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A PROFESSIONAL LAW CORPORATION

Reflections at Year's End

As we embark upon the Good Ship Hope for our journey into 2010, our reflections on the events of the past year stir mixed emotions. Some of us met with good fortune and enjoyed good health; however, for many, this was a difficult year, and for others, it was disastrous. We certainly hope that you fall into the former category. Whatever your circumstances, we thank you for being a friend to the Firm, for as clients, advisors and colleagues, you helped us to steer The Rack Law Firm, P.C. through challenging changes of course in 2009 towards a brighter horizon.

In 2009, we welcomed our newest attorney, Flora Hezel, to the firm from the Office of the Attorney General of Virginia, where she honed her skills in civil litigation of tax matters in both federal and state courts. She has been on maternity leave for the month of December to care for her new baby boy, and we plan to welcome her back to the office in early January. We also welcomed (back) Nathan Olansen to his practice in advanced estate planning and administration, including fiduciary and estate tax compliance and controversies. Our new Trust and Estate Administration paralegal, Anna Teets, brings her advanced experience and responsibility to one of the most active practice areas in the Firm.

Recently, we developed and launched our "new and improved" Estate Steward Program, which gives select estate planning clients the option to choose one of three distinct levels of client service and benefits. The Estate Steward Program (ESP) offers a flexible structure for the enhancement of the attorney-client relationship by way of a meaningful annual estate plan review, an invitation to educational workshops and seminars and, for ESP Elite members, convenient access to our attorneys that is unparalleled in Hampton Roads. If, as a client of the Firm, you have not enrolled, or at least evaluated, our new Estate Steward Program, please consider the letter and enrollment forms sent to you in early December as your renewed invitation. If you did not receive one, please contact me or our ESP Program Director, Erin Hamberg, for your program description and enrollment materials. We think you will find that the course we have charted is in the right direction.

Will Congress Pass a New Year's Resolution?

While the start of the New Year is always full of possibilities and a full measure of doubt, the mystery that shrouds the future of the federal estate tax saga continues to defy resolution. In the wake of the turbulent congressional ship of state, the precarious status of estate tax legislation is that - to follow the nautical theme - there is no rudder. Since we last wrote on

the matter, Congress has succeeded in distracting itself from the looming legislative deadline: due to inaction, there will be no estate tax imposed on estates of persons dying between January 1 and December 31 of 2010. That is not a misprint, you read it correctly: Come January 1, 2010, there will be no federal estate tax. Of course, beginning on January 1, 2011, the federal estate tax will return with a vengeance, reducing the estate tax exemption amount from the current \$3.5 million per person to the 2001 threshold of \$1 million. Those who still dare to predict the future conduct of this Congress opine that their perceived solution to the impending repeal of the estate tax will be a retroactive “patch” that will extend the \$3.5 million exemption through 2010. It is believed that this sort of resolution will buy time within which to create a new estate tax regime designed to support the spending habits of our legislative and executive branches of government. Keep your eye on the horizon and beware the mirages which afflict the weary sojourner (did we mention sea-sickness?). Godspeed.

The Distraction of Health Care Reform

Health care “reform” legislation has dominated Congressional debates for the past eight months and has consumed those institutions with efforts to support or defeat some form of it. The House passed its version of health care legislation on December 3, 2009, and as this *e-Legal* goes to the internet, the Senate endured a late-night session to pass its own version of a health care bill. Both houses of Congress will now begin the process of negotiating their way to a blended version of health care legislation which will require passage in both the House and Senate. Many anticipate that this next phase (often likened to the process of making sausage) will be more contentious than the first eight months, and that the battles will rage well into the summer. If that should happen, the incentive for Congress to enact reformative estate tax legislation in the late summer will decrease: (1) too far away from 2011; (2) too close to fall elections to reduce the exemption (in fact, many will be focused on campaigns for re-election); (3) too hot and muggy in Washington, assuming they aren't on August break.

Moreover, the budget deficit will continue to exceed \$1 trillion and the national debt will have reached a level that was unthinkable just a few years ago. Thus, if Congress continues to be distracted away from actually enacting estate tax legislation, the likely outcome is a brief (one-year) period of estate tax “windfall” in 2010 as required under current law, followed by the automatic “sunset” of the 2001 Tax Act and the return to an estate tax exemption of \$1 million for 2011 and beyond. For those legislators who desire to raise tax revenue without the political stigma of sponsoring tax legislation, this solution is an exquisitely simple strategy. We will keep our eyes on the horizon and keep you informed - *especially* if there is no New Year's resolution in sight.

