This pdf document contains the Table of Contents (Summary, plus 5 pages detailed) and sample text pages from the new 97-page 2010 edition of Natalie B. Choate's Special Report "Roth-Ready for 2010!" REVIEW the Table of Contents to make sure this Report covers the questions you are interested in. READ the sample pages to make sure Natalie's writing style suits you.

Everything You Need to Know to Get Your Clients

Roth-Ready for 2010!

by

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This is a sample of the *technical tax material* in the Special Report (pages 16–17, explaining how to compute the "Five-Year Period" that is one of the requirements requisite to having tax-free qualified distributions from a Roth IRA):

5.2.05 ***Computing Five-Year Period for qualified distributions***

Satisfying a five-year waiting period (called in this Report "the Five-Year Period") is one of two tests a Roth IRA owner must pass in order to have tax-free "qualified distributions" (¶ 5.2.04) from his Roth IRA. The Five-Year Period (called in the statute the "nonexclusion period") for *all* of a participant's Roth IRAs begins on January 1 of the first year for which a contribution was made to *any* Roth IRA maintained for that participant. § 408A(d)(2)(B); Reg. § 1.408A-6, A-2.

Fred Example: On August 3, 1999, Fred put $1,000 into his Roth IRA. Fred's Five-Year Period starts January 1, 1999, and is completed on December 31, 2003. The first year in which he can possibly have a qualified distribution is 2004. If he makes further contributions (either regular or rollover) to the same (or any other) Roth IRA, those contributions do NOT start a new Five-Year Period running. In 2006, Fred converts his $100,000 traditional IRA to a Roth IRA. This new Roth IRA instantly meets the Five-Year Period requirement, because Fred has already completed the Five-Year Period for every Roth IRA he will ever own. If Fred is already over age 59½, he can immediately take qualified distributions from his newly-created Roth IRA in 2006.

Note the following points regarding calculation of the Five-Year Period for a Roth IRA:

A. **Effect of recharacterization.** If a Roth IRA contribution is entirely recharacterized (¶ 5.6.02), it is treated as if it had never been made. Thus, in the Fred Example above, if Fred had recharacterized his 1999 Roth IRA contribution, that contribution would not start the Five-Year Period running.

B. **Contrast with DRACs.** The Five-Year Period is computed differently for a designated Roth account (DRAC). ¶ 5.7.04(B).

C. **Effect of DRAC rollover.** The method of computing the Five-Year Period for a Roth IRA does not change just because the Roth IRA receives a rollover from a DRAC, regardless of how long the DRAC had been in existence. See ¶ 5.7.09.

D. **Computing Five-Year Period for beneficiaries.** The method of computing the Five-Year Period for a Roth IRA does not change ("is not redetermined") just because the Roth IRA owner dies. The deceased participant's holding period carries over to the beneficiary. If the beneficiary is the surviving spouse, she gets to carry over the deceased participant's holding period even if she elects to treat the Roth IRA as her own Roth IRA, so in effect she gets to use her own holding period or the deceased spouse's holding period, whichever is longer. Reg. § 1.408A-6, A-7(a). For more on the spousal rollover and spousal election to treat an inherited IRA as the surviving spouse's own IRA, see ¶ 3.2 of *Life and Death Planning for Retirement Benefits*.

Scott Example: Scott contributes to his first Roth IRA in 2008. His Five-Year Period will therefore be completed December 31, 2012. He dies in 2010, leaving the Roth IRA in equal shares to his wife (age 45) and daughter. The wife and daughter divide the account into two separate equal Roth IRAs, one payable to each of them. The wife elects to treat the separate Roth IRA payable to her as her own Roth IRA.

For Scott's daughter, the Five-Year Period for her inherited Roth IRA will be completed December 31, 2012, because she gets to "carry over" Scott's holding period. Accordingly, for the daughter, all distributions after 2012 will be "qualified distributions," because she will have met both the Five-Year Period requirement and the triggering event requirement (Scott's death was the triggering event for her inherited Roth IRA).

For the Roth IRA payable to Scott's wife that she has elected to treat as her own, the election erases Scott's death as a triggering event, because the Roth IRA is now considered her own Roth IRA (not an inherited Roth IRA), and she owns it as participant (not beneficiary). For distributions after 2012 she will have met her Five-Year Period requirement, based on *Scott's* holding period, which she gets to carry over. If she had started her own Roth IRA prior to 2008 (the year Scott started his), her Five-Year Period will be based on her own Roth IRA. But regardless of which holding period start date applies, she will still not have qualified distributions from this or any of her other Roth IRAs until she attains age 59½ or becomes disabled, etc.

5.2.06 ***Tax treatment of nonqualified distributions***

A nonqualified distribution is one made before the Five-Year Period (¶ 5.2.05) is up; or which is made after expiration of the Five-Year Period but not for one of the specified reasons (age 59½, disability, death, etc.; ¶ 5.2.04). A nonqualified distribution is not *per se* excludible from gross income. However, even if a distribution is not "qualified" it receives favorable tax treatment compared with distributions from a traditional IRA.

A Roth IRA contains two types of money. First, it contains the participant's contributions; since these amounts were *already* included in the participant's gross income, these originally-contributed funds will not be included in his income *again* when they are later distributed. Thus, the amount of the participant's original contribution(s) to the Roth IRA constitutes the participant's basis (or "investment in the contract") in the Roth IRA. § 72(b)(2). If the account has grown to be worth more than the investment in the contract, the rest of the account value (which represents the earnings and growth that have occurred since the original contribution; the IRS calls this portion the "**earnings**") has not yet been taxed (and may *never* be taxed if it is distributed in the form of a qualified distribution).

