



The Roth IRA webcast will begin shortly.

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**Taking advantage of Roth IRA
conversions in 2010
Feb. 15, 2010**

Today's session begins at 3:00 p.m. Eastern (12:00 p.m. Pacific)

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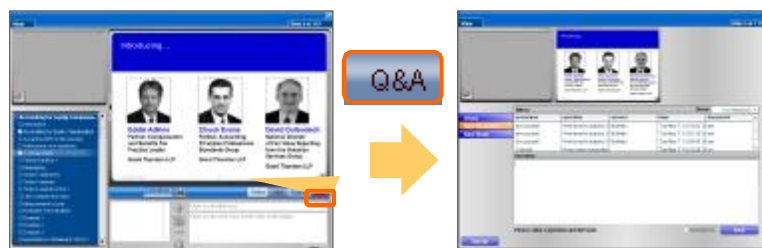
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Today's presenters



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Learning objective

Familiarize you with the Roth individual retirement account (“Roth IRA”) conversion and rollover rules, so you will be able to decide whether to

- Convert your “traditional” IRA to a Roth IRA, and/or
- Roll over money from your qualified employer retirement plan to a Roth IRA



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Our agenda

- What is new in 2010 with respect to Roth IRA conversions?
- What Roth opportunities are there with retirement plans?
- Why consider converting to a Roth IRA?
- What factors should be considered in deciding whether to convert to a Roth IRA?
- What are the procedures involved in a Roth IRA conversion?
- What are the circumstances under which a Roth IRA conversion can be recharacterized?

Group check 1

Based on what you know right now, do you think a Roth IRA conversion might be appropriate for you?

- A. Yes
- B. No
- C. Uncertain

Haven't Roth IRAs been around for a long time? Why are you having a webcast *now* on Roth IRAs?

- Roth IRAs – since 1988
 - Contributions are not tax-deductible, but distributions are tax-free (if certain conditions are met)
- New opportunity for higher income taxpayers, starting in 2010
 - Convert traditional IRA, SEP-IRA or Simple IRA to Roth IRA
 - Roll over retirement plan distributions to Roth IRA
 - Conversion or rollover
 - You pay taxes now, but distributions from the Roth IRA are tax-free
- Prior law
 - Conversion / rollover not allowed if adjusted gross income > \$100,000
 - Not indexed
 - Same for married and single taxpayers

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What Roth opportunities are there with my retirement plan, such as a 401(k) plan?

- You *cannot* convert existing funds in your plan to a Roth account *within* the plan.
- If you are eligible for a distribution from your plan, you can take a distribution and roll it over into a Roth IRA
 - Your plan will have specific terms as to when you are allowed to take a distribution.

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What Roth opportunities are there with my retirement plan, such as a 401(k) plan?

- You can make Roth contributions, if your plan permits it.
 - No income limits
 - Maximum annual contribution
 - \$16,500
 - Plus \$5,500 catch-up contribution if age 50 or older

Why should I even consider converting to a Roth IRA? Isn't the conventional wisdom to delay the payment of taxes?

- Distributions from Roth IRAs are *tax-free*
- But to be tax-free, distributions must be made
 - More than five years (measured in full tax years) after you make your first contribution to any Roth IRA, and
 - After you attain age 59½
 - Or after you die, become disabled, or acquire a first home

Roth IRAs

More on the conditions for a tax-free distribution

- Examples
 - If you are currently 45 years old, you will have to leave the funds in the Roth IRA for 14½ years in order to receive a tax-free distribution
 - But if you are currently 58 years old, you will have to leave the funds in the Roth IRA for only 5 years
- If condition not met, must pay tax on the appreciation in value since conversion date

Roth IRAs

More on tax-free distributions

- Distributions come out of a Roth IRA
 - First, from tax-exempt, non-deductible contributions
 - Then, from tax-exempt Roth IRA conversion amounts, and
 - Last, from investment income accumulated during the Roth IRA years.

Are there any other reasons to consider converting to a Roth IRA?

- No minimum distributions when you turn age 70½
 - Even if you have turned 70½ already, you can convert your traditional IRA to a Roth IRA
 - However, you cannot convert the minimum required distribution for the year of conversion from your traditional IRA to a Roth IRA

Why *not* convert to a Roth IRA?

