

How Charitable Giving Can Help Reduce Taxes Resulting from Roth IRA Conversions



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Thinking of converting your traditional IRA to a Roth IRA? Roth IRAs are a popular retirement vehicle because they enable you to withdraw earnings in retirement tax-free and do not have the required minimum distribution requirements of traditional IRAs. Up until recently, however, only those with a Modified Adjusted Gross Income (MAGI) of not more than \$100,000 qualified for a Roth IRA conversion. On January 1, 2010, the IRS dropped this restriction and, as a result, millions of Americans can now convert assets held in traditional, SEP-, or SIMPLE IRAs, or a 401(k) from a former employer to a Roth IRA.

To Roth or Not to Roth?

Converting to a Roth IRA is a taxable event¹, and the primary reason for allowing higher income earners to convert to a Roth IRA is to accelerate the collection of income taxes that might have otherwise been locked up in traditional IRAs for decades to come. As such, it is important that you consider a variety of factors when deciding whether to convert. Even though you may have to pay current income tax on the amount you convert to a Roth IRA, it still might make sense if:²

- You think you will be in the same or a higher tax bracket when you anticipate withdrawing funds,
- have a long time horizon, **and**
- you can pay the tax from sources other than your IRA (a regular taxable brokerage account or bank account) and/or contribute to charity from these sources to help offset the tax.

or

- You don't need to use the money and want to leave assets in a Roth IRA to your heirs.

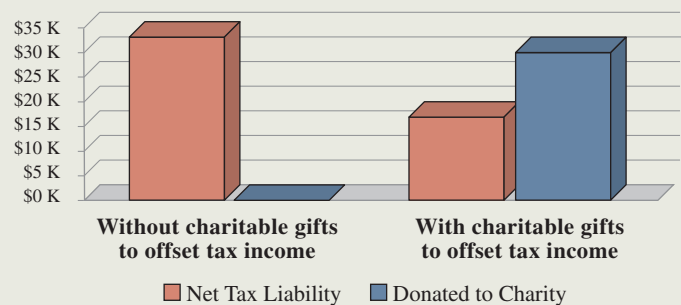
Of course, individual circumstances vary, and you should consult with your tax and financial advisors. There are also helpful tools available on the web that can help to determine if converting to a Roth IRA makes sense for your specific situation.

Charitable Gifts May Help Reduce Your Taxes

If you are considering a full or partial conversion, a charitable gift can be a great way to reduce the income taxes resulting from the conversion and support philanthropic causes important to you. As the hypothetical example to the right demonstrates, by choosing to make a charitable gift of non-IRA assets in the same year as the conversion, you could pay a smaller amount in taxes by reducing your taxable income and (potentially) your marginal tax rate. You will need to consult your tax advisor for advice on your specific situation.

You can make an incremental charitable gift or, if you have charitable donations planned for future years, you could consider accelerating them into the Roth conversion year. Generally, the deductibility limit for charitable gifts to most charities is 30% of Adjusted Gross Income (AGI) for gifts of appreciated securities held for more than a year and 50% of AGI for gifts of cash. Gifts of appreciated securities held for more than a year carry the additional benefit of avoiding capital gains taxes on their eventual sale.

**\$100,000 ROTH IRA CONVERSION
HYPOTHETICAL EXAMPLE**



Assumes a \$100,000 conversion. Without charitable gifts to offset tax income, assumes 33% marginal tax rate on conversion. With charitable gifts to offset tax income, assumes donation from non-IRA sources of \$30,000 in highly appreciated securities with a basis of \$15,000. Assumes that charitable deduction reduces donor's taxable income to a 28% marginal tax rate. Net tax liability is calculated as the actual taxes paid (\$19,600) offset by \$2,250 in capital gains taxes avoided on donation of appreciated securities, calculated at a 15% capital gains tax rate.

A Charitable Gift Account Can Simplify the Process

If you are considering making larger than normal charitable gifts this year to offset taxable income from a Roth IRA conversion, opening a Charitable Gift Account with a donor-advised fund provider (like Schwab Charitable) may make sense. It allows you to make an irrevocable charitable contribution and receive an immediate tax deduction, but spread decisions about grant recommendations to desired charities over time as you see fit. You may contribute gifts of cash, appreciated securities, C- and S-corp stock, and real estate, depending on the specific sponsoring organization. The donor-advised fund sponsor handles all the administrative details, granting and due diligence on the Account so that you can focus on the more enjoyable aspects of philanthropy.

Schwab Charitable Can Help

For more information on how charitable giving and donor-advised funds might help to defray the taxes associated with a Roth IRA conversion, please call us at (800) 746-6216 or email ask@schwabcharitable.org. We would be delighted to help you.

¹ Generally, the amount converted is treated as taxable income. There is a special rule in place for 2010 that allows you to recognize 100% of the conversion income in 2010 or split it equally between 2011 and 2012.

² "2010 Roth Conversion: Look Before You Leap." Rande Spiegelman. Schwab Center for Financial Research. www.schwab.com