Top 4 reasons to do a Roth Conversion NOW.

Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished)
Keebler & Associates, LLP
Robert.keebler@keeblerandassociates.com

Matthew Blattmachr, CFP
CEO, Peak Trust Company
mblattmachr@peaktrust.com

Why Now?

- In April 2020 Peak Trust Company conducted a nationwide survey of advisors, CPAs, and estate planning attorneys

- Survey revealed key client concerns that a ROTH conversion can address

Survey Results:

- More than 50% clients have expressed concern about the loss of the stretch option

- 72% of those clients say their top concerns are the tax consequences of distributions to self or beneficiary, followed by protecting their heirs in a blended family scenario, creditor protection, and spendthrift beneficiaries

- 71% of clients are now considering a ROTH IRA conversion

Outline

- How to take advantage of no Required Minimum Distributions in 2020
- Why converting to a Roth while the market is low is ideal
- How Roth's are a great solution to the SECURE Act
- Why a Roth makes sense when current low tax rates are likely to go up

Market Volatility & the CARES Act

Market Volatility

- Taxable income is determined based on the value of the assets on the date of the conversion
- Recovery is sheltered from all future income tax

- Recall: Undoing the conversion (recharacterization) in the event of further market decline is NO LONGER POSSIBLE after the TCJA

CARES Act

- Temporary Waiver of RMDs
  - RMDs are generally not required in 2020
  - Includes those who must make their first RMD in 2020 & "inherited" IRAs

H. R. 748, the CARES ACT, **SEC. 2203**

Pre-Secure Law for Post-Mortem Distributions

Stretch Out IRAs

"Inherited" IRA

- Two Strategies
  - Spousal Rollover
  - Inherited IRA

Both Still Available After the Secure Act

- Advantages
  - Rollover delays RMD until spouse's own RBD
  - Inherited IRA provisions allow beneficiary's life expectancy to be used for distributions after death of IRA owner

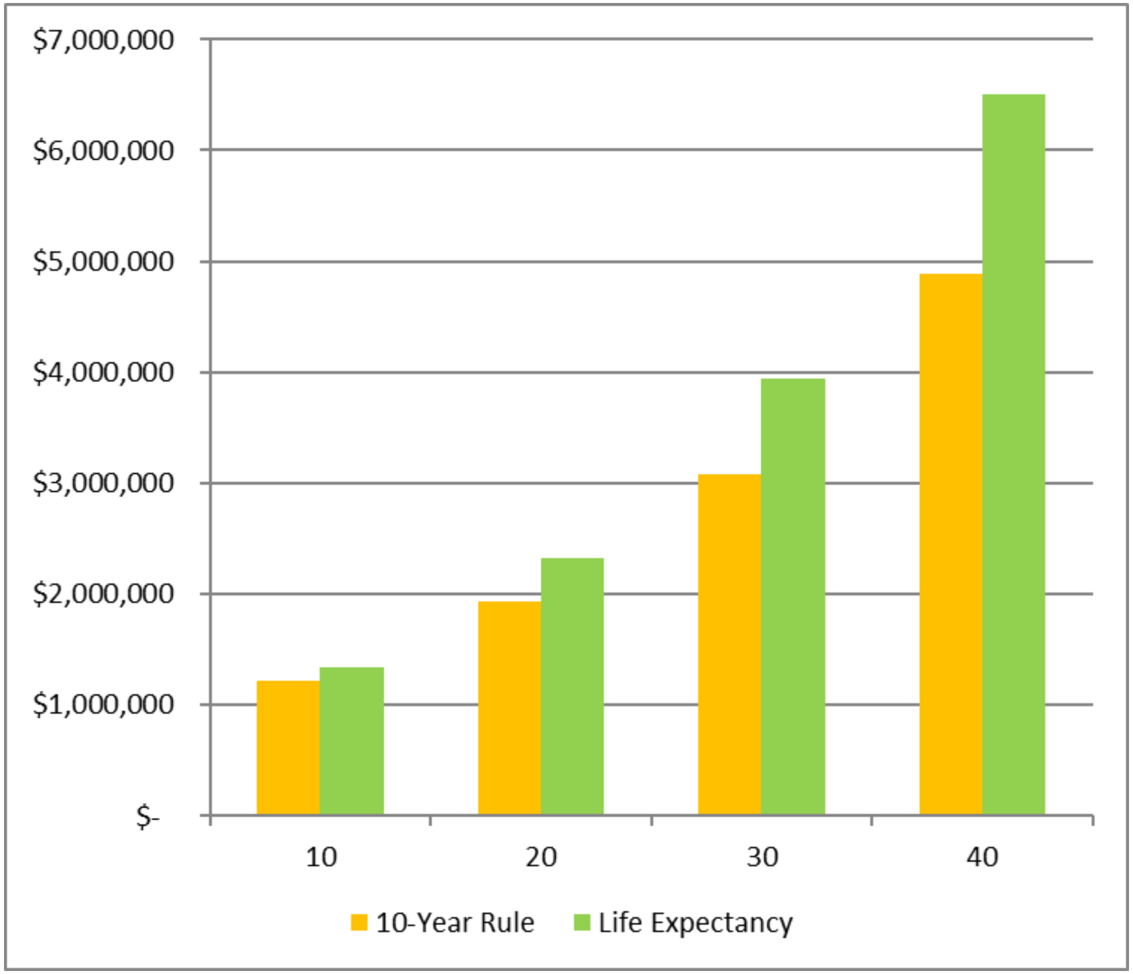
SECURE BILL
KEY CHANGES

RMDs after Death

Basically, requires all IRAs, Roth IRAS, and Qualified Plans to be distributed within 10 years of death

RMDs after Death

Example



RMDs after Death

Exceptions from the 10-year Rule for certain beneficiaries
("eligible designated beneficiary")

- Surviving Spouse
- The employee's Children under the age of majority *(not grandchildren or any other children)*
- Disabled
- Chronically ill
- Individual not more than ten years younger than employee

§§ 401(a)(2)(E)(ii)

Secure Act Beneficiary RMD Summary

Tax Terminology	Designated Non-Eligible Beneficiary	Surviving Spouse	Eligible Minor Child	Person Less Than 10 Years Younger	Disabled or Chronically Ill Person
Outright Beneficiary	10-Year Rule	Life Expectancy Rule	Life Expectancy Rule (Until Majority then 10-Year Rule)	Life Expectancy Rule	Life Expectancy Rule
Conduit Trust	10-Year Rule	Life Expectancy Rule	Life Expectancy Rule (Until Majority then 10-Year Rule)	Life Expectancy Rule	Life Expectancy Rule
Designated Beneficiary Trust	10-Year Rule	10-Year Rule	10-Year Rule	10-Year Rule	Life Expectancy Rule
Non-Designated Beneficiary Trust	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule
	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule

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Ten Year Rule - Roth vs. Traditional IRA

