IRA UPDATE: APRIL 2012

Taxes on 2010 Roth Conversions are due

When 2010 rolled around, congress lifted the income restriction on Roth conversions and allowed an option to split the inclusion of the income half in 2011 and half in 2012. As April 2011 comes, the income from the first half of that 2010 conversion is reported on your 2011 return. The actual tax paid will depend on your other income for 2011.

The delay in owing tax can present several problems, especially with estimated taxes. If you did a large conversion in 2010 and took the two year deal, you would have been expected to make estimated payments in 2011 in anticipation of the tax owed. Estimated payments can avoid a penalty as long as you pay either 90% of the current year's tax liability of 100% of the previous year's tax liability (110% if income is above $150,000). So the safe harbor is to pay 100% (or 110%) of the previous year's tax liability. Since the income on the conversion was not included in 2010 (assuming you took the two year deal), additional estimated payments may not have been required however the tax begins to be due in April 2012. Keep in mind that when you pay the tax for 2011 in April of 2012, you will also need to make your first estimated payment for 2012 at the same time and then the next estimated payment is due just two months later.

So for 2012, the safe harbor is to make estimated payments based on 2011's tax liability which does include half the income on the conversion and this is fine since in 2012 the other half of the income will also be included. Where it gets tricky is in 2013 especially if there are no conversions in 2013. In order to meet the safe harbor, you would have to make estimated payments far greater than the tax you might expect to pay or you can attempt to hit the 90% estimate. If you make the estimated payments based on 2012, then you will simply get your money back when you file your 2013 tax return which won't be until April of 2014. If you try for the 90% of the current year and under estimate, then you will get hit with under withholding penalties. Be sure to discuss this matter with your CPA if this applies to you.

While that upfront tax hit on Roth conversions may seem expensive, it is important to keep the long term in perspective; current tax rates are near historical lows and may not stay this low for much longer. Plus by converting now, you are locking in these low tax rates forever and building tax free income for your future. If you think a Roth conversion might be right for you, give me a call and we'll discuss your situation.

Sincerely,

Jeremy E. Portnoff

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