# Roth IRA Conversions

## Executive Summary

Until now, high-income earners have been effectively prevented from using Roth IRAs. Beginning in 2010, the income limits for Roth ***conversions*** are removed and therefore all taxpayers are eligible to convert certain retirement plans into Roth IRAs, including: traditional IRAs; SEP IRAs; SIMPLE IRAs; 401(a) qualified plans; 401(k)s; 403(a) annuity plans; 403(b) annuity plans; and 457(b) plans. Prior to 2010, if income exceeded $100,000 the conversion of an IRA to a Roth IRA was prohibited. In 2010 and beyond, high-income earners still cannot make ***contributions*** to Roth's if their income is over $120,000 if single or $176,000 if married filing jointly.

With traditional IRAs (and qualified plans like 401(k)s, etc.), your money goes in untaxed, and you pay ordinary income taxes whenever you take the money out of the account during retirement. With a Roth IRA the reverse is true. Your contribution is made with after-tax dollars, but then there is no tax when the money is withdrawn. A Roth conversion is accomplished by moving money from a traditional IRA (or qualified plans like 401(k)s) to a Roth IRA. You pay tax at ordinary income tax rates on the amount converted. A Roth conversion may seem counter intuitive because instinctively it seems best to defer tax as long as possible. With a conversion you are volunteering to pay tax now based on the promise that all future appreciation will escape taxation.

So why would anyone do a Roth conversion? Roth IRAs:

- allow more wealth to grow tax-free for a longer period of time;
- provide tax-free withdrawals;
- can enhance the ultimate payout to the taxpayer/beneficiaries;
- are not subject to required minimum distributions, unlike traditional IRA's;
- can continue to receive contributions after age of 70 ½ if you have earned income.

Conversions are complicated and make sense only for certain taxpayers. Like any other planning decision the answer is "it depends". Before deciding on a Roth IRA conversion, taxpayers should consider several critical factors including: age, time horizon, tax rates at conversion & distribution, current & future income, spending needs, asset mix, rate of return & taxation on invested assets,

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estate objectives and future changes in tax laws. While there is no easy answer as to whether you should convert or not, the following factors support conversion:

1) ***Front Loading the Taxes into the Roth***: You can afford to pay the taxes due on the conversion from outside (non-IRA) funds.
2) ***Tax Arbitrage***: You believe/expect to be in the same or higher tax bracket in future years or your beneficiaries who inherit these assets will not have significantly lower tax rates upon withdrawal.
3) ***Tax Diversification***: You are seeking tax diversification across taxable, tax-deferred and tax-free accounts.
4) ***Time Horizon***: You have a long time horizon between conversion and withdrawal.
5) ***Spending Rate***: You don't expect to spend all (or any) of the Roth IRA to meet your living expenses or will begin drawing on it much later in retirement.
6) ***Wealth Transfer Objectives***: You desire to leave a tax-free asset to your beneficiaries who will then stretch withdrawals over their lifetime.
7) ***Charitable Objectives***: If you plan to leave converted Roth assets to non-charitable beneficiaries then a Roth could make sense. If you plan to do any testamentary charitable giving, a traditional IRA or qualified plan is the first asset you should consider donating. By leaving your IRA to charity you all together avoid the inherent income taxes that would be paid by your heirs when funds are distributed. There would be little benefit to convert an IRA to a Roth if it will eventually be given to a charitable organization.
8) ***Opportunistic Conversions***: to take advantage of temporarily available tax attributes or market conditions:
    1) Partial conversions over a several years to utilize lower tax brackets.
    2) Favorable tax attributes such as (1) Net Operating Loss (NOL) carry-forwards (2) Business and other ordinary losses (3) Deductions and exemptions in excess of income (4) Charitable contribution carry-forwards or (5) Non-refundable credits.
    3) After-Tax Assets: If you have non-deductible IRA's or after-tax 401(k) accounts these may make sense to convert, especially if there is a high ratio of non-taxable funds to taxable funds.
    4) Market Correction: short-term economic conditions which are expected to reverse over time.

## CONCLUSION

One of the most significant variables in the Roth conversion decision is your income tax rate at the time of conversion compared to your or your beneficiaries' income tax rate at the time of distribution in the future. If the income tax rate will be the same or higher upon distribution in retirement then a conversion could be beneficial. If the income tax rate will be significantly lower in the future then a conversion may not make sense. If you believe that tax rates are going to go up in the future, then paying taxes now and eliminating future taxes provides a net gain.

So will your tax rate be higher or lower? In the short term we are confident taxes will increase but a conversion is a long-term decision that could span many decades. Tax laws constantly change as do your personal circumstances. It is anyone's guess what taxes will look like decades from now, or if our tax system will even exist in its current form. Unfortunately, there is no way of knowing for sure ahead of time if paying taxes now will save taxes later. It is this unknown, of what future tax laws might be, that will cause most taxpayers to pause before writing a large voluntary check to the U.S. Treasury. For those who can work through that uncertainty, the Roth IRA is a powerful retirement and estate planning tool that is worth considering. If you can afford to pay the taxes due from the conversion from other outside assets and have a long time horizon between conversion and withdrawal, a Roth conversion can benefit you and your beneficiaries.

# Roth IRA Conversions

## Front Loading the Taxes into the Roth

Whether a conversion is worthwhile depends in large part on how much tax you have to pay up front and where you get the money to pay that tax. By paying the taxes on conversion from outside (non-IRA) funds you are essentially shifting more assets into the Roth's tax-free environment. ***This front loading is essentially making a contribution to your Roth IRA equal to the amount of tax.*** This is the most powerful advantage to the conversion. If you are unable to pay the taxes due from outside (non-IRA) funds you probably should not do the conversion.

If you pay the taxes from the assets in your traditional IRA, you reduce the amount that will be able to grow tax-free in the Roth IRA. If you are younger than 59 1/2, the dollars you withdraw from an IRA to pay tax will usually get hit with a 10% early withdrawal penalty, as well as with ordinary income tax. (The amount converted to a Roth is subject to ordinary income tax but no penalty.)

***Example 1***: Jeff has $500,000 in a traditional IRA earning 8% per year for 10 years. Megan has the exact same traditional IRA earning 8% per year but she converts it to a Roth IRA in the first year, pays the associated tax from the IRA, and lets it grow for the same 10 years. Lastly, the ordinary tax rate today and in retirement for both Jeff and Megan is 30%.

As you can see from the example above, nothing is created or destroyed from the conversion when income tax rates remain the same and taxes are paid with IRA funds. The power of a Roth conversion is intensified by paying the taxes with outside funds that are, for example, held in a taxable investment account.

***Example 2***: Please see Exhibit A. In this example, Megan has a $1,000,000 IRA and $1,000,000 taxable account. We compare the effects of converting the $1,000,000 IRA and using the taxable account to front load the taxes into the Roth. Here we assume the income tax bracket is 40% at the time of conversion and in the after tax comparisons made for each year. We assume an inflation adjusted growth rate of 5% on all assets and that the growth in the taxable account will be taxable each year at 20% of the growth, incorporating the tax on interest, dividends and capital gains. Finally, we assume the required minimum distributions under the no conversion scenario are taxed at 30% each year. Here you can see that with the same tax rates at conversion (40%) and at withdrawal (40%), it can be very beneficial to perform a Roth conversion if you have a long time horizon. Based on the assumptions above during the 35 years in this example there was over a $1M benefit to conversion. The difference is the taxes paid on the taxable account growth. By front loading the taxes and placing those funds into the Roth's tax-free environment you avoid those taxes on future growth.

