PLANNING WITH ROTH
INDIVIDUAL RETIREMENT ACCOUNTS

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KEY FACTORS WHEN CONSIDERING A ROTH IRA CONVERSION

PERTINENT INFORMATION

- ❑ Mr. Kugler has accumulated $1,000,000 in a traditional IRA.
- ❑ Mrs. Kugler is the designated beneficiary (DB) and their daughter is the contingent beneficiary.

GOALS AND OBJECTIVES

- ❑ The Kuglers would like to review the primary differences between a traditional and Roth IRA.
- ❑ They want to know the key factors that should be examined when considering a Roth conversion.
- ❑ They would also like to know how and why each factor would impact their decision.

PROPOSED ARRANGEMENT

- ❑ Review the differences between the Roth IRA and the traditional IRA.
- ❑ Prepare a summary of the primary factors that should be considered; reviewing how and why each factor impacts the final decision concerning a Roth IRA conversion.

RESULTS AND BENEFITS

Differences between Roth and traditional IRA

- ❑ **Traditional IRA** -- The contributions are tax deductible up to specified amounts (a maximum of $5,000 plus an additional $1,000 if over age 50). Contributions are not allowed after the Required Beginning Date (RBD), age 70 ½. The values accumulate on an **income tax-deferred basis**. At that time, Minimum Required Distributions (MRD's) commence. The retirement distributions (lifetime or death) are taxed as ordinary income.
- ❑ **Roth IRA** -- The contributions are permitted up to the specific amounts. The contributions are not tax deductible and may be made after age 70 ½. The values accumulate on an **income tax-free basis**. There is no RBD and thus no MRDs applicable to the IRA owner (including a surviving spouse that implements a Roth IRA rollover). MRD's to the DB commence in the year following the death of the Roth IRA owner. Distributions (lifetime or death) are not subject to income tax to the Roth IRA owner and/or successor beneficiaries.

When reviewing the PRIMARY FACTORS the following should be considered:

- ❑ Some factors will favor the Roth conversion and others will not. The final decision will generally be based on a composite summary with additional weight given to the factors consider to be most important. Also, if a Roth conversion is desired, it is not necessary that the entire IRA be converted. The IRA owner may decide to only convert a portion of the existing IRA.
- ❑ One primary factor in determining the viability of a Roth conversion is the number of years the IRA funds will accumulate before distributions commence. The duration of the accumulation period for the IRA

owner is of paramount importance. The duration and subsequent payout to the DB must also be factored into the ultimate accumulation period. Therefore, it is important to understand when and how the payout to the DB is applicable. The DB is the individual that inherits the IRA from the IRA owner (if certain requirements are met, a trust may qualify as a DB).

- As you go through the following analysis, bear in mind that the factors that impact the duration of the IRA payout for the IRA owner must also be considered for the DB. However, there are major differences applicable to the DB. There is no Required Beginning Date or MRD applicable to the IRA owner. The DB has a Required Beginning Date and an MRD. When the IRA owner dies, the single life expectancy of the DB in the following year (RBD) will be used to determine the duration and amount of the MRDs. (Note that there is an exception if the DB is older than the IRA owner).

- If the DB dies before life expectancy, the MRD's will continue on the same basis to the successor beneficiary (just as though the DB was still alive). Also, the IRA accumulations will be reduced by the amount of the MRD paid out each year. The factors applicable to the DB would generally not be given the same weight as those applicable to the IRA owner.

- A non-spousal DB is allowed to make a direct transfer of QRP death proceeds to a Roth IRA. However, under current law, a non-spousal DB is not allowed to make a direct transfer of an inherited IRA to a Roth IRA.

- If a qualified retirement plan participant wants to convert his/her account balance to a Roth IRA, spousal consent may be required.

The following is a brief review of the PRIMARY FACTORS:

- The following scenarios assume the Roth conversion occurs after January 1, 2010. Prior to that date, there were income limitations on who could convert and IRA to a Roth IRA (MAGI could not be more than $100,000). As of that date there is no income test applicable and any IRA owner can convert. If the IRA is converted in the year 2010, unless the tax payer elects otherwise, 50% of the income will be reportable in the year 2010 and 50% in the year 2011 (at the tax rates applicable in 2010).

Splitting the IRA in to Multiple IRAs Prior to the Roth Conversion:

- Traditional IRA - When considering a Roth conversion, the IRA owner will typically separate the traditional IRA into multiple IRAs prior to implementing the conversion. For example, assume a traditional IRA with a value of $1,000,000. The IRA owner might consider separating the IRA into ten $100,000 IRAs. A Roth conversion will be filed for each. The IRA owner has a free look to determine which IRAs will be converted and which will not. Generally, only the IRAs that have increased in value will be converted. The IRA owner does not want to pay income tax on more than the actual amount in the Roth IRA. Therefore, the IRAs that have decreased in value will be re-characterized back to a traditional IRA (it's as though the transaction never took place).

  If the Roth conversion is implemented on January 1, the IRA owner does not have to finalize the decision on any of the ten IRAs until the due date income tax return with extensions (October 15th).

- Roth IRA - By utilizing multiple IRAs rather than a single IRA, the IRA owner can pick and choose the IRAs he/she wants to cancel or postpone the Roth conversion. He/she can re-characterize back to a traditional IRA and, if desired, implement a subsequent Roth conversion the following year.

- Note: If the IRA owner feels his/her income tax bracket will be higher next year, he/she may decide to go ahead with the conversion even if the IRA has decreased in value.

Using outside funds to pay the income tax on a Roth conversion rather than liquidating a portion of the existing IRA

- **Traditional IRA** -- If outside funds are not available, the Kuglers will liquidate $400,000 of the existing $1,000,000 IRA to pay the income tax (assume 40% combined federal and state). After paying the $400,000 income tax they end up with a $600,000 Roth IRA.

- Note: If the income tax is paid from the IRA, and the tax bracket remains the same, the after-tax results of retaining the traditional IRA or implementing the Roth conversion will generally produce the same after-tax values. Therefore, if this option were desired, the decision would generally be based on other factors.

- **Roth IRA** -- Having outside funds to pay the income tax will definitely make the Roth conversion more attractive. Example: Assume the Kuglers have $400,000 of cash or a high cost basis capital asset that they will liquidate. They could utilize the cash to pay the income tax on the Roth conversion. This will allow the entire $1,000,000 IRA to be converted. Either way the Kuglers are going to pay a $400,000 income tax. By using outside funds, they have a $1,000,000 Roth IRA accumulating on a tax-free basis rather than just $600,000.

- If the Kuglers do not plan to take lifetime distributions, they are in effect paying a $400,000 income tax in order to maximize the tax-free income subsequently paid to the DB (daughter). Since there is no reportable gift when the $400,000 income tax is paid, the Kuglers are in effect making a tax-free gift of the income tax that would normally be paid by the DB on the subsequent IRA distributions.

Does the IRA owner or surviving spouse need the IRA for retirement purposes?

- **Traditional IRA** -- If the existing IRA is needed for retirement purposes the IRA accumulations will be reduced. Also, the Kuglers may feel they want the maximum income that can be obtained. Therefore, they may be reluctant to pay the income tax up front because it will reduce their subsequent gross retirement income.

- **Roth IRA** -- If the existing IRA is not needed for retirement, the Kuglers will generally be more receptive to paying the income tax on the Roth conversion. This will allow them to accumulate a greater amount on a tax-free rather than tax-deferred basis for the DB.

- Note: If only a portion of the IRA is needed for retirement purposes, the Kuglers may consider retaining whatever portion of the existing IRA will provide the desired income. The balance would be converted to a Roth IRA.

Anticipated number of years before MRDs for IRA owner and/or the DB

- **Traditional IRA** – The required beginning date is always age 70 ½. If the duration until retirement is relatively short, the Kuglers may prefer to simply continue the traditional IRA. Example: Assume the IRA value is $1,000,000 and the anticipated value when MRD's are expected to commence is projected to be just $1,100,000. In this situation, the Kuglers may feel that the minimal growth does not offset the earlier payment of the income tax. As a result, they may be less likely to implement the Roth conversion.

- **Roth IRA** – There is no required beginning date for the Roth IRA owner. If the number of years before anticipated distributions is substantial, this will favor the Roth conversion. Example: assume the $1,000,000 IRA value is expected to grow over a period of years to $3,000,000 before MRDs commence. Even if the tax bracket remains constant, they would probably be willing to pay a current 40% income tax on the $1,000,000 conversion to subsequently receive $3,000,000 income tax-free.

- ❑ Note: The age and objectives of the IRA owner and DB should be considered to determine the number of years before distributions are expected to commence. Also, consideration should be given to the fact that the IRA will continue to earn interest if MRDs are being paid out.

- ❑ Note: While the health of the IRA owner is a major factor in determining the duration of the payout, the health of the DB is not a factor. The life expectancy of the DB is based on age, and determines the maximum duration of the payout. The duration will not change if the DB dies before the life expectancy.

- ❑ Note: It should also be mentioned that the projected Roth accumulations should be measured against the after-tax accumulations (same interest rate) applicable to the after-tax IRA payout of a traditional annuity. In order to provide any equitable comparison, the analysis should project the future accumulations for both the traditional IRA and Roth IRA. The after-tax annuity payout applicable to the traditional IRA should be assumed to be invested in an annuity contract that provides tax deferred accumulations. (See Kugler case based on this type of analysis).

Will a lump sum distribution or MRDs be applicable to the IRA owner and/or DB?

- ❑ **Traditional IRA** -- If a lump sum rather than installment payout is anticipated, it will reduce the duration of the IRA payout and the subsequent interest earnings. This will reduce the advantage of any Roth conversion.

- ❑ **Roth IRA** -- If an installment payout is anticipated this will allow a longer IRA stretch out and subsequent interest earnings on the remaining balance. This will increase the tax-free IRA accumulations and enhance the advantage of the Roth conversion.

Current Income tax bracket

- ❑ **Traditional IRA** -- A higher current income tax bracket will favor the traditional IRA because of the higher income tax required to implement the Roth conversion.

- ❑ **Roth IRA** -- A lower current income tax bracket will favor the Roth conversion because the income tax required to implement the conversion will be lower.