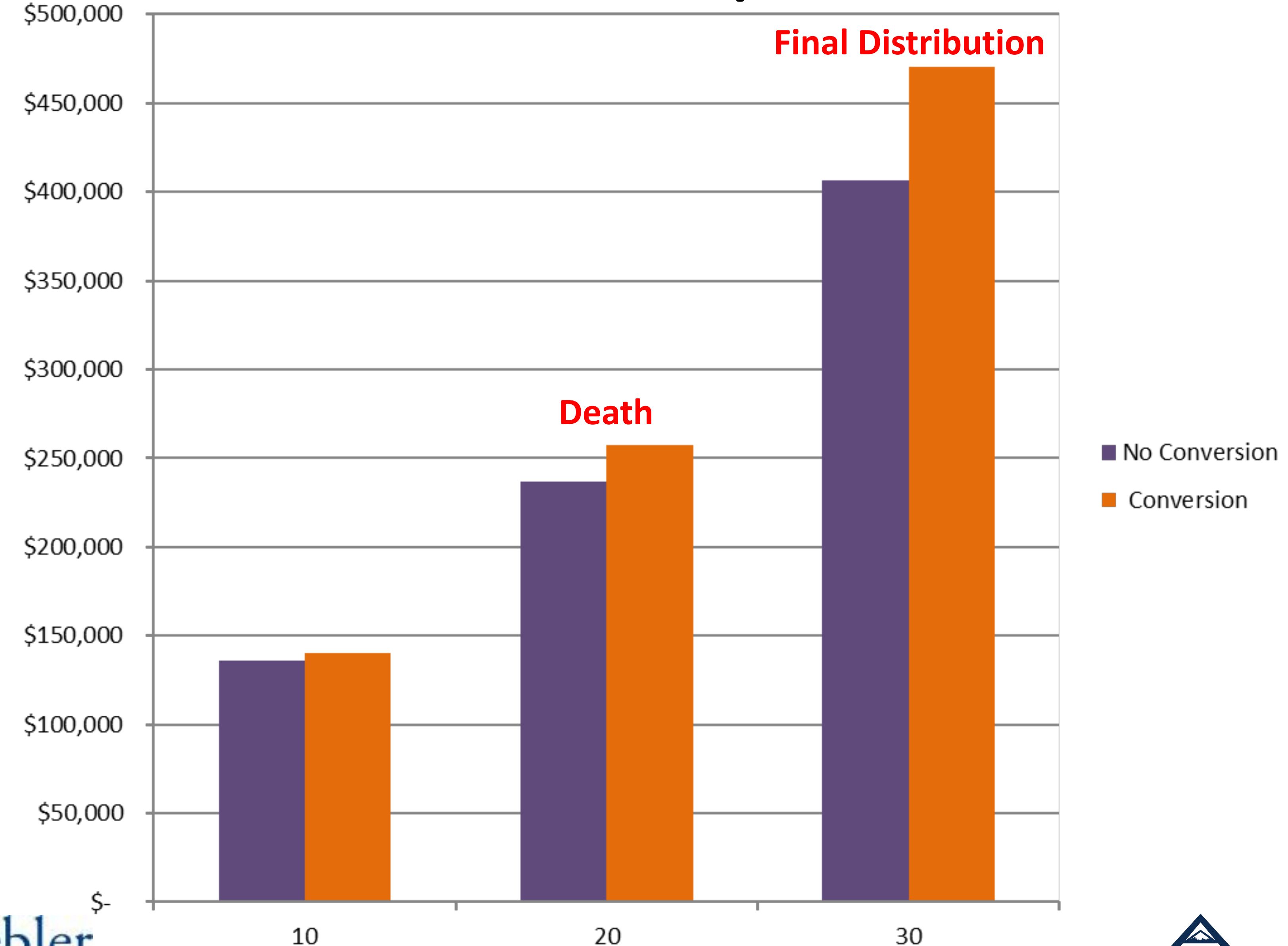
- If minimizing income taxation is the only concern, Roth distributions after death should generally be deferred until the end of the Ten-Year period – *"The Roth Reprieve"*
- Growth remains tax-exempt
- Traditional IRA distributions will be tactically withdrawn to manage income tax rates

The Roth Reprieve

Roth conversion example to illustrate the value of the "Roth Reprieve;" Consider the following:

- 66 year-old IRA married owner who expects to live to 85
- She can undertake a $100,000 conversion within the 24% bracket; to avoid confusing the driving factors of model assume all future taxable distributions from the IRA are subject to a 24% rate
- She pays the conversion tax without "outside funds"
- Assume a pre-tax rate of return of 6% and after tax-tax rate of return of 5%
- Assume the 10-year rule deferral is taken advantage of in full

The Roth Reprieve



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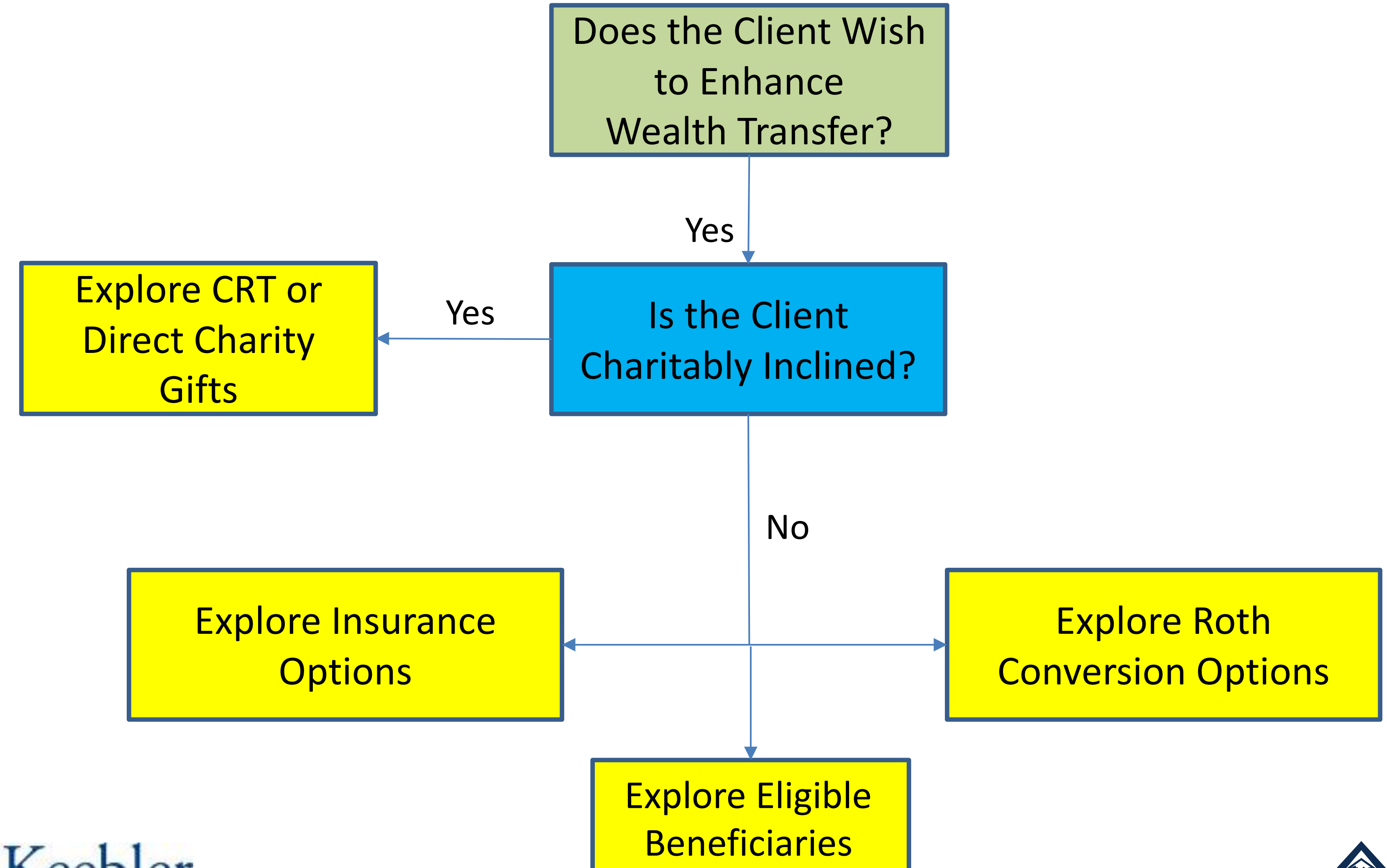
PLANNING SOLUTIONS TO ANALYZE

Solutions to Analyze

Overview

- **Roth conversions**
- Designated Beneficiary - multi-generational spray trusts
- Spousal rollovers and the *new* spousal rollover trap
- IRAs to CRTs
- IRA trusts for state income tax savings
- IRA relocation to life insurance
- Life insurance to offset increased tax-risk of early death
- Combination “hedge” strategies

Robert S. Keebler, CPA/PFS, MST, AEP: Secure Act Protocol FLOWCHART



Solutions After the Secure Act

Spousal Rollover Strategies

A. Traditional IRA to Spouse – 100% Rollover

B. Traditional IRA to Spouse – X% Disclaimer
   1.) Result: Deferral until RBD followed by 10-year payout.
   2.) Result: Children begin a 10-year payout followed by an additional 10 years at the second death

Roth Conversions

A. Lifetime Conversions by Plan Owner

B. Death-Time Conversions by Plan Owner's Family

C. Spousal Rollover Followed by a Roth Conversion

Charitable Remainder Trusts

A. Death-Time Payment to CRT – Spouse

B. Death-Time Payment to CRT - Children

Life Insurance "Relocation"

A. Acquire Life Insurance, in ILIT, on Plan Owner

B. Acquire Life Insurance, in ILIT, on Spouse

C. Acquire Life Insurance, in ILIT, Second-to-Die

ROTH CONVERSIONS

As it relates to the new 10-year rule, the purpose of Roth Conversions is to spread distributions over many years and lower brackets