- You must pay income tax on the converted amount
 - Timing = year of conversion
 - Rate = ordinary rates
 - May require a large amount of cash!
 - Accelerates income tax liability that otherwise might be paid over a long period of time in the future

How can I decide whether to convert to a Roth IRA?

- You must decide whether to
 - Pay taxes now (Roth IRA), or
 - Pay taxes later (traditional IRA)
- Thus, decision based on your guess as to whether
 - Your tax rate will be higher when you take distributions from the IRA (Roth IRA)
 - Your tax rate will be lower when you take distributions from the IRA (traditional IRA)

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What will your tax rate be in future years?

- No one knows!
- Depends on
 - Future marginal tax rates
 - Amount of your income in the future

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What will your tax rate be in future years?

Tax Bracket Scenarios				
Income Brackets (2010 levels*)		Rates		
Single	Joint	2010	2011 and beyond under current law	2011 and beyond under Obama budget
\$0 – \$8,375	\$0 – \$16,750	10%	15%**	10%
\$8,376 – \$34,000	\$16,751 – \$68,000	15%	15%	15%
\$34,001 – \$82,400	\$68,001 – \$137,300	25%	28%	25%
\$82,401 – \$171,850	\$137,301 – \$209,250	28%	31%	28%***
\$171,851 – \$373,650	\$209,251 – \$373,650	33%	36%	36%
Over \$373,650	Over \$373,650	35%	39.6%	39.6%

*Brackets are adjusted for inflation every year
 **No 10% bracket if tax cuts expire
 ***Obama proposes to widen the 28% bracket (31% before tax cuts) to apply through approximately \$200,000 of AGI for singles and \$250,000 for joint filers

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What will your tax rate be in future years?

- Roth IRA conversion may generate the greatest amount of taxable income that you've ever had
- Planning ideas
 - Consider accelerating tax deductions into your Roth conversion year
 - Do you have any tax deduction carryforwards to help offset the additional conversion income?
 - Charitable deduction carryforward ?
 - Net operating losses?

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What will your tax rate be in future years?

- Scheduled expiration of 2001 and 2003 tax cuts on Jan. 1, 2011
 - Top rate increases from 35% to 39.6%
 - Lower bracket cuts also revert
 - Capital gains rate increases from 15% to 20%
 - Dividend tax rate increases from 15% to ordinary income rates

What will your tax rate be in future years?

- President's position (supported by many Democrats)
 - Retain current 10%, 25%, and 28% brackets
 - Return to higher rates for higher income taxpayers
 - Increase capital gains and dividends rate to 20% for higher income taxpayers
 - Limit benefit of itemized deductions to 28%
 - Unpopular and unlikely

What will your tax rate be in future years?

- Additional rate increase potential in healthcare proposal
 - Increase in Medicare tax (range of .5% to 2%)
 - Possibly applying to capital gains and dividends
 - 5.4% “surtax” on all income

What will your tax rate be in future years?

- Scenarios for 2011 and beyond
 - Best case: Top rate of 35%, and 15% for capital gains and dividends
 - Worst case: top rate of 45%, and 25.4% on capital gains
 - Most likely:
 - Top rate of 39.6% on ordinary income, and 20% on capital gains and dividends
 - Extension of Bush tax cuts at lower income levels
 - Will future legislation provide for a lower tax rate on retirement distributions?
 - Large number of future retirees may exert political pressure to do so

What will your tax rate be in future years?

- Other considerations – death of spouse = single taxpayer = higher rates on same amount of income
- Amount of income – for most taxpayers, lower income during retirement years

Group check 2

Randy Retired is evaluating whether to convert his traditional IRA to a Roth IRA. He has been monitoring tax reform legislation in Congress and believes that tax rates will increase in 2011. He further believes that given the current level of the national debt, there is little chance that future income tax rates will be lower than current rates. Randy is currently in the top income tax bracket and expects to remain in this bracket throughout retirement. Given Randy's perspective on future income tax rates, Randy should convert his traditional IRA to a Roth IRA.

- A. True
- B. False

Group check – debrief

- Answer: A. True
- If Randy believes that income tax rates are going to consistently be higher than his current rate of tax, Randy should currently convert his traditional IRA to a Roth IRA.
- By converting his traditional IRA to a Roth IRA, Randy has guarded against the possibility of higher tax rates on distributions from his IRA.

