that Kim is currently employed and she has the following three accounts:

Traditional IRA ("IRA #1 – from Kim's prior employer's 401k plan)	$600,000
Traditional IRA ("IRA #2" - non-deductible - 100% basis)	400,000
Employer Sponsored 401k Plan	500,000
Total Deferred Compensation Plans	$1,500,000

If Kim wishes to convert a total of $400,000 of her IRAs, 60% of the $400,000 will be treated as taxable income. The 60% amount is determined by dividing the value of the Traditional IRA (with no basis) by the total value of all IRAs. In this case that would be $600,000 divided by $1,000,000. Note: One would not look at Kim's 401k plan in this analysis.[134]

There may be a planning opportunity for those individuals who are working at the time of conversion and participate in their employer's deferred compensation plan (such as a 401k). The following example illustrates how this can be accomplished:

***Example 20*:** Let's assume the same facts as in *Example 19*. However, in this example, let's assume that Kim first transfers all of Traditional IRA #1 (i.e., originally from her former employer's 401k plan) to her current employer sponsored 401k plan. Then, after that transfer, she converts all of Traditional IRA #2, valued at $400,000.

In this example, by first transferring Traditional IRA #1 (the IRA with no basis) to her current 401k plan, that IRA loses its identity as an IRA; thus, the only remaining IRA is the non-deductible IRA #2 (with full basis). Kim would pay no conversion tax, because income is only recognized on conversion to the extent that the value of IRA #2 exceeds its basis. In this case the value of IRA #2 was equal to its basis.

XI. How would one analyze the *conversion*?

A. The best way to analyze the *conversion* is by looking at all of the assets that would be affected by the *conversion* over the time horizon that is affected by the *conversion*.

1. All of the assets that would be affected by the conversion

---

[134] Code § 408A(d)(4)(A) provides that Code § 408(d)(2) shall be applied separately for IRAs and other individual retirement plans Code § 408(d)(2) states that for purposes of applying Code §72 one would treat all retirement plans as one plan. However, in the case of Roth IRAs when looking at distributions, one is to look to IRA accounts separate from other retirement plans.

a. It is critical to examine **all** of the participant's assets (i.e., both the IRA and non-IRA assets). To do anything else would be incomplete (and most likely inaccurate). Stated in the negative, one should **not** (a) look at the Roth and Traditional IRA accounts in isolation, and (b) ignore the non-IRA assets.

2. The analysis should take into consideration such items as asset allocation, asset turnover, asset performance (i.e., returns), as well as the impact of current and future taxes (including, but not limited to federal, state and local income and estate taxes).
3. Time horizon
   a. The time horizon should be over the longest period of time that either the Traditional or the Roth IRA can be distributed.
   b. Typically this is from the date of conversion through and including the anticipated actuarial life expectancy of the beneficiary, based on the Single Life Tables.
   c. To evaluate over a shorter period of time, would not tell the entire story.

B. In doing the analysis, it is best to compare (a) the participant's total asset values would be over the time horizon if he or she had *converted* and (b) had he or she **not** *converted*.

XII. What to consider when thinking of converting:

A. Three Stage Process
   1. Stage 1 – From conversion to 70 ½
   2. Stage 2 – From 70 ½ to death of participant
   3. Stage 3 – From death of participant to anticipated life expectancy of beneficiary

B. Analyze what the effect is over the various stages
   1. One must run the numbers at each stage to see if it makes sense.
   2. If you only look at one or two of the three stages, you have missed the analysis. The analysis has to be done over the three-stage process.

C. First – Identify the factors that affect the decision:
   1. Income Tax - Current and estimate future marginal income tax rates (both federal and state).
   2. Income Tax Favorable Situations - Significant income tax favorable situations (e.g., charitable contribution carryovers) that may affect the income tax burden of conversion.
   3. Estate tax liability – whether you will be subject to estate tax at death, and if so how much.
   4. Cash flow needs –
      a. Current and future cash flow needs for lifestyle; and
      b. Future needs for estate taxes.
   5. Estate planning goals.
   6. Life expectancy – real life expectancy, not tables.
   7. Anticipated rate of return for assets inside and outside of IRA.
   8. Anticipated life expectancy of beneficiaries.
   9. Where Congress is headed with estate, gift, GST and income taxes.

D. Second – Run the Numbers

1. There are too many variables to guess.
2. One must run varying analysis.
3. Consider building your own spreadsheet to run the analysis. Do **not** use software that does not consider estate tax; if the software does not consider the estate tax ramification the analysis would be incomplete.[135] NOTE: There is a great selection of software available (on the Internet), but not all analyze over the 3-stage horizon.

XIII. Planning after the Decision to Convert

A. At this point, let's assume that the client has done the analysis and decides he or she wishes to convert his or her current Traditional IRA to a Roth IRA. In this case, the planning, in many respects is just beginning. There are a few pointers that the planner must keep in mind and inform the client who has decided to convert, as follows:
1. Understanding the re-characterization rules.
2. Using multiple IRA accounts.
3. Integrating the re-characterization rules with multiple accounts.
4. Considering the "location of assets".

B. Revisiting re-characterizations and Use of Multiple Accounts.
1. Section VII, beginning on page 20 of this outline sets for the rules for when one could re-characterize.
2. We briefly indicated that if the participant re-characterizes a contribution, the Code and the Treasury Regulations require that the participant also transfer the earning on the re-characterized contribution.[136] The Treasury Regulations provide how the "math" is computed in determining how the "earnings" are to be allocated to the original contribution. They use the following formula:

$$\text{Net Income / (loss)} = \frac{\text{Contribution x (Adjusted Closing Balance - Adjusted Opening Balance)}}{\text{Adjusted Opening Balance.}}$$

The Treasury Regulation § 1.408A-5, Q&A-2(c) provide following definitions that apply to the formula:

*The term **adjusted opening balance** means the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions or transfers (including the contribution that is being re-characterized pursuant to section 408A(d)(6) and any other re-characterizations) made to the IRA during the computation period.*
*The term **adjusted closing balance** means the fair market value of the IRA at the end of the computation period plus the amount of any distributions or transfers (including contributions returned pursuant to section 408(d)(4) and re-characterizations of contributions pursuant to section 408A(d)(6)) made from the IRA during the computation period.*
*The term **computation period** means the period beginning immediately prior to the time the particular contribution being re-characterized is made to the IRA and ending*

---

135 Of course, if the client is not subject to estate tax, then it is not necessary.
136 Code §408A(d)(6*)*; Treas. Reg. § 1.408A-5, Q&A-2(b).

immediately prior to the re-characterizing transfer of the contribution. If a series of regular contributions was made to the IRA, and consecutive contributions in that series are being re-characterized, the computation period begins immediately prior to the time the first of the regular contributions being re-characterized was made.

