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Four years ago, the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) relaxed some restrictive rules preventing many taxpayers from converting a traditional IRA to a Roth IRA, but this favorable change was not effective until 2010. Well, 2010 is almost here and the old saying “good things come to those who wait” is certainly true in this case. This article will explain why the timing for this rule change could not have been better.

Roth IRAs offer benefits not available with a traditional IRA. First, earnings are distributed tax-free if basic Roth requirements are satisfied. Next, owners are never required to take distributions during their lifetime, so earnings can continue to compound for the benefit of the beneficiary. Finally, contributions can be made after age 70½ for additional tax-free growth.

Prior to TIPRA, traditional IRA owners could convert their account to a Roth IRA, pay any taxes due from the conversion, and receive Roth IRA benefits going forward. There was, however, a major obstacle for many taxpayers. The conversion privilege was only available when the taxpayer making the conversion had modified adjusted gross income of \$100,000 or

less. TIPRA removed this restriction beginning in 2010, and also provided that any taxes due on 2010 conversions could be paid one-half each in 2011 and 2012.

Now let’s discuss the timing aspect of the new rule for you patient investors considering a Roth conversion. If your traditional IRA has dropped in value and you expect to pay higher federal income tax rates in future years, now might be a very good time to consider converting all or part of your traditional IRA balance into a Roth IRA. Here’s why. If you convert, it will likely trigger a current tax hit on the taxable portion of the amount of your conversion. But, with your traditional IRA balance at a somewhat lower level than in previous years (and possibly your overall income, too), the tax hit will be less. Then, after the conversion, your new Roth IRA



## Traditional to Roth IRA Conversions

*(Continued on page 2.)*

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# Deduction for Qualified Motor Vehicle Taxes

Unless extended by Congress, the new temporary deduction for state and local sales and use taxes on qualified vehicles established in February by the American Recovery and Reinvestment Act will end after December 31. The deduction is




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available for sales and use taxes on new vehicle purchases for up to the first \$49,500 of the purchase price. Qualified vehicles include passenger autos, light trucks, motorcycles, and motor homes.

Taxpayers who itemize can claim this deduction as an additional itemized deduction, while nonitemizers can add the deduction to their standard deduction amount. In either case, this deduction is allowed for both regular tax and AMT purposes.

The new deduction is subject to phase-out provisions. The phase-out range for unmarried individuals and married individuals who file separately is between modified adjusted gross income (MAGI) of \$125,000 and \$135,000. The phase-out range for married joint-filing couples is between MAGI of \$250,000 and \$260,000. For this purpose, MAGI is computed as regular adjusted gross income increased by certain income from outside the U.S.

For 2009, however, itemizers who elect to deduct state and local general sales taxes in lieu of deducting state and local income taxes cannot claim the new vehicle sales and use tax deduction separately (it is included along with their other state and local sales taxes). But, these taxpayers can deduct state and local sales taxes on qualified motor vehicle purchases without regard to the \$49,500 purchase price limitation, the AGI phase-out, or whether the vehicle was new or used. However, the new qualified motor vehicle sales and use tax deduction is allowed for AMT, whereas the amount deducted in lieu of state and local income taxes is not. 


## Traditional to Roth IRA Conversions (Continued from page 1.)

balance can build up federal-income-tax-free. Eventually, you can take tax-free withdrawals (not required) when your marginal tax rate may be higher (perhaps much higher) than it is right now. So, that means less taxes now with your conversion and no taxes on your future distributions. Your patience has paid valuable dividends!

### Reverse an Ill-advised Roth Conversion.

Another great thing about the Roth conversion strategy is you can always change your mind well after the fact. Believe it or not, you have until October 15 of the year following the conversion year to recharacterize (unwind) your converted account (or accounts). For example, say you convert a traditional IRA into a Roth account in early 2010. Later next year, the value of the converted account plummets

due to poor performance of the investments held in the account. In this bleak scenario, you would pay income tax on value that later disappeared. Bad idea! Thankfully, you have until October 17, 2011 (October 15, 2011 is a Saturday), to recharacterize the converted account back to traditional IRA status. It's as though the ill-advised conversion never happened. So, you won't owe any income tax on the now-unwound conversion.

**Conclusion.** Low current tax cost for converting plus the chance to avoid higher future tax rates on income and gains that will accumulate in your Roth account as the economy recovers (we hope) may add up to the perfect storm for the Roth conversion idea. That said, please contact us prior to pulling the trigger. There are a number of variables to consider, and we would welcome the opportunity to work with you to ensure a well-informed and thoughtful decision. 