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Tax rate analysis – “forget-me-nots”

- Conversion increases your income
- Effects of more income on federal income taxes
 - Higher AGI = higher phase out of personal exemptions and itemized deductions
 - But phase-out does not apply in 2010
 - For individuals receiving Social Security and Medicare benefits
 - Higher amount of your Social Security benefits will be subject to income tax
 - Your premiums for Medicare Part B benefits (non-hospital medical coverage) will increase

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Tax rate analysis – “forget-me-nots”

- Don't forget to consider the effect on your state income tax
 - Most states use your federal income amount
 - Thus, state tax will be higher
 - Impact lessened by deduction for state tax on federal return
 - Scenario that could make your state taxes lower now than in the future
 - You now live in a state with no income tax
 - But when you retire, you plan to move to a state that has income tax
 - May cause Roth conversion to be unfavorable

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What else should I consider when deciding whether to convert to a Roth IRA?

- Income upon conversion = fair market value of investments on conversion date
- Value of your investments may be depressed
 - If so, makes this a good time to pay taxes (i.e., convert to Roth)
 - Convert ASAP if you think values are rising

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If I convert, where am I going to get the cash to pay the taxes?

- From the IRA?
- From other assets?
- Or some from both?

If I convert, where am I going to get the cash to pay the taxes?

- From the IRA
 - Reduces the amount in the IRA that can grow tax-free in the future
 - Tax treatment of IRA amount used to pay taxes
 - If you are under age 59½, you must pay a 10% early withdrawal penalty

If I convert, where am I going to get the cash to pay the taxes?

- From other assets
 - Sale of other assets may generate capital gains and/or losses
 - Do you have capital losses or loss carry forwards to offset gains?
 - Can you put the other assets to better use?
 - Municipal bonds – may generate income free of tax
 - Appreciated assets at death pass to heirs with a step-up in basis (eliminates income tax on the appreciation)
 - Discretionary spending, such as charitable donations, vacations, college tuition, in-home health care

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Cash flow relief for 2010 conversions only

- You have two options
 - Report the entire conversion amount in income in 2010, or
 - Defer the payment of taxes
 - Report \$0 income in 2010
 - Report ½ of the conversion income in 2011
 - Report the remaining ½ in 2012
- Caution: Any conversions in 2011 or later require that the income be reported in the year of conversion

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Additional relief

- Conversion is not an “all or nothing” decision
 - You can convert a partial amount of your traditional IRA, and/or
 - Roll over part of your retirement plan distribution to a Roth IRA and part to a traditional IRA
- You can also convert some this year, some next year, some the following year, etc.
 - May work better for you from a cash flow perspective
 - May keep you below a particular tax rate bracket in each year

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How can I go about determining the economics of a Roth conversion?

- Detailed calculations are not required
- The analysis comes down to this:
 - If your tax rate will be higher when you take distributions than now, CONVERT.
 - If your tax rate will be lower when you take distributions than now, DON'T CONVERT.
- Thus, spend most of your time estimating your future tax rate

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Is there any reason for detailed calculations?

- Yes, if
 - You want to prove to yourself that the decision really is all about current versus future tax rates
 - You want to determine the financial impact if you are ultimately wrong about current v. future tax rates

How can I go about determining the economics of a Roth conversion?

- Our approach
 - Analysis of traditional IRA converted to Roth IRA
 - Similar approach would apply to qualified plan distributions
 - Assume that you have three alternatives
 - Convert to a Roth IRA – use your IRA funds to pay the conversion taxes
 - Convert to a Roth IRA – use other funds to pay the conversion taxes
 - Keep the traditional IRA (no conversion)

In your analysis, consider the following funds

Your Alternatives	IRA	Investment Fund
Roth conversion – use investment fund to pay taxes	Yes	No
Roth conversion – use IRA to pay taxes	Yes	Yes
No conversion	Yes	Yes

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Assume you have \$10,000 in your IRA
 You convert in 2010
 You pay the conversion taxes in 2010 at 35%

Your Alternatives	IRA	Investment Fund	Total
Roth conversion – use investment fund to pay taxes	\$10,000	\$0	\$10,000
Roth conversion – use IRA to pay taxes	\$6,500	\$3,500	\$10,000
No conversion	\$10,000	\$3,500	\$13,500

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Assume you distribute your funds when your tax rate is still 35%
Assume no investment growth

