

December 16, 2009

Email Update

In This Issue

- Everyone can have a Roth IRA
- Roth IRA Basics
- The Big Change for 2010
- Details to consider
- Conclusion

www.FinancialPlanningForLife.com

Visit our [Learning Center](#), which has a variety of educational audio and video presentations designed to educate you. Revisit often, as we are constantly updating content.

Everyone can now have a Roth IRA!

As a result of legislation dating back to 2005 (the Tax Increase Prevention and Reconciliation Act of 2005), the rules governing Roth IRAs are changing as of January 1st, 2010. These changes, which will open Roth IRAs to higher income individuals for the first time, are among the biggest and most important changes on the IRA landscape in years.

Roth IRA Basics

Unlike a traditional IRA, which provides for pre-tax retirement savings, a Roth IRA is an effective way to fund retirement (or generational gifting) using *after-tax* dollars. Like a traditional IRA, contributions to a Roth IRA grow and compound without resulting in any *current* tax liability. However, unlike a traditional IRA, withdrawals from a Roth IRA are *tax free* whether made by you or your beneficiaries. ***In a nutshell, you contribute after-tax dollars to a Roth IRA, but you never have to worry about taxes on that money again!***

There are a few points to keep in mind when considering a Roth IRA:

- Like a traditional IRA, you may be eligible to contribute \$5,000 per year (\$6,000 if over the age of 50) if your Adjusted Gross Income (AGI) does not exceed certain limits (your ability to contribute begins to phase out if your income is between \$105,000 and \$120,000 for single filers or between \$166,000 and \$176,000 for those who are married filing jointly).
- As mentioned above, contributions to a Roth IRA are *not* tax deductible.
- Roth IRA contributions may be withdrawn prior to age 59½ without penalties or addition taxes, provided that you have held the Roth for 5 years (there are some nuances to this rule that can be discussed with your advisor).
- There are no age limits on contributions to a Roth IRA and non-working spouses may contribute also if the household has earned income.

- All balances in a Roth IRA, including investment gains and earned income, may be withdrawn *tax free* after reaching age 59½ (after a 5 year holding requirement)
- There are NO required minimum distributions for owners of a Roth IRA at age 70½.
- Beneficiaries receive the money from a Roth IRA *tax free*.

Roth IRAs have been part of the retirement planning landscape now for over 10 years; however, they have been inaccessible to many and often poorly understood. A Roth IRA can provide distinct advantages and opportunities in both your estate and retirement planning.

The Big Change for 2010

As a result of the legislation mentioned above, beginning in 2010, high-income wage earners will be eligible to convert dollars from a traditional IRA to a Roth IRA. In the past, if you had a Modified Adjusted Gross Income of more than \$100,000 (both single and married filers) you were ineligible to convert. Not so in 2010. At that time, anyone who owns a Traditional IRA will be eligible to convert to a Roth IRA. *The question, of course, is whether such a conversion would be appropriate for you.*

When assets are converted from a pre-tax vehicle (like a traditional IRA) to an after tax vehicle (like the Roth IRA), income taxes are payable on the amount of the conversion. *Under current rules*, the amount converted is considered income and taxed in the year converted (remember, however, once the taxes are paid, no taxes are due on your Roth IRA or the growth of the account again).

In 2010 there is a *one-time change* in how the taxes will be assessed and when they will be due. Individuals who convert all or part of their Traditional IRA to a Roth IRA in 2010 may elect to pay their tax bill all at once on their 2010 return or *they can elect to divide their payments evenly between their 2011 and 2012 tax returns*. This is a one-time IRS offer, and it will provide some people with enough flexibility to make the conversion. Again, the question is: Should they?