- ❑ Note: If the IRA owner has a net operating loss or charitable deduction carry forward, the applicable deduction may be applied to reduce the AGI on the conversion.

Pre-and post-retirement income tax bracket

- ❑ **Traditional IRA** -- If the anticipated tax bracket will be higher at retirement, the traditional IRA is less attractive because the higher income tax would be applicable to IRA distributions.

- ❑ **Roth IRA** -- If the anticipated tax bracket would be lower at retirement, the Roth conversion will be less attractive. Generally you do not want to pay a higher current income tax when a deferral would result in a lower income tax

- ❑ Note: When considering the and future tax bracket, the Kuglers may also want to consider their feelings about potential governmental changes (up or down) in the income tax as well as the Medicare tax applicable to retirement income.

The current amount in the traditional IRA

- **Traditional IRA** -- If the amount in the IRA is not significant, the probability of a higher tax bracket will be minimized. This will favor retaining the traditional IRA.

- **Roth IRA** -- If the amount in the IRA is substantial, the subsequent distributions to the IRA owner and/or DB may increase their future tax bracket. The potential increase in the future tax bracket will favor the Roth conversion.

Estate tax situation

- **Traditional IRA** -- If there is no anticipated estate tax at the death of the IRA owner and/or surviving spouse, the traditional IRA will not cause an increase or decrease in the estate tax.

- If there is an estate tax payable on a traditional IRA, the negative impact will be minimized because the estate tax will provide an income tax deduction on the traditional IRA distributions.

- **Roth IRA** -- If there is an anticipated estate tax at the death of the IRA owner and/or surviving spouse, the estate tax will be a factor. The number of years before the estate tax will be payable must also be considered. If the number of years is relatively short, the payment of the income tax on the Roth conversion will reduce the size of the estate and subsequent estate tax. If the estate tax becomes payable after a relatively long period of years, the increased Roth IRA accumulations will increase the size of the estate and subsequent estate tax.

- The estate tax payable on a Roth IRA cannot be used as an income tax deduction to the designated beneficiary because the Roth IRA does not generate taxable distributions.

- Note: Where applicable, state estate or inheritance taxes must also be considered.

State income tax

- **Traditional IRA** -- Some states do not provide an income tax deduction for contributions to a traditional IRA (e.g. New Jersey). This makes continuing the traditional IRA less attractive from a state income tax point of view.

- **Roth IRA** -- If the state does not provide an income tax deduction for contributions to a traditional IRA, the Roth conversion becomes more attractive because the value of the tax deduction applicable to the traditional IRA is reduced. Also, some states do not have any income tax on IRA income. If you live or move to a state that does not tax IRA income, the Roth conversion becomes more attractive because no state income tax will be payable on the conversion.

Special considerations for state laws applicable to IRAs

- **Traditional IRA** -- The following is an example of how state law may impact the IRA. Assume Mr. Kugler has creditor problems. He lives in a state that protects IRAs from the claims of creditors. However, the state he lives in does not protect an IRA distribution from the claims of creditors. Since a traditional IRA provides for MRD's at age 70 1/2 (otherwise a 50% penalty), the creditors could attach the MRD.

- **Roth IRA** -- Roth IRA values can accumulate without any MRD's applicable to the IRA owner. Since there are no required Roth IRA distributions; there can be no attachment by creditors. In this particular state, the Roth IRA would be more favorable.

- Note: some states also provide creditor protection for MRDs for IRAs and Roth IRAs.

Partial Roth conversion of an IRA asset that has substantial growth potential in the near future

- **Traditional IRA** -- assume the Kuglers do not have sufficient funds to pay the income tax on the $1,000,000 Roth conversion. The IRA includes stock in a corporation that has declined from a previous $250,000 value to $100,000. The Kuglers believe there is a reasonable possibility the specified stock value will increase substantially in the near future (maybe back to the original $250,000 value.) Should the subsequent appreciation occur, the appreciation would ultimately be taxed as ordinary income under the traditional IRA.

- **Roth IRA** -- Consideration could be given to implementing a partial Roth conversion for just 10% of the $1,000,000 IRA. The $100,000 of stock in the specified corporation would be utilized for the Roth conversion. The income tax on the $100,000 conversion would be paid from outside funds. By utilizing the partial Roth conversion, the subsequent appreciation would not produce taxable income. The balance of a portion of the IRA account could be converted at a future date.

- Note: If the $100,000 of specified stock decreases in and value to say $75,000, rather than pay the income tax on $100,000, the Kuglers could direct a reversal of the conversion via a trustee-to-trustee transfer by the due date (including extensions) for filing the income tax return. In effect, for income tax purposes it's as though the transaction never took place. Only one conversion and one re-characterization are generally allowed each year. The specified stock must remain in the traditional IRA for at least 30 days (or after the beginning of the next calendar year, if later) before the stock can again be re-characterized to a new Roth IRA.

Charitable contributions by the IRA owner

- **Traditional IRA** -- An IRA owner over age 70 ½ is allowed to exclude from gross income up to $100,000 from the IRA paid directly to charity. There is no income tax deduction because the contribution goes directly from the IRA to the charity. The amount transferred is applied against the MRD for that year and thus excluded from income. This is a significant advantage for the traditional IRA, because the IRA owner satisfies his charitable objective and eliminates the income tax applicable to the IRA distribution used to fund the charitable contribution.

- **Roth IRA** -- While the traditional IRA is generally the most economical asset to fund a charitable contribution, the Roth IRA is generally the least. The primary advantage of using an IRA to fund the charitable contribution is that the IRA owner is not taxed on the IRA distribution. However, Roth distributions are not subject to income tax. Therefore, there is no income tax advantage to using a tax-free Roth distribution to fund a charitable contribution. If a transfer from an IRA directly to a charity is anticipated, the traditional IRA may be the ideal asset.

- Note: Using the IRA to fund a charitable contribution is currently only applicable through the year 2009. Many practitioners feel Congress will subsequently extend this option.

Using the IRA to fund a credit shelter trust

- **Traditional IRA** -- In estate planning situations, a credit shelter or disclaimer trust is generally desired to reduce the estate tax payable when the surviving spouse dies. Often the IRA owner does not have sufficient probate-type assets to fund the credit shelter trust. When sufficient assets are not available, the IRA owner will sometimes name the credit shelter trust as the DB of the IRA. Under the trust arrangement, the surviving spouse is not classified as the sole outright DB. Therefore, the surviving spouse cannot implement an IRA rollover. Since the trust has other beneficiaries, the trust is treated as a non-spousal DB. The oldest trust beneficiary (generally the surviving spouse) is considered the measuring life for the current and if applicable, successor beneficiaries.

As with any non-spousal DB, MRD's must commence in the year following the death of the IRA owner. Also, the maximum duration of the IRA stretch out is measured by the life expectancy of the DB (surviving spouse). This will greatly limit the duration of the IRA stretch out.

Also, since the distributions from the traditional IRA are taxable as ordinary income, the net estate tax benefit derived from the by-pass trust is minimized.

- ❑ **Roth IRA** -- The rules applicable to a traditional IRA are also applicable to a Roth IRA. The trust is treated as a non-spousal DB. Even though the spouse survives the IRA owner, the Roth IRA must commence distributions in the year following the death of the IRA owner. Otherwise the 50% penalty tax will be applicable. Also, as noted above, the duration of the IRA payout will be based on the measuring life of the oldest trust beneficiary, generally the surviving spouse. This will significantly limit the duration of the IRA payout because the younger age of the children cannot be used because they are not the DB's of the IRA. Naming a trust as the beneficiary of a Roth IRA is not recommended because it causes immediate MRD's and significantly reduces the duration of the tax-free payout. As a result, the tax-free accumulations of the Roth IRA are minimized.

- ❑ Note: The negative impact having a trust as beneficiary of the IRA would also be applicable to a Qualified Terminal Interest (QTIP) trust. However, if the IRA owner does not have sufficient assets to fund the trust and the trust is necessary for estate tax purposes or to protect the surviving spouse and/or children from a previous marriage, the IRA owner may have no other viable option.

- ❑ Note: In situations where the IRA owner wants to provide for a surviving spouse and a child from a previous marriage, the IRA will often be separated into two IRAs, one for the surviving spouse and one for the child. The IRA for the surviving spouse will generally be paid outright to the surviving spouse. This will allow the spouse to implement the IRA rollover and to provide the advantages applicable to the spousal rollover. The IRA for the child could be paid to a trust because the spouse (older age) would not be a beneficiary of the trust. Therefore, the RBD (year following death of IRA owner) and MRD (generally the life expectancy of oldest) would be the same as if the IRA were paid directly to the oldest child.

Portion of Social Security Retirement Income Included in AGI

- ❑ **Traditional IRA** -- the Social Security retirement income paid to an individual may be tax-free, or a portion may be taxed as income (up to 85% of income). The amount taxable is determined by the taxpayers AGI. If the traditional IRA is not converted, the MRD's will increase AGI every year and may cause an ongoing increase in the portion of Social Security income that is taxable.

- ❑ **Roth IRA** -- in the year the Roth conversion is implemented, there will generally be a significant increase in AGI. The increased AGI for the year of the Roth conversion may cause an increase in the portion of Social Security retirement benefits taxed as ordinary income. Any subsequent Roth distributions are not subject to income tax. Therefore, they will not cause an increase AGI. Thus, there will be no increase in the portion of Social Security retirement benefits taxed as ordinary income.

- ❑ Note: the taxability of Social Security retirement benefits is not a factor if the taxpayer has substantial AGI from other sources that would cause him/her to always have the entire Social Security retirement benefit taxed as ordinary income.

Medicare premiums

- ❑ **Traditional IRA** -- the premium an individual pays each year for Medicare coverage is graduated in accordance with taxpayer's AGI. At the present time, the maximum increase is 100% of the standard Medicare premium. If the traditional IRA is maintained, the annual income generated by the MRD's may cause an ongoing increase in the Medicare premiums.

- **Roth IRA** -- in the year the Roth conversion is implemented, there will generally be a significant increase AGI. This may cause an increase in the Medicare premium for the year following the Roth conversion. Any subsequent Roth distributions are not subject to income tax. Therefore, they will not increase AGI. Thus, they will not contribute to an increased Medicare premium.