Your Alternatives	IRA	Investment Fund	Total	Tax	After-tax Amount
Roth conversion – use investment fund to pay taxes	\$10,000	\$0	\$10,000	\$0	\$10,000
Roth conversion – use IRA to pay taxes	\$6,500	\$3,500	\$10,000	\$0	\$10,000
No conversion	\$10,000	\$3,500	\$13,500	\$3,500	\$10,000

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Assume you distribute your funds when your tax rate has increased to 40%
Assume no investment growth

Your Alternatives	IRA	Investment Fund	Total	Tax	After-tax Amount
Roth conversion – use investment fund to pay taxes	\$10,000	\$0	\$10,000	\$0	\$10,000
Roth conversion – use IRA to pay taxes	\$6,500	\$3,500	\$10,000	\$0	\$10,000
No conversion	\$10,000	\$3,500	\$13,500	\$4,000	\$9,500

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Assume you distribute your funds when your tax rate has decreased to 30%
Assume no investment growth

Your Alternatives	IRA	Investment Fund	Total	Tax	After-tax Amount
Roth conversion – use investment fund to pay taxes	\$10,000	\$0	\$10,000	\$0	\$10,000
Roth conversion – use IRA to pay taxes	\$6,500	\$3,500	\$10,000	\$0	\$10,000
No conversion	\$10,000	\$3,500	\$13,500	\$3,000	\$10,500

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Group check 3

Which of the following scenarios will not keep Harry Happy a happy man?

- Harry converted when his rate was 35%, and took distributions when his rate was 30%.
- Harry didn't convert. He could have done so when his rate was 39.6%. When he took distributions, his rate was 25%.
- Harry converted when his rate was 35%, and took distributions when his rate was 40%.

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Group check - debrief

- Choice A
 - Converted at 35%, but rates dropped to 30%
 - Harry should not have converted
 - Conversion causes him to pay taxes at 35%
 - Without the conversion, he would pay taxes at 30%
- Choice B
 - Didn't convert, and his rate dropped from 39.6% to 25%
 - By not converting, he will pay tax at a lower rate
- Choice C
 - Converted, and his rate increased from 35% to 40%
 - By converting, he will pay tax at a lower rate

We shouldn't assume no investment growth!

- Determine the accumulation in your funds over the years, using an assumed investment rate of return
- Just as we did earlier, determine the *after-tax* amount you would have if you distribute your funds
 - Use an assumed future tax rate
- Roth IRA is already on an after-tax basis
- Approach converts the traditional IRA to an after-tax basis, allowing an apples-to-apples comparison with the Roth IRA
 - Approach makes sense, because you must pay taxes on distributions from the traditional IRA
 - However, this is for analysis only
 - You would not withdraw your entire traditional IRA at the same time
 - Doing so would push you into higher rate brackets
- In your personal analysis, build a model which shows withdrawals throughout the years based on your needs during retirement

Additional assumptions to include in the model

- If you pay the conversion taxes from assets other than the IRA
 - Are there capital gains taxes you will incur when you liquidate the assets?
- For your investment fund outside the IRA (applies if you don't convert, or if you convert and use the IRA to pay the conversion taxes)
 - Portion subject to tax each year
 - Dividends and interest
 - Realized capital gains and losses

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Same approach as before, after 10 years
 6% annual investment growth
 Tax rates at conversion / distribution = 35%, 40%

Your Alternatives	IRA	Investment Fund	Total	Tax	After-tax Amount
Roth conversion – use investment fund to pay taxes	\$18,983	\$0	\$18,983	\$0	\$18,983
Roth conversion – use IRA to pay taxes	\$12,339	\$6,817	\$19,156	\$613	\$18,543
No conversion	\$18,983	\$6,817	\$25,800	\$8,206	\$17,594

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Same approach as before, after 10 years
 6% annual investment growth
 Tax rates at conversion / distribution = 35%, 30%

Your Alternatives	IRA	Investment Fund	Total	Tax	After-tax Amount
Roth conversion – use investment fund to pay taxes	\$18,983	\$0	\$18,983	\$0	\$18,983
Roth conversion – use IRA to pay taxes	\$12,339	\$6,838	\$19,177	\$617	\$18,560
No conversion	\$18,983	\$6,838	\$25,821	\$6,312	\$19,509

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For conversions in 2010, deciding when to pay the taxes

- Your options
 - Report 100% of the conversion income in 2010
 - Report the conversion income in 2011 and 2012
 - 50% in 2011
 - 50% in 2012
- Waiting until 2011 and 2012 to pay taxes
 - Pro: You have use of your money longer
 - Con: Potentially higher tax rate

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What are the procedures involved in a Roth conversion?