Converting - Details to Consider

There is no absolute answer with respect to the decision to convert or how much to convert. In making the determination, it is important to consult a competent advisor as there are a variety of issues to consider along with a number of strategies that may provide more flexibility than you might be aware of. With that caveat, here are a few items that should be considered:

1. How much tax will you owe as a result of your conversion?

Typically, the entire amount converted would be treated as income. However, if you are one of the many that has made non-deductible contributions to your traditional IRA over the years, there will be some additional calculations. Moreover, you will need to ensure that you can document those non-deductible contributions. The

conversion calculation also takes into consideration other pre-tax retirement accounts you may own like SEP IRAs and Simple IRAs. If you have a mix of pre-tax and after tax dollars sprinkled throughout your retirement plans, the calculation on how much you will ultimately owe can be a bit complex.

2. Where will you find the money to pay the taxes?

You may think that the answer to this question is obvious as well. Unfortunately, if you are planning to pay the taxes from the proceeds of your IRA and are under the age of 59½, not only will you be subject to taxes on that money withdrawn to pay the taxes, but you may also face a 10% penalty for early withdrawal.

If you are over the age of 59½ you will not be faced with the penalty but you should still consider the opportunity cost of using dollars that would otherwise be invested in the Roth IRA and eligible to grow tax-free. Ideally, you should plan on setting aside dollars from other sources to pay the tax. One option could be applying a tax refund toward the future liability.

3. What tax bracket do you expect to be in during retirement?

Often, the idea of deferring taxes is supported by the notion that you will be in a lower tax bracket in the future. Will you? No one knows exactly what the tax load will be in the future. Traditional wisdom has said that by deferring (as you would in a traditional IRA), you avoid paying taxes at your current tax rate with the hope that, when you finally use the funds, you will be in a lower tax bracket. Additionally, with larger amount of money compounding for the future, the value of the account would be higher.

However, many people have found that their tax rate in retirement is actually equal to or greater than their tax rate while working. If you feel that might be the case (either due to your retirement earnings or increases in tax rates due to economic issues), a Roth conversion might be appropriate.

On the other hand, dollars spent on taxes now are not available for growth.

As you can see, *this is not a simple decision.*

4. What, or who, is the money in your IRA for and when will it be used?

Many of you have heard these questions from us before in helping frame some of your other allocation or investment decisions. The importance of these questions cannot be overstated. If the you do not believe the funds contributed to an IRA are going to be utilized during your lifetime, the Roth IRA could be viewed as an efficient estate transfer vehicle for heirs or charities. First, it is efficient from the standpoint that you will be able to avoid required minimum distributions (which cannot be avoided with a traditional IRA), so the balances available to transfer to your heirs or charities could be larger. It is also efficient because, due to the nature of the Roth IRA, income tax will never be owed by your heirs, enabling them to receive 100% of the proceeds.

Of course, this would require that Congress not change the rules on

this. Most people feel that Congress would not do that as the backlash would be considerable.

Conclusion

Financial planning is always about putting the odds in your favor. Since the *exact events* of the future are unknowable, we always want to retain an appropriate amount of flexibility. One of the “unknowables” in retirement planning is the tax liability in the future when you begin taking retirement distributions.

Having access to funds that will never be taxed could certainly prove to be quite valuable. Think of your retirement income as a three-legged stool. Fixed income sources like Social Security and Pensions may comprise one leg. Traditional IRAs and other pre-tax retirement plans, like 401(k)s or SEP IRAs, which provide a taxable source of income might be viewed as the second leg. Finally, a tax free source of income like that obtained from a Roth IRA might be viewed as the third leg of the stool – the leg that completes the stability of your stool.

The different tax treatment of the “third leg” would provide some nice flexibility during retirement. You just need to consider all the variables before deciding if a Roth conversion strategy makes sense for you.

A coordinated effort between yourself, your Financial Advisor and a tax professional is needed to evaluate your particular scenario so you can make an informed decision.

If someone you care about is wondering about a Roth IRA conversion, don't hesitate to have them call us. The financial decisions individuals and families make today will impact them not only tomorrow but for generations to come.

Also, *don't forget to visit our website* for constant updates and additional education tools.

Until next time; Turn off the TV set and go enjoy a Sunset!