Meanwhile, on the home front, we understand as well as anyone that the continued failure of Congress to enact a permanent solution to the estate tax conundrum gives rise to considerable challenges in the world of estate planning. Revocable and irrevocable trusts which were prepared under widely-held assumptions about the estate tax just a few years ago may have unintended results next year. Gift-making strategies may need to be implemented or ceased, depending upon the taxpayer's circumstances. If your estate plan has not been evaluated under the current legislative climate and the prospects discussed above, prudence dictates that a review

of existing legal instruments and current asset values in these uncertain times should be undertaken soon.

A Roth IRA in Every Pot

Now that we have made public our cynical insinuations about our Congress, we must credit lawmakers with one item they got right (but still enigmatic to most): the Roth IRA conversion. Conversions of a traditional IRA account to a so-called Roth IRA have been restricted legislatively to taxpayers with a modified adjusted gross income ("MAGI") of less than \$100,000, thereby restricting higher income taxpayers from the income tax benefits of a Roth IRA. However, as of January 1, 2010, the \$100,000 limitation will be eliminated, making the Roth IRA conversion available to all taxpayers, regardless of income. The suitability of the Roth IRA conversion can be determined by examining the benefits of a Roth IRA and evaluating the strategies for minimizing the income tax liability triggered by a conversion.

There are numerous benefits to owning a Roth IRA, but three of them are the most significant:

1. While distributions from a traditional IRA, 401(k) plan or 403(b) plan account are taxable as ordinary income, distributions from Roth IRA accounts are tax-free (note that there are penalty exceptions). Essentially, Roth IRAs disburse free money.
2. As opposed to all other retirement accounts, you are never required to take even a minimum distribution from a Roth IRA. This feature allows for unlimited, tax-free accumulation of your retirement assets until the time you decide to make a withdrawal (if ever).
3. Converting a retirement account to a Roth IRA presently serves as a hedge against future increases in income tax rates. Considering that individual income tax rates are lower now than anytime in the past 70 years, a reasonable inferential leap brings us to the conclusion that those rates are likely to increase in the future. This, in turn, supports the strategy of intentionally incurring the income tax liability on retirement account assets in the present in order to convert to a Roth IRA, since the owner is able to "lock in" current income tax rates.

If it is determined that a Roth conversion is the right strategy, a taxpayer must plan for payment of the income tax liability triggered upon conversion, which can be substantial. There are some opportunities to consider. If an IRA is converted in 2010, the owner may elect to pay the income tax due on the conversion in two installments: the first, due on April 15, 2011, and the second, due on April 15, 2012. This is an attractive option for someone who is averse to paying a large income tax bill all at once.

Conversion to a Roth IRA may also facilitate taking advantage of favorable tax attributes that might otherwise go unused. For example, the gain triggered by a Roth conversion may be offset by expiring charitable deduction carryforwards, net operating loss carryforwards (which many small business owners now have), and investment tax credits. There is an unusually

forgiving feature which encourages the conversion: any Roth conversion may be re-characterized as long as it is done by the end of the year. This “do-over” allows one to reverse the Roth conversion and treat it as if it had never occurred. Finally, for those taxpayers who are exposed to an estate tax liability, converting to a Roth IRA results in the voluntary (sort of) reduction in the size of the taxable estate with the payment of the income tax liability (in effect, prepaying the estate tax at significantly lower ordinary income tax rates). For those who are not in danger of the imposition of an estate tax (not counting 2010), the considerations favoring a Roth conversion should include the satisfaction of disclosing to one's fellow retirees that, even if he took an amount the others call a "required minimum distribution," he still would not have to pay income tax on the withdrawal. It is indeed a wonder that every household still does not have a Roth IRA.

This Situation Calls for Well-Informed Bravery

The New Year presents as much uncertainty as any in recent memory. From the limited perspective of the estate and income tax world, the future is downright mysterious. Nonetheless, for those not faint of heart, opportunities can be found to reduce income and estate tax liability, and we welcome inquiries by our clients and their advisors into the legal and tax topics addressed in this *e-Legal*, including the Roth IRA conversion celebrated above. And as long as there are reasons for celebration, we want to wish for you and yours a safe and prosperous New Year. Best wishes for success in the pursuit of happiness in 2010.

~ Kevin B. Rack, Esq.
~ Nathan R. Olansen, Esq.

Happy New Year!!