- Conversion from a traditional IRA
 - Contact the administrator of your traditional IRA, and tell them to convert it to a Roth IRA
 - Distribution to you, with transfer by you to Roth IRA within 60 days

What are the procedures involved in a Roth conversion?

- Distribution from your retirement plan (if permitted by your plan)
 - Trustee-to-trustee transfer from the plan to a Roth IRA
 - Distribution to you, with transfer by you to Roth IRA within 60 days
 - Plan administrator is required to withhold 20% for income taxes
 - If you wish to roll over this 20%, you will have to fund it on your own, and wait for a refund from the IRS when you file your income tax return

Are you uncertain about whether to convert?

- Good news – you can reverse the conversion
- Recharacterization
 - You transfer the current balance of the Roth IRA back to a traditional IRA
 - You amend your income tax return for the year of the conversion to reflect that there was no conversion

Are you uncertain about whether to convert?

- Deadline for recharacterization
 - Due date of the return for the year in which you converted
 - Original due date = April 15
 - Extended due date = Oct. 15
- Example
 - 2010 conversion – can be reversed as late as Oct. 15, 2011
 - You may know more about future tax rates by then

Important rules if you recharacterize

- Any IRA funds used to pay the taxes (i.e., not converted to Roth) cannot go back into an IRA
- Partial recharacterizations are permitted

Group check 4

Unger Unlucky converted his traditional IRA to a Roth IRA on June 1, 2010. On June 1, his account was worth \$1,000,000. By April 1, 2011, his account declined to \$500,000. Unger has been advised that he may avoid the income tax on the June 1 conversion by recharacterizing the Roth IRA as a traditional IRA. By what date must Unger accomplish the recharacterization?

- A. Dec. 31, 2010
- B. April 15, 2011
- C. Oct. 15, 2011

Group check – debrief

- Answer: C. Oct. 15, 2011
- A recharacterization of a Roth IRA to a traditional IRA must be accomplished by the due date for filing the return for the year in which the original conversion to a Roth IRA occurred (including extensions).

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Strategies to maximize your options related to recharacterization

- Set up multiple Roth IRAs – one for each type of investment
 - For Roth IRAs that have fallen in value, reverse the conversion and convert again at lower value in order to pay lower tax
 - Cannot reconvert until the calendar year following the initial conversion, with a minimum wait of 31 days

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Strategies to maximize your options related to recharacterization (cont.)

- Example
 - You convert in 2010
 - You reverse the conversion on Oct. 1, 2011
 - When can you reconvert?
 - Later of
 - Any time in 2011, or
 - 31 days after recharacterization, which is November 1, 2011
 - Thus, cannot reconvert until Nov. 1, 2011

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Strategies to maximize your options related to recharacterization

- Example
 - Account values at conversion date
 - Large cap \$350,000
 - International \$350,000
 - Total \$700,000
 - Accounts values at recharacterization deadline
 - Large cap \$550,000
 - International \$200,000
 - Total \$750,000
 - If all in one Roth IRA, you won't recharacterize, because account has increased in value

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Strategies to maximize your options related to recharacterization

- What if you had separate Roth IRAs?
 - Large cap Roth IRA has increased in value, so don't recharacterize
 - International Roth IRA has decreased in value, so recharacterize

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Strategies to maximize your options related to recharacterization (cont.)

- Suppose you reconvert international Roth IRA before it recovers any value
 - Values upon conversion
 - Large cap \$350,000
 - International \$200,000
 - Total \$550,000
 - You will pay taxes on \$550,000 versus \$700,000
 - You save taxes on \$150,000 of income, and this is a permanent savings!
 - Recharacterizations and reconversions provide a very valuable opportunity.

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Strategies to maximize your options related to recharacterization

- Once the deadline for recharacterization has passed
 - No longer any need to have so many separate Roth IRAs
 - Thus, consider combining them

Conversions – complicating factors

- Any IRAs with nondeductible contributions?
 - Nondeductible contributions not taxed upon conversion
 - Must aggregate all of your IRAs to calculate amount not subject to tax, even if you don't convert all of your IRAs

Why should I care about the Roth IRA minimum distribution rules?