***Example 3***: Please see Exhibit B. Here we left all the factors the same except we reduced the tax rate during withdrawal to 30% for required minimum distributions. Even with a 10% decrease in tax rates between conversion (40%) and withdrawal (30%), there is still a $600k+ benefit to conversion due to the front loading of the taxes into the Roth and the long time horizon.

| EXAMPLE 1 | Traditional IRA | Roth IRA |
|---|---|---|
| Beginning Balance | $500,000 | $0 |
| Conversion | $0 | $500,000 |
| Taxes on Conversion | $0 | ($150,000) |
| Net Balance | $500,000 | $350,000 |
| Growth for 10 Years | $1,079,462 | $755,623 |
| Taxes on Distribution | ($323,839) | ($0) |
| Ending Net Worth | $755,623 | $755,623 |

# Roth IRA Conversions

## Tax Arbitrage

***Current Tax Rates vs. Future Tax Rates***

One of the most significant variables in the Roth conversion decision is your income tax rate at the time of conversion compared to your income tax rate at the time distribution in the future. If your income tax rate will be the same or higher upon distribution in retirement then a conversion could be beneficial. ***If your income tax rate will be significantly lower in the future then a conversion may not make sense.*** If you believe that tax rates are going to go up in the future, then paying taxes now and eliminating future taxes provides a net gain. As you will see in the Tax Legislative Landscape section below, we believe taxes will increase in the near term. This however, is a long term decision that could span many decades. Unfortunately, there is no way of knowing for sure ahead of time if paying taxes now will save taxes later. As you think this through please consider the following when determining what the tax rate arbitrage might be:

1) For the past 50 years, there have only been five years (1988-1992) when the top marginal tax rates were lower than the current 35% rate. With deficits at record levels, we believe higher taxes are inevitable for high income earners during the next decade. At the same time we also know that ultimately your future tax rate is unknowable.
2) Don't rush to convert just because taxes for the affluent are likely going up. It's your own combined federal and state income tax rate now and in the future that matters.
3) Many taxpayers are currently subject to Alternative Minimum Tax (AMT) which tops out at 28%. This may be lower than when they are in retirement.
4) Tax brackets are indexed for inflation. Currently, the 35% tax bracket for a joint return starts at $374k of taxable income. Assuming a 3% inflation rate in 20 years you would need approximately $700K of income to reach the top bracket.
5) Tax rates are progressive. If you are in your peak earning years at work and will have lower income in future years it may be better to do a series of partial conversions over time.
6) Future Tax Law is Uncertain.

600 Peachtree Street, NE Suite 2700 Atlanta, GA 30308 404 253 7600 www.signaturefd.com

# Roth IRA Conversions

## Tax Legislative Landscape (as of February 2010)

The current tax law, which expires 12/31/2010, was initiated in 2001 and 2003 as part of a budget reconciliation bill. As such, the maximum term for changes to the tax law is 10 years. Some of the law has subsequently been made permanent, but much of it will revert to pre-2001 levels in 2011.

The current tax system has incorporated a new 10% tax bracket and lowered the 39.6% and 35% brackets to 35% and 33%, respectively. The rate structure is scheduled to reset in 2011, however President Obama has indicated that he would like to make the lower brackets permanent and shift the top two brackets back to 39.6% and 35%. The objective is to alter only the income taxes of high-income earners (HIE)—those making over $200,000 and married couples over $250,000.

Long-term capital gains rates are scheduled to increase to the previous level of 20%, dividends will be considered ordinary income again, and the phase-out of personal exemptions and itemized deductions will return. Obama plans to make these changes only for HIE.

Estate tax law has become increasingly complex. We are waiting eagerly to see if Congress is going to pass legislation to fix the current estate tax law. The expectation from most political pundits and advisors is an extension of the 2009 rates (45%) and exclusion ($3.5 million) into 2010 and beyond.

| Summary Chart | 2010 | Scheduled 2011+ | Obama 2011+ |
|---|---|---|---|
| **Ordinary Tax Rates < $250,000** | 10, 15, 25, 28, & 33% | 15, 28, 31, & 36% | 10, 15, 25, 28% & 36% |
| **Ordinary Tax Rates > $250,000 (HIE)** | 35% | 39.6% | 39.6% |
| **Itemized Deductions** | 0% Phase out | 3% Phase out | 3% Phase out & 28% Benefit Limit (HIE) |
| **Personal Exemptions** | 0% Phase out | 2% Phase out | 2% Phase out (HIE) |
| **Qualified Dividends*** | 0% & 15% | Ordinary Income Rates | 0%, 15% & 20%(HIE) |
| **Long-term Gains** | 0% & 15% | 20% | 0%, 15% & 20%(HIE) |
| **Estate Tax Exclusion (Lifetime, per donor)** | No Estate Tax ($3.5M in 2009) | $1 million | $3.5 million |
| **Gift Tax Exclusion (Lifetime, per donor)** | $1 million | $1 million | $1 million |
| **Annual Gift Tax Exclusion (Annual, per donee)** | $13,000 | $13,000 | $13,000 |
| **Estate Tax Max Rate** | No Estate Tax | 55% | 45% |
| **Roth IRA Conversion** | Unlimited AGI | Unlimited AGI | ? |

** Qualified dividends are not taxable to those in the 10% or 15% brackets but taxable at 15% for everyone else.*

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## Future Tax Law is Uncertain

The highest marginal tax rate between 1913 and 2010 has ranged from a low of 7% to a high of 94% and has changed over 35 times. It is anyone's guess what tax rates will look like in 10, 20 or 30 years. We could have any combination of income tax, sales and use or value-added tax, property tax and/or transfer tax (estate and gift) that could change this analysis dramatically. Some possibilities to consider:

1) There is already talk in Washington to again limit who is eligible to make a Roth conversion. With the current flexibility to later re-characterize (see tax section below) and undo your conversion by the extended due date of your tax return, you may want to act while a conversion is still an option for you. However, it is also possible that congress will remove or limit the ability to re-characterize as well.
2) Will the current system of taxation of employee benefits and IRA's will remain in place during your life and the life of your heirs? Do you trust Congress to keep its promise not to tax Roth distributions in the future? Social Security payments were tax free in the past but are now taxable for many taxpayers. Another example is that means testing is now applied to Medicare Part B premiums. Perhaps means testing will be applied in the future with respect to Roth benefits to make some (or perhaps all) benefits taxable with respect to some taxpayers. Congress tends to pay attention to the number of voters affected and the number of wealthy/HIE converters may be a relatively small group.
3) Taxes may actually be lower in the future. Given the large number of baby boomer retirees in the future and the immense amount of taxable distributions from various types of qualified plans and IRAs, there could be political pressure to reduce the income tax on ordinary distributions. Alternatively, traditional IRA/Qualified benefits in excess of certain amounts may be subject to additional taxes. Either of these changes could materially affect your Roth conversion decision.
4) The older you are the more reasonable it will be to assume that any significant tax increases will be distant enough in the future not to affect you in a significant manner. At the same time the younger person cannot reasonably believe that tax laws will not materially change during their lifetime. However, they also have a longer time horizon for the assets to possibly grow tax free which can neutralize the tax risk.

As we said above future tax law is uncertain, but that works both ways and it could be that there are immaterial net changes in the future. ***As with any planning, we consider the possibilities and then plan on what is probable not what is possible.*** With that in mind we will assume the current tax regime remains in place and congress will mostly live up to its promise to not tax Roth IRA's in the future.

