



2010 The Roth Revolution

June 15th, 2010

Presented by



Roth IRA Conversion

- 2010 presents an opportunity for 11.3 million households to convert from Traditional IRAs to Roth IRAs
- Approximately \$1.2 Trillion in previously unconvertible Traditional IRA assets



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Roth IRA Conversion

Eligibility and Deductibility Comparison

	Traditional IRA	Roth IRA
Contribution Age Limit	70 ½	None
Income Limit	None	\$120,000 (single), \$176,000 (joint)
Contribution Limit	\$5,000 (\$6,000 if 50 or older); or 100% of earned income, whichever is less	Same
Deductibility	Yes – if neither spouse participates in employer plan, otherwise limited based on income	None

Remember: withdrawals from Roth IRAs are not taxable!

General Concepts

Taxation of Roth IRA Distributions

- Qualified distributions are not subject to income tax
 - Must wait 5 years before withdrawing funds and must meet one of four tests
 1. Age 59 ½ (taxable but no penalty, if distribution before age 59 ½)
 2. Death
 3. Disability
 4. First time home buyer (limited to \$10,000)
- Non-qualified distributions will be subject to income tax to extent distribution exceeds basis
 - Distributions are not subject to income tax if they do not exceed aggregate contributions of conversions to the Roth IRA

Advantages to Roth IRA conversions

- RMD starting 70 ½ - not for Roths!
- Legacy for heirs – Roth is most tax efficient asset to leave heirs - tax-free growth and tax-free income
- Taxes on conversion should be paid by assets outside of IRA to maintain Roth IRA balance as high as possible; amounts taken from Traditional IRA to pay tax on conversion could be subject to 10% penalty



Advantages to Roth IRA conversions

- Taxable income recognized on a Roth IRA conversion in 2010 may be spread over 2011 and 2012
- Tax Rates Scheduled to Increase in 2011
- Roth IRA reduces the chances of taxation of Social Security benefits (Social Security benefits become taxable when AGI exceeds \$32,000 (MFJ) or \$25,000 (single))

Advantages to Roth IRA conversions

- Converting in a down market with lower IRA account balances reduces taxation upon conversion
- Roth IRA conversions are revocable – “recharacterizations” must be completed by October 15th following the year of conversion and reconversion can be done by later of 30 days following recharacterization or January 1st of the year following the initial conversion
- Federal tax brackets are more favorable for married couples filing joint returns than for single individuals, Roth IRA distributions won’t cause an increase in tax rates for the surviving spouse when one spouse is deceased because the distributions are tax-free

Converting Non-deductible IRAs

- All withdrawals and conversions are a proportionate share of tax-deferred earnings, previously deducted contributions, and non-deductible contributions
- Percent that is non-taxable equals:

Example:

Non-deductible IRA = \$10,000 (assuming \$10,000 basis)

Traditional IRA = \$90,000

Total IRAs = \$100,000

- If you want to convert \$50,000 of your total IRA portfolio, the taxable conversion amount would be:
$$\$50,000 \times \$90K/\$100K = \$45,000$$

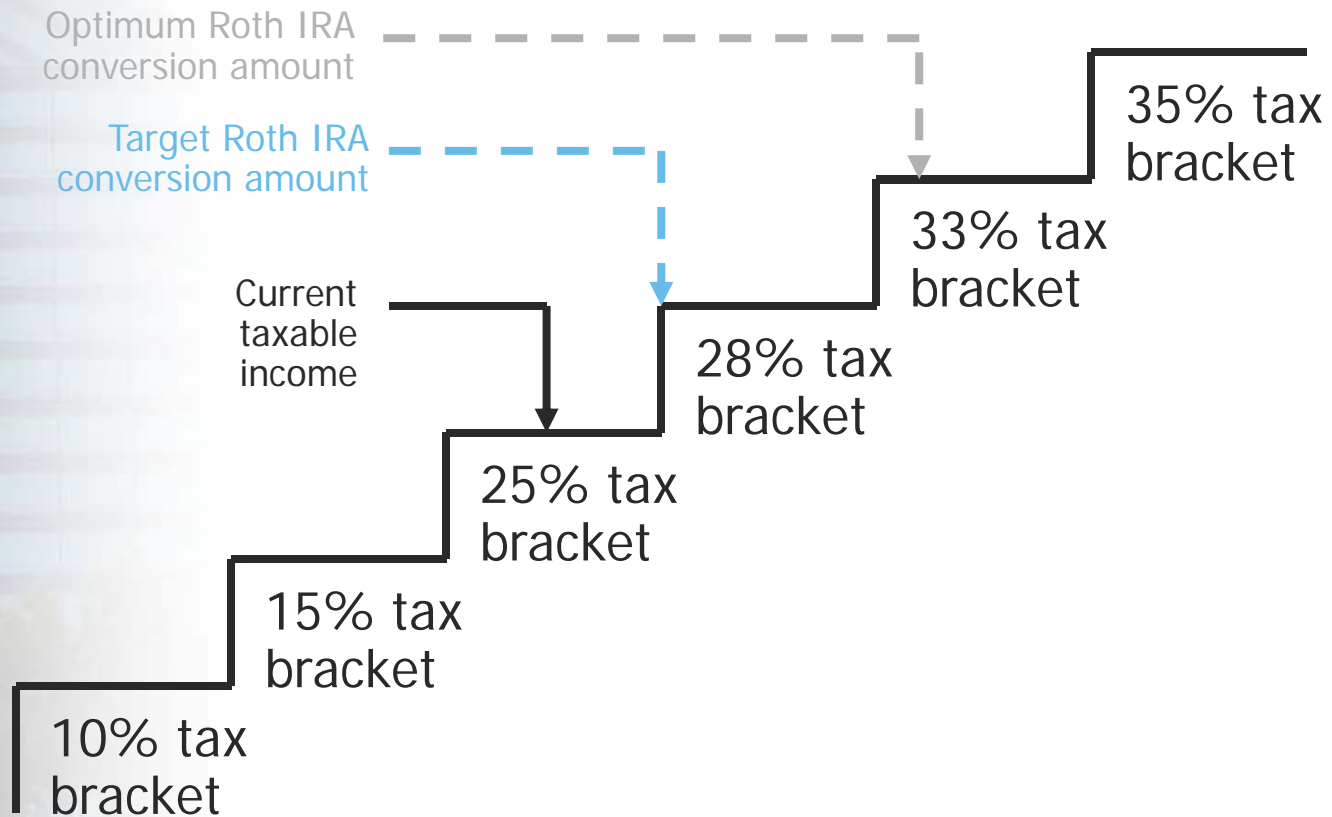
Planning Considerations:

Preparing projections is a MUST!

- Conversion may bring taxpayer into next tax bracket – effect on itemized deductions with increased AGI, social security benefits, phase out of exemptions and itemized deductions, etc. Keep as much of conversion income in the current marginal tax bracket.

Understanding the Mathematics

Choosing the Appropriate Conversion Amount



Tactical Considerations

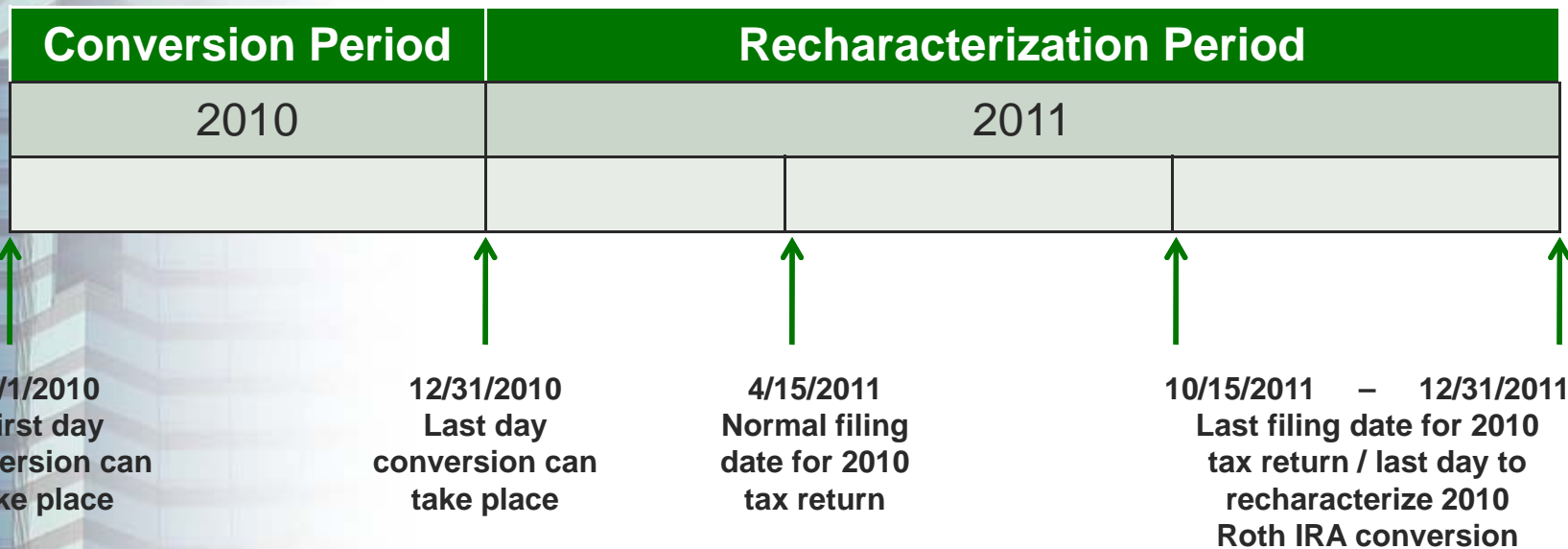
Tax Attributes

- Unused charitable contribution carryovers
- Current year ordinary losses
- Net Operating Loss (NOL) carryovers from prior years
- Alternative Minimum Tax (AMT)
- Credit carryovers



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Roth IRA Conversion Timeline



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When Converting, Pay Taxes Outside the IRA

Median Wealth After Taxes and Inflation \$1 Million IRA, \$450K Taxable Account (60%/40%)*