In addition to the foregoing, the regulations provide other guidance on how one values assets that are not valued on a regular basis, how to deal with a re-characterization if there are multiple Roth IRAs, and how to deal with multiple re-characterizations.[137]

3. Use of Multiple IRAs - In light of the recent turbulent markets, the value of assets within the newly converted Roth IRA may decrease, or certain asset classes within the IRA may decrease while other classes increase. One may have a portfolio with substantial holdings in various asset classes. If this is the case, it may be beneficial to create multiple Roth IRAs and fund each Roth IRA account, each with a separate asset class, so that if the value increases with respect to certain classes after the conversion, you keep those assets in the Roth IRA, and if the assets decrease in another class, you could look at whether you are eligible to re-characterize that Roth IRA back to a Traditional IRA.
4. Let's see how re-characterization with multiple IRAs may be beneficial.
   a. *Example 21*. Let's assume that John has a Traditional IRA valued at $1 million. Let's further assume that the assets of the IRA are invested as follows:

Asset Class	Value
Large Cap	$250,000
Mid Cap	250,000
Small Cap	250,000
International	250,000
Total	$1,000,000

In this case, let's assume at the time of filing John's tax return the year following conversion, the values of the assets are as follows:

Asset Class	Value
Large Cap	$350,000
Mid Cap	400,000
Small Cap	150,000
International	100,000
Total	$1,000,000

Thus, the net value of the total assets is $1 million. If John uses one Roth IRA account, there is no net change in value; thus, it is unlikely that he would re-characterize the account.

---

[137] Treas. Reg., § 1.408A-5, Q&A-2. The author suggests that the reader read that particular Q&A, which provides a number of good examples.

b. *Example 22*. Let's assume the same facts as *Example 21*, except in this case; he had created separate Roth IRAs for each of the investment classes. In that case, he could have kept those Roth IRA accounts invested in Large Cap and Mid Cap (i.e., the accounts that had appreciated) and "re-characterized" the Roth IRA accounts that had invested in Small Cap and International (i.e., those that had decreased in value). Remember that the income tax on the conversion is based upon the value of the assets converted on the actual date of the conversion (i.e., $500,000 for Large Cap and Mid Cap). Thus, in this case even though the asset value at the time of filing the return has increased to $750,000, the conversion tax is paid only on the $500,000 amount. After the re-characterization, subject to certain time limitations, John could then convert those IRAs invested in Small Cap and International when the values are depressed. The net result is that all of John's IRA will be converted, and he would have paid less income tax.

c. *Example 23*. Let's assume the same facts as *Example 22*, except that in the following year, John re-characterizes the Small Cap and International (using two new Roth IRA accounts). Let's assume that at "re" conversion, the values had not changed since re-characterization. Further assume that John will not re-characterize the re-converted amounts. Finally, let's assume that they had increased over time and that John's income tax rates were 40%.

Analysis:

In *Example 21*, John would have paid $400,000 (i.e., 40% of $1 million).

In *Example 22*, John would have paid $200,000 (i.e., 40% of the $500,000 that was converted and not re-characterized.

In *Example 23*, John would have paid $100,000 (i.e., 40% of the $150,000 + $100,000 that were re-converted).

The net result is by using multiple IRAs with re-characterization; John saved $100,000 in income taxes!

C. One of the authors has co-authored a more in-depth article on planning strategies for re-characterizations and re-conversions, which should be read to supplement this outline.[138]

D. Planning Pointer: Fully Convert with the intention to recharacterize

1. Let's assume that the client has made the decision to convert $400,000 (or 40%) of her $1.0 million IRA. There are a number of ways in which one could convert.

   a. First, one could simply convert $400,000 into perhaps two Roth IRAs and diversify as much as possible, with the intention that if one IRA decreases significantly, then they can re-characterize the Roth. If the a Roth account is re-characterized, we suggest placing it into a new Traditional

[138] *See*, *Roth IRA Recharacterizations and Reconversions – 10 Strategies*. Franklin and Law, *Tax Notes*, Vol. 126, Number 3, January 18, 2010.

IRA and then one does not need to wait to convert part of the remaining $600,000 of the Traditional IRA. If the Roth account is recharacterized and placed in the original Traditional IRA account, the account holder would have to wait to reconvert [139] the account later.

b. Second, one could convert all of the $1.0 million of the original Traditional IRA and place it into five accounts $200,000 accounts. Up until the recharacterization period ends (i.e., October 15 of the year following conversion), client can wait-and-see which of the two $200,000 have appreciated the most and then recharacterize the remaining three accounts.

c. A variation of the second option is to strategically (over time) invest the $1.0 million in the five accounts, instead of doing it all at one time.

d. The second (or third) option appears to be the better lifetime option; however, as discussed below if the client dies during the recharacterization period it raises issues not necessarily present in the first option.

E. Recharacterizing at death – Who can do it?

1. An issue arises when one has passed, yet the recharacterization period is still open. The question, what happens if the asset value decreased dramatically after the client dies during the recharacterization period? Let's assume that Jack converts on May 1, 2010 his $1.0 million IRA. Let's further assume that Jack dies on July 1, 2010. Let's then assume on January 1, 2011, the value of the Roth IRA is now $600,000 as a result of market fluctuations. Who can recharacterize?

2. The Treasury Regulations are helpful, but not determinative. Treas. Reg. §1.408A-5, A-6(c) provide as follows:

"(c) The election to recharacterize a contribution described in this A-6 may be made on behalf of a deceased IRA owner by his or her executor, administrator, or other person responsible for filing the final Federal income tax return of the decedent under section 6012(b)(1)."

Reading the language literally, it says that the executor, administrator of the person responsible for filing the income tax return can make the "election to recharacterize." Treas. Reg. §.1048A-5, Q-6 asks the question, "*[h]ow does a taxpayer make the election to recharacterize a contribution to an IRA for a taxable year?*" The answer to that question provides that the individual must notify both the Roth IRA and the new Traditional IRA trustee (on the date of the transfer or before) that the individual wishes to recharacterize and must provide the trustees with information set forth in the regulations.[140] The

[139] See discussion on timing for re-conversions in Section VII.E beginning on page 22 of this outline.

[140] Treas. Reg. §1.408A-5, A-6(a) provides that the notification must include the following information:

(a) the type and amount of the contribution to the Roth IRA that is to be recharacterized;

(b) the date on which the contribution was made to the Roth IRA and the year for which it was made;

(c) a direction to the trustee of the Roth IRA to transfer, in a trustee-to-trustee transfer, the amount of the contribution and net income allocable to the contribution to the trustee of the new Traditional IRA; and

regulations go on to state that the election and the "trustee-to-trustee" transfer **must** occur on or before the dues date (including extensions) for filing the individual Federal income tax return.[141]

Here's the issue:

> "Who makes the "trustee-to-trustee" transfer from the Roth IRA to the new Traditional IRA?"

