



Important News for Those Taking RMDs in 2009

If you are taking Required Minimum Distributions (RMDs) from your IRA, you should know that the government elected to waive the requirement for 2009 only. If you would like to take advantage of this one-time waiver, but already took your distribution, you have until November 30th, 2009 to 'roll' the distributed amount back to your account without penalty. Please note, however, that this will count as your one allowed "rollover" within a 12-month period for that particular IRA.

Roth Conversion Strategies

Effective January 1st, 2010, Roth IRA conversions are on sale! Heretofore, many Americans have been restricted from creating Roth IRAs due to the fact that they made more than \$100,000 in adjusted gross income, the current limit for conversions. That restriction goes away permanently this January.

But that is only the beginning of the good news. Not only will more Americans be in a position to establish tax-free growth Roth IRAs from the conversion of their traditional IRAs or rollovers from traditional pension plans like 401(k)s, but for 2010 only, they'll be allowed to spread the tax impact (normally payable in the tax year associated with the year of conversion) over two subsequent years (2011 and 2012). This effectively spreads a 2010 conversion tax consequence over three years (2010-2012).

Thus, if you convert in 2010, you do not have to report the tax due on your 2010 tax return, although you may elect to do so. Instead, if you do not report the taxable amount on your 2010 1040, you are allowed to report the taxable amount of the converted funds on your 2011 and 2012 tax returns. When you do, you have to split the tax liability equally between the two years (50% each year) and the total taxable amount of the converted funds has to be reported by time of your 2012 tax return filing. This opportunity, it is important to note, goes away after 2010. While you'll still be able to convert regardless of income after 2010, you won't be able to defer the tax impact to subsequent years – i.e., taxes will be due in the year of conversion.

Why is this happening? Well the Government (it is no secret) needs funds, and to encourage these taxable conversions, they're enticing savers with the extra incentive of spreading out the tax burden. Where can you reference this in the code? The lifting of the Roth conversion income restriction was initiated by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

Strategies to consider

1. First of all, you may not want to wait until 2010 to convert if you are currently eligible (expect to make less than \$100,000 AGI in 2009). Suppose you expect that your earned income will be less this year than next, and, therefore, you're in a lower income tax bracket this year than you expect to be next. Then, you might want to convert now. Also, you may have assets that are undervalued now that you could convert this year with lower tax consequences, because you expect that they will appreciate in 2010. Either or both of these circumstances would suggest that it may be advisable to convert in 2009, i.e., sooner than later.

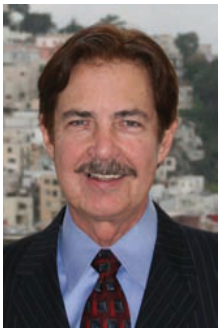
2. You may want to convert into multiple Roth IRAs for two reasons:

- You may need to reverse one or more conversions back to traditional IRAs (called re-characterizations) and having more than one Roth IRA to choose from can allow you to choose the losing Roth if some investments are doing better than others. That way your winners will continue to grow tax-free.
- It is probably best not to combine your converted traditional IRAs with Roth IRAs

formed in prior years, because if you ever have to re-characterize, the calculations can be complex.

3. You may want to convert only a portion of your traditional IRA(s) because you may have one or more depreciated assets that are likely to appreciate in the future. Converting the assets before they appreciate will save you on taxes that would apply if you were to convert after they appreciate. Also, the overall tax burden may be too high for you if you convert all of your traditional IRA(s) in one year.

4. Bear in mind that there is a five year rule associated with Roth distributions. Any distribution during the five-year period starting on January 1st of the year of your conversion, will be subject to a 10% penalty on the entire amount of the conversion (not distribution), unless the distribution is made after age 59.5 or another exception applies. Also, if an individual who spread out the income inclusion over 2011 and 2012 dies before 2012, the deferred amount is includible in the year of death, unless the spouse acquires the deferred amount.



Tom's Column

Q. I am in real estate and do many creative deals. My trust-worthy fiancé - presently not a disqualified person, right? - has proposed that my self-directed Roth IRA pay \$2,000 now in exchange for the first contract payment of \$5,000 that she'll receive on timber she owns when

she sells it later this year. She needs cash now more than later. The IRA, would, presumably benefit us both later. I understand SDIRAs pretty well, but I am anxious. Could I be penalized by the IRS for making too high a return like this, especially with my fiancé? Is risk relative to reward factored in at all by the IRS? We have a joint bank account but won't marry before the payoff is made? Thank you.