	Traditional IRA	Roth; Tax from IRA	Roth; Tax from Outside IRA**
Initial IRA Assets	\$1.0 Mil.	\$550K	\$1.0 Mil.
Initial Taxable Assets	\$450K	\$450K	\$0
Liquidate After 20 Yrs.	\$2.9 Mil.	\$3.0 Mil.	\$3.5 Mil.
Benefit as % of Original IRA		10%	60%

*Assumes initial account values at investor age 65, tax on converting a \$1 million traditional IRA to a Roth IRA would total \$450,000, and payment of any death taxes out of assets that are not the subject of this analysis. Assumes IRA participant passes away at age 85. Assumes RMDs from traditional IRA based on participant's age until his passing. Assumes no distributions from the Roth IRA until the participants' passing. Assumes any traditional IRA assets remaining after 20 years are liquidated, resulting in an income tax liability. Wealth values are adjusted for inflation.

**The investor's taxable account

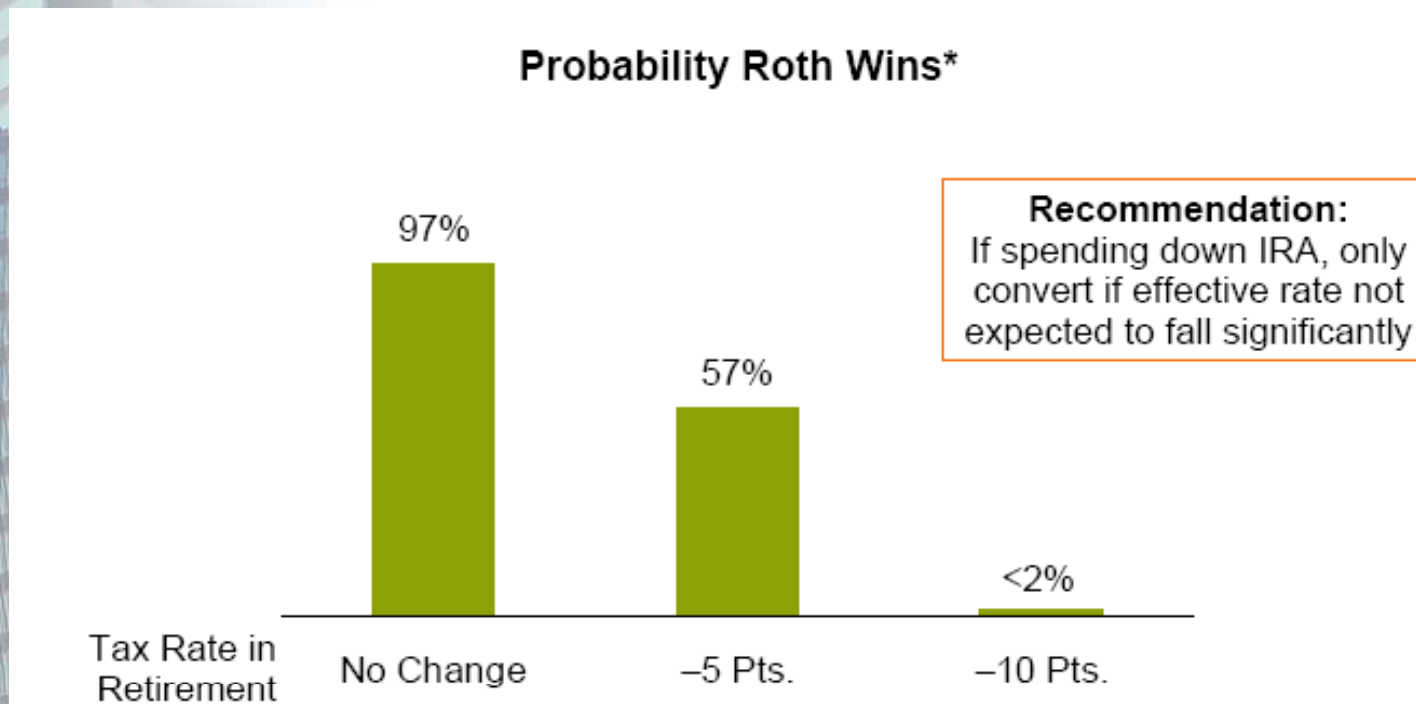
Based on estimates of the range of returns for the applicable capital markets over the next 20 years. Data do not represent past performance and are not a promise of actual future results or a range of results.



