

Professional Duties

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- 1. CLIENT**
- 2. PROFESSION**
- 3. SELF**

Net Operating Losses

2

Keys –

1. **Simple Principles**

But

2. **Complexity arises but principles of IRC Section 172 remove other tax benefits before the NOL Deduction is calculated**

Basics

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- 1. **Modify deductions for NOL year to determine the NOL that can be carried to other years**
- 2. **Taxable Income is modified in the years to which the Loss is carried to determine how much of the NOL is absorbed.**

Computing NOLs for Individual Taxpayers

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- 1. Determine eligibility
- 2. Compute the NOL business losses only

Does Not Include Capital Losses

Add Backs to Negative Taxable Income

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- 1. **Dependent and Personal Exemptions**
- 2. **Net Non-business Deductions**
- 3. **Net Capital Losses**
- 4. **NOLs carried from another year**

Use Form 1045 for Tentative Refund

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Note: Complications Because

1. There are several different carry-back periods depending on the source of the NOL
2. Use modified taxable income Not taxable income

Thus taxpayers generally Do Not fully benefit from the NOL deduction

Default is Carry-back of NOLs

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- Taxpayer can elect to carry forward the NOL but
 1. The election must be made on the original returnor
 2. On an Amended Return filed within 6 months of the due date of the Original Return

Default Carry-back Period (2 years)

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- 1. Carry-back 2 Years
- 2. Carry forward 20 Years

Special Carry back Rules for 2010

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- **Can carry back for 5 years AND CHOOSE WHAT YEAR TO CARRY BACK TO**
- **Caveat- If choosing to carry back 5 years can only offset 50% of AMTI**
- **For 2009 NOLs there is no 90% of AMTI limit**

Modifying Taxable Income

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Add back –

1. Net Capital Losses

and

2. Personal and Dependent Exemptions

Seven Income, Exclusion and Deduction Items

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That are both affected by AGI and affect AGI

1. Special allowance for rental real estativities for passive activity losses
2. Taxable social security benefits
3. IRA deductions
4. Excludable savings bond interest
5. Employer assistance program benefits
6. Student loan interest deduction
7. Tuition and fee deduction

Itemized Deductions

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- **Must Be Recalculated**
 - ie. **Medical Deductions**
 - Charitable Contributions**
 - Miscellaneous Itemized Deductions**

NOL Carried Between Joint & Separate Returns

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**May Need to Allocate the NOL,
Income and Deductions, or the
Modified Taxable Income between
the spouses**

CAPITAL LOSS ISSUES

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- Basis adjustments at death affect both capital gains(step-up) and capital losses(step-down)
- Unused capital losses from a last tax return are lost forever
- MFJ returns offer very interesting possibilities BUT lost at second death
- Gifts of “LOSS ASSETS” create different basis for gains and losses
- Strategies for using capital losses(ie Buy/write strategies)

AMT Basics 2009

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AWSCPAS

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Itemized Deductions

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- **Not usable**
- **Medical difference (7.5% becomes 10.0%)**
- **Taxes**
- **Miscellaneous itemized deductions**

Roth Conversion Update

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ROTH CONVERSIONS

Roth Myth Number One

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**ONLY CONVERT IF YOU CAN
PAY THE TAXES FROM AFTER
TAX FUNDS**

Impact of the Free Look Period

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- The free look period runs from the date of the conversion until the due date of that year's return including extensions.
- Thus, a conversion in January has as much as a 21-month free look and a May conversion has a 17 month maximum free look.
- Thus, convert all and watch results carefully.

Example 1 for Free Look

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- The investment is **DOWN 10%** by the following **October 1st** simply **RECHARACTERIZE** and pay no taxes.
- The amount **RECHARACTERIZED** can be **RECONVERTED** after 31 days. However, the **ROTH** rules of the new year apply.

Example 1 for Free Look (continued)

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- If a 2010 conversion is **RECHARACTERIZED** in 2011 and then **RECONVERTED** note that the full taxes are actually due earlier than for a 2010 conversion.

Example 2 for Free Look

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- By October 1 of 2011 the ROTH conversion account is up 40%
- Taxpayer will want to keep the entire conversion and find a way to pay the taxes
- Note that 50% of the taxes will be due for tax year 2011 and 50% for tax year 2012.

The Cost of Tiptoeing

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- Many financial professionals and clients suggest doing a little bit i.e. 20% in early 2010 and then seeing how it goes!
- Reasoning based upon overemphasis on “paying the taxes”
- The huge fallacy in this reasoning is demonstrated in the following examples.

Therefore

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- With “Free Look” you have much to gain and very little to lose by converting it all
- **AND**
 - Converting early in 2010 maximizes BOTH
 - The length of the “Free Look” period and
 - The time the earnings are Tax Free when the account goes up

ROTH Myth Number Five

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**ROTH ACCOUNTS LOSE THEIR
ADVANTAGE WHEN THE
TAXPAYER DIES**

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NO Minimum Distributions

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- **During the lifetime of the ROTH account owner there are no minimum distributions required.**
- **Thus, the taxpayer has the flexibility to maximize the ROTH account for their heirs.**

Special Rights of the Spouse

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- **Spouses can roll the ROTH account of their deceased spouse into their own ROTH account and retain tax-free growth and no minimum distributions.**

ROTH Myth Number Four

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LOWER TAX RATES IN RETIREMENT

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Morningstar View

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- “However, I think the odds are excellent that tax rates across the board are currently low relative to where they could be in the future. If you share that view, you’ll want to take advantage of every means you can to pay taxes now rather than waiting until later.”
- Christine Benz Personal Finance Editor

Social Security Taxation

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- For taxpayers whose modified adjusted gross income (MAGI) is in the range around the point where Social Security becomes taxable, the marginal rates are 150% to 185% of the published rates.