Let's examine state law. Under both Florida law and New York law, where the authors reside, and, under most if not all states, unless the beneficiary of an IRA is the estate, the executor or personal representative, is not the person who can control the IRA (whether Roth or Traditional). Further, the person responsible for filing the income tax return, in that person's fiduciary capacity also has no ability to control the IRA. Generally, the named beneficiary, who is generally an individual would be the person in control of the IRA (whether Roth or otherwise). So, even though the Treasury Regulations contemplate that the fiduciary (i.e., executor, administrator, personal representative, or person responsible for filing the decedent's final Federal income tax return) would "make the election", it does not answer the question of who will move the funds from the Roth IRA to the new Traditional IRA. Frankly, currently, the authors know of no good answer; however there are some thoughts that could be considered.

3. Some approaches that may be possible are as follows:
   a. First, review the custody or trustee agreement to see if someone other than the participant can make a trustee-to-trustee transfer to accomplish the recharacterization. If the agreement is silent, which some are, consider asking the custodian or trustee to consider a modification.
   b. Second, review the beneficiary designation and determine if you can put precatory language that the beneficiary(ies) would either take the funds under this Roth IRA or a mirror Traditional IRA for the same beneficiary(ies). Perhaps one can put a clause that says if the value of the assets decrease by more than "X"%, then the beneficiaries agree to transfer the assets back to the Traditional IRA, held for them on the same terms and conditions (see the fourth point below).
   c. Third, make sure that there is a recipient Traditional IRA to receive the Roth IRA funds. Some financial institutions close the original Traditional IRA if there are no funds in the account. Thus, perhaps leaving a nominal amount in the Traditional IRA to keep the account open.
   d. Fourth, make sure that there are identity of beneficiaries between the Roth IRA and the Traditional IRA account. If the beneficiaries are not

(d) the name of the trustee of the Roth IRA and the trustee of the new Traditional IRA and any additional information needed to make the transfer.

141 Treas. Reg. §1.408A-5, A-6(a) and (b).

identical, there may be an issue of whether there was a gift made from the Roth IRA beneficiaries to the Traditional IRA beneficiaries.

e. Fifth, consider inserting language in the Will or Revocable Trust providing the personal representative the ability to do the re-characterization.

f. Consider writing a letter to all involved to express the participant's desires and to discuss the issue and the preferred course of action.

4. This may work where there is an identity of beneficiaries between the client's non-IRA and IRA assets. However, let's say that it makes sense to leave Roth IRA assets in a conduit trust for the benefit of grandchildren, but if Traditional IRA assets were to be distributed, it may have made sense to leave them to children instead. What would happen? Clearly in this case, with lack of identity of beneficiaries, there is a question of whether there was a gratuitous transfer made by the junior generation (i.e., the grandchildren) to the more senior generation (i.e., the children). Perhaps there can be conditional gifts under the will/revocable trust to offset that issue, but that may raise other issues. Suffice to say, this is an issue not yet resolved, but must be considered in planning.

XIV. Running some numbers

A. The following results and charts are based upon some "number running". The basic data and assumptions are as follows:

B. Basic Facts:

1. Caleb, who was born on January 2, 1951, is unmarried and has one child, Mitch, who was born on March 1, 1980.

2. Caleb plans to leave all of his assets to Mitch.

3. Caleb's anticipated date of death will be January 1, 2035.

4. Mitch's anticipated life expectancy would be through 2064 (i.e., when he would be approximately 84 years of age).

5. Caleb currently has the following assets:

a. Traditional IRA - $1 million, with no non-deductible contributions.

b. Other investible assets (marketable securities, cash, etc.) - $9 million with a tax basis of $9.0 million.

c. No other assets (to simplify the fact pattern).

6. Let's assume that Caleb only earns income from his investments.

7. Let's assume that after Caleb dies, Mitch will have only the income from the assets he inherits from Caleb.

8. Assume that Caleb and Mitch will have the same investment philosophy, investing in a balanced type of asset allocation, which will have approximately 35% in equities, 45% in fixed income and about 20% in alternative investments. Let's assume the pre-tax rate of return is approximately 7.63% and there is a turnover rate of assets of about 37.4% to maintain that balanced asset allocation.

9. The federal income tax over Caleb and Mitch's lifetime will be:

a. Income Taxes for 2010 are based on income tax rates as exist in 2010.

b. For future years, the income tax rates established by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the

Jobs and Growth Relief Reconciliation Act of 2003 (JGTRRA) are assumed to sunset in 2011. Ordinary income attributable to retirement plan distributions and taxable interest is taxed at the marginal rate. Future tax brackets are adjusted for inflation according to the inflation rate specified of 2.5%. We have assumed that the capital gains and qualified dividend rates will be 20%, however.

10. Estate Taxes - The estate and gift rates and credits are assumed to stay frozen at 2009 rates and values. State death taxes are based on the pre-EGTRRA rules for computing the maximum allowable state death credit.
11. For this first hypothetical, there are no state income and estate taxes.
12. Income tax on conversion from Traditional to Roth IRA will be paid by non-Roth IRA/ non-IRA assets. Estate taxes will be apportioned to the non-IRA assets.
13. Caleb will convert 100% of his Traditional IRA to a Roth IRA on January 1, 2010, and elect not to defer the income over two years, but instead to recognize income in 2010.

C. Assumptions:

1. In order to compare the benefits or detriment of converting an asset to a Roth IRA, an "apples-to-apples" comparison is necessary. To do such an analysis, the best way to compare two investments or assets held in different vehicles is to hypothetically liquidate the investment at any point in time and compare the value of such investments post liquidation. Clearly, liquidation comes with a cost. For Traditional IRAs, the cost of liquidation is the income tax (adjusted for of any 691(c) or other deduction that may be applicable). For Roth IRAs, depending upon when the asset is hypothetically liquidated, there may be an adjustment for a 10% penalty, or if the Roth was converted, and/or tax deferred (i.e., under the special 2-year deferral for conversions in 2010). And, potential recognition of earnings (and applicable 10% penalty) if distributed in the first five years.
2. We have taken the approach that we will compare, on the one hand, the client has "done nothing" (i.e., not converted the Traditional IRA to a Roth IRA), and on the other hand, the client that has converted (any part or all of) his or her IRA. Then at specific points in time (which is generally at the end of each year) we have hypothetically liquidated the Traditional IRA (for those clients who "did nothing") and Roth IRA (for those who converted 100% of the Traditional IRA) and compared the values, not only of the IRAs, but of the client's total portfolio (i.e., of the "other assets, too).
3. We have assumed that there are no significant administration costs of liquidation, and that assets can be hypothetically liquidated each year, at year end, without any other penalty or cost (other than those mentioned above).
4. We assumed that Mitch will survive the full distribution of the Roth IRA, thus, we did not apply an estate tax at his generation to the benefit or burden of converting.

