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Charitable Fund Can Help Offset Fees Associated with ROTH IRA Conversion

Adapted from Jeffrey J. Pritchard, CFP at the Tacoma Community Foundation by Mauri Ingram & Pamela Jons, Whatcom Community Foundation

Over the last year we have seen a number of articles, analysis and anecdotes urging upper-income taxpayers to take advantage of a once-in-a-generation opportunity -converting traditional tax-deferred IRA into a tax-free ROTH IRA.

ROTH IRAs have long been recognized as a superior retirement saving vehicle since savings compound faster over time tax-free vs. tax-deferred. Congress restricted ROTH access, making them unavailable to upper-income individuals and couples. However, a one-time window of opportunity exists in 2010 for taxpayers of **any** income level to convert their traditional IRA into a ROTH IRA. And that window will close in 2011.

What's the Catch? Any IRA funds converted to a ROTH IRA are reportable as regular taxable income and thereby taxable at your highest marginal rate. That could generate a sizeable amount of tax liability. As a result, what might have been a straightforward obvious decision becomes complex. In order to accurately estimate if future tax-free growth can compensate for the premature tax payment, one now enters the world of financial modeling with a myriad of critical assumptions such as future growth rates, future tax rates, life expectancy, and other exciting conversation topics.

For those who are philanthropically inclined and contemplating a significant charitable gift, or even gradually increasing their annual giving - this is the year to act! Tax-deductible charitable contributions made in 2010 can offset taxable "income" created by converting to a ROTH IRA. But what if an individual is uncomfortable making such a major gift all in one year?

The Community Foundation's Unique Role: offsetting all the taxable income generated by a ROTH conversion necessitates an equally significant charitable gift. And while many individuals may contribute at that level cumulatively over a period of years, they may be uncomfortable in making such a large gift, and would prefer to maintain more modest annual support over time. (Translation: The amount you need to contribute to offset taxes may be much more than you normally give annually, but what about cumulatively over 5-10 years?)

By establishing, or adding to, a charitable fund at The Whatcom Community Foundation, individuals can take the full charitable tax-deduction in 2010 to offset their IRA conversion, and support charitable organizations gradually over time from their fund, providing the same consistent, annual support that they have provided in the past.

In utilizing this charitable fund strategy, individuals and couples can take advantage of the one-time ROTH IRA conversion opportunity, offset resulting taxes for 2010, AND maintain the manner in which they've supported the charities of their choice.

If you would like to discuss any of the above in greater detail, please contact Mauri Ingram or Pamela Jons at 360-671-6463. As with all tax-related issues, individuals should consult with their professional tax advisor.