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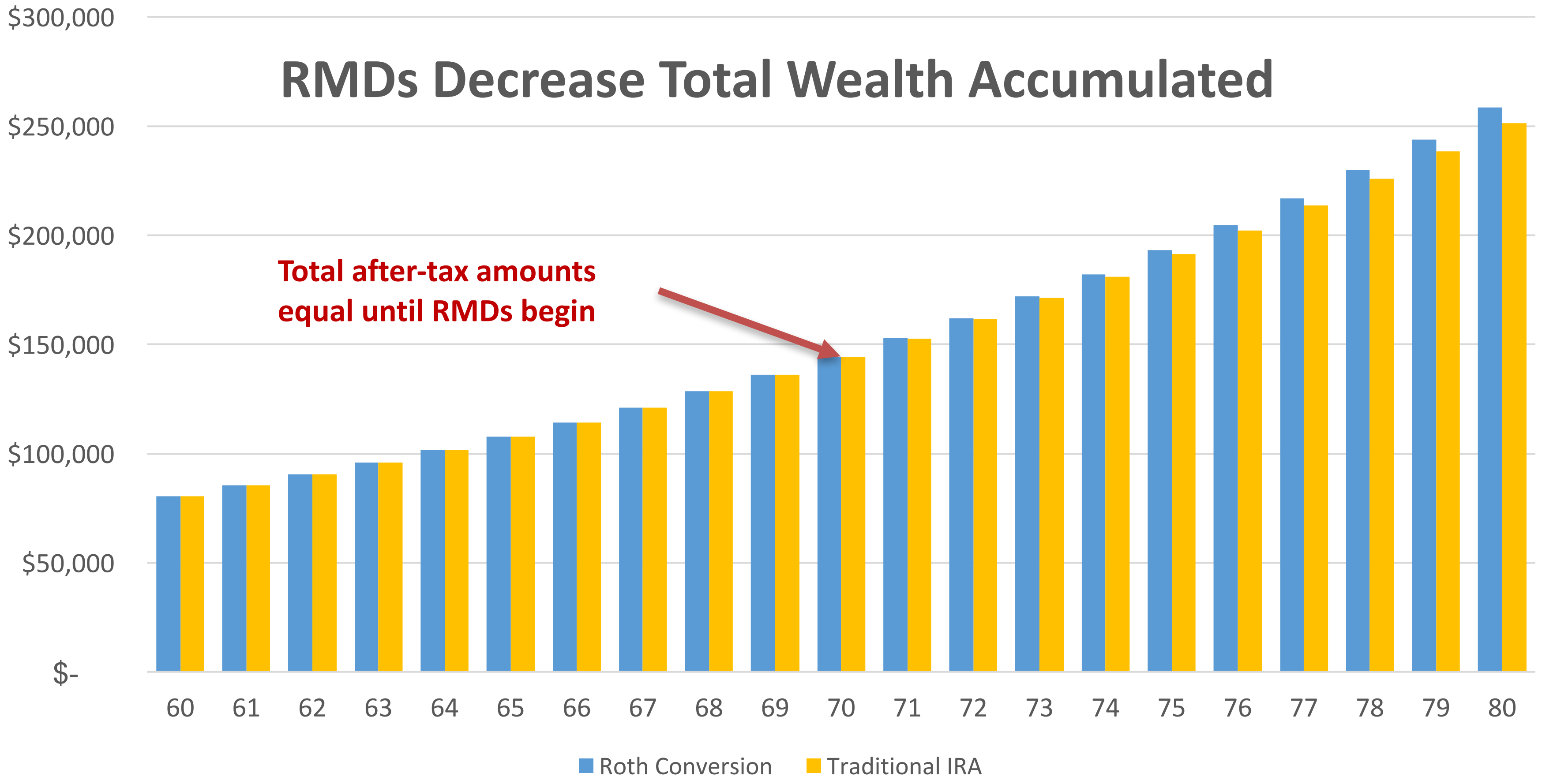
General Roth Concepts

- 100% of growth is tax-exempt
- No required minimum distributions at age 72
  – NOTE: Distributions from Roth IRAs cannot be used to fulfill the RMD from a traditional IRA
- RMDs on Inherited Roth IRAs

General Concepts



The graphic compares a $100,000 Roth Conversion at age 60 to "doing nothing." It assumes 24% tax rate applies to all distributions/conversions, the conversion tax is paid from the IRA, a 6% pre-tax rate of return, and a 4.75% after-tax rate of return.

General Concepts

- Convertible accounts
  - Traditional IRAs
  - 401(k) plans
  - Profit sharing plans
  - 403(b) annuity plans
  - 457 plans
  - "Inherited" 401(k) plans (see Notice 2008-30)
- Non-convertible accounts
  - "Inherited" IRAs
  - Education IRAs

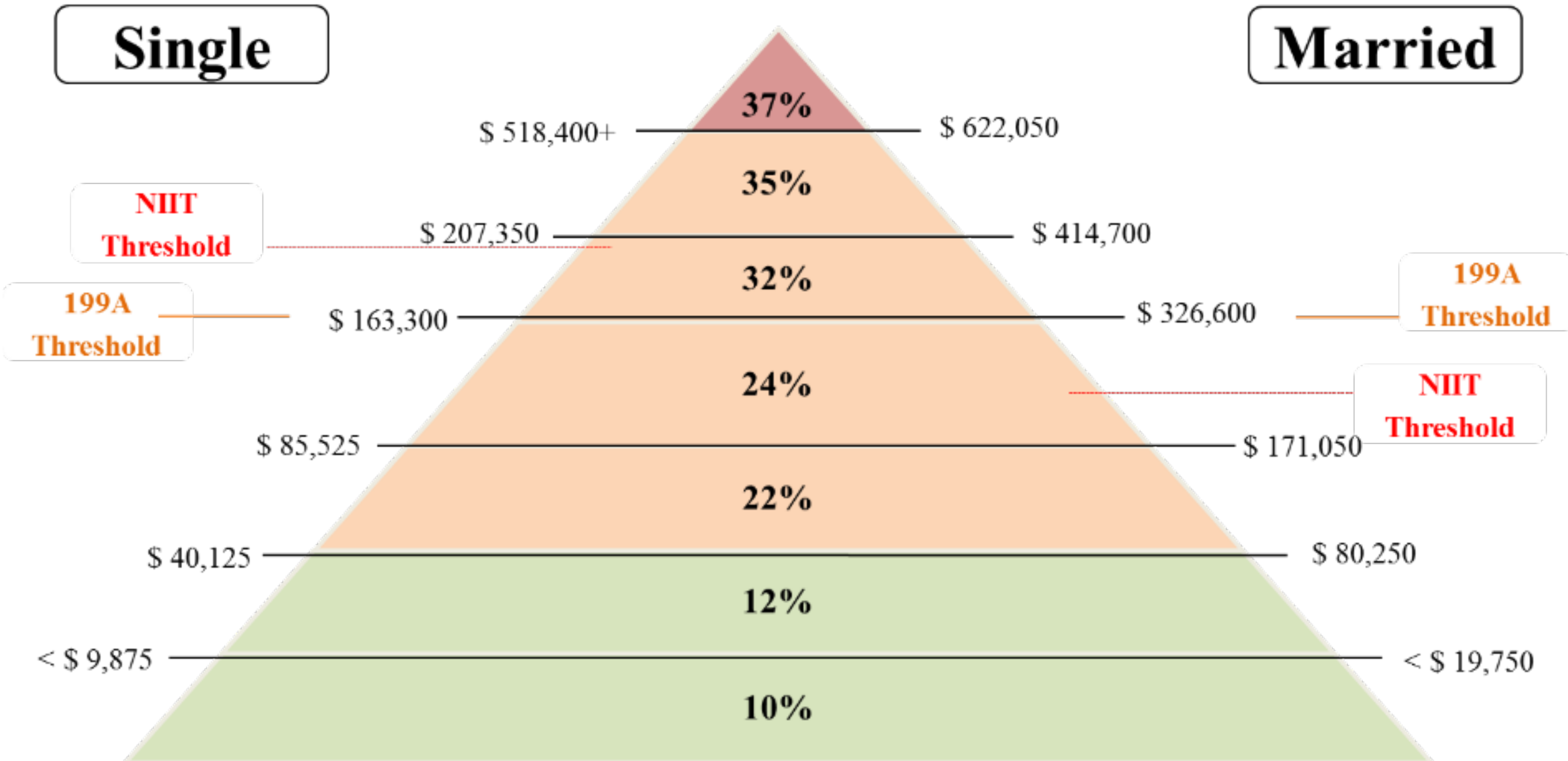
Micro Roth Conversions

- Converting smaller amounts of traditional IRA to reach the top of the income tax bracket to pay a smaller percentage than would the inheritor be taxed at.
- Example:
  - C is married and retired with income of $50,000 and has a traditional IRA of $300,000 that he will not need in the future.
  - C's IRA beneficiary is his daughter T who is in the 22% income tax bracket.
  - If C converts $30,000 of his traditional IRA to a Roth IRA for the next ten, he will be only paying 12% on income tax because he will be just under the top of his income tax bracket, and thus be transferring $30,000 more to T, due to paying 10% less on income tax payments than T would have to pay if she inherits the full amount of the traditional IRA.