D. Fact Pattern #1

1. Results

a. Based upon the *Basic Facts*, which we call "*Fact Pattern #1*", the results are as follows:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$2,192,064	$0
Estimated Value of Roth IRA	$0	$2,192,064
Estimated Value of Other Assets	$9,170,236	$9,291,204
Total Value of Assets	$11,362,300	$11,483,267
	Benefit / (Detriment) of Conversion	$120,967

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$3,309,452	$0
Estimated Value of Roth IRA	$0	$6,604,722
Estimated Value of Other Assets	$21,001,162	$18,545,553
Total Value of Assets	$24,310,614	$25,150,275
	Benefit / (Detriment) of Conversion	$839,661

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$121,887,613	$135,714,435
Total Value of Assets	$121,887,613	$135,714,435
	Benefit / (Detriment) of Conversion	$13,826,822

2. Based on these facts:
   a. By the end of Stage 1 (i.e., in the year immediately before Caleb's required beginning date (and when he would be required to take his required minimum distributions)), Caleb would be better off by $120,967 by having converted to a Roth IRA.
   b. By the end of Stage 2 (i.e., when Caleb would have died), he would be better off by $839,661.
   c. By the end of State 3 (i.e., Mitch's life expectancy based on IRS tables), Mitch would be better off by $13,826,822. Using a present value rate of interest of 2.5%, this translates to $3,555,574 of a net benefit at the end of Mitch's life expectancy.

E. *Fact Pattern #2* -

1. Assume the same facts as the *Fact Pattern #1*, except Caleb will recognize income in 2011 and 2012 (under the default rules).
2. Based upon the foregoing, the results are as follows:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$2,192,064	$0
Estimated Value of Roth IRA	$0	$2,192,064
Estimated Value of Other Assets	$9,170,236	$9,277,314
Total Value of Assets	$11,362,300	$11,469,378
	Benefit / (Detriment) of Conversion	$107,078

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$3,309,452	$0
Estimated Value of Roth IRA	$0	$6,604,722
Estimated Value of Other Assets	$21,001,162	$18,513,662
Total Value of Assets	$24,310,614	$25,118,383
	Benefit / (Detriment) of Conversion	$807,769

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$121,887,613	$135,556,347
Total Value of Assets	$121,887,613	$135,556,347
	Benefit / (Detriment) of Conversion	$13,668,734

3. Comparing the Basic Facts to this second example, we can see that the benefits decreased, as follows:
   a. In Stage 1 it decreased from $120,967 to $107,078;
   b. In Stage 2 it decreased from $839,661 to $807,769; and
   c. In Stage 3, it decreased from $13,826,822 to $13,668,734.
4. In analyzing this, we note that income tax rates in coming years (2011 and 2012) will likely be higher (assuming repeal of EGGTRA and increased capital gains and qualified dividend rates). Thus, by recognizing income in 2010 (a lower-income-tax-rate year), versus deferring to 2011 and 2012 (higher-tax-rate years), the benefit is more.

F. *Fact Pattern #3* -

1. Let's assume the same facts as the *Fact Pattern #2* (i.e., where Caleb recognized income in 2011 and 2012), except that the Caleb and Mitch invest in an all equity portfolio, where his investment would be roughly 63% in equities and 37% in alternatives, and his pretax return would be roughly 8.95% with a turnover ratio of about 43.25% to maintain that mix.
2. Based upon the foregoing, the results are as follows:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$2,497,253	$0
Estimated Value of Roth IRA	$0	$2,497,253
Estimated Value of Other Assets	$10,425,988	$10,557,948
Total Value of Assets	$12,923,241	$13,055,201
	Benefit / (Detriment) of Conversion	$131,960

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$4,566,414	$0
Estimated Value of Roth IRA	$0	$9,035,403
Estimated Value of Other Assets	$29,692,538	$26,190,988
Total Value of Assets	$34,258,951	$35,226,391
	Benefit / (Detriment) of Conversion	$967,440

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$257,488,305	$282,716,385
Total Value of Assets	$257,488,305	$282,716,385
	Benefit / (Detriment) of Conversion	$25,228,080

3. By comparing *Fact Pattern #2* with *Fact Pattern #3*, one can see that if the return is higher, it yields a better result. So, in this case, the results were as follows:
   a. Stage 1 the benefit increased from $107,078 to $131,960;
   b. Stage 2 the benefit increased from $807,769, to $967,440; and
   c. Stage 3 increased from $13,668,734 to $25,228,080.
4. By comparing *Fact Pattern #1* with *Fact Pattern #3*, we see that even though the tax rates were lower in 2010 (versus 2011 and 2012 under Fact Pattern #2), the benefit was more with deferral, as follows:
   a. Stage 1 the benefit increased from $120,967 to $131,960;
   b. Stage 2 the benefit increased from $839,661 to $967,440; and
   c. Stage 3 increased from $13,826,822 to $25,225,080.
5. This illustrates that even though one factor may cause the benefit to decrease, another factor may cause the benefit to increase, so much so, that it out shines the decrease.
6. Our analysis shows that the important factors are: (1) tax rates (both income and estate tax), (2) investment performance, and (3) time horizon. These, by the way are the same three factors that are relevant in almost all analyses when comparing alternatives in the investment world. The only basic difference is the algebra to compute the differences.

G. *Fact Pattern #4* -

1. Assume the same facts as the *Fact Pattern #1*, except:
   a. Caleb lives in a state where there is an income tax of 5%, and Mitch lives in that same state.
2. Based upon the foregoing, the results are as follows:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$2,192,064	$0
Estimated Value of Roth IRA	$0	$2,192,064
Estimated Value of Other Assets	$8,900,760	$9,036,406
Total Value of Assets	$11,092,824	$11,228,469
	Benefit / (Detriment) of Conversion	$135,646

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$3,309,452	$0
Estimated Value of Roth IRA	$0	$6,604,722
Estimated Value of Other Assets	$19,597,368	$17,264,765
Total Value of Assets	$22,906,820	$23,869,486
	Benefit / (Detriment) of Conversion	$962,666

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$107,158,654	$122,022,328
Total Value of Assets	$107,158,654	$122,022,328
	Benefit / (Detriment) of Conversion	$14,863,674

3. Based upon the foregoing, one can see that by moving to a state with an income tax, at the time of conversion benefit is increased. Comparing *Fact Pattern #1* with *Fact Pattern #4*, one sees that:
   a. In Stage 1, the benefit increased from $120,967 to $135;646;
   b. In Stage 2, from $839,661 to $962,666; and
   c. In Stage 3, from $13,826,822 to $14,863,674.

What this illustrates is that it is general, for those individuals who live in states who are subject to an income tax; there is a benefit of converting over not converting.