The general rule is that all distributions from a Roth IRA are deemed to come *first* out of the participant's contributions. ¶ 5.2.07, #1. Thus, if the participant or beneficiary wants to get money out of the Roth IRA, but does not meet the requirements for a qualified distribution, he can still withdraw money income tax-free, up to the amount the participant contributed.

Jules and Jim Example: In 2007, Jules converted his $400,000 traditional IRA to a Roth IRA. He dies in 2009, leaving the account (now worth $500,000) to his son Jim. Jim wants to use the "stretch" life-expectancy payout method for this inherited Roth IRA. Accordingly, he must start taking minimum required distributions in 2010. Jules's death is a "triggering event," but the Five-Year Period will not be up until December 31, 2011, so the distributions Jim is forced to take in

This is a sample of the *planning advice* in the Special Report (pages 72–73, discussing the planning implications of the new "beneficiary Roth conversion," whereby certain nonspouse beneficiaries are allowed to convert certain inherited nonIRA plans into "inherited" Roth IRAs):

5.8.05 ***Planning implications: Beneficiaries who will NOT roll to Roths***

For a nonspouse Designated Beneficiary who inherits a QRP, 403 plan, or governmental 457(b) plan, the nonspouse beneficiary plan-to-Roth-IRA rollover offers an intriguing planning possibility. A beneficiary may want to consider rolling all or part of the inherited plan to an inherited Roth IRA via direct rollover. Probably not too many beneficiaries will want to do this because:

1. The beneficiary may not be able to afford to pay the income tax cost of a Roth conversion.

2. If the beneficiary is eligible and can afford a Roth rollover, the beneficiary would usually be better off converting his/her *own* plan or IRA to a Roth IRA status rather than converting the inherited plan:

Daphne Example: In 2010, Daphne inherits a $200,000 401(k) plan from her deceased mother (all pre-tax money) and she also has a $200,000 IRA of her own. She wants to have a $200,000 Roth IRA and can afford to pay the income tax on a $200,000 Roth conversion, but cannot afford to convert *both* plans to Roth IRAs. If she converts her own IRA to a Roth, she: will not have to take any MRDs from it during her entire life; and can leave it, at her death, to a Designated Beneficiary who can take tax-free distributions over such beneficiary's life expectancy. In contrast, if she converts the *inherited* plan to an *inherited* Roth IRA, she will have to immediately start taking MRDs, over her own single life expectancy as beneficiary; and whatever is left in it at her death, her successor beneficiary will have to withdraw over what is left of Daphne's life expectancy. So there is much more deferral-potential "bang for the buck" in converting your own IRA or plan to a Roth IRA than in converting an inherited plan to an inherited Roth IRA.

5.8.06 ***Beneficiaries who WILL roll to Roths***

However, that being said, there will be some cases where the beneficiary will want to roll an inherited plan to an inherited Roth IRA:

1. An eligible individual who is so in love with Roth IRAs that he/she wants to convert BOTH his/her own plans and IRAs AND the inherited plan to Roth IRA status.

2. If the inherited plan contains after-tax money, it would be cheaper to convert the inherited plan than to convert the beneficiary's own plan, if the beneficiary's plan is all pretax money.

3. If the deceased participant's estate was subject to federal estate taxes, the beneficiary will be entitled to apply the "IRD deduction" (income tax deduction for federal estate taxes paid on the benefits) to the conversion. Like after-tax money (#2), this factor could make the

conversion of the inherited plan “cheaper.” See § 691(c) and ¶ 2.3.04 of *Life and Death Planning for Retirement Benefits* regarding this deduction.

4. Any beneficiary who really wants a Roth IRA, but does not have a plan or IRA of his/her own that he/she can convert—especially if he/she expects his/her income tax bracket to be higher in the future.

Frank Example: Frank is age 40 and working. He has a 401(k) plan. He’d like to convert part of this plan to a Roth IRA in 2010, but he cannot take a distribution from his 401(k) plan (that could be rolled to a Roth) until he reaches age 59½ or terminates employment—by which time he expects to be in higher bracket. He inherits a plan from his father; he can convert that inherited plan to an inherited Roth IRA right now while he is in a low bracket.

Sarah Example: Sarah and Jane are spinster sisters who live together. Jane has a high income from her job, and substantial wealth. She supports Sarah who does not work. Jane dies in 2009, leaving her 401(k) plan and other wealth to Sarah. Sarah is in a low tax bracket; she expects her tax bracket to increase once Jane’s estate is eventually transferred to her. Sarah has no plan or IRA of her own she can convert to a Roth IRA. She has Jane’s 401(k) plan balance transferred directly to an inherited Roth IRA.

5.8.07 ***Implications for clients retiring or leaving their jobs***

George Example: George is retiring at age 65 from XYZ Corp. He has a $200,000 401(k) plan balance. He also owns a $1 million IRA, all pre-tax money. He does not expect to be reemployed again ever. Should he roll over his 401(k) balance to an IRA? Or should he leave it where it is?

There are many factors to consider in making the decision whether to roll money out of a company plan, including creditors’ rights, investment control, and fees, just to name a few. The new plan-to-Roth-IRA rollover option, and Notice 2008-30, created a new reason why George might want to leave the money right where it is instead of rolling it over to an IRA: When George dies, if the money is still in the 401(k) plan, his nonspouse Designated Beneficiaries will have the option to roll the inherited plan to an inherited Roth IRA. If George rolls the money to an IRA now, his nonspouse beneficiaries will not be able to convert the inherited IRA to an inherited Roth IRA.

Does this factor mean that George should not roll over to an IRA? Not necessarily. For example, if George is leaving his retirement benefits to his spouse or to charity, he can ignore this factor. But this new factor must enter in to the decision process; something new for your “rollover checklist”!

[end of sample pages]