General Concepts

- Reasons for converting to a Roth IRA
  - Taxpayers have special favorable tax attributes including charitable deduction carry-forwards, investment tax credits, net operating losses (NOLs), high basis non-deductible traditional IRAs, etc.
  - Suspension of the minimum distribution rules at age 72 provides a considerable advantage to the Roth IRA holder
  - Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax
  - Taxpayers who can pay the income tax on the IRA from non-IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields

2020 Tax Brackets



General Concepts

- Reasons for converting to a Roth IRA
  - Taxpayers who need to use IRA assets to fund their Basic Exclusion Amount (BEA) bypass trust are well advised to consider making a Roth IRA election for that portion of their overall IRA funds
  - Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates
  - Federal tax brackets are more favorable for married couples filing joint returns than for single individuals
  - Post-death distributions to beneficiaries are tax-free
  - Tax rates are expected to increase in the near future
  - Impact of the new 3.8% Medicare surtax

General Concepts

- Reasons for converting to a Roth IRA
  - Impact on the taxation of Social Security
  - Impact on Medicare premiums

Taxation of Roth IRA Conversions

Taxation of Roth IRA Conversions

- When a traditional IRA has non-deductible contributions, a portion of the conversion to a Roth IRA will be non-taxable "basis" to the IRA owner
- In determining the non-taxable portion of a Roth IRA conversion, all traditional IRAs and IRA distributions during the year (including outstanding rollovers) must be combined for apportioning "basis"
  - See IRS Form 8606

Taxation of Roth IRA Conversions

Current year non-deductible IRA contributions	$	1,000
Prior year non-deductible IRA contributions		6,000
Total non-deductible IRA contributions	$	7,000
FMV of all IRAs	$	580,000
Outstanding rollovers		20,000
Distributions		-
Roth IRA conversions		100,000
Total value of IRAs, distributions and Roth IRA conversions	$	700,000
"Basis apportionment" factor		**0.0100**
Gross Roth IRA IRA conversion	$	100,000
Non-taxable portion		(1,000)
Taxable Roth IRA conversion	$	99,000

Taxation of Roth IRA Distributions

Taxation of Roth IRA Distributions

- Qualified distributions
  - Not subject to income tax
- Non-qualified distributions
  - Potentially subject to income tax

Taxation of Roth IRA Distributions

- A Roth IRA distribution will be treated as a “qualified distribution” if both of the following requirements are met:
  - The distribution is made:
    - On or after the IRA owner turns 59½
    - To a beneficiary (or the IRA owner’s estate) on or after the death of the IRA owner
    - Because the IRA owner is “disabled”
    - For a “qualified special purchase” (i.e. first-time home buyer)
  - A five-year mandatory holding period has passed

CAUTION: If both requirements are not met, then the distribution is a “non-qualified distribution”

Taxation of Roth IRA Distributions

- For purposes of determining a “qualified distribution”, the five-year holding period for all of a participant’s Roth IRAs begins as of January 1st of the first year in which a contribution or conversion was made to any Roth IRA owned by that participant
  - If the participant dies during the five-year holding period, then the five-year holding period “tacks” to the beneficiary (i.e. the holding period of the decedent and the beneficiary combined must be five years)

Taxation of Roth IRA Distributions

- If a distribution is a “non-qualified distribution”:
  - The distribution is first determined to be a non-taxable return of the Roth IRA owner’s previously taxed amounts (i.e. basis)
  - If the distribution exceeds the Roth IRA owner’s previously taxed amounts, the excess distribution will be subject to income tax

Taxation of Roth IRA Distributions

Step 1:
(Non-taxable)

Contributions

> Regular contributions
> Rollovers from other Roth IRAs
> Rollovers from "designated Roth accounts"

Step 2:
(Non-taxable)

Conversions (First-in, first-out basis)

> Taxable portion of prior conversion
> Non-taxable portion of prior conversion

Step 3:
(Taxable)

Earnings

Taxation of Roth IRA Distributions

- To the extent that an IRA owner is less than age 59½ at the time he/she receives a non-qualified distribution, the taxable portion of the distribution (i.e. “earnings”) will be subject to the 10% early withdrawal penalty
  - Exceptions to the 10% early withdrawal penalty:
    - Death
    - Disability
    - Substantially Equal Periodic Payments (SEPPs)
    - Medical expenses > 10% of adjusted gross income
    - Health insurance premiums paid by unemployed individuals
    - Qualified higher education expenses
    - Qualified first-time homebuyer expenses

Taxation of Roth IRA Distributions

- To the extent that an IRA owner is less than age 59½ at the time he/she receives a non-qualified distribution, the taxable portion of a previous conversion amount will be subject to the 10% early withdrawal penalty if the distribution is within a five-year period following the conversion
  - The five-year holding period is determined on a conversion-by-conversion basis
  - The five-year holding period for each conversion begins as of January 1st
  - If the year in which the conversion is made the exceptions to that apply to the taxable portion of a non-qualified distribution (i.e. “earnings”) also apply to the taxable portion of a prior conversion amount (e.g. death, disability, etc.)

Taxation of Roth IRA Distributions

- The amount of a non-qualified distribution subject to the 10% early withdrawal penalty is determined as follows:

  Gross non-qualified Roth IRA distribution
- First-time homebuyer expenses
- Prior year Roth IRA contributions

  Gross non-qualified Roth IRA distribution subject to 10% tax
- Taxable portion of prior year Roth IRA conversions > 5 years
- Non-taxable portion of prior year Roth IRA conversions

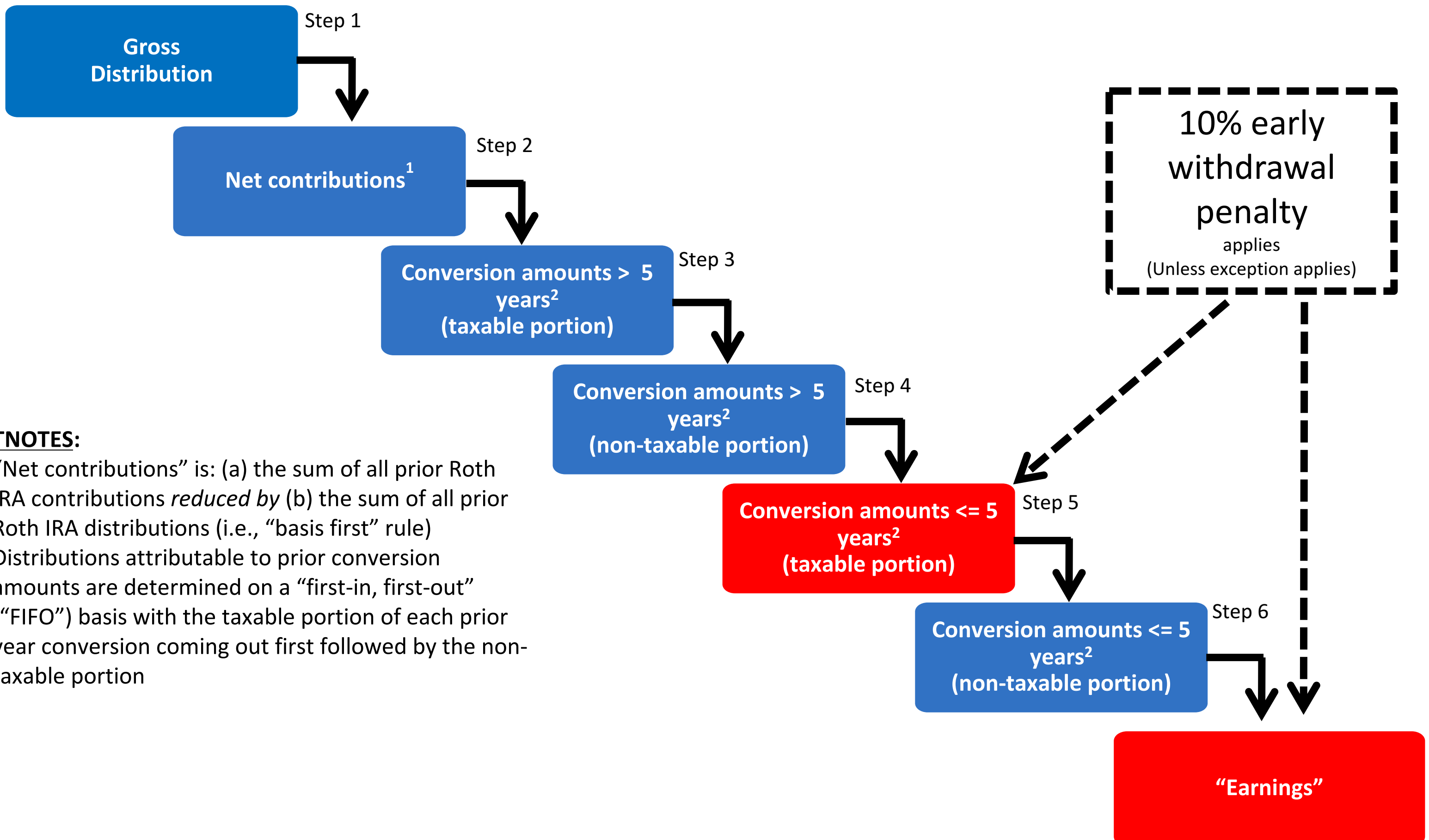
  Net non-qualified Roth IRA distribution subject to 10% tax