4. However, notably, one sees the impact of income taxes on the overall wealth of the individuals, under the "Conversion scenario" in comparing *Fact Pattern #1* with *Fact Pattern #4*, one sees that the "Total Value of Assets" decreased in all three stages:
   a. In Stage 1, from $11,483,267 to $11,228,469;
   b. In Stage 2, from $25,150,275 to $23,869,486; and
   c. In Stage 3, from $135,714,435 to $122,022,328.
5. What this illustrates is that even though in states with state income taxes, it is more beneficial to convert you are better off if you live in a state where this is no income tax. This is not new; it just illustrates the case clearly.

H. Fact *Pattern #5* -

1. Assume the same facts as the *Fact Pattern #1*, except:
   a. Caleb and Mitch will live in a state where there is an estate tax equal to the state death tax credit with a $1.0 million estate tax exemption
2. Based upon the foregoing, the results are as follows:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$2,192,064	$0
Estimated Value of Roth IRA	$0	$2,192,064
Estimated Value of Other Assets	$7,821,139	$7,999,141
Total Value of Assets	$10,013,203	$10,191,205
	Benefit / (Detriment) of Conversion	$178,002

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$3,309,452	$0
Estimated Value of Roth IRA	$0	$6,604,722
Estimated Value of Other Assets	$17,541,396	$15,066,769
Total Value of Assets	$20,850,848	$21,671,491
	Benefit / (Detriment) of Conversion	$820,643

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$105,239,617	$118,789,671
Total Value of Assets	$105,239,617	$118,789,671
	Benefit / (Detriment) of Conversion	$13,550,054

3. Based upon the foregoing, one can see that, all things being equal, those who live in states subject to a state death estate tax receive a greater benefit earlier and less of a benefit later from converting, vis-à-vis those who live in states not subject to an estate tax.
4. Comparing *Fact Pattern #1* with *Fact Pattern #5*, one sees the benefit as follows:
   a. At the end of Stage 1, the benefit increased from $120,967 to $178,002;
   b. At the end of Stage 2, the benefit decreased from $839,661 to $820,643; and
   c. At the end of Stage 3, the benefit decreased from $13,826,822 to $13,550,054.
5. In the "no convert" scenario, where there is a Traditional IRA, the beneficiaries do not take advantage of paying state death taxes, because they

are not recouped by the section 691(c) deduction. Thus, in the early years, where the state death taxes are larger as a proportion to taxes attributable to the Traditional IRA, the beneficiaries are disadvantaged in the "no convert" scenario vis-à-vis the "convert" scenario. However, in later years, this advantage is not as relevant (this is especially true after the participant reaches his or her required beginning date). And, over time, with positive investment returns, and sufficient passage of time, the advantage is not as relevant. Thus, in early years when the assets are appreciating in value, it is more beneficial for those in states with a state death tax, however, in later years, the benefit is not as evident.

6. The analysis also illustrates that even though the net benefit is more (as was the case where there was a state *income* tax), the assets that the participant and the beneficiary receives is much less. This is because of the imposition of the state death tax.

I. Fact *Pattern #6* -

1. Assume the same facts as the *Fact Pattern #1*, except that the conversion tax will be paid by the Roth IRA (instead of the non-IRA Assets):
2. The results are as follows:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	**No Conversion**	**Conversion**
Estimated Value of Traditional IRA	$2,192,064	$0
Estimated Value of Roth IRA	$0	$1,461,930
Estimated Value of Other Assets	$9,170,236	$9,959,940
Total Value of Assets	$11,362,300	$11,421,870
	Benefit / (Detriment) of Conversion	$59,570

Stage 2 - Caleb's Death (2035)	**No Conversion**	**Conversion**
Estimated Value of Traditional IRA	$3,309,452	$0
Estimated Value of Roth IRA	$0	$4,404,818
Estimated Value of Other Assets	$21,001,162	$20,296,097
Total Value of Assets	$24,310,614	$24,700,915
	Benefit / (Detriment) of Conversion	$390,301

Stage 3 - Beneficiary's Death (2064)	**No Conversion**	**Conversion**
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$121,887,613	$129,614,385
Total Value of Assets	$121,887,613	$129,614,385
	Benefit / (Detriment) of Conversion	$7,726,771

3. Based upon the foregoing, in comparing *Fact Pattern #1* with *Fact Pattern #6*, one can see that, the benefit drops significantly when using Roth IRA assets to pay the conversion tax, as follows:
   a. At the end of Stage 1, the benefit decreases from $120,967 to $59,570;
   b. At the end of Stage 2, the benefit decreases from $839,661 to $390,301;
   c. At the end of Stage 3, the benefit decreases from $13,826,822 to $7,726,771.
4. This fact pattern illustrates that it is more beneficial to pay the conversion taxes with non-IRA assets. Paying conversion tax with non-IRA assets is equivalent to the participant making a lump-sum contribution to the Roth IRA of an amount equal to the conversion tax. The following example illustrates this point:

a. Example: Let's assume Bill has a Traditional IRA valued at $1 million at the time of the conversion. Assume further that he converts and elects to recognize the income in 2010. Thus, Bill's conversion tax is $350,000. If Bill uses the Roth IRA to pay the tax, the Roth IRA will have $650,000 (i.e., $1 million less $350,000 tax). If instead Bill uses $350,000 of non-IRA assets, the Roth IRA remains at $1 million. Thus, to pay the tax with non-IRA assets is effectively a lump sum contribution to the Roth IRA (in this case equal to $350,000).

b. In comparing the "conversion" versus "non-conversion" scenarios, if the participant pays the conversion tax with non-IRA assets, the Roth IRA will have the same starting value as the previous Traditional IRA. However, a Roth IRA with an equal starting value to a Traditional IRA is clearly not equivalent – it is far more advantageous. Distributions from Roth IRAs are tax-free; whereas, distributions from Traditional IRAs are subject to income tax. In other words, it is much better to have a $1 million Roth IRA as compared to a $1 million Traditional IRA.

5. Special Note: Paying the tax with the Roth IRA assets is not a good idea primarily because the tax payment not only uses funds that will grow tax free for quite some time (i.e., over the participant's lifetime and the anticipated life expectancy of the beneficiary), but the payment of the tax with Roth IRA funds is deemed to be a "non-qualified distribution", thus, the 10% early withdrawal penalty tax may be added to the income tax if the participant is under the age of 59 ½.

6. Although not suggested, as one can see, paying the tax with the Roth IRA assets is not detrimental, it simply reduces the benefit. Thus, if there is no other source of payment, the Roth IRA may be used to pay the tax.