- Note: the Medicare premium is not factor if the IRA owner has other significant income that would cause the taxpayer to always pay the maximum premium.

Pre age 59 ½ distributions and the Roth Five-year rule

- **Traditional IRA** -- A distribution to an IRA owner prior to age 59 ½ is considered to be a pre-retirement distribution and may be subject to a 10% penalty tax in addition to the regular income tax (exceptions for death, disability etc.). The 10% penalty tax is not applicable if the distributions are structured as a series of periodic payments (IRC section 72 (t)) based on the IRA owner's life expectancy. In order to eliminate the 10% penalty tax, the periodic distributions must continue for the later of five-years or when the IRA owner attains age 59 ½.

- **Roth IRA** – pre-age 59 ½ distributions to a Roth IRA owner are subject to the 10% penalty tax on the same basis as the traditional IRA owner (i.e. exception for periodic distributions).

- **The Roth IRA has an additional 5-year requirement.**

  Regular Income Tax -If distributions are taken (before or after age 59 ½) before the Roth has been in effect for five taxable years, any distributions in excess of the aggregate contributions to the Roth IRA will be taxable as ordinary income. For this purpose all Roth IRAs are aggregated. Since the amount of the Roth conversion counts as a Roth contribution, the five-year rule should not be a problem unless the distribution exceeds the rollover amount.

  10% Penalty Tax - If the five-year rule is **not** satisfied the 10% pre-age 59 1/2 distribution penalty tax will be applicable. The 10% penalty tax will apply even if there is no regular income tax.

- Note: In addition to the systematic distribution, the following distributions are also exempt from the 10% penalty tax. Distributions resulting from: death, disability, up to $10,000 for first time homebuyer, qualified medical expenses, health insurance premiums for the unemployed, qualified educational expenses, and qualified hurricane expenses up to $100,000.

Community Property States

- Some states provide community property rights for assets owned by a married couple. In most community property states, the retirement account will be considered a community property asset (i.e. each spouse owns a 50% interest). The spousal community property rights vary significantly from state to state. This is especially true with respect to the IRA and QRP assets.

- The factors that make a Roth conversion more or less favorable will not change in a community property state. However, the non-IRA owner and/or non-participant spouse is generally considered to own 50% of their spouses' retirement account. This often makes simple changes more complex (e.g., Roth conversion). The spouses may have different objectives and both signatures may be required to implement a change.

- We cannot provide a generic community property summary concerning the impact of the spousal community property rights on a conversion to a Roth IRA. Nevertheless, if the IRA owner or plan participant is in a community property state, the spousal community property rights must be considered.

Summary

- There are many factors that should be considered before making a decision on the conversion to a Roth IRA. In this analysis we have only provided the primary factors. Of course, some factors are more important to a particular IRA owner and will have a greater impact on the final decision.

RE-CHARACTERIZATION FROM AN IRA TO A ROTH IRA AND BACK TO AN IRA AGAIN

PERTINENT INFORMATION

- In April of this year, Mr. Kugler converted his traditional IRA to a Roth IRA when the fair market value of his assets was valued at $60,000.
- He is in the 30% combined state and federal tax bracket and will pay approximately $18,000 in taxes on his conversion.
- Unfortunately, the value of the assets has decreased substantially.
- In December of this year, his Roth portfolio is now valued at $20,000.

GOALS AND OBJECTIVES

- Mr. Kugler wants to know if there is any way he can avoid paying almost everything that remains in his account in income taxes.
- Can Mr. Kugler avoid paying any taxes on the conversion?

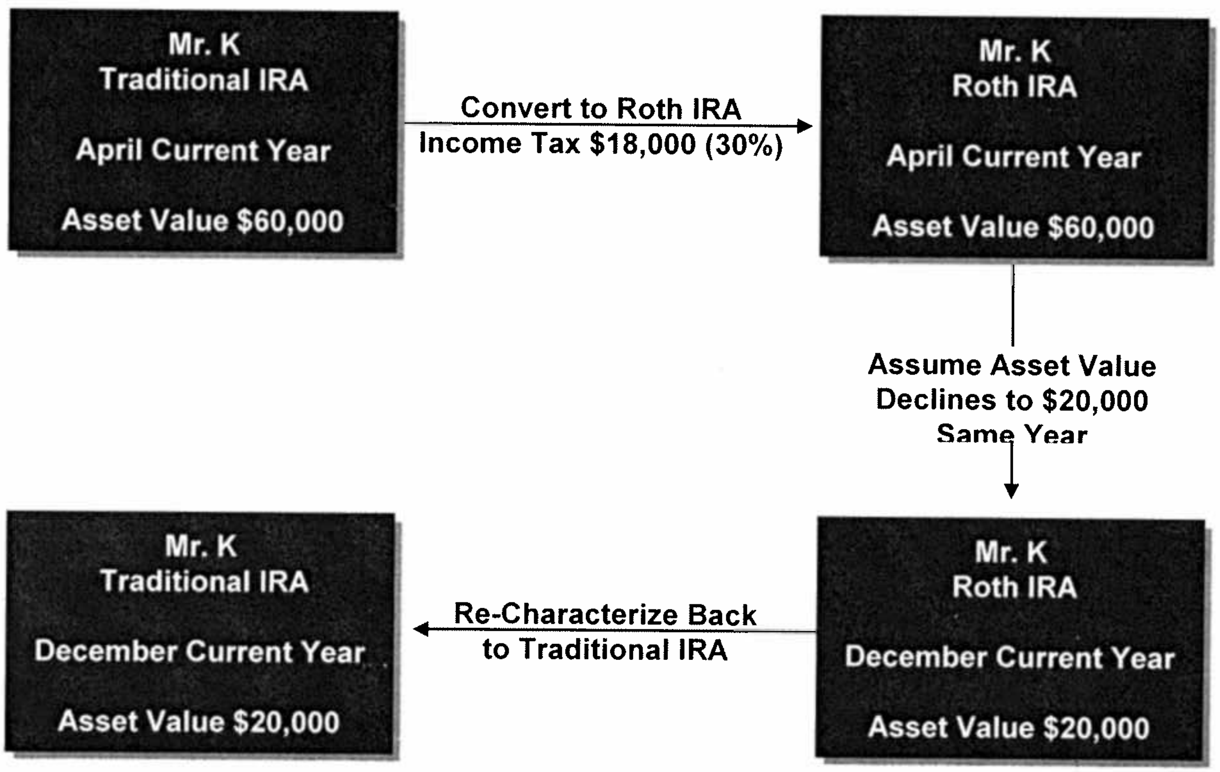
PROPOSED ARRANGEMENT

- Immediately re-characterize the funds back into the traditional IRA before the date he is required to file his tax return for the year of the rollover.
- If Mr. Kugler made a conversion (during the calendar year) to a Roth IRA, and the value of the assets has subsequently decreased substantially, he should revise the transactions.

RESULTS AND BENEFITS

- Mr. Kugler will re-characterize the funds back as a traditional IRA and it is like the transaction never took place.
- Mr. Kugler can direct the reversal of the conversion via a trustee-to-trustee transfer by the due date (including extensions) for filing his return.
- He will save all income taxes that would be due on the conversion.
- Mr. Kugler must file IRS Form 8606 with his return. The Roth IRA custodian must transfer directly to the traditional IRA trustee the converted amount plus any allocable net income on said funds.
- Note: Partial re-conversions are permitted.
- Only one conversion and one re-characterization are generally allowed each year. The assets must stay in the re-characterized traditional IRA for at least 30 days (or after the beginning of the next calendar year, if later) before they can be re-characterized to a Roth IRA.

CONVERT TO ROTH IRA AND BACK TO IRA



- Mr. K will not have to pay the $18,000 of income tax on the original conversion.
- Note: If Mr. Kugler wants to convert the following year when the value is just $20,000, the income tax would be just $6,000.
- Note: Mr. K must reconvert the IRA funds back by due date for filing (including extensions) of his income tax return.

SPLITTING THE TRADITIONAL IRA INTO MULTIPLE IRAS PRIOR TO THE ROTH CONVERSION TO ENHANCE THE VIABILITY OF RECHARACTERIZATION

PERTINENT INFORMATION

- Mr. Kugler has $1,000,000 in a traditional IRA.
- He has decided to convert his traditional IRA to a Roth IRA.
- Mr. Kugler plans to convert the entire $1,000,000 IRA and pay the income tax on the conversion with outside funds.

GOALS AND OBJECTIVES

- Mr. Kugler wants to know if there is a special procedure that should be followed **before** implementing the conversion to a Roth IRA.

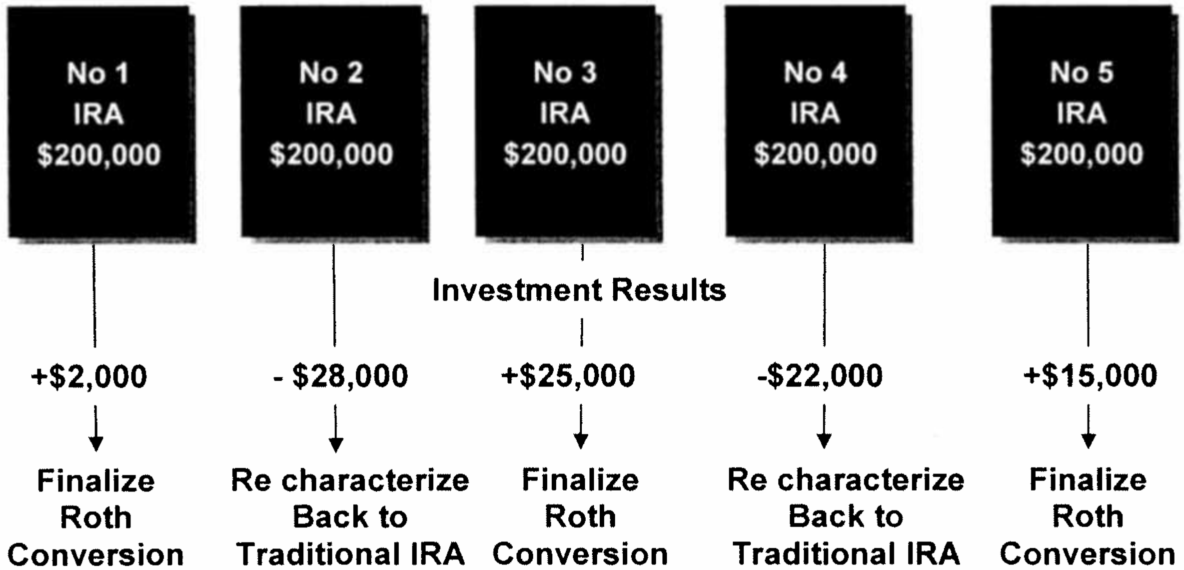
PROPOSED ARRANGEMENT

- He should consider splitting his traditional IRA into multiple IRAs.
- Mr. Kugler could take his $1,000,000 IRA and it divide into five separate $200,000 IRAs.
- He would then file a Roth conversion for each IRA.
- Each of the five IRAs will convert to five separate Roth IRAs.