# Roth IRA Conversions

## Tax Diversification

Most professionals agree that if your current and future tax rates are the same and IRA funds are used to pay the tax on conversion, then you will be in the same economic position by converting to a Roth as is you did not convert. We agree but believe this overlooks one very important fact – the Roth IRA's unique tax-free status. The Roth's tax-free status provides higher rates of return on investments of comparable risk. It is this differential in the rates of return on investments in the Roth that is often overlooked. Over time it is impossible for a taxable account to maintain parity with a tax-free account assuming comparable risk factors on the investments. For example, you can purchase a tax-free municipal bond in a taxable account paying 4% and a taxable bond, with a comparable level of risk, paying 5% in the Roth. They have the same level of risk and both are tax free but the Roth earns an extra 1% . A more aggressive investor could invest in other taxable assets and the Roth would eliminate any taxes on short or long term gains. ***This differential in rates of rates of return compounded over time within the Roth's tax-free environment is a major benefit of the Roth IRA.***

As mentioned above, by paying the conversion taxes with funds from a taxable account you are essentially making a contribution to your Roth IRA equal to the amount of tax. This converts those funds from taxable to tax-free from which you will receive substantial economic benefit. This economic benefit counterbalances the risk that your tax rate may be lower in the future and supports the conversion decision.

Just as your portfolio is diversified among stocks, bonds and other assets it is also appropriate to diversify your tax accounts between taxable, tax-deferred and tax free. Having money in a Roth account gives you more control over your tax bracket in retirement. For instance, you might take out just enough from your traditional IRA distributions to fill the 15% bracket, and then take the rest of your living expenses out of your taxable accounts and Roth. Another version of this kind of planning might help higher-income retirees avoid the brackets where Social Security income is taxed. Roth IRA distributions are not included in the Social Security taxability calculation and therefore having a Roth IRA to supplement retirement income can help manage the taxability of Social Security benefits.

## Time Horizon

The more time you have between conversion and distribution the stronger the case for using the ROTH. ***Even in cases when you might be in a lower tax bracket in the future, if you use outside funds to pay the income tax on the conversion and have a long time horizon, it is possible that a conversion would be beneficial.***

Roth's, unlike traditional IRAs, do not have any minimum distribution requirements once you turn age 70 1/2. So long as the money remains in the account, both Roth's and traditional IRAs give you the benefits of tax deferral, which eliminates a significant drag on the growth of your money. If you can afford to keep your money in the Roth account, and take retirement income from other sources, then the dollars can grow tax-free for a longer period of time.

## Spending

If you're about to retire and will need to draw from your IRAs for your own living expenses soon, you are probably not a good Roth conversion candidate. The more time the assets have to grow tax-free the more attractive conversion. ***The later you can begin spending and the less you ultimately spend the more beneficial a conversion will be.*** For those spending down their IRA's during retirement the tax rate arbitrage difference will be very important. If your tax rate might be lower in the future then you should avoid conversion unless you are

young. If there is no change in tax rates but the assets are spent down over a longer time period the Roth conversion is still advantageous.

# Wealth Transfer Objectives

## Stretching the Time Horizon

As we mentioned in the time horizon section above, Roth IRA's are not subject to required minimum distributions (RMDs) after you turn 70-½ as are traditional IRAs. Therefore, you can extend the time horizon and leave your Roth untouched and growing for your entire lives. While RMDs are not required during your lifetime and that of your spouse, your heirs will be subject to them. The Roth account will still be subject to estate taxes, and your heirs will have to take required distributions each year but can stretch these over their life span. However, unlike the traditional IRA, they will not have to pay taxes on the distributions they receive.

If you do not plan to spend your Roth and will leave most or all of it to your beneficiaries, then you will need to consider their tax brackets during withdrawal before converting. If their rates are the same or higher than yours, that will support conversion based on the tax arbitrage theory discussed earlier. If their rates are considerably lower than yours and you expect that difference to continue over their lifetime the conversion may not make sense. At the same time the longer time horizon will help to counterbalance this assuming the estimated difference in rates is roughly 10% or less.

## Maximizing Your After-Tax Estate

If you will have a taxable estate, a Roth conversion may help to maximize your after-tax estate. While there is currently no estate tax, it is scheduled to come back with a $1 million per person exclusion in 2011. We expect that there will be legislation this year to return the exclusion to $3.5 million per person with a maximum tax rate of 45% for 2010 and beyond. If for some reason there is no such legislation the number of families subject to estate taxes will increase dramatically.

Roth IRAs are subject to estate taxes but not income taxes. Traditional IRAs are subject to estate taxes and income taxes. On a $1,000,000 IRA, in a taxable estate, there would be $450,000 ($1M X 45%) of estate taxes and $350,000 of income taxes ($1M X 35%) assuming your heirs are in the maximum tax bracket. Total taxes would be $800,000 of a $1M IRA or 80%. Because of this double taxation the government lets your heirs deduct any Federal estate tax paid on an IRA whenever the IRA is subject to both taxes.

This deduction is commonly known as the "IRD Deduction" which stands for Income in Respect of the Decedent. IRD is income that has never had taxes paid on it and would have been taxable to the decedent when received. Your beneficiaries will claim the deduction on their personal tax return as a miscellaneous itemized deduction on Schedule A as funds are withdrawn from the IRA. Unlike most miscellaneous itemized deduction this one is not reduced by 2 percent of your Adjusted Gross Income (AGI) and it is not subject to Alternative Minimum Tax. Note that the IRD related estate tax is paid at death, while the IRD deduction is received over time as the traditional IRA funds are withdrawn over the life of the heir.

On first glance it appears that a Roth conversion will reduce your taxable estate by the estate taxes paid. However, this will depend on how much of your IRA is subject to estate taxes, the IRD deduction and the ratio of taxable assets to tax-deferred assets. We have made the following observations:

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1) ***If the IRA is all IRD***: An IRD deduction is obtained on the entire IRA balance. If the full exclusion amount, $3.5M, is available against taxable assets and therefore the entire IRA is subject to estate taxes, then there is no difference between doing nothing and doing a full conversion. In Example 4, Exhibit C, you will see the Net After-Tax to Heirs is $4,682,500 either way. Please note this does not consider the net present value difference between an up front estate reduction and an IRD deduction spread out over the beneficiaries stretch period. If the stretch period is substantial the estate reduction will be more beneficial on a net present value basis.
2) ***Beneficiary Tax Rates***: If your beneficiaries who inherit your IRA will have a lower tax bracket then it may not make sense to convert. In Example 4, if their tax rate were to be 10% lower at 25% then they would be $55,000 better off if you did not convert and $110,000 better off if their tax rates were 15% if you did not convert. This is the same rationale as if you were going to spend the assets during your lifetime. If the drop in tax rates is 10% or less then a conversion still make sense if they will stretch the withdrawal over their lifetime.
3) ***If the IRA is not all IRD***: When an IRD deduction is not obtained on the entire IRA balance a conversion will reduce the estate by the taxes paid, and the reduced estate taxes will in turn reduce the IRD deduction. The net of these offsetting items will be the benefit of conversion. This is what we will refer to as the Estate Conversion Benefit. The maximum Estate Conversion Benefit is $551,250. This is equal to maximum exclusion of $3.5M times the maximum estate tax rate of 45% times the maximum income tax rate of 35%. You will need to consider your income and estate tax rates and plan accordingly. If any of the exclusion is applied to IRA assets, the IRD deduction will be reduced and therefore a conversion is particularly beneficial up to the point that the IRA assets are sheltered by the exclusion.
4) ***Partial Conversion***: When the IRA is not all IRD it may be beneficial to do a partial conversion to the extent you can afford to pay the taxes from outside funds. In Example 5, Exhibit D, $1M of the $3.5M exclusion is being used for taxable assets and $2.5M of the exclusion is used for IRA assets. By converting the $2.5M, it reduces the estate by $875,000 which saves $393,750 in estate taxes but it conversely reduces the IRD deduction by $137,813. The net of the two creates a Estate Conversion Benefit of $255,938.
5) ***Full Conversion***: Example 6 Exhibit D, demonstrates a full conversion of the $5M IRA. Here the benefit of conversion goes up to $393,750. The reason this is a greater benefit than Example 5 is because there were additional IRA funds that were not receiving an IRD deduction. Note however that here the tax on conversion is greater than the taxable assets available which conflicts with the concept of front loading the taxes from above. However, for those with a shorter timeframe and a taxable estate this produces the greatest benefit from an after-tax estate perspective.
6) ***Beneficiary Tax Rates***: Again in Examples 5&6 you will see that that the "Do Nothing" scenario provides the largest wealth transfer when the beneficiaries tax rates will be less than yours at conversion. The reduced income taxes they would pay at their rate erases the estate conversion benefit. It appears neutral with a 10% reduction in income tax rates. However, if they stretch withdrawals out over their lifetime conversion is still beneficial. If their tax rates will be significantly less then conversion would not be beneficial. Finally, please note that our examples demonstrate what would happen if beneficiary's income tax rates were lower. If their rates were actually higher compared to your rate at the time of conversion then this would create additional benefit to them by being taxed at your lower rates. This would be in addition to the estate conversion benefit.
7) ***State Estate Taxes***: In addition to the federal estate tax, in certain states there is also a state level estate tax. Georgia does not have such a tax. The federal tax law does not allow an income tax deduction for any state level estate taxes paid on IRD. Therefore, you would be losing a part of the IRA balance to state estate taxes for which your beneficiaries would not receive a deduction on their income tax returns. By converting you avoid the state estate taxes on the income tax caused by conversion.