J. Fact *Pattern #7* -

1. Assume the same facts as the *Fact Pattern #1*, except that the estate tax is apportioned to the Roth IRA.

2. The results are as follows:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$1,390,625	$0
Estimated Value of Roth IRA	$0	$1,397,280
Estimated Value of Other Assets	$9,971,675	$10,085,987
Total Value of Assets	$11,362,300	$11,483,267
	Benefit / (Detriment) of Conversion	$120,967

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$1,942,417	$0
Estimated Value of Roth IRA	$0	$3,875,281
Estimated Value of Other Assets	$22,368,197	$21,274,994
Total Value of Assets	$24,310,614	$25,150,275
	Benefit / (Detriment) of Conversion	$839,661

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$120,805,197	$130,849,034
Total Value of Assets	$120,805,197	$130,849,034
	Benefit / (Detriment) of Conversion	$10,043,836

3. In comparing the results of this *Fact Pattern #7*, with the *Fact Pattern #1*, one can see that the results are may not be what one would anticipate. The difference is as follows:
   a. Stage 1 – no difference
   b. Stage 2 – no difference
   c. Stage 3, decrease in benefit from $13,668,734 to $10,043,836.
4. The lack of difference is explained by the fact that the assets are fully liquidated, with that being the case, and with no state death tax, there is no difference through the date of death of the participant. However, after the participant dies, the decrease of benefit of paying with the estate's estate tax is fairly evident.

K. What do the foregoing fact patterns / examples illustrate?
   1. What the examples illustrate are the following:
      a. First, it is important to "run the numbers" because one cannot determine the net benefit or burden without running the numbers.
      b. Second, although various theories exist where it may be beneficial to convert, versus not convert, because there are so many variables at play, one cannot guess at when it is beneficial (or not).
      c. Third, the analysis must be done over a period of time that encompasses the life expectancy of both the participant and the beneficiary. To do otherwise would be incomplete.

XV. Charitable Giving
   A. The issue today is whether one should make a gift of one's IRA to charity at death (on the one hand) or keep the IRA and convert it to a Roth IRA and give other assets to charity at death (on the other hand). This can be illustrated by the following chart:[142]

	No Conversion	**Conversion**
During Life	Do **not** convert the Traditional IRA	Convert the Traditional IRA to a Roth IRA
At Death	Give the Traditional IRA to Charity; and give other assets to Family	Give non-IRA assets to charity (in an amount equal to what the Traditional IRA would have been had one **not** converted)[143], give balance of assets (including the Roth IRA) to family.

   B. Like the previous analyses, it requires number-crunching.
   C. Our initial number crunching shows that there is a "so-called" cross over point, in that it does not work to the family's benefit to give the Traditional IRA to

[142] This chart is borrowed from an article published by the authors of this outline, together with Richard S. Franklin, Esq., titled *Roth the Traditional IRA or Leave it to Charity?*

[143] By giving the charity what it would have received had the participant not converted, the charity is as well off regardless of the participant's conversion decision.

charity at death, however, in later years (generally after the participants required beginning date) the benefit flows in favor of the family.

D. Based on data, if the net returns over the three states are slightly positive, and then the benefit is positive. If the returns are zero or negative then the result is negative. The following examples illustrate our point.

E. Examples – Continuing with *Fact Pattern #1*, let's assume that Caleb wishes to make a charitable bequest at death. Let's assume now, that before the new change in Roth IRA provisions, he was advised by his advisor to leave his Traditional IRA at death to the charity. QUERY: Does this make sense today?

1. Let's assume that the facts are the same as Fact Pattern #1, which we restate here:
    a. Caleb, who was born on January 2, 1951, is unmarried and has one child, Mitch, who was born on March 1, 1980.
    b. Caleb plans to leave all of his assets to Mitch.
    c. Caleb's anticipated date of death will be January 1, 2035.
    d. Mitch's anticipated life expectancy would be through 2064 (i.e., when he would be approximately 84 years of age).
    e. Caleb currently has the following assets:
        i. Traditional IRA - $1 million, with no non-deductible contributions.
        ii. Other investible assets (marketable securities, cash, etc.) - $9 million with a tax basis of $9.0 million.
        iii. No other assets (to simplify the fact pattern).
    f. Let's assume that Caleb only earns income from his investments.
    g. Let's assume that after Caleb dies, Mitch will have only the income from the assets he inherits from Caleb.
    h. Assume that Caleb and Mitch will have the same investment philosophy, investing in a balanced type of asset allocation, which will have approximately 35% in equities, 45% in fixed income and about 20% in alternative investments. Let's assume the pre-tax rate of return is approximately 7.63% and there is a turnover rate of assets of about 37.4% to maintain that balanced asset allocation.
    i. The federal income tax over Caleb and Mitch's lifetime will be:
        i. Income Taxes for 2010 are based on income tax rates as exist in 2010.
        ii. For future years, the income tax rates established by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Relief Reconciliation Act of 2003 (JGTRRA) are assumed to sunset in 2011. Ordinary income attributable to retirement plan distributions and taxable interest is taxed at the marginal rate. Future tax brackets are adjusted for inflation according to the inflation rate specified of 2.5%. We have assumed that the capital gains and qualified dividend rates will be 20%, however.
    j. Estate Taxes - The estate and gift rates and credits are assumed to stay frozen at 2009 rates and values. State death taxes are based on the pre-EGTRRA rules for computing the maximum allowable state death credit.
    k. For this first hypothetical, there are no state income and estate taxes.

l. Income tax on conversion from Traditional to Roth IRA will be paid by non-Roth IRA/ non-IRA assets. Estate taxes will be apportioned to the non-IRA assets.

m. Caleb will convert 100% of his Traditional IRA to a Roth IRA on January 1, 2010, and elect not to defer the income over two years, but instead to recognize income in 2010.

2. However for this *Fact Pattern #8*, let's also now assume that Caleb will leave the balance of his Traditional IRA to charity (instead of leaving it to his son, Mitch). In considering the Roth Conversion, so that charity receives the same amount, what we will assume when Caleb does the conversion, he will leave an amount from his non-IRA funds to charity equal to the amount that his Traditional IRA would have grown to had he not converted and left it at death.

   a. Recall that we compare: (a) where Caleb does no conversion, to (b) where Caleb converts his Traditional IRA to a Roth IRA. In this case, Caleb's $1.0 million IRA would have grown to approximately $3.3 million by the time of his death (after taking into consideration growth (of about 7.8% per year) and having taken out his mandatory required distributions from 2021 until his estimated death in 2035 when he would be 84 years old). We will assume that the Traditional IRA (of $3.3 million) will go to charity under the "no conversion" scenario, and in the "conversion" scenario, an equal amount would go to charity, however, it will be taken from the "other assets" (thus, preserving the Roth IRA for Caleb).

