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Roth IRA opportunity expanded in 2010

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Recent changes in the tax laws are prompting individuals who historically have not qualified for Roth IRAs to take a second look at the Roth. Currently, an individual taxpayer or married couple filing jointly whose modified adjusted gross income is greater than \$100,000 annually cannot convert a traditional IRA to a Roth IRA. Also, under current law, income taxes are due in the year of the conversion.

Beginning in 2010, any funds in traditional IRAs, SEP or SIMPLE IRAs, and employer plans (subject to plan rules) can be converted to Roth IRAs, under the 2006 Tax Increase Prevention and Reconciliation Act. The icing on the cake is that income on the conversion will not be taxed in 2010. Instead, taxpayers can spread the tax over 2011 and 2012.

Conversion Becomes Easier

Congress offered a second incentive with the Pension Protection Act of 2006. Under current law, employees cannot convert money

in 401(k)s or other employer plans directly to a Roth IRA. If the employer plan allows distributions to a traditional IRA, the employee can convert to a traditional IRA, then turn around and convert that into a Roth IRA. Beginning in 2008, distributions from employer plans can be converted directly into a Roth IRA, providing the employee qualifies for a Roth IRA conversion.

The Roth Advantage

The Roth IRA offers a number of tax advantages over a traditional IRA. For example, after paying income tax on the conversion, the Roth IRA grows tax free forever. Plus, there are no required minimum distributions (RMDs), so the Roth IRA can continue to grow and even be passed on to beneficiaries tax free.

Investors with traditional IRAs must begin taking yearly RMDs at age 70½, regardless of whether they need or want the income. By contrast, there are no RMDs for Roth IRAs. After a Roth IRA holder dies, the Roth IRA transfers to the spouse, with no RMDs over the spouse's lifetime. Other, non-spouse beneficiaries will be required to take minimum distributions; however, the distributions will be tax free and can be spread over the beneficiaries' lifetimes. For example, children or even grandchildren who are much

younger than the original Roth IRA holder and his or her spouse can spread the distributions over a long period of time, creating an opportunity for considerable tax-free growth if invested and diversified effectively.

Planning for High Income Taxpayers

For taxpayers whose income historically has not allowed them to take advantage of contributing or converting to a Roth, funding a traditional non-deductible IRA now for conversion to a Roth IRA in the future is a wise strategy for many—but not all—investors. All traditional, SEP, and SIMPLE IRAs need to be factored into the conversion decision. If an investor has a large amount of money in these types of accounts, converting to Roth IRAs may offer fewer benefits. On the other hand, individuals who have the majority of their retirement assets in qualified retirement plans and a smaller percentage in IRAs could see significant benefits.

Financial planners frequently advise clients to have a mix of traditional and Roth IRAs. Investors who expect to have less taxable income in retirement generally benefit more from traditional IRAs; those who expect to have more taxable income in retirement generally benefit more from the Roth. Before making a decision about Roth con-

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versions and retirement planning, investors should consider their own situation and consult their financial and tax advisers.

Conclusion

Many forward-looking investors are considering the opportunity of converting their traditional IRA assets into a Roth IRA. In addition, investors who cannot currently contribute to a Roth are looking into contributing annually into traditional, non-deductible IRAs. The more they have invested in deductible and non-deductible IRAs, the more they can convert in 2010 when the income limitations are removed and they can pay no taxes on the conversion until 2011 and 2012. Investors should carefully weigh their personal options before deciding if a Roth conversion is right for them.

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