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Big Changes in IRA to Roth-IRA Conversion Rules

The year 2010 will be a pivotal year for retirement planning. It is the first year in which individuals will be able to convert funds in regular IRAs (as well as 401k accounts) to Roth IRAs regardless of their income level. This new conversion option poses significant tax planning challenges and opportunities for 2010 and 2011.

Conversions to Roth IRAs. Beginning in 2010, there is no income limitation on individuals that can make conversions of traditional IRAs to Roth IRAs. Additionally, married taxpayers filing a separate return will be able to convert amounts in a traditional IRA into a Roth IRA (currently they are barred from doing).

A conversion from a regular IRA to a Roth IRA is subject to tax as if funds were distributed from the traditional IRA and not recontributed to another IRA, but the conversion is not subject to the 10% premature distribution tax.

Why make an IRA-to-Roth IRA conversion? Roth IRAs have two major advantages over regular IRAs:

A. Distributions from regular IRAs are taxed as ordinary income (except to the extent they represent nondeductible contributions). By contrast, Roth IRA distributions are tax-free if they are “qualified distributions,” that is, if they are made (1) after the 5-tax-year period that begins with the first tax year for which the taxpayer made a contribution to a Roth IRA, and (2) when the account owner is 59 1/2 years of age or older or on account of death or disability.

B. Regular IRAs are subject to the lifetime required minimum distribution rules that generally require minimum annual distributions to be made commencing in the year following the year in which the IRA owner attains age 70 1/2. By contrast, Roth IRAs are not subject to the lifetime required minimum distribution rules.

A similar comparison could be made between distributions from 401k plans and Roth IRAs.

There are other tax advantages: (1) Because distributions from Roth IRAs are tax-free (if they are qualified distributions), they may keep a taxpayer from being taxed in a higher tax bracket that would otherwise apply if he were withdrawing taxable distributions, and (2) Qualified distributions do not enter into the calculation of tax owed on Social Security payments.

Who should make IRA-to-Roth IRA conversions?

The consensus view is that the conversion route should be considered by taxpayers who:

- have a number of years to go before retirement (and are therefore able to recoup the dollars that are lost to taxes on account of the conversion);
- anticipate being taxed in a higher bracket in the future than they are now; and
- can pay the tax on the conversion from non-retirement-account assets (otherwise, there will be a smaller buildup of tax-free earnings in the depleted retirement account).

Complicating factor for 2010 conversions. A unique income inclusion rule will apply for IRA to Roth-IRA conversions occurring in 2010. Unless an individual

elects otherwise, none of the gross income from the conversion is included in income in 2010; half of the income resulting from the conversion will be includible in gross income in 2011 and the other half in 2012 (Code Sec. 408A(d)(3)(A)).

A major wild card in making this choice is the tax-rate picture after 2010. Absent Congressional action, after 2010 the tax brackets above the 15% bracket will revert to their pre-2001 levels. That means the top four brackets will be 39.6%, 36%, 31%, and 28%, instead of the current top four brackets of 35%, 33%, 28%, and 25%. The Administration has proposed to increase taxes only for those making \$250,000, but it is difficult, at this point in time, to predict who will get hit by higher rates. What's more, there are proposals on the table to help finance healthcare reform with a surtax on higher-income taxpayers.

If you have not been able to deduct IRA contributions, the conversion to a Roth-IRA generally is taxable only to the extent of earnings on the nondeductible contributions. However, if you previously made deductible IRA contributions, or rolled over qualified plan funds to an IRA, complex rules determine the taxable amount.

Per Diem Rates for 2009

Most people realize that the IRS allows business travelers to deduct a daily per diem amount while out of town. The method of deduction is called the "simplified (high-low) method for substantiating travel allowances." However, that rate is subject to change each year.

The simplified method can be used to deduct per diem amounts paid for lodging plus meal and incidental expenses (M&IE) during travel within the continental U.S. The per diem amounts are:

- A. January 1, 2009 through September 30, 2009:
 - 1. High-cost localities (as defined by the IRS)
 - a. \$198 for lodging

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- b. \$58 for meals and incidental expenses
 - 2. Other localities – which is most places
 - a. \$113 for lodging
 - b. \$45 for meals and incidental expenses
- B. October 1, 2009 through December 31, 2009 and September 30, 2010:
 - 1. High-cost localities (as defined by the IRS)
 - a. \$193 for lodging
 - b. \$65 for meals and incidental expenses
 - 2. Other localities – which is most places
 - a. \$111 for lodging
 - b. \$52 for meals and incidental expenses

General partners, S corporation shareholders, and self-employed individuals cannot use the per diem for lodging. They may deduct only the actual expense. They may, however, deduct the per diem rate for meals and incidental expenses even if the actual M&IE is less than the per diem amount.

Florida Unemployment Wages and Tax

Effective January 1, 2010, Florida unemployment tax is increasing substantially for most businesses regardless of whether the business has had any unemployment claims.

The wages subject to the tax is increased from \$7,000 to \$8,500. The minimum annual tax rate will increase almost twelvefold from \$8.40 per employee to \$100.30 per employee.

Employers should have received notice of their 2010 increased rate during December 2009.