RESULTS AND BENEFITS

- Even after the Roth conversion is filed, Mr. Kugler does not have to finalize the transaction until the due date of his income tax return plus extensions for the year of the Roth conversion.
- The IRA owner has a "free look" to determine which Roth conversions will be finalized and which will not.
- The "free look" is accomplished via a so-called re characterization back to a traditional IRA.
- The end result is a reversal of the conversion via a trustee to trustee transfer of the assets in the Roth IRA back the original traditional IRA.
- The re characterization must be done before the due date of filing the income tax return for the year of the Roth conversion.
- Mr. Kugler can select which of the five IRAs he wants to finalize as a Roth conversion.
- The others will be re characterized back to a traditional IRA.
- Generally the Roth conversion will be finalized for the IRAs that increase in value. The IRAs that decrease in value will normally be re characterized back to the traditional IRA.
- Note: If the five IRAs are converted to one Roth IRA the investment results for each IRA would be commingled with the other four IRAs. As a resort, it would not be possible to separately re-characterize the least performing IRA.

❑ The following example may prove helpful



❑ IRA number 2 decreased by $28,000, and IRA number 4 decreased by $22,000.

❑ Mr. Kugler does not want to pay income tax on the combined $50,000 of value that is no longer in the Roth IRA.

❑ Therefore, he will re characterize the two Roth IRAs back to traditional IRAs.

❑ Mr. Kugler must file IRS form 8606 with his income tax return. The Roth IRA custodian must transfer the conversion amount plus net income directly to the traditional IRA trustee.

❑ Under this arrangement Mr. Kugler will only pay income tax on the three IRAs that increased in value. The income tax payable will be based on the original $200,000 value for each IRA.

❑ Mr. Kugler can subsequently implement a Roth conversion for the two re characterized traditional IRAs.

❑ Assuming the values remain the same, he will pay income tax on the combined $350,000 reduced value, rather than the original $400,000 value.

❑ If he is going to be in a higher tax bracket next year, he may decide to forgo the re characterization entirely. This is particularly true if the decrease in IRA value is a relatively insignificant amount.

❑ Note: only one conversion and one re-characterization for each IRA is generally allowed each year. The assets must stay in the re-characterized traditional IRA for at least 30 days. (Or, after the beginning of the next calendar year, if later).

❑ If the Roth conversion is implemented on January 1, Mr. Kugler will have until the date he is required to file his income tax return in the following year to finalize his decision. That would give him until October 15 of the following year (including extensions).

USING NON-IRA FUNDS TO PAY THE INCOME TAX ON A ROTH CONVERSION WHEN THE IRA OWNER (AGE 70) WANTS TO MAXIMIZE AFTER-TAX DISTRIBUTIONS FOR HIS SON

PERTINENT INFORMATION

- ❑ Mr. Kugler will turn age 70½ in the year 2010.
- ❑ When he attains age 70 ½ (his RDB), Mr. Kugler expects to have approximately $1,000,000 in his traditional IRA.
- ❑ Mr. and Mrs. Kugler have substantial outside income and expect to be in a high income tax bracket (assume 40% federal and state) during their lifetime.
- ❑ They expect the estate of the surviving spouse to be taxed at a 45% estate tax rate.
- ❑ They realize the RBD for Mr. Kugler's traditional IRA is rapidly approaching, and they want to consider a conversion to a Roth IRA.
- ❑ To qualify for a Roth conversion, the taxpayer must have an adjusted gross income of $100,000 or less. However, starting in year 2010, high-income individuals may convert their traditional IRA (taxable MRD's) to a tax-free Roth IRA without regard to their adjusted gross income.
- ❑ If Mr. Kugler converts to a Roth IRA in the year 2010, he will not have to pay any income tax on the conversion that year. He is allowed to pay half of the tax bill for this conversion in 2011, and the other half in 2012.
- ❑ Under the Roth IRA, there is no lifetime RBD for Mr. Kugler, nor is there one for Mrs. Kugler if she inherits the Roth IRA from Mr. K and rolls it into her name.

GOALS AND OBJECTIVES

- ❑ The Kuglers' primary objective is to maximize the after-tax MRDs to their son (age 50).
- ❑ The Kuglers would like to review a spreadsheet showing the accumulated values if Mr. Kugler's traditional $1,000,000 IRA is converted to a Roth IRA in the year 2010 and no distributions are taken during the lifetime of Mr. or Mrs. Kugler (assume 20 years).
- ❑ The following assumptions are used for the calculations in this case:
    - ❑ Funds in the IRAs (traditional and Roth) grow by 6% per year.
    - ❑ The $400,000 income tax on the IRA conversion will be paid by from non-IRA funds. $200,000 of the income tax will be paid in year 2011 and the other $200,000 in the year 2012.
    - ❑ The Kuglers realize their non-IRA investments will be reduced by the $400,000 used to pay income tax on the Roth conversion. Therefore, to evaluate the economic viability of the Roth, they want to remove the $400,000 plus an assumed 4.5% after tax growth rate from their ultimate Roth IRA accumulations.
    - ❑ Since the Kuglers do not need the MRD's from the traditional IRA, they want to assume the after-tax MRD's are reinvested at the same 4.5% after tax growth rate.
- ❑ The Kuglers want to then compare the net 20-year Roth value to the traditional IRA and after tax MRD value.

PROPOSED ARRANGEMENT

- ❑ Prepare a spreadsheet showing the 20-year accumulations of both the traditional and Roth IRA values under the proposed assumptions.

Total after tax payout
Years 1-20 (age 70-90)

Traditional IRA (No Conversion)		Roth IRA (Conversion)
$1,000,000	Value at Age 70½	$1,000,000
1,101,093[1]	Value in 20 Years	3,207,135[3]
1,103,223[2]	Plus Reinvested MRDs (4.5% after tax)	
	Minus Roth "Missed Opportunity" Cost (4.5% after tax)	(903,268)[4]
$2,204,316	**Accumulated Value**	**$2,303,867**

1 Traditional IRA value after 20 years assuming 6% growth with MRD's withdrawn.
2 If Mr. Kugler does not convert the IRA, he will take the after-tax MRDs and reinvest at an assumed 4.5% after tax return, the reinvested MRDs will grow to $1,103,223.
3 $1,000,000 Roth IRA growing at 6% tax-free for 20 years.
4 Assuming Mr. Kugler converts the traditional IRA to a Roth IRA at age 70, he will use "outside" (investment) funds to pay the income tax. The cost to convert is assumed to be $400,000, spread over two years. Based upon 4.5% after tax return, the $400,000 "missed opportunity" cost will grow to $903,268 in 20 years.

- ❑ The net 20-year Roth accumulation is $99,551 greater than the traditional IRA.
- ❑ Note: The figures would be closer if the assumed term of years was shorter and the income tax rate was lower.
- ❑ Also, the accumulated Roth value will not be subject to income tax in future years. However, $1,101,093 of the remaining traditional IRA will be subject to income tax when distributed.
- ❑ Since the objective is to maximize the IRA payout to their son, they want to assume further that their son inherits the IRA or Roth IRA from the surviving spouse after 20 years. At that time, the son will be age 70. He will also be in a 40% income tax bracket and take MRDs over his assumed 17 year life expectancy.
- ❑ Assuming the surviving spouse dies after 20 years, the after tax distributions to Mr. and Mrs. Kugler's son are assumed to be paid over his 17 year fixed period life expectancy.
- ❑ Note: payout for year one is 1/17 of fund value, payout for year two is 1/16 of fund value, etc., until the entire value is paid out in 17 years.

Years 21-37
17 year (life expectancy) after tax MRD's to son age 70

Traditional IRA (No Conversion)		Roth IRA (Conversion)
\$1,162,196[5]	Total after-tax MRDs (17 years)	\$4,052,863[7]
1,677,878[6]	Total reinvested after-tax MRD's	
\$2,840,074		**\$4,052,863**

5 Total MRDs paid of \$1,936,994, less 40% income tax (\$774,798), produces \$1,162,196 net after tax.
6 \$1,103,223 plus 4.5% after-tax growth produces \$1,677,878 of after-tax MRDs over 17 years.
7 \$2,303,868 plus 6% tax-free growth produces \$4,052,863 of non-taxable MRDs over 17 years.

RESULTS AND BENEFITS

Years 1-20

- The 20-year Roth IRA values are approximately \$99,000 higher (\$2,303,867 vs. \$2,204,316) than the traditional IRA values.
  - In addition, the withdrawal from the Roth would not be subject to income tax, whereas \$1,101,083 of the \$2,204,316 traditional IRA accumulations would be.

Years 21-37

- The after-tax payout over the son's (Designated Beneficiary) 17-year life expectancy favors the Roth by \$1,212,789 (Roth \$4,052,863 vs. Traditional \$2,840,074).
- It should be noted that if the surviving spouse dies in 20 years, the \$100,000 of additional Roth value will cause additional estate tax of \$45,000 (45% x \$100,000) also the son's estate will be enhanced by \$1,212,789 after the 17-year payout.
- In many cases, the IRA owner may only want to consider converting only a percentage of the traditional IRA to the Roth IRA.
- Based upon the Kugler's objectives and assumptions for this case, the Roth conversion would appear to be the better choice.
- Any change in the objectives and assumptions would impact the illustrated results. (See prior cases on Key Factors to be Considered when Considering a Roth IRA Conversion.)