Pay Taxes While Balances are Low

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- The “perfect storm” in financial markets has created an opportunity to pay taxes on much lower balances.
- S&P now approximately 70% of where it was on October 12, 2007. (S&P January 25, 2010 was 1,092.76 versus 1,561.80 on October 12, 2007.)

Flexibility of Tax Payment Advantages

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- If taxpayer has business loss in 2010 choose to tax part or all in 2010
- Social security considerations may also dictate when to pay
- Rates may be known for 2011 before the decision has to be made
- Charitable contribution deductibility may be improved by timing income recognition

Special Tax Rule for 2010 Conversions

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- **No Tax in 2010**
- **Pay tax on 50% of the conversion in tax year 2011.
(April 2012)**
- **Pay tax on 50% of the conversions in tax year 2012.
(April 2013)**
- **Taxes are paid based upon the prevailing rate for
the conversion.**
- **Conversions may result in AMT issues.**

ROTH Conversions Myth Number Three

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PAY TAXES LATER

- Unique 2010 Rules and The Perfect Financial Storm

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Market at 70% of Peak

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- Pay tax on a lower value
- Only pay taxes if investment makes money in the Free Look period

Note: One could make a strong case for taking more risk in investments until October 1, 2011 and then lower the risk after October 1, 2011.

Market at 70% of Peak

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- Pay tax on a deferred basis.
- The deferral period allows those between 57 ¼ and 59 ½ to convert now and pay no penalty when making withdrawals to pay taxes
- Variable annuities with living benefits offer substantial upside potential for income, death benefits and principal while maintaining guarantees for income and living benefits in a declining market.

Tax Rates May Be Higher In The Future

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- **Ordinary Income Marginal Rates are at Historically Low Rates**
- **Financing the Deficit Will Require Higher Rates in the Future**

Converting May Improve Taxation of Social Security Benefits

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- **ROTH withdrawals ARE NOT part of the calculation for taxability of Social Security.**
- **Thus, When Senior Citizens Convert. The Benefits May Include:**
 - Eliminating The Taxability of Social Security.
 - Little or No Tax on Conversions While Heirs Might Have Significant Taxation.
 - Greater After-Tax Cash Flow.

Inflation Can Be The Converter's Edge

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**Natural Resource Inflation Can Be A Huge
Conversion Investment Opportunity**

**ROTH Conversions Prevent Future
Taxation On Inflationary Gains**

If You Are Under 59 1/2

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- **If the Roth IRA is less than 5 years:**

Basis - No Tax and Penalty

Growth – Tax and Penalty

If You are Under 59 1/2

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- **If the Roth IRA is 5 years old:**

Basis - No Tax and No Penalty

Growth – Tax and Penalty

If You Are Over 59 1/2

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- **If the Roth IRA is less than 5 years:**

Basis - No Tax and No Penalty

Growth – Tax and No Penalty

If You Are Over 59 1/2

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- **If the Roth IRA is 5 years old:**

Basis - No Tax and No Penalty

Growth – No Tax and No Penalty

Roth Myth Number Two Asset Allocation Funds Are Best

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**REMEMBER THE
FREE LOOK PERIOD**

Put Each Investment Into a Separate Account

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- At October 1, 2011 evaluate each investment separately.
- **RECHARACTERIZE** any of the investments that are losing positions at that point.

Deadly Tax Triangle

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**Big Dollar Mistakes
Especially In Combination**

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Triangle

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- **NOLs**
- **AMT**
- **ROTH Conversions**

NOL and AMT

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- **Example 1-**
- **Assume 2009 NOL Carry back Amount is \$60,000**
- **2007 Facts:**
 - **1. Ordinary Income is:**
 - ✦ **Self-employment of \$120,000**
 - ✦ **Capital Gain \$400,000**
 - ✦ **Husband and Wife Only**
 - ✦ **AMT addition is \$12,679 in 2007**

Example 1 (Cont)

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- **Itemized Deductions:**
 - State Taxes and Real Estate Taxes \$20,000
 - Contributions \$20,000
 - Qualified Residence Interest \$20,000
 - Miscellaneous Itemized Deductions \$20,000

Carry Back to 2007

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- **Reduce Taxes from \$77,185 to \$57,728**
- **Marginal Savings is \$19,457**
- **Marginal Percentage Savings(Federal is 32.43%)**

Bigger NOL

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- Assume the NOL from 2009 is \$150,000 rather than \$60,000.
- Carrying back to 2007 reduces taxes from \$77,185 to \$38,508.
- Marginal Savings is \$36,677
- Marginal Percentage Savings is 24.45%

Convert ROTH IRA in 2009 For Bigger NOL

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- **Convert \$240,000**
- **Net Federal Tax Cost From ROTH Conversion in 2009 is \$453**
- **Thus, Compare:**
 - Saving \$36,677 to Converting \$240,000 at a cost of \$453
 - Effective Conversion Cost is $\$37,130 / 240,000$ or 15.47%

Convert ROTH IRA 2009

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- **Convert \$150,000**
- **Net Federal Tax Cost From ROTH Conversion in 2009 is \$453**
- **Thus, Compare:**
 - Saving \$19,457 to Converting \$150,000 at a cost of \$453
 - Effective Conversion Cost Is $\$19,910 / \$150,000$ or 13.27%

Conclusions

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- **The interactions between AMT, NOL and ROTH Conversions are Complicated BUT**
- **It is Very Likely That A ROTH Conversion is Preferred to a Carry back**
- **Reasons are:**
 - **1. No Loss of Itemized Deductions**

Caution

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**Large Miscellaneous Deductions
Could Cause The Conclusions
To Change**

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