Taxation of Roth IRA Distributions

	Distribution within 5 years	Distribution beyond 5 years
Age < 59½	Income Tax: Yes (earnings only) 10% Penalty : Yes (earnings & taxable portion of prior conversion amounts)	Income Tax: Yes (earnings only) 10% Penalty: Yes (earnings only)
Age ≥ 59½	Income Tax: Yes (earnings only) 10% Penalty: No	Income Tax: No 10% Penalty: No

Taxation of Roth IRA Distributions

“Ordering Rules”

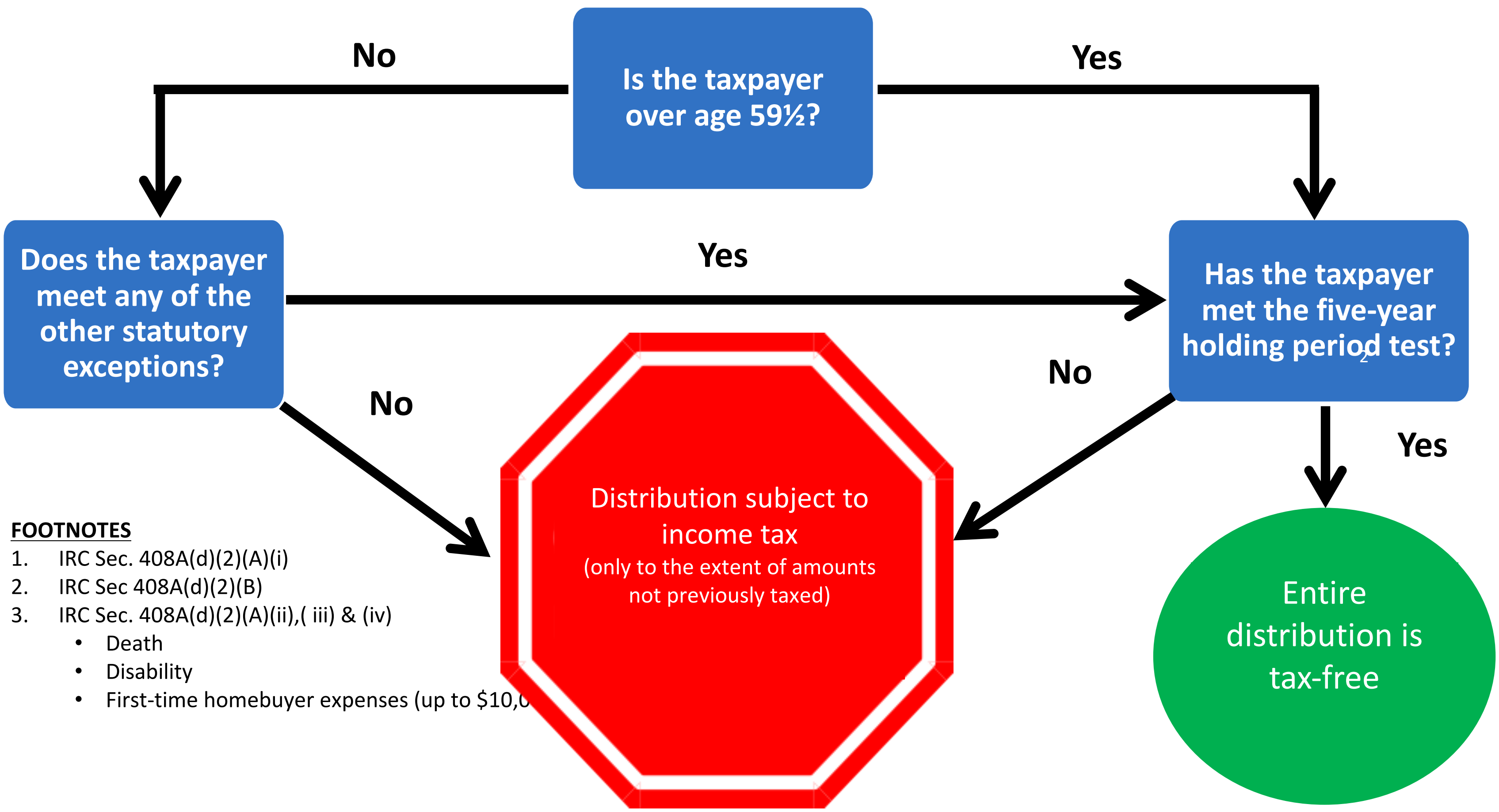


<u>FOOTNOTES</u>:

1. “Net contributions” is: (a) the sum of all prior Roth IRA contributions *reduced by* (b) the sum of all prior Roth IRA distributions (i.e., “basis first” rule)
2. Distributions attributable to prior conversion amounts are determined on a “first-in, first-out” (“FIFO”) basis with the taxable portion of each prior year conversion coming out first followed by the non-taxable portion

Taxation of Roth IRA Distributions

"Seasoning Rule"