DEATH BED STRATEGIES VIA IRA CONVERSION TO A ROTH IRA

PERTINENT INFORMATION

- Mr. Kugler is a widower, age 75. He has just learned of a terminal illness that will shorten his life expectancy.

- He has a substantial estate that is in a 45% estate tax bracket and has $1,000,000 in a rollover IRA.

- Mr. Kugler has earned income of less than $100,000; therefore, he qualifies for conversion to a Roth IRA (any potential MRD would not be counted toward AGI for purposes of the conversion calculation).

- Note: Commencing in the years 2010 the $100,000 earned income limitation is eliminated and any IRA owner will be allowed to implement the Roth conversion.

- Mr. K's children also have substantial estates. They are in a 40% income tax bracket (combined federal and state).

- At Mr. K's demise, the children intend to take MRDs from Mr. K's IRA.

GOALS AND OBJECTIVES

- At Mr. Kugler's demise the $1,000,000 IRA will cause a 45% estate tax, and the subsequent distributions to the children will be subject to income tax.

- Mr. K wants to know if there is a way to structure the IRA to minimize the taxes to his children.

PROPOSED ARRANGEMENT

- If Mr. Kugler qualifies (income less than $100,000), immediately convert the IRA to a Roth IRA.

- Mr. K will pay the $400,000 (40%) income tax on the $1,000,000 conversion from outside sources.

- It is important to pay the taxes on the conversion from a traditional IRA to a Roth IRA from outside sources. Otherwise, the new Roth IRA will only have $600,000 (rather than $1,000,000) to compound tax-free over the children's life expectancies.

RESULTS AND BENEFITS

- Converting to a Roth IRA would cause Mr. Kugler to pay $400,000 in current income taxes.

- As a result of the conversion, the children will receive the IRA benefits income tax-free at Mr. K's demise.

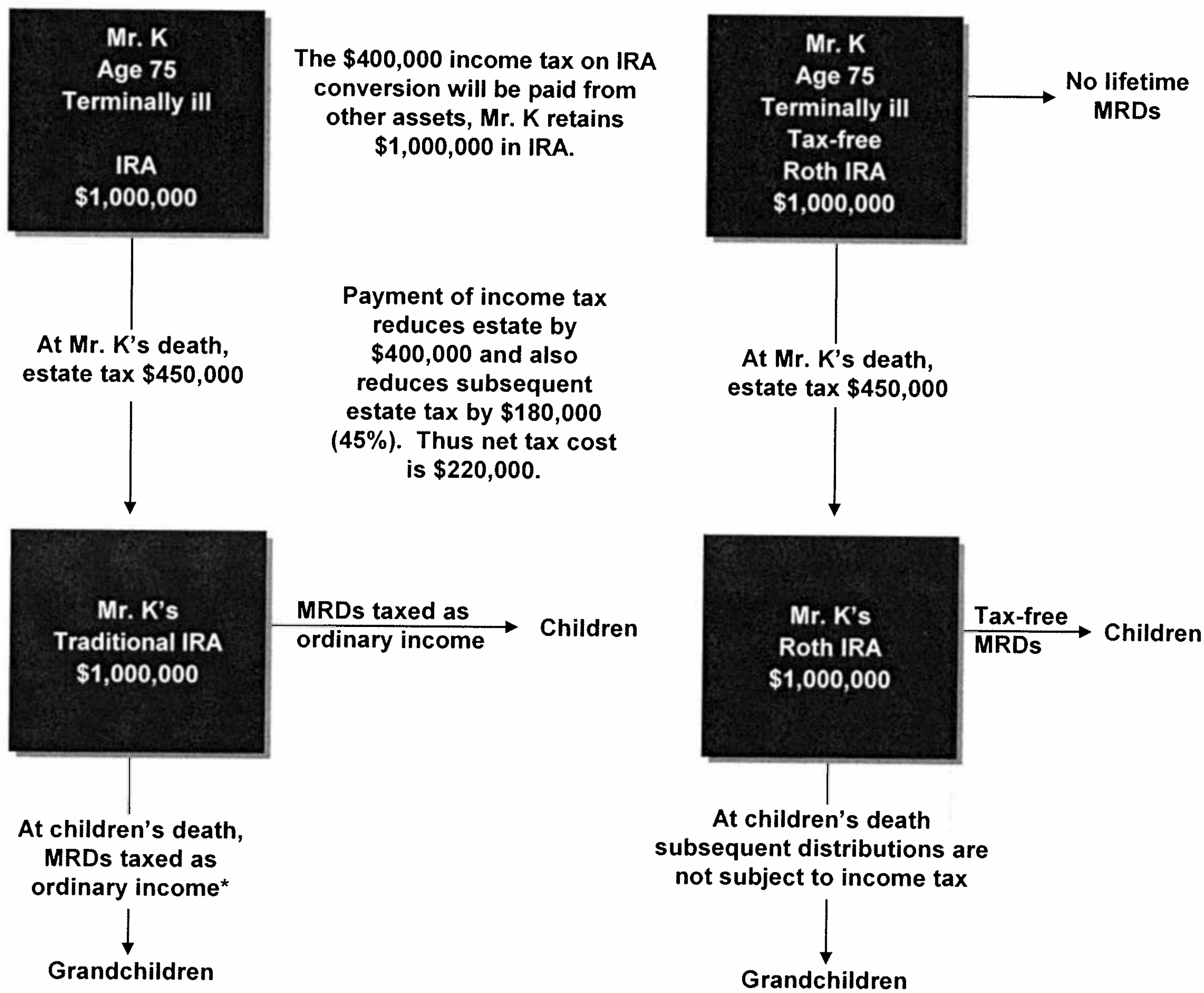
- When Mr. K pays the income tax on the IRA conversion because of his health, he is in effect paying the income tax for his children. However, the payment of the income tax is not considered a gift for gift tax purposes.

- Also, the payment of the income tax will reduce Mr. K's estate by $400,000 and save $180,000 (45%) in estate taxes at his subsequent demise. Thus, the net cost for the $1,000,000 IRA conversion is just $220,000.

- After the conversion, the $1,000,000 Roth IRA and subsequent growth will be income tax-free to the children and grandchildren.

IF NO CONVERSION

LIFETIME CONVERSION TO ROTH IRA



Note: Mr. K must have the Roth IRA for five years; otherwise, if death occurs during the five-year period, the distributions are only tax-free to the extent of the $1,000,000 IRA rollover amount (IRC Section 408(a)).

* Federal estate tax attributable to IRA would provide deduction against income tax IRC Section 691(c).

ANALYSIS OF STRETCH OUT IRAs UNDER DIFFERENT SPOUSAL BENEFICIARY OPTIONS (DEATH AFTER RBD)

PERTINENT INFORMATION

- There are four Kugler brothers.
- Each has a traditional IRA and expects to accumulate $1,000,000 by age 70.
- At age 70 each brother expects to commence taking Minimum Required Distributions (MRDs).
- They believe their IRA will earn 7% and they will only take the MRDs during their lifetime. The 7% growth rate will consist of 3% income and 4% appreciation.
  - Note: The definition of trust income will vary based on state laws.
- Estate tax on the IRA will be paid from other estate assets or life insurance.

GOALS AND OBJECTIVES

- Each brother would like an illustration showing the payout and accumulations for the IRA under the following assumptions.
  - The payout to each brother (age 70) is for 16-years (Mr. K dies age 85).
  - The surviving spouse is 7 years younger (age 63) and will survive by seven years and also die at age 85.

PROPOSED ARRANGEMENT

- Assume the following designated beneficiaries are applicable:
  - Kugler brother No. 1 – Mrs. K is the outright beneficiary, and she will name their son as designated beneficiary. Their son will be age 50 in the year following Mrs. K's death (34.2 year life expectancy).
  - Kugler brother No. 2 – A Conduit QTIP Trust will be beneficiary. Mrs. K will qualify as sole designated beneficiary. The son is the remainder interest beneficiary.
  - Kugler brother No. 3 – An Accumulation QTIP Trust will be the beneficiary. Mrs. K will be the oldest Trust beneficiary. However, under this arrangement she does not qualify as the sole designated beneficiary. She is considered a non-spousal designated beneficiary. At Mrs. K's death the son is the remainder interest beneficiary.
  - Kugler brother No. 4 – Assume Mrs. K is the outright beneficiary, and she will name their grandson* as the designated beneficiary. The grandson will be age 30 (53.3 year life expectancy) in the year following Mr. K's death.

* Assume the son has predeceased Mrs. K so there would be no generation skipping transfer.

Note: A credit shelter bypass trust, structured with the same payout requirements to the surviving spouse as a QTIP, could produce the same results for retirement distribution purposes. However, the trust principal would not be included in the surviving spouse's subsequent estate.

Note: In each situation the MRD will be greater than the income earned within the IRA.

Kugler Brother 1
Beneficiary: Mrs. K outright

During Mr. K's Lifetime (Uniform Table life expectancy)

Year	Mr. Kugler's Age	IRA Beginning Balance	Uniform Table Life Expectancy	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	70	$1,000,000	27.4	3.65%	($36,496)	$1,033,504
2	71	1,033,504	26.5	3.77%	(39,000)	1,066,849
--			--			--
10	79	1,277,882	19.5	5.13%	(65,532)	1,301,801
--			--			--
15	84	1,369,220	15.5	6.45%	(88,337)	1,376,728
16 (year of death)	85	1,376,728	14.8	6.76%	(93,022)	1,380,077
				Total MRDs	**($986,008)**	

At Mr. K's death, Mrs. K is the outright beneficiary of the IRA.

In year following Mr. K's death, Mrs. K (age 79) will roll IRA into her own name and take first MRD (if Mrs. K were under age 70½ at the time of the rollover, the MRDs would begin at her age 70½).

