WHAT YOU NEED TO KNOW ABOUT 2010 ROTH IRA CONVERSIONS

OPPORTUNITY FOR HIGH-INCOME EARNERS TO CONVERT

If you've been shut out of a Roth IRA because of your income, 2010 is the year that you may finally be able to take advantage of these tax-free accounts. That's because in 2010 you'll be able to convert a Traditional IRA to a Roth IRA. As an added bonus, for tax year 2010, you'll be able to spread the tax impact over the next two years – 2011 and 2012.

THE DETAILS

Starting in 2010, most taxpayers – regardless of their income or tax-filing status – will be able to convert a Traditional IRA to a Roth IRA as spelled out in the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), passed in May 2006. Before TIPRA, only people – single or married filing jointly – with modified adjusted gross income below \$100,000 could convert.

BENEFITS OF ROTH IRAS

- Gross income remains unaffected Qualified distributions are not included in your gross income if you have met the five-year aging requirement and are age 59½ or older. (Early withdrawals are subject to a 10% penalty, although certain exceptions apply.)
- Tax advantages for beneficiaries Once the five-year aging requirement is satisfied, heirs can also withdraw the money without paying federal income tax. Beneficiaries, however, are required to take annual minimum distributions.
- Flexible withdrawals Unlike a Traditional IRA, the Roth IRA does not require you to take annual minimum distributions beginning at age 70½, which gives you added flexibility. You can withdraw money when needed or let it potentially grow free from federal, and in most cases, state income taxes, which can dramatically increase the amount available for your retirement or for your beneficiaries who inherit the account.
- Convenient rollover options Another possibility is to roll over your workplace savings plan, such as a 401(k) plan, to a Roth IRA. This is a strategy you may want to consider if you are about to change jobs or are approaching retirement. Here, too, the \$100,000 income limitation will be eliminated in 2010.

TAX IMPLICATIONS OF A ROTH IRA CONVERSION

When converting from a Traditional IRA to a Roth IRA, you will owe income tax on any taxable portion of the account balance. An important point to note: Conversions must occur on a pro rata basis, meaning you cannot choose to only convert the portion you've already paid taxes on. For example, say you have an existing \$100,000 rollover IRA with pretax money. You make \$5,000 in after-tax contributions to it every year from 2008 to 2010, for \$15,000 in total. You'd owe taxes on 87% of the \$15,000 because taxes are calculated as a proportion of the total of your IRA accounts (\$115,000). This is a simplified example, so please consult a tax advisor to see what this may mean in your situation.

If you do the conversion in 2010, TIPRA offers an additional benefit. You can elect to pay any federal tax on the conversion in 2010, or, as long as the converted amounts are not distributed before 2012, half of the taxable amount will be included in income for 2011 and half for 2012. Those who convert in 2010 may have a dramatically higher tax bill in 2011 and 2012. Of course, it is generally better not to pay those taxes with funds withdrawn from the IRA or other retirement accounts, since doing that could generate yet more tax. Again, please consult with a tax advisor to understand the implications for your situation.

POTENTIAL ESTATE-PLANNING BENEFITS OF A ROTH IRA

People who inherit Roth IRAs also get favorable tax treatment, so converting a Traditional IRA or workplace savings account to a Roth IRA may be a savvy estate-planning tool. Non-spouse beneficiaries must take distributions over their life expectancies but, unlike with a Traditional IRA, they generally don't have to pay income tax on the withdrawals. When a spouse – let's assume it's a wife – inherits a Roth IRA, she has the additional option she has with a Traditional IRA, which is to roll over the retirement account into her own Roth IRA.

DETERMINING IF A ROTH IRA CONVERSION IS RIGHT FOR YOU

To learn more about the benefits of Roth IRA conversion, please contact your investment professional.



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