Old North State Trust, LLC

2010 Roth Conversion Opportunity

Beginning in 2010, the rules surrounding conversions of traditional IRA money to a Roth IRA are changing. As the law currently stands, only individuals with modified adjusted gross incomes (MAGI) of $100,000 or less can convert. However, the 2010 change eliminates the MAGI limitations, meaning most investors will be eligible to convert their traditional IRAs to Roth IRAs regardless of your income and your tax filing status. Additionally, there's a special rule in place for 2010 only that will allow you to recognize 100% of the conversion income in 2010 and pay all of the tax for 2010 or split it equally between the next two tax years (2011 and 2012).

To better understand a few of the primary reasons to consider a Roth conversion you should be aware of the tax implications of the Roth verses the Traditional IRA at the time of distribution, which is age 59 ½ or later:

Traditional IRA: Contributions are tax deductible and all distributions are taxable at your then current income tax rate.

If you are covered by an employer-sponsored plan, and you're a single tax filer, a traditional IRA contribution is fully deductible for 2010 only if your MAGI is $56,000 or below (deductibility phases out between MAGI of $56,000 and $66,000). If you're a married couple filing jointly, the ability to deduct your contribution phases out between $89,000 and $109,000 (or between $167,000 and $177,000 for the nonparticipant spouse of an active plan participant, when filing jointly.

Roth IRA: Contributions are not tax-deductible, but earnings can be withdrawn income-tax-free if you're at least 59½ and have had the Roth at least five years. You don't have to take required minimum distributions (RMDs) starting at age 70½, as you do with a traditional IRA.

Generally, a conversion makes sense if:

- You think you will be in the same or a higher tax bracket at retirement
- You have a long time horizon,
- You can pay the tax from sources other than your IRA, such as from regular taxable brokerage or bank accounts
- You don't need to use the money and want to leave an income-tax-free Roth IRA to your heirs for gift and estate-planning purposes.

Other points to consider

- There will be taxes due on the money you convert from your tax deductible IRA.
- The amount of dollars you convert could potentially put you into a higher tax bracket in the year of conversion.
- You will get the most benefit from the conversion if you use money outside of your IRA to pay the conversion taxes.
- You can convert just part of your traditional IRA assets. Doing so gives you tax diversification and may help you avoid getting pushed into a higher tax bracket.
- You should consider your future tax rate. If you expect your combined taxes (fed/state/local) to go up, converting may be for you.

While a conversion does finally allow many high-income investors the opportunity to have a Roth, it's important that you analyze your situation and are comfortable with your decision. Taxpayers in the top brackets might find the projections less compelling because of a lower probability they will be in the same or a higher bracket after retirement. Nevertheless, if you're in the highest brackets and expect to stay that way throughout retirement, it could still make sense—especially if you're convinced that tax rates will continue to rise no matter how much you make. Income tax rates may never be lower than they are currently and, combined with depressed asset values, now may be the time to take advantage.

Income taxes aside, very high net worth individuals may find that converting part or all of a traditional IRA to a Roth is advantageous for estate-planning purposes, especially if there is a significant IRA balance that doesn't need to be tapped during the owner's lifetime. Though the value of a Roth will still be included in the gross estate, because there are no required minimum distributions, the account could grow larger than it otherwise might under traditional IRA distribution rules—leaving more for heirs to withdraw income-tax-free over their lifetimes.

If, in the end, you change your mind and need to "undo" the conversion- you can for any reason. All earnings and contributions would have to be transferred back to the traditional IRA. Also, you cannot re-characterize a portion of the account, you have to make the election for the entire amount.

Keep in mind that the bigger your Roth balance, the greater the potential advantage. In simple terms, you will be paying the taxes due on the acorn and not the tree. For further analysis of the conversion question as always, please consult your tax advisor.