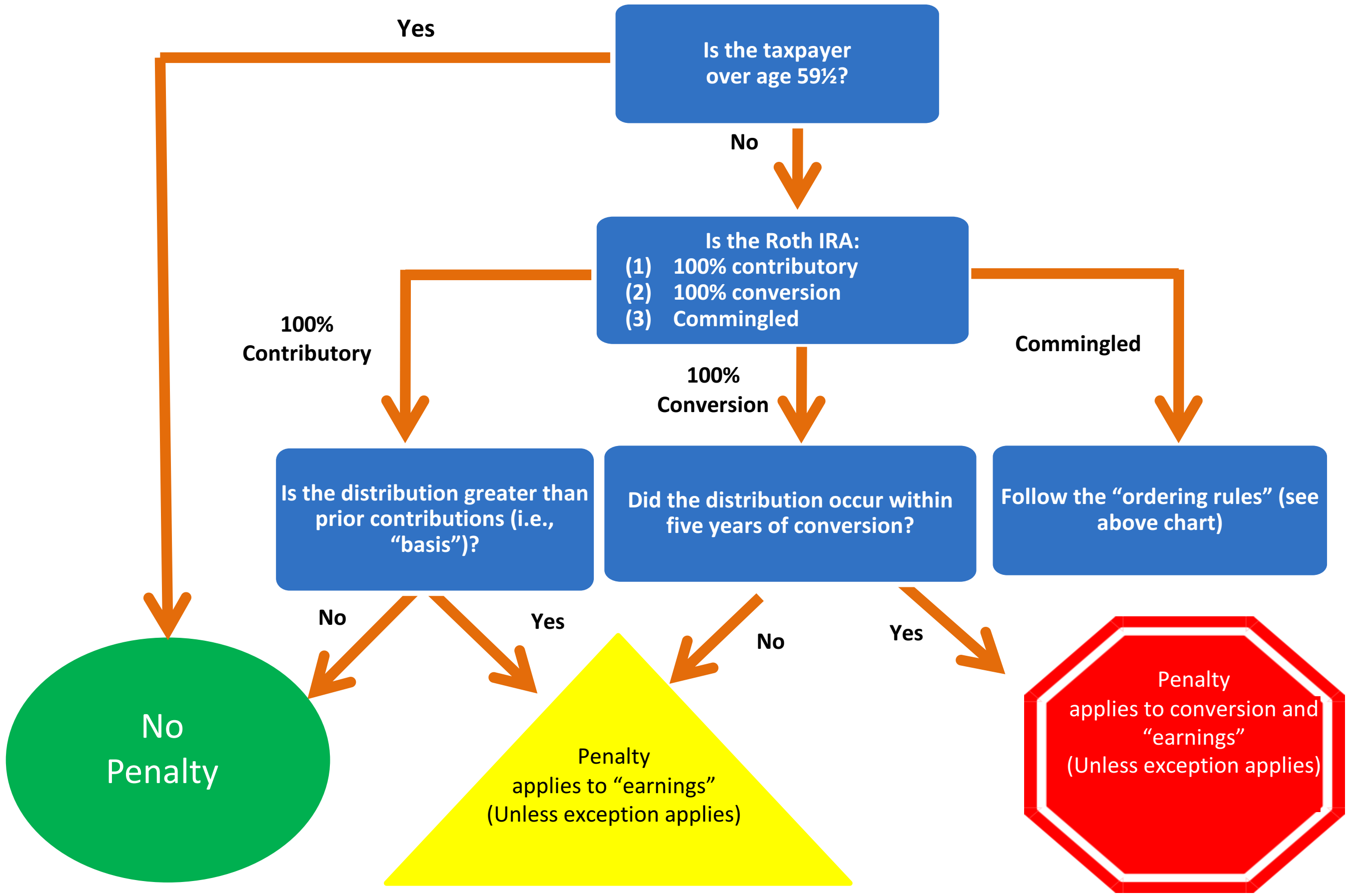


FOOTNOTES

1. IRC Sec. 408A(d)(2)(A)(i)
2. IRC Sec 408A(d)(2)(B)
3. IRC Sec. 408A(d)(2)(A)(ii),(iii) & (iv)
    - Death
    - Disability
    - First-time homebuyer expenses (up to $10,0

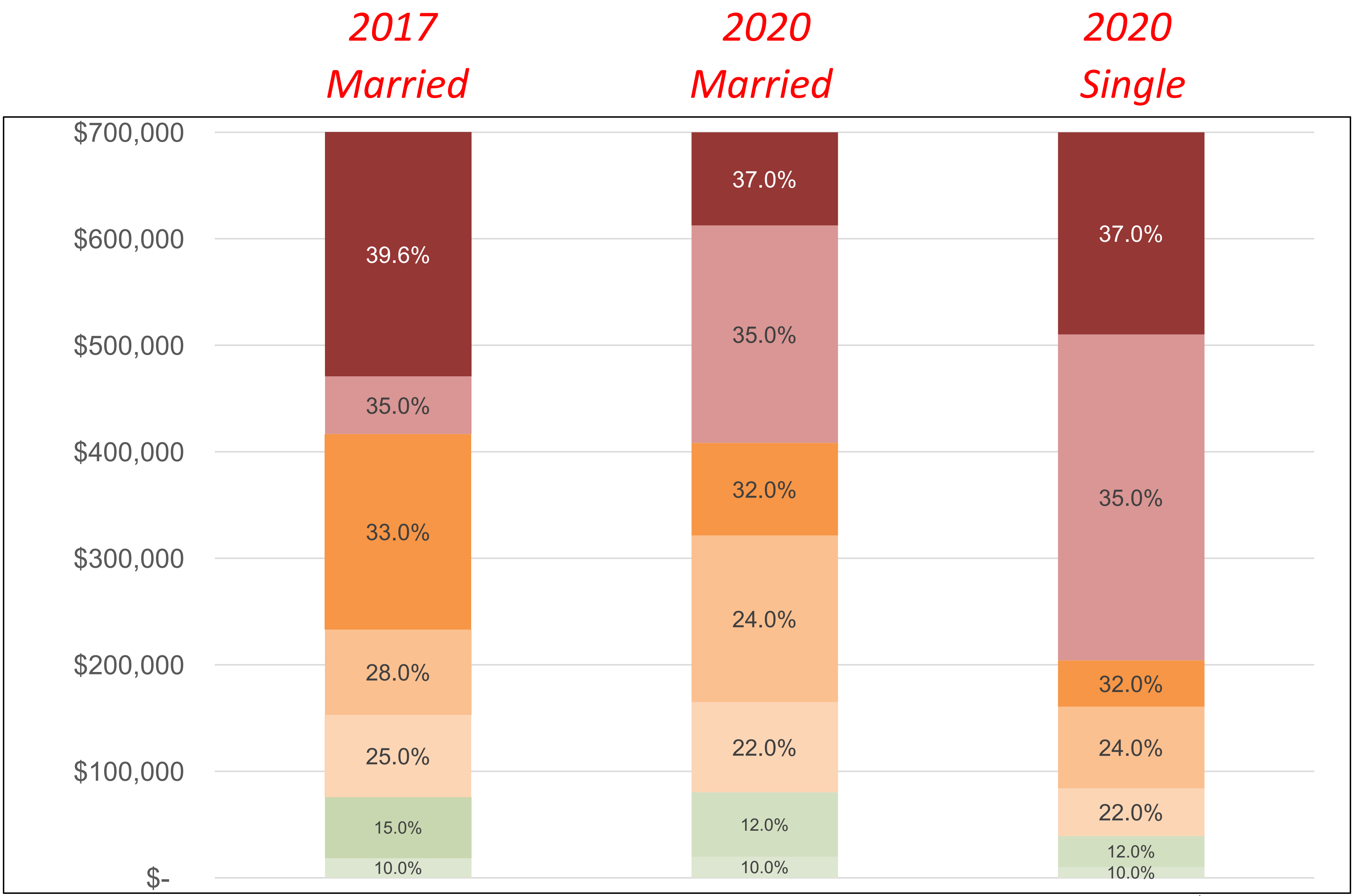
Taxation of Roth IRA Distributions

"Penalty Box Rules"



Exceptions to 10% early withdrawal penalty :

1. Death
2. Disability
3. Series of substantially equal periodic payments
4. Medical expenses greater than 7.5% AGI
5. Health insurance premiums for unemployed individuals
6. Higher education expenses
7. First-time homebuyer expenses (up to $10K)



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Mathematics of Roth IRA Conversions

Mathematics of Roth IRA Conversions

- In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:
  - The annual growth rates are the same
  - The tax rate in the conversion year is the same as the tax rate during the withdrawal years (i.e. A x B x C = D; A x C x B = D)

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Mathematics of Roth IRA Conversions

	Traditional IRA	Roth IRA	Life Insurance
Current Account Balance	$ 1,000,000	$ 1,000,000	$ 1,000,000
Less: Income Taxes @ 40%	-	(400,000)	(400,000)
Net Balance	**$ 1,000,000**	**$ 600,000**	**$ 600,000**
Growth Until Death	300.00%	300.00%	300.00%
Account Balance @ Death	$ 3,000,000	$ 1,800,000	$ 1,800,000
Less: Income Taxes @ 40%	(1,200,000)	-	-
Net Account Balance to Family	**$ 1,800,000**	**$ 1,800,000**	**$ 1,800,000**

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Mathematics of Roth IRA Conversions

- Tactical considerations
  - Unused charitable contribution carryovers
  - Current year ordinary losses
  - Net Operating Loss (NOL) carryovers from prior years
  - Alternative Minimum Tax (AMT)
  - Credit carryovers
  - Dollar-cost averaging to reduce the risk that the amount converted will decrease in value

Mathematics of Roth IRA Conversions

- Critical decision factors
  - Tax rate differential (year of conversion vs. withdrawal years)
  - Use of “outside funds” to pay the income tax liability
  - Need for IRA funds to meet annual living expenses
  - No RMDs
  - Tax-free post-mortem distributions
  - Time horizon
  - Estate tax considerations
  - Ten Year “Roth Coast” period

Mathematics of Roth IRA Conversions

Deferral Beyond the RBD

Using Outside Funds to Pay Conversion Tax

Tax Rate Arbitrage

10-Year Post-mortem Tax-free Growth
"Roth Coast Period"