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## Charitable Objectives

If you plan to do any testamentary charitable giving, a traditional IRA or qualified plan is the first asset you should consider donating. By leaving your IRA to charity you entirely avoid the inherent income taxes that would be paid by your heirs when funds are distributed. There would be little benefit to convert an IRA to a Roth if it will eventually be given to a charitable organization. A Roth IRA is more appropriate to leave to family members because the IRA owner has already paid the income tax on the Roth IRA account.

## Opportunistic Conversions

There will be years when Roth conversions are especially attractive to take advantage of unique circumstances or tax attributes such as:

***Partial Conversions***: Roth conversions are not an all or nothing decision. It may be prudent to convert just enough assets to keep taxable income below a particular tax rate bracket in any one year. If you are in your peak earning years at work and will have lower income in future years it may be better to do a series of partial conversions over time. For example, if you were making $500k annually before retirement you would be in the maximum tax bracket. If upon retirement at age 60, you had little or no other income you would be better off making partial Roth conversion from age 60 to 70 utilizing the lower tax brackets available to you during those years.

***Favorable Tax Attributes***: Some taxpayers have tax attributes available that can help reduce or eliminate the associated conversion tax. Items to look for to optimize conversions are (1) Net Operating Loss (NOL) carry-forwards (2) Business and other ordinary losses (3) Deductions and exemptions in excess of income (4) Charitable contribution carry-forwards or (5) Non-refundable credits.

***After-Tax Assets:*** If you have non-deductible IRA's or after-tax 401(k) accounts these may make sense to convert since the taxable income you have to recognize will reduced by your non-deductible contributions. To determine the nontaxable amount from a conversion you must determine the total amount of nondeductible contributions made to all of your traditional IRAs and divide by the total value of all of your traditional IRAs. The ratio determined above is then multiplied by the total amount converted to determine the nontaxable amount and the remainder is treated as ordinary taxable income. This "aggregation rule" prohibits you from only converting only your nondeductible contributions.

If you hold after-tax money in a 401(k) plan, you can request a direct rollover of pretax contributions and earnings to a traditional IRA and convert after-tax assets and earnings directly to a Roth IRA. This allows you to fund a Roth IRA conversion and pay income taxes only on earnings from after-tax contributions. However, certain plan contracts (set by the employer and the company that administers the plan) may not have the necessary provisions to make the strategy effective. You would need to check to see if your qualified plans allow active employees to make withdrawals of the after-tax amounts from their plans for reasons other than hardship.

***Market Correction:*** During period of large market declines you may want to consider using that as an opportunity to make a conversion at depressed values which will reduce the conversion taxes.

## Tax Rules and Mechanics

### 2010 Conversion Rules: Spreading the Tax

For Roth conversions completed during 2010, the taxable income will be recognized 50% in 2011 and 50% in 2012.

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This is essentially an interest free loan from the government. You can also elect not to spread the tax and have it all subject to tax in 2010. This would make sense if your tax rate will be higher in 2011 & 2012. As highlighted in the tax legislative update above income tax rates for high income earners are slated to increase in 2011 from 35% to 39.6%. For the dollars in that bracket that is a 13.14% increase in taxes. With that in mind, a three year tax projection should be prepared to optimize conversion amounts with the lowest amount of tax, to determine which year to elect to include the income and to coordinate timely payment of the required tax.

If your 2010 quarterly estimated tax payments are based on 110% of your actual 2009 tax liability then the Roth conversion taxes can be delayed until April 15, 2011. By that point we will have clarity in the tax laws and you can elect which year to include the income. While you can wait until the extended due date of your return (October 15, 2011) to make the election decision, if you ultimately decide to include the income in 2010 the taxes would need to be paid by April 15, 2011 in order to avoid a late payment penalty.

## The Roth Mulligan: Re-characterization and Reconversion

One nice aspect of Roth conversions are that you can essentially change your mind if it doesn't work out the way you expected. You can reverse the conversion (this is called re-characterization) any time before the due date of your individual tax return, including extensions (October 15). These re-characterized funds must be adjusted for any gains/losses that occur during that time period. In addition, you would forego the 2010 opportunity to spread the tax over the two years, which may or may not matter to you.

You might decide to re-characterize if the value of the assets drops after conversion. For example, if you convert an investment that is valued at $500,000 and it drops to $250,000 by the following October. You would owe income tax on $500,000 and have a $250,000 Roth IRA. Therefore, if the investment goes down, you should re-characterize the Roth IRA to avoid the tax on a $500,000 conversion. If you do, you will be in the same position as you would have been if you had never made the conversion. You can then reconvert to a Roth IRA at the then lower $250,000 value if you meet certain rules.

There are rules that limit the frequency of conversions, re-characterizations, and reconversions. You may not make a Roth conversion, re-characterize it and reconvert the same IRA money in the same year. You can do it over different calendar years, but you must still wait 30 days before reconverting a Roth IRA that you had previously converted and re-characterized.

For those who are making substantial conversions, it may make sense to convert into multiple Roth IRA accounts with different types of investments or asset classes. The Roth's that go up in value will be maintained and those that do not will be re-characterized by October 15th of the following year. This way you are only paying taxes on the accounts that increase in value and you can reconvert those that do not, subject to the rules above. Here again, keep in mind the potential increase in tax rates in 2011 from 35% to 39.6% for high income earners. The value of the accounts would have to decrease by 13% just to make up for the tax rate difference.

## Roth Contribution Limits

Each taxpayer with earned income is allowed to contribute up to $5,000 ($6,000 if over age 50) per year to a Roth IRA subject to the following adjusted gross income limits:



600 Peachtree Street, NE Suite 2700 Atlanta, GA 30308 404 253 7600 www.signaturefd.com

# Roth IRA Conversions

- Single filers, Head of Household or Married Filing Separately (and you did not live with your spouse during the year) with modified adjusted gross income up to $105,000 can make a full contribution. Contributions are phased-out starting at $105,000 and you cannot make a contribution if your adjusted gross income is in excess of $120,000.
- Joint filers with modified adjusted gross income up to $166,000 ($167,000 in 2010) can make a full contribution. Once again, this contribution is phased-out starting at $166,000 ($167,000 in 2010) and you cannot make a contribution if your adjusted gross income is in excess of $176,000 or $177,000 in 2010.
- If your tax filing status is Married Filing Separately (and you live with your spouse) you cannot make a Roth IRA contribution if your AGI is in excess of $10,000.

