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Dear Clients and Friends,

Starting January 1, 2010, all taxpayers will be able to convert traditional IRAs, SEPs, Simple IRAs and eligible 401 (k)s (collectively referred to as pension plans) into Roth IRAs (Roths) because the $100,000 AGI income limitation is eliminated. Unlike all other pension plans, Roths allow for tax-free growth and more importantly, tax-free distributions. Although the general belief is that it is always best to defer taxes, this presents a rare opportunity for retirement and legacy planning, while addressing the uncertainty of future tax rates. The tax-free benefits are why the Roths should be considered in a tax – exempt income strategy including investing Roth assets in covered call writing, short term capital gains, or high yield dividends and interest.

Roth account holders and their spouses, unlike IRA owners, are not subject to required minimum distributions (RMDs); non-spouse beneficiaries must take distributions, but they will generally be tax-free and can be taken over the course of their lives. This fact allows Roths to grow tax–free for generations. Withdrawals can be made after the account is held for 5 years and the taxpayer turns age 59 ½, with some exceptions. Taxpayers in lower tax brackets, who have RMDs and receive Social Security benefits that are partially taxed, should consider converting enough of the pension plan assets to a Roth in order to lower future RMD amounts and avoid potential income taxes on their Social Security benefits in future years.

Paying income taxes now is the major drawback of converting to a Roth; however, the regulations allow for partial conversions. Taxes due for the converted assets are due in 2010, but the income taxes can be deferred one–half each until 2011 and 2012 with the income tax rate determined by each tax year. The good news is that the assets used to pay the conversion tax will reduce your taxable estate, while your heirs will eventually inherit the Roth from which they can withdraw tax-free income throughout their lives. The conversion tax should not be paid from these converted assets as it dramatically reduces the benefits of conversion. Also, if your plan is to leave your IRA to charity, do not convert to a Roth, as the charity is not subject to income taxes.

In conclusion, no one can guess what the tax rates will be in the future (current rates are lower than they have been in years) and given the depth of the fiscal crisis, it seems likely taxes will increase. If congress changes these rules, Roth owners would presumably be grandfathered into the new rules. Although not guaranteed, that is typically what happens when changes to the tax code modify former tax benefits. Most importantly, Roth conversions come with a "do–over" provision called re-characterization, which allows you to convert back to a traditional IRA. Those who re-characterize will receive a tax refund on taxes paid, or the tax liability will be removed if the taxes have not yet been paid. Conversion to a Roth in 2010 gives you until October 15, 2011 to re-characterize.

Please contact one of us to discuss your individual situation.

Sincerely,
LEVIN, SILVEY, ZELKO & MACKEY, PA., CPA'S

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