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To My Clients and Friends:

ROTH IRA CONVERSIONS

Most taxpayers eligible to make Roth IRA conversions.

The advantages of a Roth IRA are:

1. ***Qualified*** distributions are tax free.
2. Amounts converted to the Roth IRA can be withdrawn anytime on a tax free first-in first-out basis.
3. Roth distributions are not income for consideration of determining taxable Social Security benefits.
4. Roth IRAs are not subject to the required minimum distribution rules.

The disadvantages of a Roth IRA are:

1. Income taxes are required to be paid for the tax year of the IRA conversion or in a tax year earlier that would otherwise be the case.
2. Roth IRA contributions are not tax deductible.
3. Income recognized on the conversion may trigger the taxability of Social Security benefits.

The mechanics of the Roth IRA conversion is that a traditional or rollover IRA is converted to the Roth IRA and the value of the IRA at the time of conversion is recognized (taxed) as ordinary income. For example, if you have $100,000 in an IRA that is converted to a Roth IRA, the conversion amount is recognized as taxable income. Assuming a combined federal and State tax rate of 40%, taxes of $40,000 would be due for the conversion.

Roth IRA conversions can also be made directly from most qualified retirement plans without the need to rollover the retirement plan to an intermediary IRA.

The tax rules prohibit a Roth IRA conversion of a re-characterized back into a regular IRA.

A Roth IRA distribution is a ***qualified*** distribution if it meets the following requirements:

1. The distribution is made on or after the taxpayer reaches age 59-1/2; and
2. The distribution is made after the five-year tax period beginning with the first taxable year of the first contribution to a Roth IRA.

Exceptions to the five-year requirement are provided for death, disability and special purpose distributions (i.e., first-time home buyer – limited to $10,000)

A Roth IRA owner has one five-year tax test period.

Other factors to consider are the climate of rising tax rates and the volatility of the stock market. Since Roth IRA conversions can no longer be re-characterized extra care and planning should be undertaken to be more certain the desired outcome. For example, a conversion of $100,000 from a traditional IRA that later drops to a $50,000 value means that income tax was unnecessarily paid on the $50,000 decrease in value. Further, commencing the five-year tax period sooner rather than later starts the clock for meeting the ***qualified*** distribution requirement.

In summary, consideration of conversion of your existing IRA or qualified retirement plan to a Roth IRA is complex and should be made on a case by case basis.

If you would like me to perform a study of your specific situation to determine if a Roth IRA conversion is the right decision for you, please contact me.

This letter along with other useful tax planning information can also be located at my Web Site www.solakco.com for future reference.

Very truly yours,

Charles E. Solak

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