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Case Study #1:

65 Year Old Spending IRA Down Over 20-Year Period

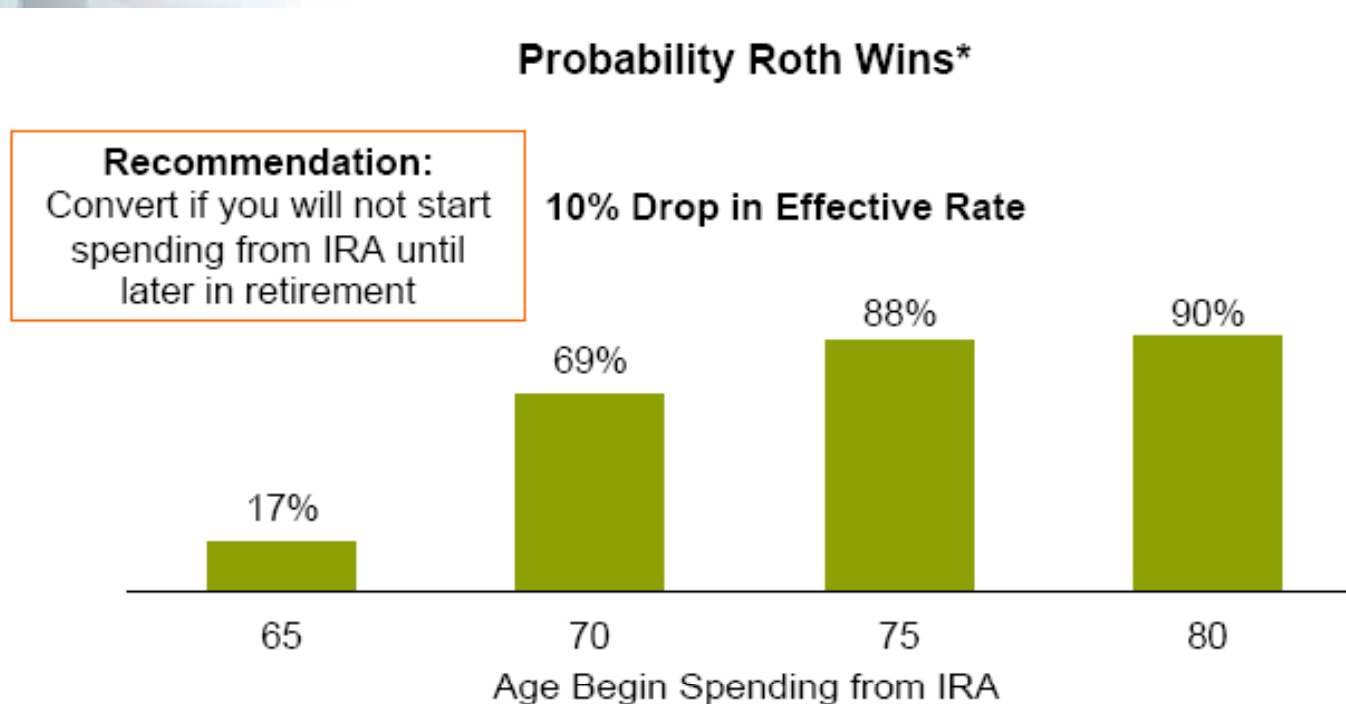


*Wealth adjusted for inflation. Assumes that investor pays 45% blended federal/state tax rate upon conversions; taxes on Roth are paid out of a taxable account. Investor owns IRA between ages 65 and 85. Assumes that any estate taxes are paid out of assets that are not the subject of this analysis. Assumes distribution and spending of 1/20 of Roth IRA in Year One at age 65, 1/19 of remaining Roth IRA in Year Two at age 66, and so on, until 100% of the Roth IRA is distributed and spent in Year 20 at age 85. Assumes the identical dollar value of distributions and spending from the traditional IRA scenario. Assumes any traditional IRA assets remaining after 20 years are liquidated resulting in an income tax liability.

Based on estimates of the range of returns for the applicable capital markets over the next 20 years. Data do not represent past performance and are not a promise of actual future results or a range of results.

Case Study #2:

Expect Effective Rate to Fall; Spending of 5% of IRA



*Assumes that investor pays 45% blended federal/state tax rate upon conversion; taxes on Roth are paid out of a taxable account. Investor owns IRA between the stated age and age 85. Assumes that any estate taxes are paid out of assets that are not the subject of this analysis. Assumes only Required Minimum Distributions (RMDs) from traditional IRA are distributed until age indicated. Assumes a linear distribution and spending of Roth IRA beginning at the indicated age through age 85. Assumes the identical dollar value of distributions and spending from the traditional IRA scenario. Assumes any traditional IRA assets remaining at the end of the term are liquidated resulting in an income tax liability.

Based on estimates of the range of returns for the applicable capital markets over the next 20 years. Data do not represent past performance and are not a promise of actual future results or a range of results.

Case Study #3:

No Spending from IRA and Kids Likely to “Stretch” It

Median *Additional* After-Tax Wealth in Roth, Per \$ Million Converted
20 Yrs. + 30-Yr. Stretch (\$ Mil.)*



*Assumes initial account values at investor age 65, tax on converting a \$1 million traditional IRA to a Roth IRA would total \$450,000 and payment of any death taxes out of assets that are not the subject of this analysis. Assumes IRA participant passes away at age 85, at which time the beneficiary of the IRA is 55. Assumes Required Minimum Distributions (RMDs) from traditional IRA based on participant's age until his passing, at which point RMDs are calculated based on the beneficiary's age. Assumes no distributions from the Roth IRA until the participant's passing, at which point RMDs are calculated based on the beneficiary's age. Values are adjusted for inflation. Assumes any traditional IRA assets remaining after 50 years are liquidated resulting in an income tax liability.