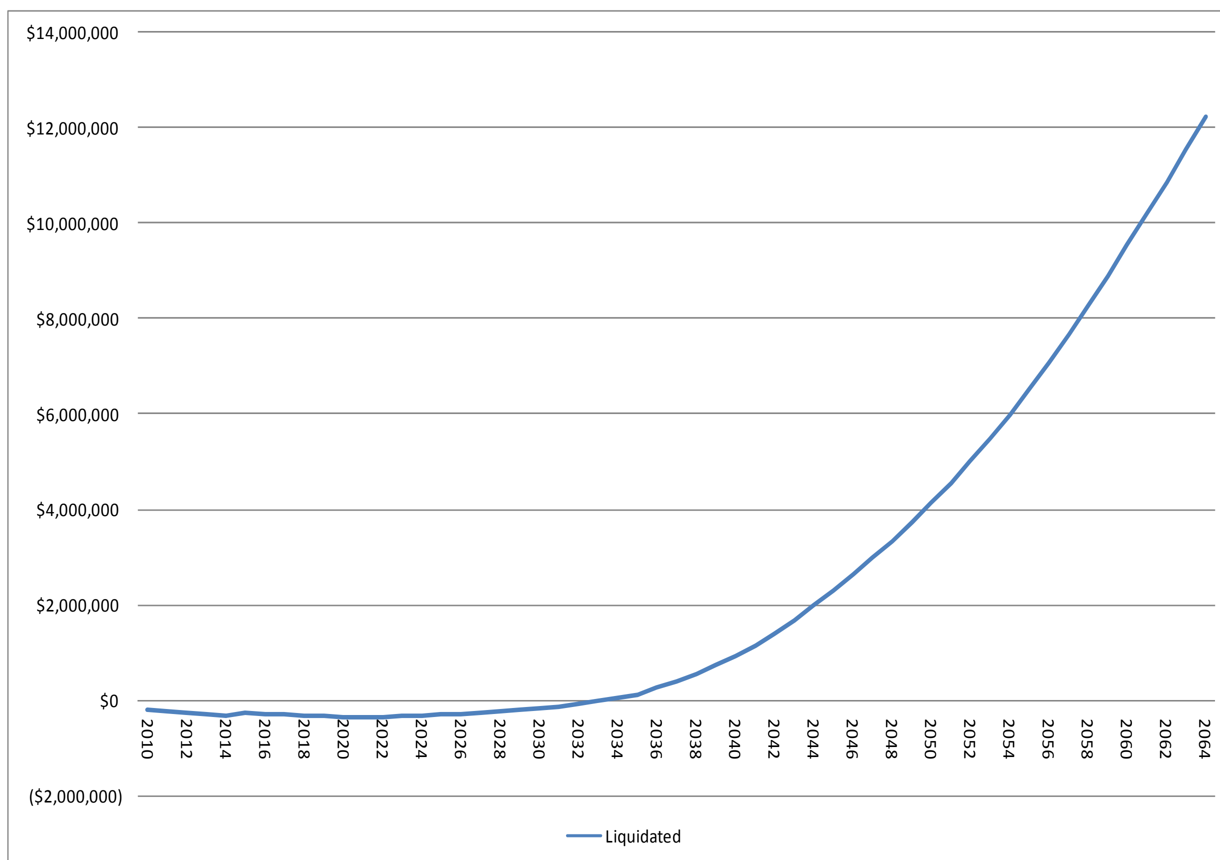
   b. When we run the numbers, the following results occur:

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$2,192,064
Estimated Value of Other Assets	$10,634,096	$8,085,569
Total Value of Assets	$10,634,096	$10,277,632
	Benefit / (Detriment) of Conversion	($356,464)

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$6,604,722
Estimated Value of Other Assets	$23,211,214	$16,725,354
Total Value of Assets	$23,211,214	$23,330,076
	Benefit / (Detriment) of Conversion	$118,862

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$114,639,568	$126,863,972
Total Value of Assets	$114,639,568	$126,863,972
	Benefit / (Detriment) of Conversion	$12,224,404

   c. In analyzing the amounts, we see that in the early years (i.e., in Stages 1 and 2) the results show at first a negative and then a small positive amount. Thereafter, the results show by the end of Stage 3 a very significant benefit. If we were to plot the data points at the end of each year, we would have a graph as follows:



   d. The chart illustrates that until approximately 2031 or 2032 (a few years before Caleb's demise it would have been detrimental to have made the conversion, but, as is illustrated by the chart, from 2033 onward, there is a net benefit, and the benefit continues through the end of Stage 3.

3. When we compare *Fact Pattern #1* to *Fact Pattern #8*, we note the following differences:
   a. First, by the end of the Stage 1 it would be beneficial to do the conversion in Fact Pattern #1, whereas it takes until almost the end of Stage 2, for the participant to break even on the conversion.
   b. Second, by the end of Stage 3, both scenarios yield a positive result.
   c. In looking at the total assets at the end of Stage 2 (i.e., the death of the participant, Caleb), note the following:
      i. Difference between the "No-Conversion Scenarios in *Fact Patterns #1* and *#8*:
         I. Total Value of Assets - *Fact Pattern #1*: $24.310 million; and
         II. Total Value of Assets – *Fact Pattern #8*: $23.211 million
         III. The difference is 1.099 million, which can be reconciled. Interestingly, if one takes the $3.309 million Traditional IRA, and reduces it by the income taxes (at 39.6%); the balance would be $1.998 million. If one then tax affects that amount for estate taxes (of 45%); the remaining balance would be $1.099 million. Thus, this mathematically proves the

difference between *Fact Pattern #1* where the Traditional IRA goes to the beneficiary (under the No-conversion scenario) and *Fact Pattern #8*, where the Traditional IRA goes to charity (under the No-Conversion scenario).

ii. Difference between the "Conversion Scenarios in *Fact Patterns #1* and *#8*:

I. Total Value of Assets - *Fact Pattern #1*: $25,150 million; and

II. Total Value of Assets – *Fact Pattern #8*: $23.330 million

III. The difference is $1.820 million, which can be reconciled. In this case, since the assets that are being used are "non-IRA" assets, one does not need to "income tax effect" the assets. They all would have a step-up in basis. Thus, the only tax effecting that must be done is with respect to the estate taxes. Thus, if one removes the estate tax (at 45%) from the $3.309 million transfer of assets, the resulting difference is $1.820 million. Thus reconciling the difference in the total amounts.

F. What does this mean?

1. What this example illustrates is that when there is an estate tax (even with the charitable gift), given that there will be an income tax, too, and in cases where assets will appreciate over time, it is beneficial to convert the Roth IRA and leave non-IRA (or other) assets to charity.

2. In running other examples, we note that if there is no growth in the assets, that the conversion (in the charitable gift example) is not beneficial. We illustrate this in *Fact Pattern #9*. In this example, it will be exactly the same as *Fact Pattern #8*, but we will have no growth.