Year	Mrs. Kugler's Age	IRA Beginning Balance	Uniform Table Life Expectancy	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	79	$1,380,077	19.5	5.13%	($70,773)	$1,405,909
2	80	1,405,909	18.7	5.35%	(75,182)	1,429,141
3	81	1,429,141	17.9	5.59%	(79,840)	1,449,340
4	82	1,449,340	17.1	5.85%	(84,757)	1,466,037
5	83	1,466,037	16.3	6.13%	(89,941)	1,478,719
6	84	1,478,719	15.5	6.45%	(95,401)	1,486,828
7	85	1,486,828	14.8	6.76%	(100,461)	1,490,445
				Total MRDs	**($596,356)**	

At Mrs. K's death, the son is the sole designated beneficiary. However, the MRDs will now be based on the son's (age 50) fixed period life expectancy in the year following Mrs. K's death.

At Mrs. K's Death: Payout to son for 34.2 year fixed period life expectancy

Year	Son's Age	IRA Beginning Balance	Fixed Life Expectancy Table V	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	50	$1,490,445	34.2	2.92%	($43,580)	$1,551,195
2	51	1,551,195	33.2	3.01%	(46,723)	1,613,056
--						
10	59	2,060,444	25.2	3.97%	(81,764)	2,122,911
--						
20	69	2,529,047	15.2	6.58%	(166,385)	2,539,696
--						
30	79	1,833,037	5.2	19.23%	(352,507)	1,608,843
--						
35	84	147,674	0.2	100.00%	(158,011)	(0)
				Total MRDs	**($6,337,349)**	

If son dies before 34.2 years, MRDs will continue to son's designated beneficiary (assume Mr. K's grandson).

Kugler Brother 2
Beneficiary: Conduit QTIP

During Mr. K's Lifetime (Uniform Table life expectancy)

Year	Mr. Kugler's Age	IRA Beginning Balance	Uniform Table Life Expectancy	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	70	$1,000,000	27.4	3.65%	($36,496)	$1,033,504
2	71	1,033,504	26.5	3.77%	(39,000)	1,066,849
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10	79	1,277,882	19.5	5.13%	(65,532)	1,301,801
--			--			--
15	84	1,369,220	15.5	6.45%	(88,337)	1,376,728
16 (year of death)	85	1,376,728	14.8	6.76%	(93,022)	1,380,077
				Total MRDs	**($986,008)**	

At Mr. K's death, Mrs. K (then age 78) will be recognized as sole designated beneficiary via conduit QTIP. However, she is not the IRA owner (cannot roll over); therefore, her single life expectancy (redetermined) in the year of Mr. K's death under Table V may be used for MRD calculations. She is not required to take the first distribution until the following year (if Mr. K died prior to age 70½, then MRDs may be deferred until he would have reached age 70½).

At Mr. K's Death; payout to Mrs. K via conduit QTIP (redetermined single life expectancy)

Year	Mrs. Kugler's Age	IRA Beginning Balance	Table V Single Life Expectancy	Applicable Percentage	MRD*	IRA Ending Balance 7% Growth
1	79	$1,380,077	10.8	9.26%	($127,785)	$1,348,897
2	80	1,348,897	10.2	9.80%	(132,245)	1,311,075
3	81	1,311,075	9.7	10.31%	(135,162)	1,267,688
4	82	1,267,688	9.1	10.99%	(139,306)	1,217,120
5	83	1,217,120	8.6	11.63%	(141,526)	1,160,793
6	84	1,160,793	8.1	12.35%	(143,308)	1,098,741
7	85	1,098,741	7.6	13.16%	(144,571)	1,031,081
				Total MRDs	**($963,903)**	

At Mrs. K's death, the son is the sole designated beneficiary. However, the MRDs are based on Mrs. K's fixed period single life expectancy in the year of her death.

* The MRD is greater than the assumed 3% income earned by the IRA. However, if the IRA income were greater, the distribution from the IRA would be increased to satisfy the QTIP spousal income requirement.

At Mrs. K's Death: Payout to son for Mrs. K's 7.6 year fixed period life expectancy

Year	Son's Age	IRA Beginning Balance	Fixed Life Expectancy Table V	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1		$1,031,081	7.6	13.16%	($135,669)	$967,588
2		967,588	6.6	15.15%	(146,604)	888,715
3	Not	888,715	5.6	17.86%	(158,699)	792,226
4	A	792,226	4.6	21.74%	(172,223)	675,459
5	Factor	675,459	3.6	27.78%	(187,627)	535,114
6		535,114	2.6	38.46%	(205,813)	366,759
7		366,759	1.6	62.50%	(229,224)	163,208
8		163,208	0.6	100.00%	(174,632)	(0)
				Total MRDs	**($1,410,492)**	

Kugler Brother 3

Beneficiary: Accumulation QTIP

During Mr. K's Lifetime (Uniform Table life expectancy)

Year	Mr. Kugler Married (Age)	IRA Beginning Balance	Uniform Table Life Expectancy	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	70	$1,000,000	27.4	3.65%	($36,496)	$1,033,504
2	71	1,033,504	26.5	3.77%	(39,000)	1,066,849
--			--			--
10	79	1,277,882	19.5	5.13%	(65,532)	1,301,801
--			--			--
15	84	1,369,220	15.5	6.45%	(88,337)	1,376,728
16 (year of death)	85	1,376,728	14.8	6.76%	(93,022)	1,380,077
				Total MRDs	($986,008)	

At Mr. K's death, Mrs. K (age 78) will be the oldest beneficiary of the QTIP Trust. Therefore, her life expectancy will be used for retirement distribution calculations. However, she is not the sole designated beneficiary. As a result, her single life expectancy is **not** redetermined under Table V. Thus the payout is for a fixed period based upon her life expectancy (10.8 years) in the year **following** Mr. K's death.

At Mr. K's Death; 10.8 year fixed period (life expectancy at age 79) payout to traditional QTIP

IRA

Year	Beginning Balance	MRD paid to QTIP	Ending Balance
1	$1,380,077	($127,785)	1,348,897
2	1,348,897	(137,643)	1,305,678
3	1,305,678	(148,372)	1,248,703
4	1,248,703	(160,090)	1,176,022
5	1,176,022	(172,944)	1,085,399
6	1,085,399	(187,138)	974,239
7	974,239	(202,966)	839,469
	Total	$(1,136,939)	

QTIP

3% IRA Income to Mrs. K via QTIP	Difference Between MRD and 3% QTIP	Cumulative after Tax (40%) difference	3% from prior year's QTIP balance to Mrs. K
($41,402)	($86,383)	($51,830)	$0
(40,467)	(97,176)	(110,135)	(1,555)
(39,170)	(109,202)	(175,656)	(3,304)
(37,461)	(122,629)	(249,234)	(5,270)
(35,281)	(137,664)	(331,832)	(7,477)
(32,562)	(154,576)	(424,577)	(9,955)
(29,227)	(173,739)	(528,821)	(12,737)*
($255,570)			($40,298)

At Mrs. K's death, the son is the sole designated beneficiary. However, the MRDs are now based on Mrs. K's remaining unused fixed period life expectancy in the year of her death.

At Mrs. K's Death: Payout to son is for Mrs. K's remaining unused 3.8 year life expectancy

IRA

Year	Beginning Balance	MRD paid to QTIP	Ending Balance
1	$839,469	($220,913)	$677,319
2	677,319	(241,900)	482,832
3	482,832	(268,240)	248,390
4	214,592	(265,777)	0
	Total	(996,830)	

QTIP

3% IRA Income to Son via QTIP	Difference Between MRD and & 3% QTIP	Cumulative after Tax (40%) difference	3% from prior year's QTIP balance to son
(25,184)	(195,729)	(646,258)	(15,865)
(20,320)	(221,580)	(779,206)	(19,388)
(14,485)	(253,755)	(931,459)	(23,376)
(7,452)	(258,326)	(1,086,455)	(27,944)
(67,440)			(86,572)

Note: The MRD is greater than the assumed 3% income earned by the IRA. The excess (after-tax) is accumulated in the QTIP trust to eventually be paid to the remainder beneficiary. However, if the IRA income were greater, the distribution from the IRA would be increased to satisfy the QTIP spousal income requirement.

Kugler Brother 4
Beneficiary: Mrs. K outright

During Mr. K's Lifetime (Uniform Table life expectancy)

Year	Mr. Kugler's Age	IRA Beginning Balance	Uniform Table Life Expectancy	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	70	$1,000,000	27.4	3.65%	($36,496)	$1,033,504
2	71	1,033,504	26.5	3.77%	(39,000)	1,066,849
--			--			--
10	79	1,277,882	19.5	5.13%	(65,532)	1,301,801
--			--			--
15	84	1,369,220	15.5	6.45%	(88,337)	1,376,728
16 (year of death)	85	1,376,728	14.8	6.76%	(93,022)	1,380,077
				Total MRDs	**($986,008)**	

At Mr. K's death, Mrs. K is the outright beneficiary of the IRA.

In year following Mr. K's death, Mrs. K (age 79) will roll IRA into her own name and take her first MRD (if Mrs. K were under age 70½ at the time of the rollover, the MRDs would begin at her age 70½).

Year	Mrs. Kugler's Age	IRA Beginning Balance	Uniform Table Life Expectancy	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	79	$1,380,077	19.5	5.13%	($70,773)	$1,405,909
2	80	1,405,909	18.7	5.35%	(75,182)	1,429,141
3	81	1,429,141	17.9	5.59%	(79,840)	1,449,340
4	82	1,449,340	17.1	5.85%	(84,757)	1,466,037
5	83	1,466,037	16.3	6.13%	(89,941)	1,478,719
6	84	1,478,719	15.5	6.45%	(95,401)	1,486,828
7	85	1,486,828	14.8	6.76%	(100,461)	1,490,445
				Total MRDs	**($596,356)**	

At Mrs. K's Death: Payout to grandson for 53.3 year fixed period single life expectancy

Year	Grand-son's Age	IRA Beginning Balance	Fixed Life Expectancy Table V	Applicable Percentage	MRD	IRA Ending Balance 7% Growth
1	30	$1,490,445	53.3	1.88%	($27,963)	$1,566,812
10	39	2,305,431	44.3	2.26%	(52,041)	2,414,769
20	49	3,571,389	34.3	2.92%	(104,122)	3,717,264
30	59	5,092,612	24.3	4.12%	(209,573)	5,239,523
40	69	6,108,868	14.3	6.99%	(427,194)	6,109,295
50	79	3,929,373	4.3	23.26%	(913,808)	3,290,622
54	83	482,183	0.3	100.00%	(515,936)	0
				Total MRDs	**($16,320,607)**	

If grandson dies before 53.3 years, MRDs will continue to the designated beneficiary.