Based on estimates of the range of returns for the applicable capital markets over the next 50 years. Data do not represent past performance and are not a promise of actual future results or a range of results

Good Candidates for Roth Conversion

- Can pay conversion taxes from other (non-retirement) assets
- Don't expect significant decline in effective tax rate in retirement years
- Intend to transfer IRA to family who will stretch it
- Don't expect to spend meaningfully (or at all) from IRA in retirement
- Don't plan to leave IRA to charity

Partial conversion can hedge future tax risk
and potentially minimize current tax bill

Reasons to Convert in 2010

- Lower tax rates
- Lower IRA values (means lower tax cost to convert)
- Maximize years of tax deferral
- . . . And have the option to “recharacterize”

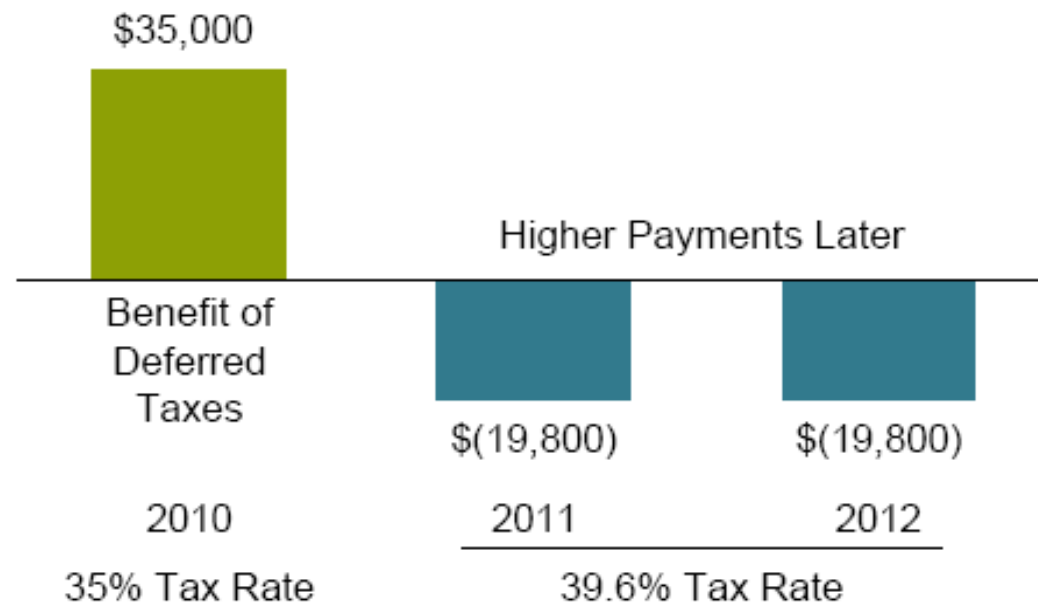
Critical Conversion Decisions

- Tax rate differential (year of conversion vs future years)
- Use of outside funds to pay tax liability
- Need for IRA funds to pay living expenses
- Time Horizon



Pay the Conversion Taxes in 2010

Converting \$100K of an IRA
With Income Split Between 2011 and 2012



Equivalent to borrowing for two years at an annual rate of 8.6%

Roth Conversions: Key Questions

- What is the investor's spending relative to assets?
- Where are the investor's assets located: Retirement vs. Taxable?
- How are the investor's assets invested?
- Can the investor pay conversion taxes from the taxable account?
- Will the investor's tax rate change in 2011? 2012? In retirement?
By how much?
- Who is the beneficiary of the retirement assets? Will the beneficiary stretch RMDs?
- Have there been any nondeductible contributions?
Net operating losses?



Estate Implications of Roth Conversions

- The primary reasons to convert to a Roth IRA are driven by quantitative analysis of income tax effects; however, estate implications can't be avoided.
- A properly designed Roth IRA conversion will incorporate estate implications to get the maximum wealth transfer to heirs and to ensure continuity with an existing estate plan.

Estate Tax Schedule

Year of Death	Exemption Amount	Top Tax Rate
2008	\$2 million	45%
2009	\$3.5 million	45%
2010	No Federal Estate Tax	n/a
2011 & after	\$1 million	55%



Estate Planning Considerations

- Beneficiary Designations Forms
- Income in Respect of Decedent
- Bypass Trust Funding
- GST Planning
- Use of Trusts as Beneficiaries

Beneficiary Designation Forms

- New beneficiary designation forms must be filled out for each new Roth IRA account.
- This process is crucial to ensure proper stretch of IRA distributions to the next generations.
- Must be consistent with existing estate plan.

Income in Respect of Decedent (IRD)

- IRA's are considered IRD in an estate.
- No step up at death.
- IRA assets are included in value subject to estate tax and distributions to heirs are subject to income tax.
- Income tax deduction is available for portion of estate tax attributable to IRD.
- Taxpayers may benefit from paying income tax before estate tax is levied on IRA's.

