STANISLAWSKI & COMPANY, INC.

A Certified Public Accounting and Business Consulting Firm

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RE: 2010 IRA to Roth IRA Conversions

Dear Friends of Stanislawski & Company, Inc.:

Well everyone has been talking about it . . . and now it's here! Starting in 2010, there's a new rollover/conversion opportunity for those who have traditional IRAs and qualified employer sponsored retirement plan accounts (such as 401(k)'s and profit sharing plans). You can rollover/convert these funds into Roth IRAs, regardless of your adjusted gross income (AGI). In all prior years there was an AGI limit which prevented most people from participating. Now you are able to convert any amount you want (it's not an all or nothing decision). This article pertains to conversions into a Roth IRA only (not the regular annual contribution rules or the required minimum distribution rules).

What's the benefit of a Roth IRA?
Here's a brief summary:

- Roth IRAs enjoy tax-free earnings (forever!).
- Qualified distributions are tax-free (forever!).
- A Roth IRA owner does not have required minimum distributions after the owner reaches age 70 ½.
- Beneficiaries of Roth IRAs also enjoy tax-free earnings and tax-free withdrawals. However, beneficiaries of Roth IRAs have to commence regular withdrawals from a Roth IRA after the account owner dies.
- Potential hedge against rising income taxes in the future.

Why would you want to convert in the first place?
Conversions will provide an opportunity to generate future tax-free income for your retirement. The earnings and appreciation in your Roth IRA are tax-free.

What's the catch on the conversion?
The amount that you rollover from your traditional IRA/Pension to a Roth IRA becomes taxable income in almost all cases. You will be paying tax now for the future privilege of tax-free earnings and withdrawals, and freedom from the required minimum distribution rules. For example, Joe converts $100,000 from a traditional IRA account to a Roth IRA and he is in the 35% tax bracket (35% = 28% federal and 7% state); his taxes will be $35,000 on the conversion.

Why is the conversion for 2010 so important?
For conversions done during 2010, you will be allowed to pay all the taxes on the 2010 conversion in either 2010 **<u>or</u>** pay half the taxes in 2011 and the other half in 2012. Please note that if you use IRA funds to pay the taxes, those funds will be considered an IRA distribution and will be subject to income taxes (and may be assessed a penalty if you are under age 59 ½). We recommend that you pay the conversion taxes from other sources.

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How does this Two (2) Year Rule work?
For example, Joe converts a traditional IRA in the amount of $100,000 to a Roth IRA in 2010. If Joe doesn't want to pay the taxes on the $100,000 conversion in 2010, he can report $50,000 (1/2 of the $100,000) of the conversion in 2011 as income and pay taxes on it, and report the remaining $50,000 in 2012 as income and pay the tax. Although the conversion was in 2010, it is not taxable income for 2010. Instead, half the income can be reported in 2011 and half in 2012. California allows the same option. We just don't know if your income tax rates will be higher in 2011 and 2012.

If you only have a non-deductible IRA (i.e. IRAs that were funded with after tax dollars and no deductions were taken), what happens?
If you made contributions to only non-deductible IRAs, then only the earnings will be subject to tax when you convert to a Roth IRA. Your original non-deductible IRA contribution portion will be converted with no tax. Many people with non-deductible IRAs are seriously considering this option because they have already paid the tax on the original contribution and now they will realize the benefits of a Roth IRA.

If you have deductible and non-deductible IRAs, and you don't plan on converting the entire amount, things can get complicated. Under IRS rules, the amount you convert will be deemed to consist of a pro-rata portion of the taxable and nontaxable dollars of all your IRAs.

Is a Roth IRA conversion right for you?
There's not an easy answer. There are many factors involved depending upon your situation, such as, your income tax rate now and in the future, the length of time you can leave the funds in the Roth IRA without taking withdrawals, and how you're going to pay the income taxes on the conversion. The other consideration is whether you have available non-pension and/or non-IRA cash funds to pay this tax.

If you are interested in a conversion during 2010, please call our office to set up a meeting to discuss your financial situation. As a reminder, for those clients that qualify for required minimum distributions (RMD) in 2010, you must receive a distribution before December 31, 2010. The option to not take an RMD only pertained to the 2009 tax year. Also, you cannot rollover your taxable RMD into a Roth IRA. Keep in mind that even though a Roth IRA is income tax free, it is still an asset in your estate and may be subject to estate taxes.

In closing, one of our ongoing goals is to communicate with our friends and clients, and assist them in understanding current developments and their financial options. We truly hope that the above current developments offer you some insight, and help you in your financial and tax decisions. Our motto is "the better you do . . . the better we do" so we are extremely motivated towards your business and personal success.

Sincerely,

Charles G. Stanislawski, M.B.T., C.P.A

Business is great at Stanislawski & Company, Inc. and we are looking for more.