While taxpayers subject to the AGI limits above cannot make Roth contributions they are able to make a traditional IRA contribution (typically non-deductible) and the law says they can immediately turn around and convert the money into a Roth account. This appears to be an oversight that might be legislatively fixed in the future.

## Qualified (Tax-Free) Distributions from Roth's

One of the main benefits of the Roth is that qualified distributions are tax-free. In order to be qualified a distribution must meet both of these criteria:

- You must have held any Roth IRA for five years, AND
- There must be one qualifying event:
    - You are over 59 ½
    - First-time homebuyer expenses ($10,000 lifetime limit)
    - Death or Disability

**Exceptions** include the qualifying events above, certain medical expenses, qualified higher education expenses, certain payments to purchase health insurance in cases of unemployment and periodic payments utilizing IRS Rule 72(t).

### ORDERING RULES FOR ROTH IRA DISTRIBUTIONS

Distributions are subject to ordering rules. Amounts are deemed to first come from regular contributions, then converted amounts, and finally earnings.

| Roth Withdrawals | | |
|---|---|---|
| | Income Tax | 10% Penalty |
| **Contributions to Roth's** | | |
| Contributions are withdrawn before 59 ½ | No | No |
| Earnings are withdrawn before 59 ½ | Yes | Yes (exceptions apply |
| **Conversions to Roth's** | | |
| Converted funds are withdrawn in first five years | No | Yes (exceptions apply |
| Earnings are withdrawn in first five years | Yes | Yes (exceptions apply |
| Beneficiaries withdraw converted funds within first five years | No | No |
| Beneficiaries withdraw earnings within first five years (measured from the year of opening Roth, not when inherited) | Yes | No |

# Roth IRA Conversions

**Distributions of Contributions** are tax-free and penalty-free when distributed for any reason at any time. The first contribution to *ANY* Roth IRA starts a 5-year holding period clock running. The 5-year period is important when making distributions from earnings (see below).

**Distributions of Converted** assets are subject to ordinary income tax on the conversion date from another retirement plan into the Roth IRA. If you pay the taxes from the assets in your traditional IRA, you reduce the amount that will be able to grow tax-free in the Roth IRA. If you are younger than 59-1/2, the dollars you withdraw from an IRA to pay tax will usually get hit with a 10% early withdrawal penalty, as well as with ordinary tax. (The amount converted to a Roth is subject to ordinary tax but no penalty.)

The conversion can be into a new Roth IRA, which makes record keeping easier, or into a Roth that existed prior to the conversion. For each conversion, the 5 year holding period begins on January 1 of the tax year in which you convert. This may not be the same 5 year period used to determine whether your withdrawal is a qualified distribution as described above.

This is known as the ***recapture rule*** and the reason for this special rule is to ensure that taxpayers don't convert funds solely to avoid the early distribution penalty. If you make a non-qualified withdrawal within five years of conversion you will be subject to the 10% penalty on the earnings and the original conversion amount, unless an exception applies. This is because amounts converted are not subject to the 10% penalty at conversion but if you withdraw these funds within the first five years this exception no longer applies and they recapture the penalty you should have paid at the time or conversion.

**Earnings** are only tax-free and/or penalty-free if the holder meets the criteria above. If distributions are made from earnings and the 5-year holding period for *ANY* Roth IRA has *not* been met, the distribution is always subject to income tax and is subject to the 10% penalty unless the taxpayer meets an exception.

## Required Distributions

Traditional IRA's are subject to Required Minimum Distributions (RMDs). Required Minimum Distributions (RMDs) generally are minimum amounts that a retirement plan account owner must withdraw annually starting with the year that he or she reaches 70 ½ years of age or, if later, the year in which he or she retires. However, if the retirement plan account is an IRA or the account owner is a 5% owner of the business sponsoring the retirement plan, the RMDs must begin once the account holder is age 70 ½, regardless of whether he or she is retired.

Upon the death of the owner of the traditional IRA, different RMD rules apply depending on if she died before or after her required beginning date and who the beneficiaries are. In that regard please see the flowchart in Exhibit E.

Roth's, unlike traditional IRAs, do not have any minimum distribution requirements at age 70-1/2. If you can afford to keep your money in the Roth account, and take retirement income from other sources, then the dollars can grow tax-free until your death. Therefore, you can extend the time horizon and leave your Roth untouched and growing for your entire lives. While required distributions are not required during

# Roth IRA Conversions

your or your spouse's lifetime, your heirs will be subject to them. The Roth account will still be subject to estate taxes, and your heirs will have to take required distributions each year but can stretch these over their life span. But they won't have to pay taxes on the distributions they receive. When a Roth IRA account owner dies, the following RMD rules apply:

- If the Roth IRA beneficiary is the account owner's spouse, the spouse can defer distributions from Roth IRA until the later of:
  - December 31 of the year the owner dies
  - December 31 of the year the owner would have turned 70 ½
  - Or the spouse could elect to treat the Roth IRA as his own and delay distributions until after his death
- If the Roth IRA beneficiary is not the account owner's surviving spouse, distributions can be deferred until:
  - December 31 of the year that is five years after the account owner's death, at which time the entire account must be distributed
  - December 31 of the year after the account owner's death and distributions can be made over the beneficiaries life expectancy.

# Exhibit A

## Example 2

Tax Assumptions:
40% Tax Rate Applied to Conversion of Traditional IRA
40% Tax Rate Applied to Liquidation of Traditional IRA
40% Tax Rate Applied to RMDs
20% Tax Rate Applied to Growth of Brokerage Account (estimation of effect of capital gains due to rebalancing and tax on investment income)
0%

