

December, 2011

To My Clients and Friends:

ROTH IRA CONVERSIONS

For tax years beginning in 2010, an opportunity exists for almost all holders of individual retirement accounts (IRA's) to make a conversion to Roth IRA's. In prior years, an income limitation restricted most Roth IRA conversions. Beginning in 2010, those income limitations have been lifted thereby making most taxpayers eligible to make Roth IRA conversions.

The advantages of a Roth IRA are:

1. **Qualified** distributions are tax free;
2. Amounts converted to the Roth IRA can be withdrawn anytime on a tax free first-in first-out basis;
3. Roth distributions are not income for consideration of determining taxable Social Security benefits;
4. Roth IRAs are not subject to the required minimum distribution rules.

The disadvantages of a Roth IRA are:

1. Income taxes are required to be paid for the tax year of the IRA conversion or in a tax year earlier that would otherwise be the case;
2. Roth IRA contributions are not tax deductible;
3. Income recognized on the conversion may trigger the taxability of Social Security benefits.

The mechanics of the Roth IRA conversion is that a traditional or rollover IRA is converted to the Roth IRA and the value of the IRA at the time of conversion is recognized (taxed) as ordinary income. For example, if you have \$100,000 in an IRA that is converted to a Roth IRA, the conversion amount is recognized as taxable income. Assuming a combined federal and State tax rate of 40%, taxes of \$40,000 would be due for the conversion.

Roth IRA conversions can also be made directly from most qualified retirement plans without the need to rollover the retirement plan to an intermediary IRA.

A Roth IRA conversion can be re-characterized back into a regular IRA so that income previously recognized is reversed and taxes would not have to be paid on the conversion. This is particularly useful if a decline in the market value of the previously converted IRA occurs.

The time limits for re-characterizations are essentially April 15 for the year following the IRA conversion (date in which the income taxes are due) and then again on October 15 for the year following the year of conversion the final date for re-characterizations.

A Roth IRA distribution is a *qualified* distribution if it meets the following requirements:

1. The distribution is made on or after the taxpayer reaches age 59-1/2; and
2. The distribution is made after the five-year tax period beginning with the first taxable year of the first contribution to a Roth IRA.

Exceptions to the five-year requirement are provided for death, disability and special purpose distributions (i.e. first time home buyer – limited to \$10,000)

Each Roth IRA owner has one five-year tax test period.

Other factors to consider are the climate of rising tax rates and the volatility of the stock market. Since Roth IRA conversions can be re-characterized within the tax year of the conversion *and* until October 15 of the year following the conversion a taxpayer has considerable latitude in the tax planning opportunity. Further, commencing the five-year tax period sooner rather than later starts the clock for meeting the *qualified* distribution requirement.

I trust that this letter will be useful to you in your tax and financial planning.

In summary, consideration of conversion of your existing IRA or qualified retirement plan to a Roth IRA is complex and should be made on a case by case basis. All Roth IRA conversions need to be closely monitored during the “re-characterization” period to determine if the Roth IRA should stand.

If you would like me to perform a study of your specific situation to determine if a Roth IRA conversion is the right decision for you please contact me.

This letter along with other useful tax planning information can also be located at my Web Site www.solakco.com for future reference.

Very truly yours,

Charles E. Solak

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