Illustration of Estate Tax vs. Income Tax

- IRA Value
- 34% combined fed/state income tax
- Balance after income tax
- Federal estate tax at 45%
- Balance

- IRA balance
- Less: Estate tax deduction
- Balance
- 34% combined fed/state income tax
- **Net wealth to family**

Estate Tax on Traditional IRA	Income Tax on Roth IRA
\$2,000,000	\$2,000,000
	(680,000)
\$2,000,000	\$1,320,000
(900,000)	(594,000)
\$1,100,000	\$726,000
\$2,000,000	
(\$900,000)	
\$1,100,000	
(374,000)	
\$726,000	\$726,000

Bypass Trust Funding & GST Planning

- If a taxpayer is planning to fund a bypass trust with an IRA, it is typically better to fund bypass trust with a Roth IRA.
- Example: Assume a 40% income tax rate and a \$3.5 million exemption. If an IRA were used to fund the bypass trust, it would only net \$2.1 million (\$3.5 million less 40% income tax) to decedent's heirs. If the bypass trust were to be funded with a Roth IRA, the full \$3.5 million would pass outside of the surviving spouse's estate.
- The income tax paid on the Roth conversion may also reduce the value of the decedent's estate, possibly saving more estate tax (as illustrated in the previous slide).
- May be used to fund GST exempt trust for the benefit of children and grandchildren to further benefit from tax free distributions.

Using Trusts as Beneficiaries

- Using trusts as IRA beneficiaries instead of leaving them outright to beneficiaries may offer additional asset protection.
- Must be left to a trust that will allow for the stretch of IRA or Roth IRA distributions.
- Consult an attorney.



ROTH IRA's and INVESTMENT CONSIDERATIONS

Investment Considerations

- Tax-free withdrawals – are you kidding me?
- Really need a long-term horizon on the Roth account(s) to make sense
- Use of Roth from an asset allocation standpoint
- Diversification of tax strategies
- Really case by case decision

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Asset Splitting

- “Split” your traditional IRA you are thinking about converting into sectors/asset classes
- Gets around the “cherry picking” rule
- Concept is this – you convert an asset that later has a significant slide in value – and you would rather “look back” and not have paid taxes on the higher conversion value
- If all assets held in the same Conversion Account – the gains and losses are deemed to be pro-rata across all securities held in the account
- However, if you had converted to multiple Roths...

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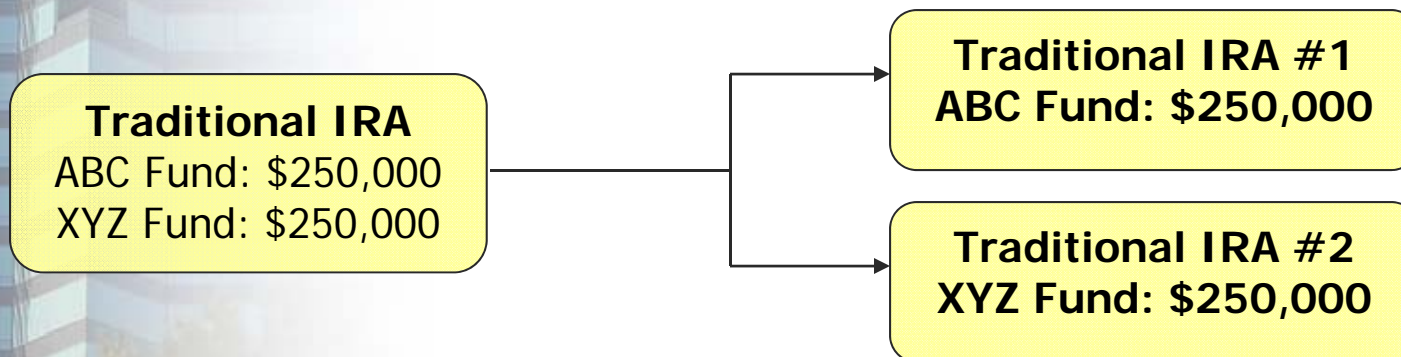
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Tactical Considerations

