ED SLOTT'S IRA ADVISOR

March 2010

TAX & ESTATE PLANNING FOR YOUR RETIREMENT SAVINGS

Paying the Tax on a Roth Conversion

Estimated Tax Rules When Income Increases

The impact of a Roth conversion on estimated tax payments has been a hot topic among advisors and consumers alike. Although many articles warn consumers of the impending estimated tax chaos, the reality is that with a little planning, most, if not all of your clients should be able to avoid any problems.

Estimated taxes are nothing new. In fact, many of your clients, particularly those that are self-employed, may already be making estimated tax payments. But the 2010 opportunity for clients to do a Roth conversion has put many advisors in a tizzy. There have even been stories in the media saying that some people who convert to a Roth IRA are setting themselves up for an underpayment penalty. That's not true - if you know how the estimated tax rules work.

With a little planning, most, if not all of your clients should be able to avoid any estimated tax problems.

Most clients will be able to hold onto their money much longer than they thought before they have to fork it over to the IRS. Not only that, while your clients are holding onto their cash, the newly converted Roth IRA is earning tax-free income. In effect, the combination of the estimated tax rules and the two-year deferral option for 2010 Roth conversions allow your clients to get an interest-free loan from the government to build a tax-free savings account.

The common Roth conversion / estimated tax scenario that advisors are dealing with now stems from 2010 Roth conversions. The client has two tax payment options. If they convert $100,000 to a Roth IRA in 2010, they can take the default option and include $50,000 (one-half) of the 2010 conversion income on their 2011 tax return and the remaining $50,000 (the other half) on their 2012 return. Alternatively, if they wish, they can elect out of the two-year deal and report the entire $100,000 of 2010 conversion income in 2010. Advisors need to know when the tax is due on each option so the client will steer clear of any estimated tax penalty.

Will my Client Need to Make Estimated Tax Payments?

Most salaried individuals have taxes withheld from their paychecks throughout the year. On the other hand, many sources of income, including interest, dividends, alimony, prizes, real estate income, gains from the sale of an asset and self-employment income do not have taxes withheld. But just because the taxes on income from these sources

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