RESULTS AND BENEFITS

- Brother No. 1, **outright to spouse** and subsequent rollover with **son** as remainder beneficiary.

Years		MRDs	IRA Balance
16	During Mr. K's Lifetime	$986,008	$1,380,077
7	During Mrs. K's Lifetime	596,356	1,490,445*
34	During Son's Lifetime	6,337,349	0
57		**$7,919,713**	

- Brother No. 2, **conduit QTIP trust** (spouse is sole designated beneficiary) with son as remainder beneficiary.

Years		MRDs	IRA Balance
16	During Mr. K's Lifetime	$986,008	$1,380,077
7	During Mrs. K's Lifetime	963,903	1,031,081*
8	During Son's Lifetime	1,410,492	0
31		**$3,360,403**	

- Brother No. 3, an accumulation **QTIP trust** (spouse is not sole designated beneficiary) with son as remainder beneficiary.

Years		MRDs	3% IRA Income via QTIP	Ending IRA Balance	After-Tax QTIP Balance	3% Income from QTIP Balance	IRA & QTIP Balance
16	During Mr. K's lifetime	(986,008)	$0	1,380,077	$0	$0	1,380,077
7	During Mrs. K's lifetime	(1,136,939)	255,570**	839,469	528,821	$40,298**	1,368,290*
4	During son's lifetime	(996,830)	67,440	0	1,086,455	86,572	1,086,455
27		**($3,119,777)**	**$323,011**			**$126,870**	

Summary of MRD Payout: 16 years to Mr. K $986,008; 7 years to the QTIP Trust during Mrs. K's lifetime $1,136,939; and 3.8 additional years to the QTIP Trust after Mrs. K dies for the balance of her 10.8 year life expectancy $996,830.

Note: the QTIP balance is the cumulative after-tax (assume 40%) MRDs in excess of 3% QTIP income paid out to Mrs. K for her lifetime and then to their son for four years. The QTIP trust is assumed to grow by a net 4% each year (7% growth less 3% income payout).

- Brother No. 4, **outright to spouse** and subsequent rollover with grandson as remainder beneficiary.

Years		MRDs	IRA Balance
16	During Mr. K's lifetime	$986,008	1,380,077
7	During Mrs. K's lifetime	596,356	1,490,445*
54	During Grandson's lifetime	16,320,607	0
77		**$17,902,972**	

* Estate tax is assumed to be payable from other estate assets or life insurance.

** The total payout to Mrs. K would be $295,868 (3% income from IRA $255,570 plus 3% income from QTIP $40,298). Mrs. K is entitled to income earned on IRA and QTIP assets, but not the MRD.

ANALYSIS OF STRETCH OUT ROTH IRAs UNDER DIFFERENT SPOUSAL BENEFICIARY OPTIONS

PERTINENT INFORMATION

- There are four Kugler brothers.
- Each has a Roth IRA and expects to accumulate $1,000,000 by age 70.
- Minimum Required Distributions (MRDs) are not required during the lifetime of each Kugler brother. There is no lifetime RBD for the IRA owner, therefore MRDs are not applicable. However, MRDs *are* applicable at the designated beneficiary's RBD.
- They believe their Roth will earn 7%. The 7% growth rate will consist of 3% income and 4% appreciation.
  - Note: The definition of trust income will vary based on state laws.
- Any estate tax on the Roth IRA will be paid from other estate assets or life insurance.

GOALS AND OBJECTIVES

- Each brother would like an illustration showing the payout and accumulations for the Roth under the following assumptions.
  - Assume Mr. K dies at age 85.
  - The surviving spouse is 7 years younger (age 63) and will survive by seven years and also die at age 85.

PROPOSED ARRANGEMENT

- Assume the following designated beneficiaries are applicable:
  - Kugler brother No. 1 – Mrs. K is the outright beneficiary, and she will name their son as designated beneficiary. Their son will be age 50 in the year following Mrs. K's death (34.2 year life expectancy).
  - Kugler brother No. 2 – A Conduit QTIP Trust will be beneficiary. Mrs. K will qualify as sole designated beneficiary. The son is the remainder interest beneficiary.
  - Kugler brother No. 3 – An Accumulation QTIP Trust will be the beneficiary. Mrs. K will be the oldest Trust beneficiary. However, under this arrangement she does not qualify as the sole designated beneficiary. She is considered a non-spousal designated beneficiary. At Mrs. K's death the son is the remainder interest beneficiary.
  - Kugler brother No. 4 – Assume Mrs. K is the outright beneficiary, and she will name their grandson* as the designated beneficiary. The grandson will be age 30 (53.3 year life expectancy) in the year following Mr. K's death.

* Assume the son has predeceased Mrs. K so there would be no generation skipping transfer.

Note: A credit shelter bypass trust, structured with the same payout requirements to the surviving spouse as a QTIP, could produce the same results for retirement distribution purposes. However, the trust principal would not be included in the surviving spouse's subsequent estate.

Note: In each situation the MRD will be greater than the income earned within the IRA.

Kugler Brother 1
Beneficiary: Mrs. K outright

During Mr. K's Lifetime

- $1,000,000 Roth IRA, growing at 7% tax-free, will be worth $2,952,164 in 16 years. At Mr. K's death, Mrs. K is the outright beneficiary of the Roth.

At Mr. K's death

- In year following Mr. K's death, Mrs. K (age 79) will roll over the Roth IRA into her own name. There are no MRDs on a qualified rollover of a Roth IRA. After seven additional years, the value of the Roth IRA at 7 % would be $4,740,530.

At Mrs. K's Death

- At Mrs. K's death, the son is the sole designated beneficiary. However, the MRDs will now be based on the son's (age 50) fixed period life expectancy in the year following Mrs. K's death.

- Payout to son is for 34.2 year fixed period life expectancy.

Year	Son's Age	Roth Beginning Balance	Fixed Life Expectancy Table V	Applicable Percentage	MRD	Roth Ending Balance 7% Growth
1	50	$4,740,530	34.2	2.92%	($138,612)	$4,933,755
2	51	4,933,755	33.2	3.01%	(148,607)	5,130,511
--						
10	59	6,553,477	25.2	3.97%	(260,059)	6,752,162
--						
20	69	8,043,925	15.2	6.58%	(529,206)	8,077,794
--						
30	79	5,830,186	5.2	19.23%	(1,121,190)	5,117,109
--						
35	84	469,693	0.2	100.00%	(502,571)	0
				Total MRDs	**($20,156,663)**	

If son dies before 34.2 years, MRDs will continue to son's designated beneficiary (assume Mr. K's grandson).

Kugler Brother 2
Beneficiary: Conduit QTIP

During Mr. K's Lifetime

- ❑ \$1,000,000 Roth IRA, growing at 7% tax-free, will be worth \$2,952,164 in 16 years.

At Mr. K's Death

- ❑ At Mr. K's death, Mrs. K (then age 78) will be recognized as sole designated beneficiary via conduit QTIP. However, she is not the Roth owner (cannot roll over); therefore, her single life expectancy (redetermined) in the year of Mr. K's death under Table V may be used for MRD calculations. She is not required to take the first distribution until the following year (if Mr. K died prior to age 70½, then MRDs may be deferred until he would have reached age 70½).

- ❑ Payout to Mrs. K is via conduit QTIP with redetermined single life expectancy

Year	Mrs. Kugler's Age	Roth Beginning Balance	Table V Single Life Expectancy	Applicable Percentage	MRD*	Roth Ending Balance 7% Growth
1	79	\$2,952,164	10.8	9.26%	(\$273,348)	\$2,885,467
2	80	2,885,467	10.2	9.80%	(282,889)	2,804,560
3	81	2,804,560	9.7	10.31%	(289,130)	2,711,750
4	82	2,711,750	9.1	10.99%	(297,994)	2,603,578
5	83	2,603,578	8.6	11.63%	(302,742)	2,483,087
6	84	2,483,087	8.1	12.35%	(306,554)	2,350,349
7	85	2,350,349	7.6	13.16%	(309,256)	2,205,617
				Total MRDs	(\$2,061,914)	

* The MRD is greater than the assumed 3% income earned by the Roth. However, if the Roth income were greater, the distribution from the Roth would be increased to satisfy the QTIP spousal income requirement.

At Mrs. K's Death

- ❑ At Mrs. K's death, the son is the sole designated beneficiary. However, the MRDs are based on Mrs. K's fixed period single life expectancy in the year of her death.

- ❑ The payout is to the son for Mrs. K's 7.6 year fixed period life expectancy.

Year	Son's Age	Roth Beginning Balance	Fixed Life Expectancy Table V	Applicable Percentage	MRD	Roth Ending Balance 7% Growth
1		\$2,205,617	7.6	13.16%	(\$290,213)	\$2,069,797
2		2,069,797	6.6	15.15%	(313,606)	1,901,077
3	Not	1,901,077	5.6	17.86%	(339,478)	1,694,675
4	A	1,694,675	4.6	21.74%	(368,408)	1,444,894
5	Factor	1,444,894	3.6	27.78%	(401,360)	1,144,677
6		1,144,677	2.6	38.46%	(440,261)	784,544
7		784,544	1.6	62.50%	(490,340)	349,122
8		349,122	0.6	100.00%	(373,561)	0
				Total MRDs	**(\$3,017,225)**	

Kugler Brother 3
Beneficiary: Accumulation QTIP

During Mr. K's Lifetime

- $1,000,000 Roth IRA, growing at 7% tax-free, will be worth $2,952,164 in 16 years.