3. The results are as follows

Stage 1 - Year Before Caleb Turns 70 1/2 (2020)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$1,000,000
Estimated Value of Other Assets	$6,525,000	$5,332,500
Total Value of Assets	$6,525,000	$6,332,500
	Benefit / (Detriment) of Conversion	($192,500)

Stage 2 - Caleb's Death (2035)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$1,000,000
Estimated Value of Other Assets	$6,770,584	$5,621,423
Total Value of Assets	$6,770,584	$6,621,423
	Benefit / (Detriment) of Conversion	($149,162)

Stage 3 - Beneficiary's Death (2064)	No Conversion	Conversion
Estimated Value of Traditional IRA	$0	$0
Estimated Value of Roth IRA	$0	$0
Estimated Value of Other Assets	$6,770,584	$6,621,423
Total Value of Assets	$6,770,584	$6,621,423
	Benefit / (Detriment) of Conversion	($149,162)

4. What can we glean from these results?

a. Stage 1 yields a detriment of $192,500. In this case, if there is no growth, the Traditional IRA would stay at a flat $1.0 million through Stage 1 (i.e., before the participant would take his minimum required distributions). The difference between the "Conversion" and "No-conversion" is equal

to the income tax on the conversion less the estate tax attributable to the tax. Thus, if one multiplies the $1.0 million by the tax rate in 2010 (i.e., 35%), and then multiplies that product of $350,000 by the reciprocal of the estate tax (i.e., 1 – 45% = 55%), the amount would be $192,500. As one can see, without growth, the conversion is detrimental.

b. Stages 2 and 3: have the same difference of $149,162. The reason that the difference is less than at the end of Stage 1, is because from age 70 ½ through death (i.e., age 84) the Traditional IRA (in the no-conversion scenario) begins to "reverse" itself, in that the Traditional IRA must be distributed to the participant, and income taxes have to be paid. Reconciling Stage 2 and 3 is difficult because the income tax rates decreased over time (because, with no growth and/or income, the only income was the minimum required distributions from age 70 ½ through death (at age 84)). Let's examine this carefully. When the participant converted, conversion tax of $350,000 was due (i.e., $1.0 million multiplied by 35% marginal tax rate). Over the participant's life, he had withdrawn $525,314 in minimum required distributions. The distributions were taxed at marginal rates of 15% (i.e., the RMDs were approximately $35,000 per year). Thus, the total income tax paid on the RMDs through death was $78,797 (i.e., 15% of $525,314). Thus, the difference between taxes paid of $350,000 (in the "conversion" scenario) and taxes paid of $78,797 (in the "no-conversion" scenario), is $271,120. When one estate tax affects this amount at 45%, the difference is $149,162 (i.e., 271,120 multiplied by 1 minus 45%). Thus, the family would be worse off by $149,162 by having converted (if there was a testamentary charitable intent) and there was no growth.

G. Equilibrium?

1. We ran a number of simulations to see what type of return would generate enough income to make one indifferent regarding the conversion. We found that in the year after death of the participant, Caleb, if the assets had income returns of just under 1% and principal growth of just under 1% (with an asset turn-over rate of 25%, the difference in Stage 3 (which is ultimately where one would analyze the difference would be close to zero. Thus, the assets have to have at minimal income and growth to "break even".
2. What this illustrates in the testamentary charitable situation is that there must be at least some positive return to be indifferent; and greater returns for the conversion to be beneficial.

H. Overall conclusion, converting a Traditional IRA to a Roth IRA and leaving other assets to charity may yield a better result for the family in certain circumstances. Running the numbers to determine this is critical. Regardless of what the numbers show, it should be up to the client to make the decision.

XVI. Conclusion

From its inception almost 35 years ago, the IRA has evolved, the recent changes in the Roth IRA rules, requires one to understand, not only the rule changes, but also the economic benefit of conversion (and/or contributions) to a Roth IRA. This outline summarized most of the rules

regarding Roth IRA contributions, Roth IRA conversions, and focused on the salient issues regarding conversion. The outline also illustrated the benefits and burdens of conversion with the use of numerous fact patterns. There are numerous factors that should be explored before consulting with the client on whether it 'make sense' to convert. What is clear is that 'running the numbers' is important. What is also clear is that this could be very beneficial to those who have the ability to convert their Traditional IRAs to Roth IRAs.

Biography, Disclosures and Disclaimers

Presenter's Biography

Writers' Biographies

Mitchell A. Drossman is a Managing Director and the National Director of Wealth Planning Strategies at U.S. Trust, Bank of America Private Wealth Management in New York City, specializing in sophisticated tax, estate and financial planning. Prior to joining U.S. Trust, Mitchell was with the New York City law firm of Proskauer Rose LLP, for approximately nine years where he practiced exclusively in the Trusts & Estates area. Mr. Drossman is also a Certified Public Accountant and was formerly with the Big Four accounting firm of Ernst & Young, LLP. He is a member of the Association of the Bar of the City of New York (and its Committee on Estate and Gift Taxation, 1996-2000), the New York State Bar Association (and its Trusts and Estates Section and Estate Planning Committee), the New York State Society of CPAs (and served as the Chair of the Committee on Income Taxation of Estates and Trusts), a member of UJA-Federation's Trusts and Estates Specialty Group (and currently serves as its Chair) and a member of the Alumni Admissions Board of Brooklyn Law School. Mr. Drossman received his J.D. *cum laude* from Brooklyn Law School where he served as an editor of the *Law Review*.

Lester B. Law is a Senior Vice President and Wealth Strategist for the National Wealth Strategies Group of US Trust, Bank of America Private Wealth Management. He is board certified by the Florida Bar as a Specialist in Wills, Trusts and Estates Law. Lester is an active member and is a member of various committees in the both the American Bar and the Florida Bar's Real Property Probate and Trust Law Sections. Lester earned his Bachelor's degree (with honors) in accounting from Florida International University, Miami, Florida. He earned his Master's in Taxation degree from the University of Miami, Miami, Florida. He earned his Juris Doctor from the University of North Carolina at Chapel Hill. And, he earned his Master's of Law degree from the University of Florida, receiving the Richard B. Stephens award.

Disclosure

U.S. Trust, Bank of America Private Wealth Management operates through Bank of America, N.A. and other subsidiaries of Bank of America Corporation. Bank of America, N.A., Member FDIC

Opinions expressed in this article are those of the author and may differ from U.S. Trust and/or Bank of America Corporation and its subsidiaries.

Legal Advice Disclaimer:

The analyses, suggestions and recommendations above are based upon general fact patterns and on income and estate tax laws in effect as of the date of the analysis. These analyses are not intended to provide, and should not be construed to constitute, complete accounting, insurance, investment, legal or tax advice. Always consult with your tax, legal or other advisors before implementing any changes to your current situation.

IRS Circular 230 Disclosure:

Pursuant to IRS Regulations, we inform you, that any tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax related penalties or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.