A. Your scenario raises a number of issues. First, certain "judgment clouding" transactions between an IRA and an individual with whom the IRA owner has an interest and who may impact the IRA's investment decisions are prohibited. It is not clear (there is no "bright-line" in the regulations) which transactions and which "individuals" (e.g., possibly your fiancée) are covered by this prohibition, but there is a risk that the Department of Labor or the IRS might regard a loan to a fiancé, especially when motivated by a "need for cash," as falling within the scope of this prohibition. Second, although I know of nothing specific to reference on this point, I suspect the IRS would scrutinize the high payback by someone close to you as an avoidance of the Roth IRA contribution limits. This is an issue that is high on the IRS' priority list, as Roth IRA issues directly affect tax revenue. Your scenario may also involve Unrelated Business Income Tax (UBIT) issues associated with the timber business, as well as possible usury issues associated with the interest rate - since this is a loan to an individual. While I cannot offer any specific advice, I would strongly consider consulting with a qualified attorney familiar with prohibited transaction rules before proceeding with your plan. Such a professional may be able to suggest an alternative approach that would pose less or no risk to your Roth IRA.

Self-directed IRAs are Buying Lots of Real Estate

Poor credit and limited finances don't have to stand in the way of investing.

While today's residential market is flooded with foreclosed properties, the resulting devaluations in many parts of the country are creating unique opportunities for long-term investment buyers. With many consumers increasingly concerned about liquidity as a result of the reeling economy, investors are turning to their retirement accounts to take advantage of an incredible buyer's market. Since the credit market is effectively in neutral, investors are scooping up properties in some areas for less than 50% of appraised value, with all cash purchases with their self-directed IRAs.

For example, on July 6, I heard from a real estate broker in Florida that he was able to purchase a 2,800 square ft. home on a golf course in a gated

community (and needing no repair) for \$100,000. It was listed by the bank that foreclosed on it at its appraised value of \$200,000, and it sold two years ago for \$440,000!

Although we may not yet have reached the bottom of the market for residential real estate, and the window of opportunity will likely stay open until the third or fourth quarter of 2010, today's prices are creating the dual potential for significant appreciation within the next five- to ten-year time frame, as well as the production of positive cash flow during the holding period.

Experienced real estate investors, brokers and realtors are taking action now, recognizing that more foreclosures will follow in the first quarter of next year as adjustable rate mortgages (ARM mortgages) sold in 2007 kick in with a vengeance.

At PENSCO Trust, we have seen a 32% increase in IRA real estate purchases (up from \$19 Mil to \$26 Mil) between the first and second quarters of this year. Most of this increase was associated with foreclosures in the residential market, however, we have also seen quite a few real estate syndicators buying up unimproved land (undeveloped lots), with the idea of conditioning it through entitlement in time for the next upswing in the real estate development sector. In some cases, they are buying at 10 cents on the dollar. These deals are not for the faint of heart and may require a longer holding period, so they are not suitable for anyone with liquidity needs. However, this is exactly what makes them a potentially good fit for IRAs, because unless you're currently taking distributions, long holding periods are what saving for retirement is all about. Another avenue self-directed IRA investors are pursuing is to provide credit to others for the purpose of buying real estate. With traditional credit markets almost nonexistent, borrowers are getting needed funds from IRA investors looking to increase the investment yield on their retirement accounts. Such investors may offer the down payment, first or second mortgage, or even become a co-tenant on a purchase when the buyer does not have the necessary funds.

For example, one (non-IRA) investor may locate a great investment property, but not have sufficient funds to buy the property. By combining forces and funds with an IRA investor, who may participate through an equity investment or an extension of credit, they can jointly acquire the property.

Certainly, investing today is more challenging than in a bull market, but some things are certain. Real estate values are down in most areas of the country, building has almost come to a screeching halt and demand will eventually catch up to supply, at which time prices will rise. How long that will take is anyone's guess, but some like those odds better than investing in the stock market. Whatever strategy you choose, the fact remains that you must take action to keep your wealth growing.

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