| | | | Roth Conversion Scenario | | | | | No Conversion Scenario | | | | | | | Comparison | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Age | Year | Annual Return | Traditional IRA account value | Roth IRA Account value | Brokerage Account Value | Total Portfolio Value | Total After-Tax Liquidated Portfolio Value | Traditional IRA account value | RMD Divisor | RMD Pre-Tax | Roth IRA | Brokerage Account Value | Total Portfolio Value | Total After-Tax Liquidated Portfolio Value | Difference in Pre-Tax Total Portfolio Value Caused by Conversion | Difference in After-Tax Liquidation Value of Total Portfolio Value Caused by Conversion |
| Pre-Convert | | | 1,000,000 | - | 1,000,000 | | | 1,000,000 | | | | 1,000,000 | | | | |
| Post-Convert | | | - | 1,000,000 | 600,000 | 1,600,000 | 1,600,000 | 1,000,000 | | | - | 1,000,000 | 2,000,000 | 1,600,000 | (400,000) | - |
| 60 | 2010 | 5% | - | 1,050,000 | 624,000 | 1,674,000 | 1,674,000 | 1,050,000 | | | - | 1,040,000 | 2,090,000 | 1,670,000 | (416,000) | 4,000 |
| 61 | 2011 | 5% | - | 1,102,500 | 648,960 | 1,751,460 | 1,751,460 | 1,102,500 | | | - | 1,081,600 | 2,184,100 | 1,743,100 | (432,640) | 8,360 |
| 62 | 2012 | 5% | - | 1,157,625 | 674,918 | 1,832,543 | 1,832,543 | 1,157,625 | | | - | 1,124,864 | 2,282,489 | 1,819,439 | (449,946) | 13,104 |
| 63 | 2013 | 5% | - | 1,215,506 | 701,915 | 1,917,421 | 1,917,421 | 1,215,506 | | | - | 1,169,859 | 2,385,365 | 1,899,162 | (467,943) | 18,259 |
| 64 | 2014 | 5% | - | 1,276,282 | 729,992 | 2,006,273 | 2,006,273 | 1,276,282 | | | - | 1,216,653 | 2,492,934 | 1,982,422 | (486,661) | 23,851 |
| 65 | 2015 | 5% | - | 1,340,096 | 759,191 | 2,099,287 | 2,099,287 | 1,340,096 | | | - | 1,265,319 | 2,605,415 | 2,069,376 | (506,128) | 29,911 |
| 66 | 2016 | 5% | - | 1,407,100 | 789,559 | 2,196,659 | 2,196,659 | 1,407,100 | | | - | 1,315,932 | 2,723,032 | 2,160,192 | (526,373) | 36,467 |
| 67 | 2017 | 5% | - | 1,477,455 | 821,141 | 2,298,597 | 2,298,597 | 1,477,455 | | | - | 1,368,569 | 2,846,024 | 2,255,042 | (547,428) | 43,555 |
| 68 | 2018 | 5% | - | 1,551,328 | 853,987 | 2,405,315 | 2,405,315 | 1,551,328 | | | - | 1,423,312 | 2,974,640 | 2,354,109 | (569,325) | 51,207 |
| 69 | 2019 | 5% | - | 1,628,895 | 888,147 | 2,517,041 | 2,517,041 | 1,628,895 | | | - | 1,480,244 | 3,109,139 | 2,457,581 | (592,098) | 59,460 |
| 70 | 2020 | 5% | - | 1,710,339 | 923,672 | 2,634,012 | 2,634,012 | 1,647,918 | 27.4 | 59,449 | - | 1,576,550 | 3,224,468 | 2,565,301 | (590,456) | 68,711 |
| 71 | 2021 | 5% | - | 1,795,856 | 960,619 | 2,756,476 | 2,756,476 | 1,665,019 | 26.5 | 62,186 | - | 1,678,416 | 3,343,435 | 2,677,427 | (586,959) | 79,048 |
| 72 | 2022 | 5% | - | 1,885,649 | 999,044 | 2,884,693 | 2,884,693 | 1,679,978 | 25.6 | 65,040 | - | 1,786,137 | 3,466,116 | 2,794,124 | (581,423) | 90,569 |
| 73 | 2023 | 5% | - | 1,979,932 | 1,039,006 | 3,018,937 | 3,018,937 | 1,692,561 | 24.7 | 68,015 | - | 1,900,024 | 3,592,586 | 2,915,561 | (573,648) | 103,376 |
| 74 | 2024 | 5% | - | 2,078,928 | 1,080,566 | 3,159,494 | 3,159,494 | 1,702,517 | 23.8 | 71,116 | - | 2,020,402 | 3,722,919 | 3,041,912 | (563,425) | 117,582 |
| 75 | 2025 | 5% | - | 2,182,875 | 1,123,789 | 3,306,663 | 3,306,663 | 1,709,580 | 22.9 | 74,346 | - | 2,147,610 | 3,857,190 | 3,173,358 | (550,527) | 133,306 |
| 76 | 2026 | 5% | - | 2,292,018 | 1,168,740 | 3,460,759 | 3,460,759 | 1,713,466 | 22.0 | 77,708 | - | 2,282,004 | 3,995,470 | 3,310,083 | (534,711) | 150,675 |
| 77 | 2027 | 5% | - | 2,406,619 | 1,215,490 | 3,622,109 | 3,622,109 | 1,714,274 | 21.2 | 80,824 | - | 2,423,718 | 4,137,992 | 3,452,283 | (515,883) | 169,827 |
| 78 | 2028 | 5% | - | 2,526,950 | 1,264,110 | 3,791,060 | 3,791,060 | 1,711,318 | 20.3 | 84,447 | - | 2,573,362 | 4,284,680 | 3,600,153 | (493,620) | 190,907 |
| 79 | 2029 | 5% | - | 2,653,298 | 1,314,674 | 3,967,972 | 3,967,972 | 1,704,736 | 19.5 | 87,760 | - | 2,731,058 | 4,435,795 | 3,753,900 | (467,823) | 214,071 |
| 80 | 2030 | 5% | - | 2,785,963 | 1,367,261 | 4,153,223 | 4,153,223 | 1,694,253 | 18.7 | 91,162 | - | 2,897,186 | 4,591,439 | 3,913,738 | (438,215) | 239,486 |
| 81 | 2031 | 5% | - | 2,925,261 | 1,421,951 | 4,347,212 | 4,347,212 | 1,679,582 | 17.9 | 94,651 | - | 3,072,136 | 4,751,718 | 4,079,885 | (404,506) | 267,327 |
| 82 | 2032 | 5% | - | 3,071,524 | 1,478,829 | 4,550,353 | 4,550,353 | 1,660,429 | 17.1 | 98,221 | - | 3,256,311 | 4,916,740 | 4,252,568 | (366,387) | 297,785 |
| 83 | 2033 | 5% | - | 3,225,100 | 1,537,982 | 4,763,082 | 4,763,082 | 1,636,490 | 16.3 | 101,867 | - | 3,450,128 | 5,086,618 | 4,432,022 | (323,536) | 331,060 |
| 84 | 2034 | 5% | - | 3,386,355 | 1,599,502 | 4,985,857 | 4,985,857 | 1,607,455 | 15.5 | 105,580 | - | 3,654,016 | 5,261,471 | 4,618,489 | (275,614) | 367,368 |
| 85 | 2035 | 5% | - | 3,555,673 | 1,663,482 | 5,219,155 | 5,219,155 | 1,573,786 | 14.8 | 108,612 | - | 3,867,950 | 5,441,736 | 4,812,221 | (222,581) | 406,933 |
| 86 | 2036 | 5% | - | 3,733,456 | 1,730,021 | 5,463,477 | 5,463,477 | 1,535,278 | 14.1 | 111,616 | - | 4,092,316 | 5,627,595 | 5,013,483 | (164,117) | 449,994 |
| 87 | 2037 | 5% | - | 3,920,129 | 1,799,222 | 5,719,351 | 5,719,351 | 1,491,741 | 13.4 | 114,573 | - | 4,327,503 | 5,819,243 | 5,222,547 | (99,892) | 496,804 |
| 88 | 2038 | 5% | - | 4,116,136 | 1,871,191 | 5,987,326 | 5,987,326 | 1,442,995 | 12.7 | 117,460 | - | 4,573,898 | 6,016,892 | 5,439,694 | (29,566) | 547,632 |
| 89 | 2039 | 5% | - | 4,321,942 | 1,946,039 | 6,267,981 | 6,267,981 | 1,388,882 | 12.0 | 120,250 | - | 4,831,889 | 6,220,772 | 5,665,219 | 47,209 | 602,762 |
| 90 | 2040 | 5% | - | 4,538,039 | 2,023,880 | 6,561,920 | 6,561,920 | 1,330,403 | 11.4 | 121,832 | - | 5,101,188 | 6,431,591 | 5,899,430 | 130,329 | 662,490 |
| 91 | 2041 | 5% | - | 4,764,941 | 2,104,835 | 6,869,777 | 6,869,777 | 1,267,579 | 10.8 | 123,185 | - | 5,382,103 | 6,649,682 | 6,142,650 | 220,095 | 727,126 |
| 92 | 2042 | 5% | - | 5,003,189 | 2,189,029 | 7,192,217 | 7,192,217 | 1,200,471 | 10.2 | 124,272 | - | 5,674,933 | 6,875,405 | 6,395,216 | 316,813 | 797,001 |
| 93 | 2043 | 5% | - | 5,253,348 | 2,276,590 | 7,529,938 | 7,529,938 | 1,129,193 | 9.6 | 125,049 | - | 5,979,961 | 7,109,155 | 6,657,477 | 420,783 | 872,461 |
| 94 | 2044 | 5% | - | 5,516,015 | 2,367,653 | 7,883,669 | 7,883,669 | 1,055,362 | 9.1 | 124,087 | - | 6,296,590 | 7,351,952 | 6,929,807 | 531,717 | 953,862 |
| 95 | 2045 | 5% | - | 5,791,816 | 2,462,360 | 8,254,176 | 8,254,176 | 979,277 | 8.6 | 122,716 | - | 6,625,029 | 7,604,306 | 7,212,595 | 649,870 | 1,041,581 |