At Mr. K's Death

- At Mr. K's death, Mrs. K is not the outright beneficiary of the Roth. At Mr. K's death, Mrs. K (age 78) will be the oldest beneficiary of the QTIP Trust. Therefore, her life expectancy will be used for retirement distribution calculations. However, she is not the sole designated beneficiary. As a result, her single life expectancy is not redetermined under Table V. Thus the payout is for a fixed period based upon her life expectancy (10.8 years) in the year **following** Mr. K's death.

- After Mr. K's death, there is a 10.8 year fixed period (life expectancy at age 79) payout to traditional QTIP

Roth IRA

Year	Beginning Balance	MRD paid to QTIP	Ending Balance With 7% Income
1	$2,952,164	($273,348)	$2,885,467
2	2,885,467	(294,435)	2,793,014
3	2,793,014	(317,388)	2,671,137
4	2,671,137	(342,453)	2,515,663
5	2,515,663	(369,950)	2,321,809
6	2,321,809	(400,312)	2,084,024
7	2,084,024	(434,172)	1,795,734
	Total	(2,432,059)	

QTIP

3% Roth Income to Mrs. K via QTIP	Difference Between MRD and 3% QTIP	Cumulative difference	3% from prior year's QTIP balance to Mrs. K
($88,565)	($184,784)	($184,784)	$0
(86,564)	(207,871)	(392,655)	(5,544)
(83,790)	(233,598)	(626,252)	(11,780)
(80,134)	(262,319)	(888,572)	(18,788)
(75,470)	(294,481)	(1,183,052)	(26,657)
(69,654)	(330,658)	(1,513,710)	(35,492)
(62,521)	(371,651)	(1,885,361)	(45,411)
($546,698)			($143,671)

At Mrs. K's Death

- At Mrs. K's death, the son is the sole designated beneficiary. However, the MRDs are now based on Mrs. K's remaining unused fixed period life expectancy in the year of her death.

- After Mrs. K's Death, the payout to son is for Mrs. K's remaining unused 3.8 year life expectancy

Roth IRA

Year	Beginning Balance	MRD paid to QTIP	Ending Balance With 7% Income
1	$1,795,734	($472,562)	$1,448,874
2	1,448,874	(517,455)	1,032,840
3	1,032,840	(573,800)	531,339
4	531,339	(568,532)	0
	Total	($2,132,349)	

QTIP

3% Roth Income to Son via QTIP	Difference Between MRD and & 3% QTIP	Cumulative difference	3% from prior year's QTIP balance to son
($53,872)	($418,690)	($2,304,051)	($56,561)
(43,466)	(473,989)	(2,778,039)	(69,122)
(30,985)	(542,815)	(3,320,854)	(83,341)
(15,940)	(552,592)	(3,873,446)	(99,626)
($144,264)			($308,649)

Note: The MRD is greater than the assumed 3% income earned by the Roth. The excess is accumulated in the QTIP trust to eventually be paid to the remainder beneficiary. However, if the Roth income were greater, the distribution from the Roth would be increased to satisfy the QTIP spousal income requirement.

Kugler Brother 4
Beneficiary: Mrs. K outright

During Mr. K's Lifetime

- $1,000,000 Roth IRA, growing at 7% tax-free, will be worth $2,952,164 in 16 years. At Mr. K's death, Mrs. K is the outright beneficiary of the Roth.

At Mr. K's death

- In year following Mr. K's death, Mrs. K (age 79) will roll over the Roth IRA into her own name. There are no MRDs on a qualified rollover of a Roth IRA. After seven additional years, the value of the Roth IRA at 7 % would be $4,740,530

At Mrs. K's death

- At Mrs. K's death, the payout to the grandson is for a 53.3 year fixed period single life expectancy

Year	Grand-son's Age	Roth Beginning Balance	Fixed Life Expectancy Table V	Applicable Percentage	MRD	Roth Ending Balance 7% Growth
1	30	4,740,530	53.3	1.88%	(88,941)	4,983,426
10	39	7,332,687	44.3	2.26%	(165,523)	7,680,451
20	49	11,359,211	34.3	2.92%	(331,172)	11,823,184
30	59	16,197,637	24.3	4.12%	(666,569)	16,664,902
40	69	19,429,955	14.3	6.99%	(1,358,738)	19,431,314
50	79	12,497,822	4.3	23.26%	(2,906,470)	10,466,199
54	83	1,533,638	0.3	100.00%	(1,640,993)	0
				Total MRDs	**($51,909,562)**	

- Note: If the grandson dies before 53.3 years, MRDs will continue to the designated beneficiary.

- Note: If the son had not predeceased, there would be a GST tax so the benefit could have been paid ($3,500,000) to the grandson with the balance to the son.

RESULTS AND BENEFITS

- Brother No. 1, **outright to spouse** and subsequent rollover with **son** as remainder beneficiary.

Years		MRDs	Roth Balance
16	During Mr. K's Lifetime	$0	$2,952,164
7	During Mrs. K's Lifetime	0	4,740,530*
34	During Son's Lifetime	20,156,663	0
57		**$20,156,663**	

- Brother No. 2, **conduit QTIP trust** (spouse is sole designated beneficiary) with son as remainder beneficiary.

Years		MRDs	Roth Balance
16	During Mr. K's Lifetime	$0	$2,952,164
7	During Mrs. K's Lifetime	2,061,914	2,205,617*
8	During Son's Lifetime	$3,017,225	0
31		**$5,079,139**	

- Brother No. 3, an accumulation **QTIP trust** (spouse is not sole designated beneficiary) with son as remainder beneficiary.

Years		MRDs	3% Roth Income via QTIP	Ending Roth Balance	After-Tax QTIP Balance	3% Income from QTIP Balance	Roth & QTIP Balance
16	During Mr. K's lifetime	$0	$0	$2,952,164	$0	$0	$2,952,164
7	During Mrs. K's lifetime	(2,432,059)	546,698**	1,795,734	1,885,361	143,671**	3,681,095*
4	During son's lifetime	(2,132,349)	144,264	0	3,873,446	308,649	3,873,446
27		**($4,564,408)**	**$690,962**			**$452,320**	

Summary of MRD Payout: 16 years to Mr. K $0; 7 years to the QTIP Trust during Mrs. K's lifetime $2,432,059; and 3.8 additional years to the QTIP Trust after Mrs. K dies for the balance of her 10.8 year life expectancy $2,132,349.

Note: The QTIP balance is the cumulative MRDs in excess of 3% QTIP income paid out to Mrs. K for her lifetime and then to their son for four years. The QTIP trust is assumed to grow by a net 4% each year (7% growth less 3% income payout).

- Brother No. 4, **outright to spouse** and subsequent rollover with grandson as remainder beneficiary.

Years		MRDs	Roth Balance
16	During Mr. K's lifetime	$0	$2,952,164
7	During Mrs. K's lifetime	0	4,740,530*
54	During Grandson's lifetime	51,909,562	0
77		**$51,909,562**	

* Estate tax is assumed to be payable from other estate assets or life insurance.

** The total payout to Mrs. K would be $690,369 (3% income from IRA $546,698 plus 3% income from QTIP ($143,671). Mrs. K is entitled to income earned on IRA and QTIP assets, but not the MRD.

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MEMORANDUM

TO: ALL PLAN SPONSORS
FROM: WITMAN STADTMAUER, P.A.
RE: 2010 COST-OF-LIVING ADJUSTMENTS

2010 COST OF LIVING ADJUSTMENTS

The Internal Revenue Service in IR- 2009-94 has announced the 2010 cost-of-living adjustments applicable to certain dollar limitations as they apply to benefits and other provisions affecting qualified retirement plans and Individual Retirement Accounts ("IRAs"). The limits largely remain unchanged from 2009 because the cost-of-living index for the quarter ending September 30, 2009, is less than the cost-of-living index for the quarter ending September 30, 2008.

	2008	2009	2010
Maximum Pre-tax Contribution by Employees to 401(k) Plans (402(g))	$ 15,500	$ 16,500	$ 16,500
Maximum Pre-tax Catch Up Contribution by Employees Age 50 or Over	$ 5,000	$ 5,500	$ 5,500
Defined Benefit Maximum (415(b))	$185,000	$195,000	$195,000
Defined Contribution Maximum (415(c))	$ 46,000	$ 49,000	$ 49,000
Highly Compensated Employees - Compensation Earned Exceeding	$105,000	$110,000	$110,000
Compensation Cap (401(a)(17), 404(1), 408(k))	$230,000	$245,000	$245,000
Income Subject to Social Security Tax	$102,000	$106,800	$106,800
IRAs for Individuals age 49 and below	5,000	5,000	5,000
IRAs for Individuals age 50 and above	6,000	6,000	6,000

In addition, please be advised of the following:

- Under the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"), the Internal Revenue Service waived the requirement that required minimum distributions be taken during the 2009 calendar year from defined contribution plans and IRAs. If you are age 70½ or older and are required to take required minimum distributions from your defined contribution plan or from your IRA, please contact your individual tax advisor to discuss this issue.
- If you have a Plan Participant who is on "qualified military service" please contact this office or the Plan's third party administrator to discuss how The Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act") may affect your Plan.
- The Internal Revenue Service has recently issued "Notice of Your Rollover Options" and "Your Rollover Options from Designated Roth Accounts" (collectively "Rollover Notices"). These Rollover Notices replace the "Special Tax Notice". Effective January 1, 2010 and thereafter, if a Participant requests a distribution from a qualified plan, in addition to the appropriate Distribution Election Forms, he/she must be provided with the applicable Rollover Notice(s). Please contact your Plan's third party administrator for a copy of the Rollover Notice(s).
- If your Plan provides for automatic 401(k) enrollments also know as a Eligible Automatic Contribution Arrangement ("EACA") and/or has a Qualified Default Investment Alternative ("QDIA"), and you require our assistance in preparing or reviewing the required notices to Participants with respect to same, please contact this office.

The above information is general in nature and is not intended to provide advice or guidance for specific situations. Questions regarding the above can be addressed with Gary D. Stadtmauer, Esq. (*gstadtmauer@wsmesq.com*), Barbara S. Murray, Esq. (*bmurray@wsmesq.com*), Leonard J. Witman, Esq. (*lwitman@wsmesq.com*), Sandy Vogel (*svogel@wsmesq.com*), or Arlene Greenwald (*agreenwald@wsmesq.com*).

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