- No distributions required when you reach age 70½
- Do you want to accumulate funds for your heirs?
 - Tax-free accumulation continues beyond age 70½
 - Heirs pay no income tax on Roth IRA distribution
 - Heirs must take distributions over their expected lifetimes
- Caution: Conversion may not make sense if your heirs will have a lower tax rate than your current rate

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Are there any other ways to take advantage of the Roth rules?

- Make non-deductible contributions to a traditional IRA and convert the IRA to a Roth IRA
- Can make two years' worth of non-deductible contributions to an IRA in 2010
 - One for 2009, as long as made by April 15, 2010
 - One for 2010, made anytime during 2010

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If I convert to a Roth IRA, can I make contributions to the IRA in the future?

- Yes, but only if your AGI is below a specified amount
- Amounts for 2010
 - Married filing jointly - must be less than \$177,000
 - Single – must be less than \$120,000

Big question

- Is there any chance Congress will change the law so that distributions from Roth IRAs are subject to tax?

Estate planning considerations for Roth IRAs

- No required minimum distributions at age 70½
- Contributions may be made after age 70½
 - Must have income from employment or self-employment
 - Must meet the income limitations for contributions
- IRA may be left intact for heirs
 - Roth IRA will be includable in decedent's estate for estate tax purposes
 - Income will not be includable in heir's income for income tax purposes
 - Heir generally able to take out distributions over his or her lifetime

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Asset protection issues

- IRAs (both traditional and Roth) generally have \$1 million of protection in bankruptcy court
- IRAs that hold nothing but assets rolled over from a qualified retirement plan have additional protection
- Keep separation
 - Your IRAs that are qualified plan rollovers
 - Your other IRAs

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Group check 5

Danny Deceased died in 2010, leaving among other assets, a Roth IRA worth \$2,000,000. His Roth IRA named his nephew, Leroy Lucky, as the designated beneficiary of the account. Under the Roth IRA rules, Leroy is required to receive distributions from the Roth IRA over his lifetime. What are the income tax consequences to Leroy of the distributions?

- A. Leroy must include the distribution in income.
- B. Leroy will be subject to a 10% early withdrawal penalty if he receives a distribution before he turns 59½.
- C. There are no income tax consequences of the distribution.

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Group check – debrief

- Answer: C. There are no income tax consequences of the distribution.
- Designated beneficiaries of an inherited traditional IRA are required to take distribution into income.
- The early withdrawal penalty does not apply to designated beneficiaries of an IRA.

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Summary

- Roth IRAs generally may be distributed on a tax-free basis
- Roth IRAs are not subject to minimum distribution requirements
- Starting in 2010, conversions to Roth IRAs are available without regard to income level
- The decision as to whether to convert rests heavily on current v. future tax rates
- Conversions can be recharacterized by the tax return deadline for the year of conversion

Group check 6

Based on what you know right now, do you think a Roth IRA conversion might be appropriate for you?

- A. Yes
- B. No

APPENDIX

More information on the 5-year waiting period

- It is a once-in-a-lifetime test
- Starts running in the year you first have a Roth IRA
 - But an inherited Roth does not count
 - 5-year waiting period for inherited Roth is based on when decedent first established a Roth IRA

APPENDIX

More information on the 5-year waiting period

- Determining the 5-year period
 - Year of first contribution or conversion counts as a whole year
 - Example
 - You convert to Roth in July 2010
 - 5-year period runs through December 31, 2014
 - 5-year waiting period is satisfied for any distributions made on or after January 1, 2015
 - Example
 - You first established a Roth IRA in 2006
 - As of January 1, 2011, you have met the 5-year waiting period
 - Applies to all of your Roth IRAs
 - Thus, the 5-year waiting period for a 2010 Roth conversion is met on January 1, 2011
 - No exception to the 5-year waiting period for death

APPENDIX

More information on the 5-year waiting period

- If you take a distribution before the end of the 5-year period
 - Investment income is taxable
 - Subject to 10% early distribution penalty if you are not at least 59½

APPENDIX

More information on the 5-year waiting period

- Caution
 - Even if you have satisfied the 5-year waiting period, you are still subject to the 10% early distribution penalty on the investment earnings if you take a distribution before 5 years from the conversion
 - This is the case even though the distribution is not subject to regular income tax
 - Exception - attainment of age 59½, disability, death, medical hardship, and additional exceptions apply under § 72(t)(2)

Our presenters will now answer your questions



Please type in your questions at any time.

Who to contact

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