With winter comes ski season, and this may be the year you decide to purchase a timeshare unit in your favorite ski area. But, before the purchase, consider the tax aspects of timeshare ownership. Like other dwellings, the tax treatment of timeshares depends on how you use the property. However, the rules are somewhat complicated by the fact that timeshare ownership is often limited to only one or two weeks a year.

If you use the timeshare and do not rent it out (or hold it out for rent), the property taxes should be deductible. Property taxes usually are included in the annual "maintenance fee," but should be detailed on the bill requesting payment of the fee. Other items buried in the maintenance fee, such as utilities and association membership charges, are nondeductible personal expenses. If the timeshare is mortgaged, the interest expense generally can be deducted as qualified residence interest; however, restrictions apply.

If you rent your timeshare unit for some or all of your allotted time, you are likely to be subject to the vacation home rules that limit deductions and require allocation of expenses. As a result, allocable rental expenses (including allocable interest and property taxes) generally can be deducted up to the amount of rental income. In this situation, the personal portion of property taxes usually can be deducted. The personal portion of any mortgage interest expense may be deductible depending upon how often you actually use the property, but quite often this interest is not deductible with a rental unit.

**Example: Allocating timeshare expenses between personal and rental use.**

Rob owns weeks 27 and 28 in unit #112 at the Mountain Chalet Resort. In 2009, he rents out week 27 and uses week 28 for a family vacation. Rob's timeshare weeks cost a total of \$22,000, partly financed by a \$15,000 mortgage loan arranged through the developer. Rob's interest expense is \$1,750, and his annual maintenance fee is \$800

## Tax Aspects of Owning a Timeshare Unit

(\$300 of which is for property taxes).

Additionally, Rob incurs \$125 in advertising expense to rent week 27. The rental income is

\$1,050. From his conversations with resort management, Rob determines that the unit is rented approximately half the year and used by the owners for the other half. He uses this information for his allocation method (50% rental and 50% personal).

Based on this information, Rob should report \$1,050 of rental income. He may then deduct up to that amount of allocable rental expenses (using 50% as the allocation percentage). Allocable rental expenses before depreciation total \$1,400 (\$875 of mortgage interest, \$150 of property taxes, \$250 of maintenance fees, and \$125 of advertising expense), so Rob can completely offset his rental income with allocable expenses. (The \$350 of allocable expenses in excess of rental income is carried forward to the next year.) Rob can claim the remaining \$150 of property taxes as a personal itemized deduction. The remaining \$875 of mortgage interest is nondeductible.

**Note:** To treat interest paid on a timeshare as investment interest, you must prove your intent for holding the unit is its potential appreciation in value. In most cases, this is difficult to prove.

If you are thinking about purchasing a timeshare or investment real estate, it is always a good idea to know the tax aspects of ownership in advance to avoid surprises down the road. So, please contact us if you have tax-related questions.



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# Minimize Taxes with the Specific ID Method

As year-end approaches, you may be thinking of making some adjustments to your investment portfolio. Be aware that if you sell less than your entire interest in securities (stocks or mutual funds) you purchased at various times and prices, you have two options for identifying the particular shares sold—(1) the first-in, first-out (FIFO) method and (2) the specific identification (specific ID) method. FIFO is used if you do not (or cannot) specifically identify which shares of stock are sold, so


the oldest securities are assumed to be sold first. Alternatively, you can use the specific ID method to select the particular shares you wish to sell. This is typically the preferred method, as it allows you at least some level of control over the amount and character of the gain (or loss) realized on the sale, which can lead to tax savings opportunities.

For example, if you realized some capital losses earlier this year (or you have a capital loss carryover from last year), realizing a short-term (versus long-term) gain may be advantageous. This can be accomplished by specifically identifying the newest shares of a particular security as sold. Then, the older shares can be

sold (generating a more tax-friendly, long-term gain) later, when the gain will not be offset by capital losses.

Be careful, though, if your basis in the shares differs (and it often does), because the specific ID method affects the amount of the gain as well as the holding period. Sometimes, reducing the current taxable gain by selling the highest basis shares first is more beneficial than obtaining the lower, long-term capital gain rate. Each case will depend on your specific facts, and will require comparative calculations.

The specific ID method requires that you adequately identify the specific stock to be sold. This can be accomplished by delivering the specific shares to be sold to the broker selling the stock. Alternatively, if the securities are held by your broker, IRS regulations say you must notify your broker regarding which shares you want to sell and identify them by reference to their purchase date and per-share price. The broker must then issue you a written confirmation of your instructions.

Unfortunately, discount and online brokers may be unwilling or unable to issue these confirmations. In this scenario, the Tax Court's 1994 *Concord Instruments Corp.* decision seems to say you can give oral instructions regarding which shares to sell and still use the specific ID method, even though no confirmation is forthcoming. However, you should carefully document your instructions. 



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