# Exhibit B

## Example 3

Tax Assumptions:
40% Tax Rate Applied to Conversion of Traditional IRA
40% Tax Rate Applied to Liquidation of Traditional IRA
30% Tax Rate Applied to RMDs
20% Tax Rate Applied to Growth of Brokerage Account (estimation of effect of capital gains due to rebalancing and tax on investment income)
0%

| | | | Roth Conversion Scenario | | | | | No Conversion Scenario | | | | | | | Comparison | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Age | Year | Annual Return | Traditional IRA account value | Roth IRA Account value | Brokerage Account Value | Total Portfolio Value | Total After-Tax Liquidated Portfolio Value | Traditional IRA account value | RMD Divisor | RMD Pre-Tax | Roth IRA | Brokerage Account Value | Total Portfolio Value | Total After-Tax Liquidated Portfolio Value | Difference in Pre-Tax Total Portfolio Value Caused by Conversion | Difference in After-Tax Liquidation Value of Total Portfolio Value Caused by Conversion |
| Pre-Convert | | | 1,000,000 | - | 1,000,000 | | | 1,000,000 | | | | 1,000,000 | | | | |
| Post-Convert | | | - | 1,000,000 | 600,000 | 1,600,000 | 1,600,000 | 1,000,000 | | | - | 1,000,000 | 2,000,000 | 1,600,000 | (400,000) | - |
| 60 | 2010 | 5% | - | 1,050,000 | 624,000 | 1,674,000 | 1,674,000 | 1,050,000 | | | - | 1,040,000 | 2,090,000 | 1,670,000 | (416,000) | 4,000 |
| 61 | 2011 | 5% | - | 1,102,500 | 648,960 | 1,751,460 | 1,751,460 | 1,102,500 | | | - | 1,081,600 | 2,184,100 | 1,743,100 | (432,640) | 8,360 |
| 62 | 2012 | 5% | - | 1,157,625 | 674,918 | 1,832,543 | 1,832,543 | 1,157,625 | | | - | 1,124,864 | 2,282,489 | 1,819,439 | (449,946) | 13,104 |
| 63 | 2013 | 5% | - | 1,215,506 | 701,915 | 1,917,421 | 1,917,421 | 1,215,506 | | | - | 1,169,859 | 2,385,365 | 1,899,162 | (467,943) | 18,259 |
| 64 | 2014 | 5% | - | 1,276,282 | 729,992 | 2,006,273 | 2,006,273 | 1,276,282 | | | - | 1,216,653 | 2,492,934 | 1,982,422 | (486,661) | 23,851 |
| 65 | 2015 | 5% | - | 1,340,096 | 759,191 | 2,099,287 | 2,099,287 | 1,340,096 | | | - | 1,265,319 | 2,605,415 | 2,069,376 | (506,128) | 29,911 |
| 66 | 2016 | 5% | - | 1,407,100 | 789,559 | 2,196,659 | 2,196,659 | 1,407,100 | | | - | 1,315,932 | 2,723,032 | 2,160,192 | (526,373) | 36,467 |
| 67 | 2017 | 5% | - | 1,477,455 | 821,141 | 2,298,597 | 2,298,597 | 1,477,455 | | | - | 1,368,569 | 2,846,024 | 2,255,042 | (547,428) | 43,555 |
| 68 | 2018 | 5% | - | 1,551,328 | 853,987 | 2,405,315 | 2,405,315 | 1,551,328 | | | - | 1,423,312 | 2,974,640 | 2,354,109 | (569,325) | 51,207 |
| 69 | 2019 | 5% | - | 1,628,895 | 888,147 | 2,517,041 | 2,517,041 | 1,628,895 | | | - | 1,480,244 | 3,109,139 | 2,457,581 | (592,098) | 59,460 |
| 70 | 2020 | 5% | - | 1,710,339 | 923,672 | 2,634,012 | 2,634,012 | 1,647,918 | 27.4 | 59,449 | - | 1,582,733 | 3,230,651 | 2,571,484 | (596,639) | 62,528 |
| 71 | 2021 | 5% | - | 1,795,856 | 960,619 | 2,756,476 | 2,756,476 | 1,665,019 | 26.5 | 62,186 | - | 1,691,313 | 3,356,332 | 2,690,325 | (599,857) | 66,151 |
| 72 | 2022 | 5% | - | 1,885,649 | 999,044 | 2,884,693 | 2,884,693 | 1,679,978 | 25.6 | 65,040 | - | 1,806,315 | 3,486,293 | 2,814,302 | (601,600) | 70,392 |
| 73 | 2023 | 5% | - | 1,979,932 | 1,039,006 | 3,018,937 | 3,018,937 | 1,692,561 | 24.7 | 68,015 | - | 1,928,082 | 3,620,644 | 2,943,619 | (601,706) | 75,318 |
| 74 | 2024 | 5% | - | 2,078,928 | 1,080,566 | 3,159,494 | 3,159,494 | 1,702,517 | 23.8 | 71,116 | - | 2,056,978 | 3,759,496 | 3,078,489 | (600,001) | 81,006 |
| 75 | 2025 | 5% | - | 2,182,875 | 1,123,789 | 3,306,663 | 3,306,663 | 1,709,580 | 22.9 | 74,346 | - | 2,193,381 | 3,902,961 | 3,219,129 | (596,298) | 87,534 |
| 76 | 2026 | 5% | - | 2,292,018 | 1,168,740 | 3,460,759 | 3,460,759 | 1,713,466 | 22.0 | 77,708 | - | 2,337,688 | 4,051,154 | 3,365,767 | (590,395) | 94,991 |
| 77 | 2027 | 5% | - | 2,406,619 | 1,215,490 | 3,622,109 | 3,622,109 | 1,714,274 | 21.2 | 80,824 | - | 2,490,035 | 4,204,309 | 3,518,599 | (582,200) | 103,510 |
| 78 | 2028 | 5% | - | 2,526,950 | 1,264,110 | 3,791,060 | 3,791,060 | 1,711,318 | 20.3 | 84,447 | - | 2,651,114 | 4,362,432 | 3,677,905 | (571,373) | 113,155 |
| 79 | 2029 | 5% | - | 2,653,298 | 1,314,674 | 3,967,972 | 3,967,972 | 1,704,736 | 19.5 | 87,760 | - | 2,821,048 | 4,525,784 | 3,843,889 | (557,812) | 124,082 |
| 80 | 2030 | 5% | - | 2,785,963 | 1,367,261 | 4,153,223 | 4,153,223 | 1,694,253 | 18.7 | 91,162 | - | 3,000,256 | 4,694,508 | 4,016,807 | (541,285) | 136,416 |
| 81 | 2031 | 5% | - | 2,925,261 | 1,421,951 | 4,347,212 | 4,347,212 | 1,679,582 | 17.9 | 94,651 | - | 3,189,172 | 4,868,754 | 4,196,921 | (521,542) | 150,291 |
| 82 | 2032 | 5% | - | 3,071,524 | 1,478,829 | 4,550,353 | 4,550,353 | 1,660,429 | 17.1 | 98,221 | - | 3,388,244 | 5,048,672 | 4,384,501 | (498,319) | 165,852 |
| 83 | 2033 | 5% | - | 3,225,100 | 1,537,982 | 4,763,082 | 4,763,082 | 1,636,490 | 16.3 | 101,867 | - | 3,597,933 | 5,234,422 | 4,579,827 | (471,340) | 183,256 |
| 84 | 2034 | 5% | - | 3,386,355 | 1,599,502 | 4,985,857 | 4,985,857 | 1,607,455 | 15.5 | 105,580 | - | 3,818,712 | 5,426,168 | 4,783,185 | (440,311) | 202,671 |
| 85 | 2035 | 5% | - | 3,555,673 | 1,663,482 | 5,219,155 | 5,219,155 | 1,573,786 | 14.8 | 108,612 | - | 4,050,530 | 5,624,316 | 4,994,801 | (405,161) | 224,353 |
| 86 | 2036 | 5% | - | 3,733,456 | 1,730,021 | 5,463,477 | 5,463,477 | 1,535,278 | 14.1 | 111,616 | - | 4,293,808 | 5,829,086 | 5,214,975 | (365,608) | 248,503 |
| 87 | 2037 | 5% | - | 3,920,129 | 1,799,222 | 5,719,351 | 5,719,351 | 1,491,741 | 13.4 | 114,573 | - | 4,548,969 | 6,040,710 | 5,444,013 | (321,358) | 275,338 |
| 88 | 2038 | 5% | - | 4,116,136 | 1,871,191 | 5,987,326 | 5,987,326 | 1,442,995 | 12.7 | 117,460 | - | 4,816,439 | 6,259,433 | 5,682,235 | (272,107) | 305,091 |
| 89 | 2039 | 5% | - | 4,321,942 | 1,946,039 | 6,267,981 | 6,267,981 | 1,388,882 | 12.0 | 120,250 | - | 5,096,638 | 6,485,520 | 5,929,967 | (217,539) | 338,014 |
| 90 | 2040 | 5% | - | 4,538,039 | 2,023,880 | 6,561,920 | 6,561,920 | 1,330,403 | 11.4 | 121,832 | - | 5,389,197 | 6,719,600 | 6,187,439 | (157,681) | 374,481 |
| 91 | 2041 | 5% | - | 4,764,941 | 2,104,835 | 6,869,777 | 6,869,777 | 1,267,579 | 10.8 | 123,185 | - | 5,694,444 | 6,962,022 | 6,454,991 | (92,246) | 414,786 |
| 92 | 2042 | 5% | - | 5,003,189 | 2,189,029 | 7,192,217 | 7,192,217 | 1,200,471 | 10.2 | 124,272 | - | 6,012,692 | 7,213,163 | 6,732,975 | (20,946) | 459,242 |
| 93 | 2043 | 5% | - | 5,253,348 | 2,276,590 | 7,529,938 | 7,529,938 | 1,129,193 | 9.6 | 125,049 | - | 6,344,235 | 7,473,429 | 7,021,751 | 56,509 | 508,186 |
| 94 | 2044 | 5% | - | 5,516,015 | 2,367,653 | 7,883,669 | 7,883,669 | 1,055,362 | 9.1 | 124,087 | - | 6,688,340 | 7,743,702 | 7,321,557 | 139,967 | 562,112 |
| 95 | 2045 | 5% | - | 5,791,816 | 2,462,360 | 8,254,176 | 8,254,176 | 979,277 | 8.6 | 122,716 | - | 7,045,211 | 8,024,489 | 7,632,778 | 229,687 | 621,398 |