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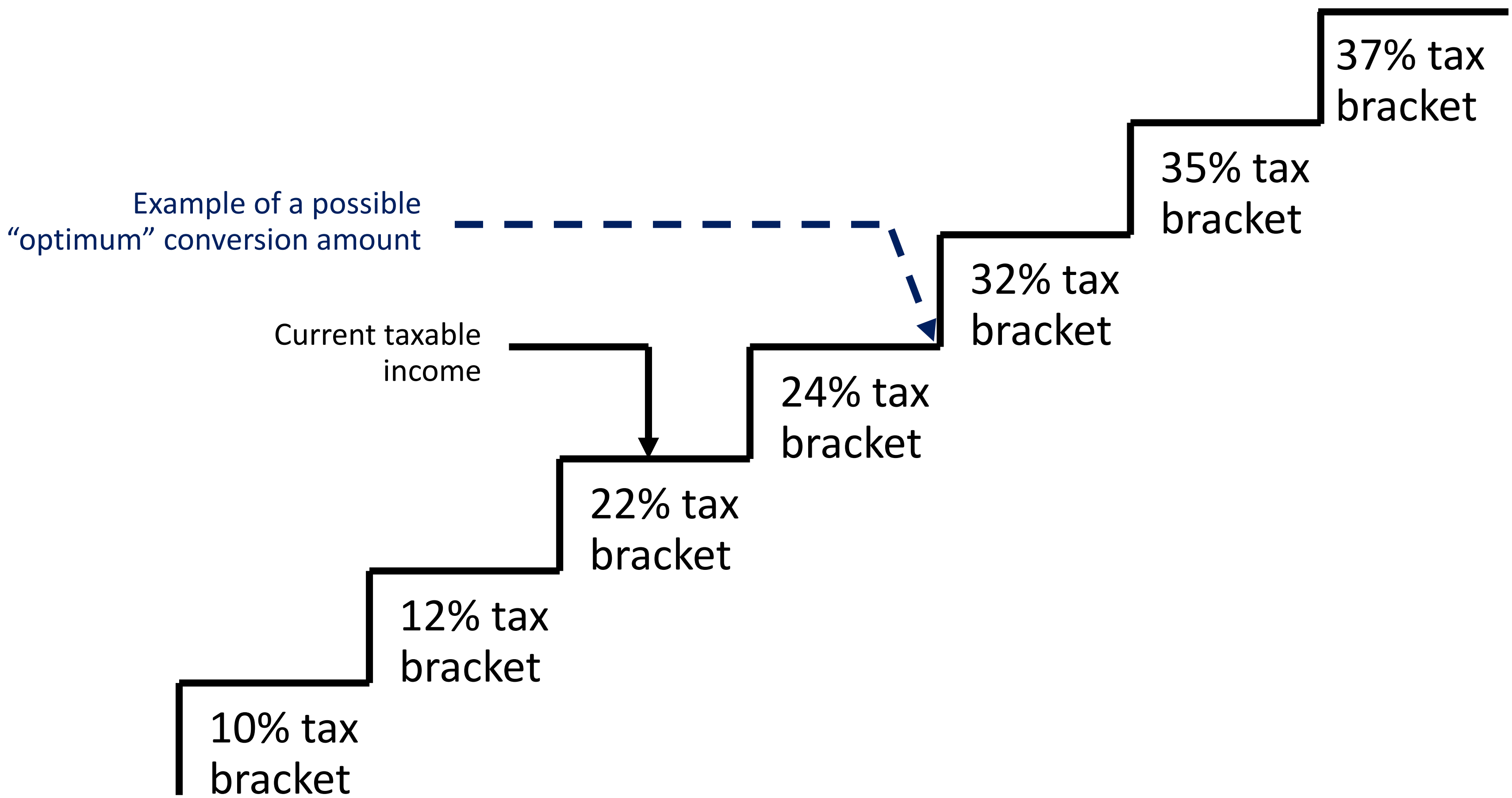
Mathematics of Roth IRA Conversions

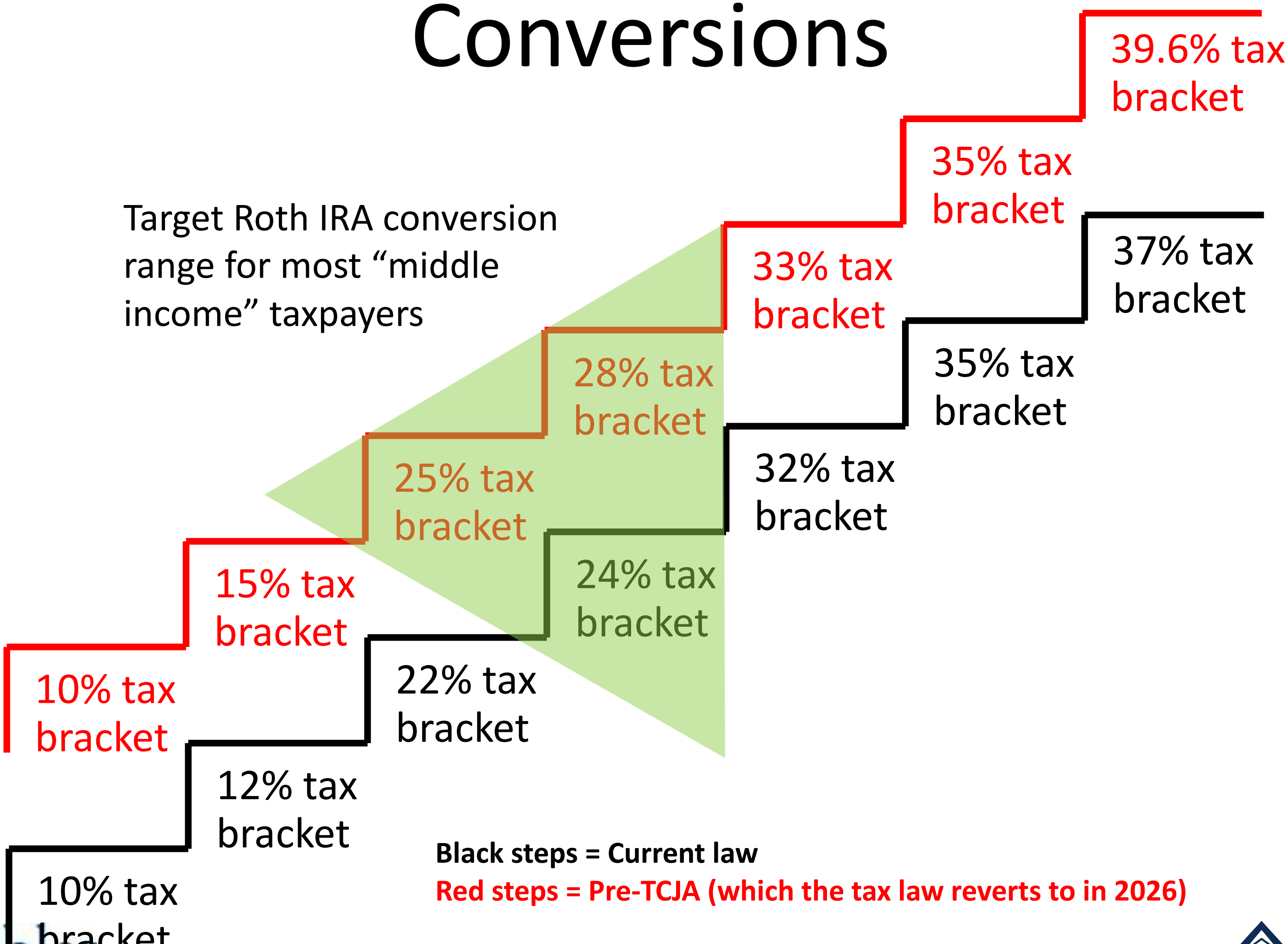
- The key to successful Roth IRA conversions is usually to avoid large jumps in brackets (e.g. converting at a 32% when distributions will likely be subject to a 24% rate will often be ineffective)

- Although brackets are the primary consideration, there are others: capital gains, AMT, NIIT, 199A, etc.
- Timing conversions in critical

