

December 16, 2009

Senator Mark Miller
Co-Chair, Joint Committee on Finance
Room 317 East
State Capitol
P.O. Box 7882
Madison, WI 53707-7882

Representative Mark Pocan
Co-Chair, Joint Committee on Finance
Room 309 East
State Capitol
P.O. Box 8953
Madison, WI 53708

Re: **Roth IRA Conversions (P.L. 109-222 § 512)**

Dear Chairmen Miller and Pocan:

The Investment Company Institute, the national association of U.S. investment companies, commonly referred to as mutual funds, strongly urges the Wisconsin legislature to adopt changes to Wisconsin's tax law to allow Wisconsin residents to convert traditional Individual Retirement Accounts (IRAs) to Roth IRAs beginning in 2010, consistent with recent changes in federal law. Mutual funds are widely used for IRA savings¹ and Institute members assist IRA owners in understanding and complying with tax law.

Prior to 2010, individuals owning traditional IRAs can convert to Roth IRAs only if their income does not exceed \$100,000 and their filing status is not "married filing separately." Section 512 of the Tax Increase Prevention and Reconciliation Act of 2006, P.L. 109-222 (TIPRA), removes these restrictions, effective beginning in 2010. In addition, for *any* taxpayer who makes a Roth conversion in 2010 (and only in 2010), the amount required to be included in federal gross income is proportioned ratably over the 2011 and 2012 tax years, unless the taxpayer elects to include the entire amount in 2010.

According to the Wisconsin Department of Revenue, Wisconsin tax law has not yet been conformed for this change in federal law and thus the state tax consequences of a conversion made during and after 2010 by a Wisconsin taxpayer will depend on whether the conversion would have been

¹ As of the end of second quarter of 2009, IRAs held an estimated \$3.7 trillion in assets, about 45 percent of which were held in mutual funds. See http://www.ici.org/pdf/09_q2_retmrkt_update.pdf.

permitted under federal law prior to 2010.² Unless the state law is changed, a Wisconsin resident who elects to convert a traditional IRA to a Roth IRA, but who could not convert under pre-2010 federal law, will be subject to significant state tax penalties. If the taxpayer is under age 59 1/2, the taxpayer would be subject to an early distribution penalty equal to 3.33% of the amount converted. The taxpayer also would be subject to a 2% penalty for an excess contribution to the Roth IRA.

The Institute and its members urge you to correct this problem promptly. Conforming Wisconsin law to the new federal law will benefit Wisconsin and its residents in several important respects:

Wisconsin residents will not face unexpected penalties. The new Roth conversion rules are being widely publicized nationally in the media and by IRA providers and financial planners. But in Wisconsin this is a trap for the unwary. Some Wisconsin residents will convert without knowing they have a state tax problem. If they do convert and do not recharacterize the contributions promptly, they could find themselves in the tax equivalent of a “Catch-22.” Generally under Wisconsin law excess contributions must be removed or the individual faces a 2% penalty every year until the contributions are removed. If the deadline for recharacterization has passed, the taxpayer’s only option to avoid the state penalty is a distribution from the Roth IRA. But the distribution from the Roth IRA could result in *federal tax penalties* if done before age 59 ½ and before a 5-year holding period.

Wisconsin residents will have access to a useful tax planning tool available to residents of other states. Roth IRAs offer a number of advantages over traditional IRAs, depending on a taxpayer’s individual situation. For example, Roth IRAs are well suited for individuals, such as those early in a career, who expect their tax bracket to be higher in retirement. No required minimum distributions are required for Roth IRAs during the owner’s lifetime, making them a helpful estate planning tool. When used in conjunction with pre-tax retirement savings like traditional IRAs and 401(k) plans, Roth IRAs also present a useful tax planning tool as a hedge against the unpredictability of future tax rates. All of these advantages will make converting to a Roth IRA an attractive proposition for many taxpayers, particularly as they can spread taxable income attributable to the conversion over a two-year period by making the conversion in 2010. These advantages, available to residents of other states, will not be available in Wisconsin, unless the law is changed.

Administrative difficulties will be avoided. Unless state law is changed, Wisconsin residents who convert to a Roth IRA but who could not convert under pre-2010 federal law will in effect have a perfectly legal Roth IRA under federal law, but for Wisconsin purposes a Roth IRA with an “excess contribution.” In addition, taxpayers at any income level will pay income tax in 2010 for Wisconsin purposes but can spread the income for federal tax purposes over 2011 and 2012. This will create

² See <http://www.rcvenue.wi.gov/taxpro/news/091030.html>.

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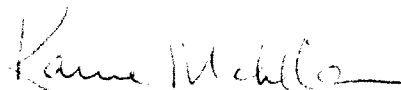
administrative difficulties for the Wisconsin Department of Revenue, which will need to create separate reporting systems, and for Wisconsin taxpayers, who will need to track the same Roth IRA separately for federal and state law.

Wisconsin will not lose an important source of revenue to other states. Adopting section 512 of TIPRA to allow all Wisconsin residents to make Roth conversions should generate short term revenue for Wisconsin, because in a Roth IRA conversion the individual pays income tax on the amount converted. If the law is not changed, a Wisconsin taxpayer earning more than \$100,000 (or married filing separately) who might be interested in converting but is aware of the adverse state tax consequences likely will not convert. That taxpayer may choose to convert later if he or she later moves out of the state. Similarly, a non-Wisconsin resident may choose to convert before moving to Wisconsin. In these cases, Wisconsin would lose revenue to other states.

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If you have any questions, please contact the undersigned or Michael Hadley (202-326-5810).

Sincerely,



Karrie McMillan
General Counsel

cc: Members, Wisconsin Joint Committee on Finance
Senator Jim Sullivan
Bob Lang, Director, Legislative Fiscal Bureau

The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.33 trillion and serve almost 90 million shareholders.