Roth IRA Segregation Conversion Strategy

STEP 1: Create separate IRAs for each asset, asset class or investment sector

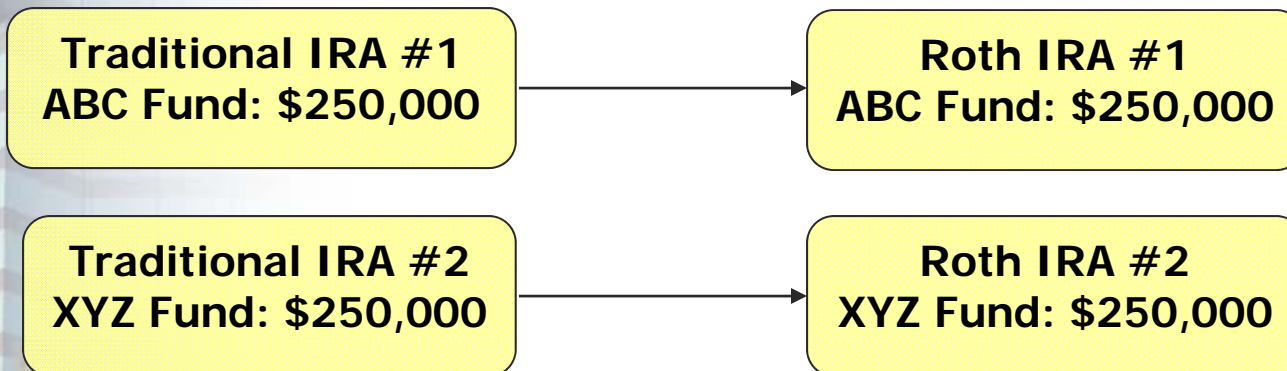


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Tactical Considerations

Roth IRA Segregation Conversion Strategy

STEP 2: Convert IRAs to separate Roth IRAs

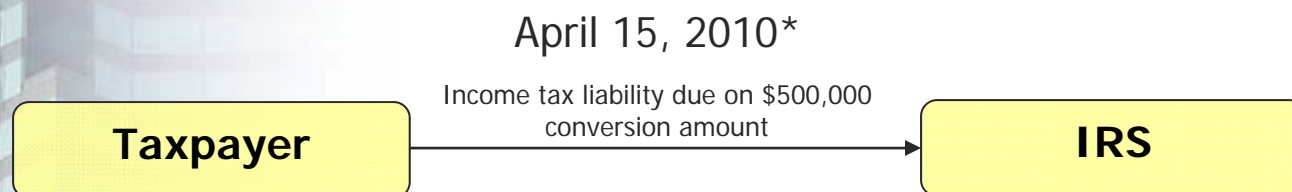


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Tactical Considerations

Roth IRA Segregation Conversion Strategy

STEP 3: Pay income tax on Roth IRA conversion



* **NOTE:** Either a tax return or an extension must be filed by this date. Regardless of what is chosen, the tax liability due on the Roth IRA conversion must be remitted by this date in order to avoid late payment penalties and interest.

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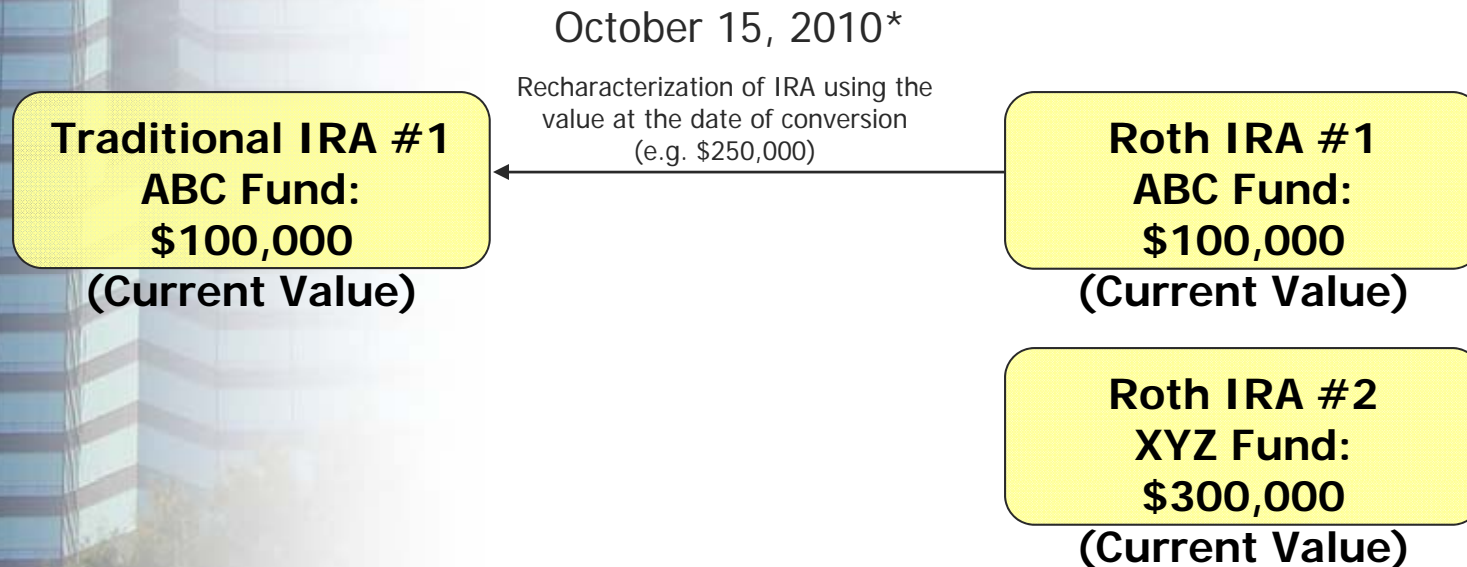
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Tactical Considerations

Roth IRA Segregation Conversion Strategy

STEP 4: Recharacterize Roth IRA conversion



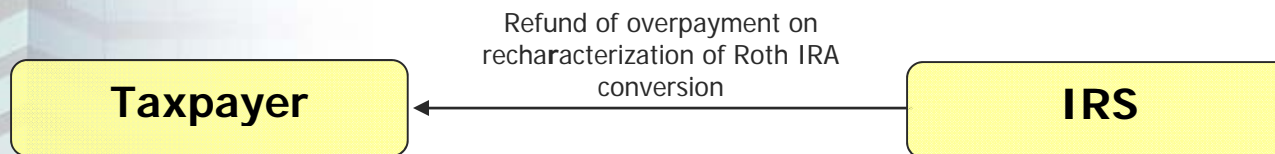
* **NOTE:** October 15, 2010 is the latest date for which a 2009 recharacterization can take place (either by filing extensions or by filing an amended return).

