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FINANCIAL PLANNER

W Security National
M WEALTH MANAGEMENT

The Roth IRA Safety Valve

As a rule, financial planners favor consolidating IRAs into a single account for ease of management. Having lots of different accounts means lots of different statements and, very often, an incoherent and impulse-driven investment approach. However, there is a circumstance in which having multiple accounts can be advantageous. It has to do with conversions of traditional IRAs to Roth IRAs.

When a traditional IRA is converted to a Roth IRA, all of the nontaxed portion of the account becomes taxable. Assume that a \$500,000 IRA is converted by a taxpayer in the 35% tax bracket. The tax cost of the conversion comes to \$175,000.

All income and growth in the Roth IRA is potentially tax free after the date of the conversion. But what if the market tanks? Say that the \$500,000 Roth IRA falls to \$400,000? The owner still will owe the full \$175,000 in taxes on the conversion.

The tax code has a safety valve built in for such situations. The account owner is permitted to recharacterize the conversion, going back to the traditional IRA format and erasing the tax obligation. The recharacterized IRA then can be converted to Roth status at a later date—at least 30 days, or the next tax year, whichever is later.

A middle ground is possible, one that involves using multiple Roth IRAs to receive the conversions.

A two-basket plan

For the sake of simplicity, assume that the \$500,000 IRA is half in bonds, half in stocks. When the account is converted, one Roth IRA will be a basket for all the bonds, a second Roth IRA will own all the stocks. Now let's say that the account contraction is concentrated in one or the other asset class. Perhaps an interest rate hike causes bond values to fall, or a major economic setback hurts stock values. For whatever reason, at year-end one IRA is worth \$150,000, and the other is worth \$250,000.

At that point the owner can decide to recharacterize just one of the Roth IRAs, the one that declined in value. He can cut his tax bill on the conversion in half by so doing.

What about the situation when the accounts don't go down in value? There still can be added financial flexibility in having more than one Roth IRA. For example, let's say that by tax time the person who converted the \$500,000 traditional IRA can't come up with the necessary \$175,000 to pay the tax. He or she might decide to recharacterize one of the two IRAs, cutting the tax bill in half, just to ease the burden on his cash flow.

Caveats. Normally, the income tax is due on a conversion to a Roth IRA in the tax year of the conversion. For 2010 Roth conversions only, the income can be spread over the 2011 and 2012 tax years instead. A 2010 conversion that is recharacterized won't be eligible for this favorable treatment.

But is the treatment so favorable? Tax professionals debate that question daily. Income tax rates for top-bracket taxpayers appear to be headed higher, perhaps sharply higher, as the Bush tax cuts expire at the end of 2010.

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trust \:trəst\ n **1 a:** assured reliance on the character, ability, strength, or truth of someone or something **b:** one in which confidence is placed



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DENA JOHNSTON *Wealth Management Advisor*

Dena began her career at Security National Bank in 1986 as a Financial Services Representative in the Retail Division. She has experience as a Personal Banking, Mortgage Loan, and Consumer Investment Representative, before moving to Executive offices as the Administrative Assistant. Dena joined the Wealth Management area in 2005 in the Personal Trust Administration area, as a Wealth Management Advisor.

Dena graduated from Iowa State University with a B.S. in Finance. She is a member of the Siouxland Estate Planning Council, a recent graduate of the ABA National Trust School and is a Certified Trust and Financial Advisor.

Dena is a trusted community leader, who served on the boards or is a member of Quota International of Sioux City, Retired Senior Volunteer Program, United Way Loyal Contributor and Sunnybrook Community Church.

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