SIGNATUREFD

*Financial Design for Life*

# Roth IRA Conversions (Exhibit C)

| | Example 4 | | |
|---|---|---|---|
| | Do Nothing | Full Conversion | Benefit |
| IRA | $ 1,000,000 | $ 1,000,000 | |
| Taxable | 5,000,000 | 5,000,000 | |
| Conversion @ 35% Income Tax Rate | | (350,000) | $157,500 |
| Total Estate | $ 6,000,000 | $ 5,650,000 | |
| Estate Tax @ 45% Rate | (1,125,000) | (967,500) | |
| Net Estate | $ 4,875,000 | $ 4,682,500 | |
| | | | |
| IRD Deduction | $ (450,000) | | $(157,500) |
| Tax on IRA after IRD @ Heirs 35% rate | $ (192,500) | | |
| **Net After Tax to Heirs** | **$ 4,682,500** | **$ 4,682,500** | |
| Estate Conversion Benefit | | $ - | $ - |
| | | | |
| Tax on IRA after IRD @ Heirs 25% rate | $ (137,500) | | |
| **Net After Tax to Heirs** | **$ 4,737,500** | **$ 4,682,500** | |
| Estate Conversion Benefit | | $ (55,000) | |
| Compared to 35% above | $ 55,000 | $ - | $(55,000) |
| | | | |
| Tax on IRA after IRD @ Heirs 15% rate | $ (82,500) | | |
| **Net After Tax to Heirs** | **$ 4,792,500** | **$ 4,682,500** | |
| Estate Conversion Benefit | | $ (110,000) | |
| Compared to 35% above | $ 110,000 | $ - | $(110,000) |



600 Peachtree Street, NE Suite 2700 Atlanta, GA 30308 404 253 7600 www.signaturefd.com

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# Roth IRA Conversions (Exhibit D)

| | | Example 5 | | Example 6 | |
|---|---|---|---|---|---|
| | | Compared to Do Nothing | | Compared to Do Nothing | |
| | Do Nothing | Convert $2.5M | Benefit | Full Conversion | Benefit |
| IRA | $ 5,000,000 | $ 5,000,000 | | $ 5,000,000 | |
| Taxable | 1,000,000 | 1,000,000 | | 1,000,000 | |
| Conversion @ 35% Income Tax Rate | | (875,000) | $ 393,750 | (1,750,000) | $ 787,500 |
| Total Estate | $ 6,000,000 | $ 5,125,000 | | $ 4,250,000 | |
| Estate Tax @ 45% Rate | (1,125,000) | (731,250) | | (337,500) | |
| Net Estate | $ 4,875,000 | $ 4,393,750 | | $ 3,912,500 | |
| | | | | | |
| IRD Deduction | $ (1,125,000) | $ (731,250) | $ (137,813) | | $ (393,750) |
| Tax on IRA after IRD @ Heirs 35% rate | $ (1,356,250) | $ (619,063) | | | |
| **Net After Tax to Heirs** | **$ 3,518,750** | **$ 3,774,688** | | **$ 3,912,500** | |
| Estate Conversion Benefit | | $ 255,938 | $ 255,938 | $ 393,750 | $ 393,750 |
| | | | | | |
| Tax on IRA after IRD @ Heirs 25% rate | $ (968,750) | $ (442,188) | | | |
| **Net After Tax to Heirs** | **$ 3,906,250** | **$ 3,951,563** | | **$ 3,912,500** | |
| Estate Conversion Benefit | | $ 45,313 | | $ 6,250 | |
| Compared to 35% above | $ 387,500 | $ 176,875 | $ (210,625) | $ - | $ (387,500) |
| | | | | | |
| Tax on IRA after IRD @ Heirs 15% rate | $ (581,250) | $ (265,313) | | | |
| **Net After Tax to Heirs** | **$ 4,293,750** | **$ 4,128,438** | | **$ 3,912,500** | |
| Estate Conversion Benefit | | $ (165,313) | | $ (381,250) | |
| Compared to 35% above | $ 775,000 | $ 353,750 | $ (421,250) | $ - | $ (775,000) |



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# Exhibit E