Tactical Considerations

Roth IRA Segregation Conversion Strategy

STEP 5: File (or amend) income tax return
claiming refund for recharacterization

October 15, 2010



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Benefit to Splitting

- The effect of not splitting the IRA vs Splitting into multiple Roths is as follows:

	<u>No split</u>	<u>Splitting</u>
Value on date of conversion	\$500,000	\$500,000
Value of Roth IRA after recharacterization	\$300,000	\$300,000
Value of Traditional IRA after recharacterization	\$100,000	\$100,000
Ordinary Income Recognized	\$375,000	\$250,000
Tax @ 28%	\$105,000	\$ 70,000

Saved Taxes of \$35,000!!

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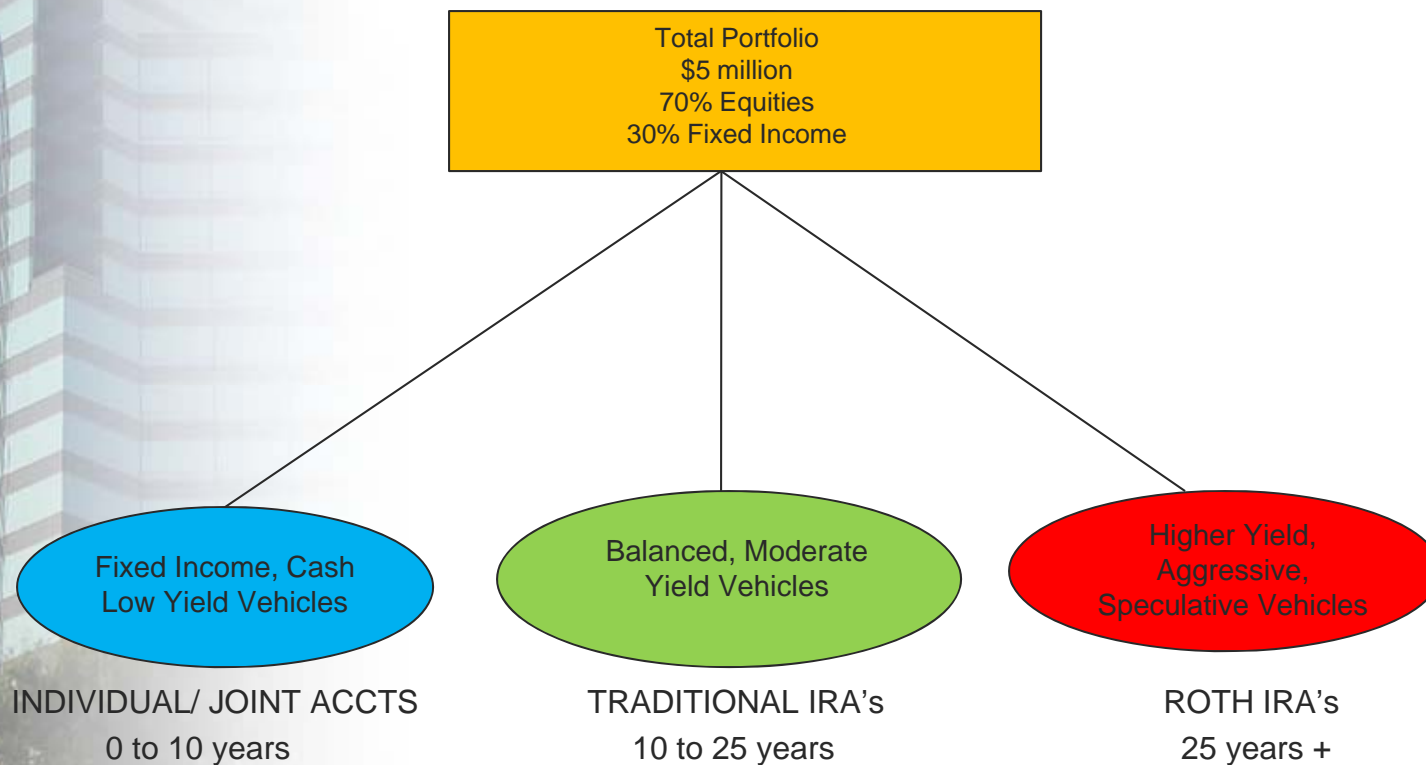
Asset Allocation Decisions

- For you, or your beneficiaries, the Roth IRA provides an amazing opportunity to diversify tax strategies amongst your investments
- Low yield, low turnover in taxable accounts
- Moderate yield, moderate turnover in Regular IRA's
- High yield, high turnover, and highest potential make great Roth candidates!

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Potential Asset Allocation Model – Retirement Planning



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ROTH – Miscellaneous Cool Things

- Roth withdrawals don't count towards reduction of SS benefits
- Can add significant \$\$ to beneficiaries in a STRETCH format over regular IRA
- www.vanguard.com – Roth Conversion calculator – start point only!!

Contact Information

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