Mathematics of Roth IRA Conversions



Mathematics of Roth IRA Conversions

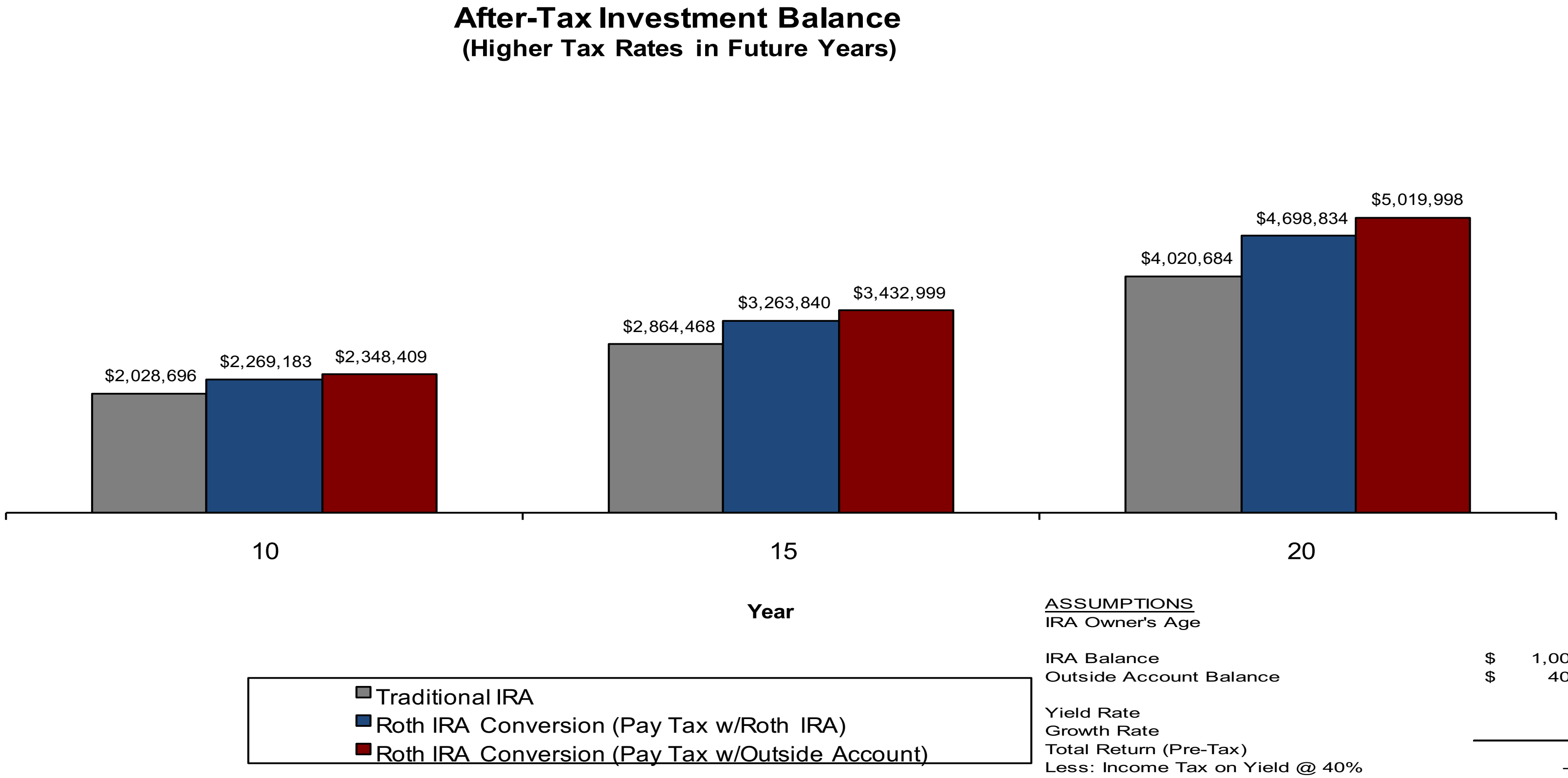


Mathematics of Roth IRA Conversions

- Tactical considerations
  - Unused charitable contribution carryovers
  - Current year ordinary losses
  - Net Operating Loss (NOL) carryovers
  - Alternative Minimum Tax (AMT) credits
  - Other credit carryovers

Mathematics of Roth IRA Conversions

Example #6 – 70 Year-Old IRA Owner



ASSUMPTIONS		
IRA Owner's Age		70
IRA Balance	$	1,000,000
Outside Account Balance	$	400,000
Yield Rate		2.00%
Growth Rate		6.00%
Total Return (Pre-Tax)		8.00%
Less: Income Tax on Yield @ 40%		-0.80%
Less: Income Tax on Growth @ 20%*		-0.60%
Total Return (After-Tax)		6.60%
Tax Rate - Current Year		30.00%
Tax Rate - Future Years		40.00%

* Assumes 50% annual turnover on growth

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Roth Conversion Subsequent to Owner's Death by **surviving spouse**

- Determine the likely IRA value at first spouse's death
- Acquire Insurance to pay the Roth conversion taxes at first spouse's death
- Conversions over 1-11 years

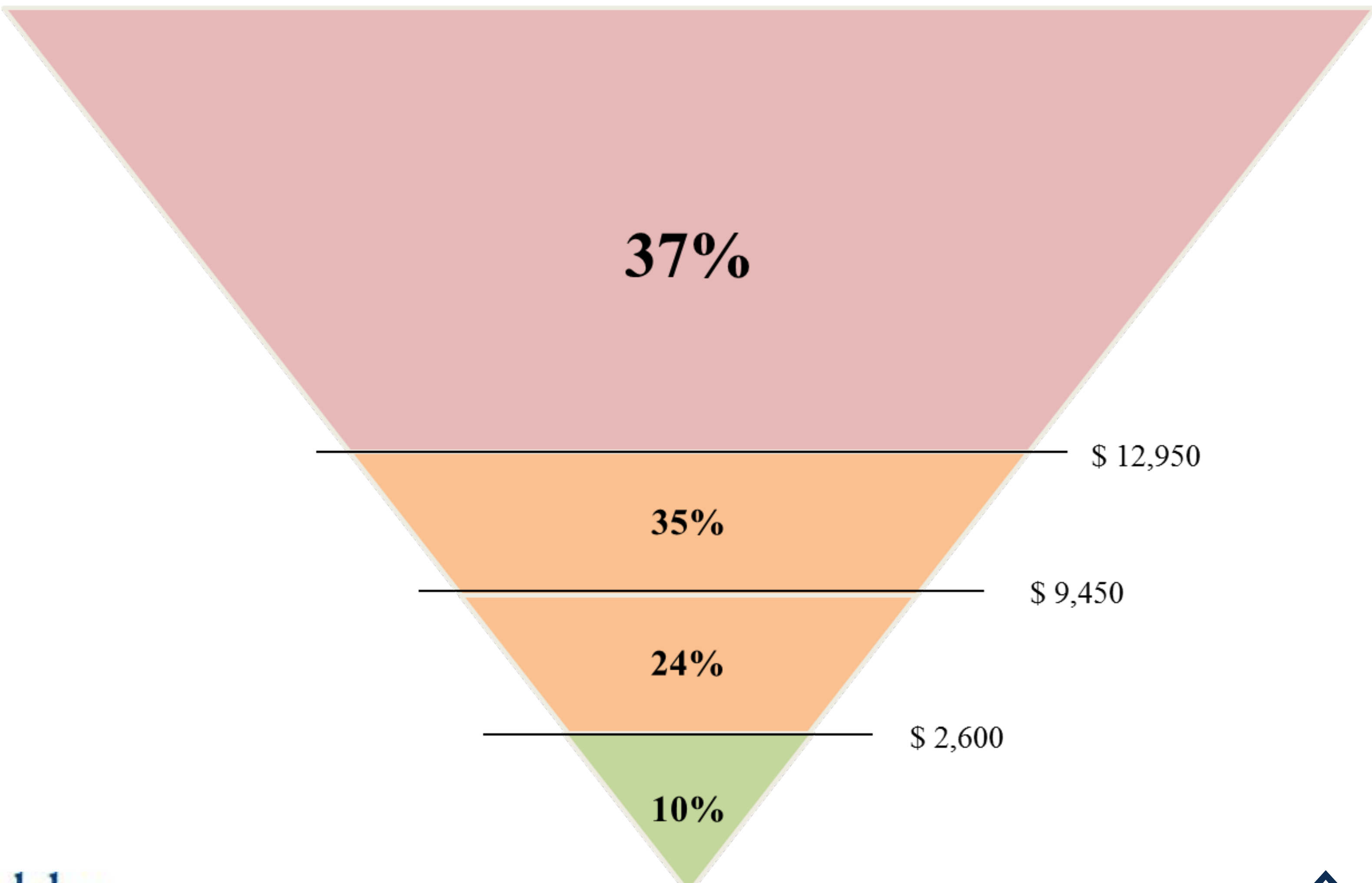
Income Taxation of IRA Trusts

Income Taxation of IRA Trusts

- Income taxed to either the trust or the beneficiaries
  - If income is accumulated, then the income is taxed to the trust/estate (37% Rate)
  - If income is distributed, then the trust/estate gets an income tax deduction and beneficiaries report taxable income
  - Roth and Traditional
  - IRA income distributed on a pro rata basis

Foundational Concepts

2020 Ordinary Income Tax Rates for Estates & Trusts



Foundation Concepts
General Tax Rules

- Two Trust Strategy
  - One Trust for the Traditional IRA
  - One Trust for the Roth IRA

Addressing Client Concerns

Clients are worried about:

- Tax consequences of distributions to self or beneficiary
- Protecting their family in a blended family scenario
- Creditor/Predator Protection for beneficiaries
- Spendthrift beneficiaries

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Trusted IRA

- What is a Trusteed IRA
- How does a Trusteed IRA compare to a Trust as a Beneficiary
- Benefits of a Trusteed IRA and how it answers ALL client's worries

Q & A

Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished)
Keebler & Associates, LLP
Robert.keebler@keeblerandassociates.com

Matthew Blattmachr, CFP
CEO, Peak Trust Company
mblattmachr@peaktrust.com