

New Roth IRA Rules Open Doors for Taxpayers

A convergence of factors in 2010—tax deferral, no income limitations, and lower IRA balances due to market declines—is creating a potential opportunity to win in the income tax game.

The opportunity to convert one's traditional IRA into a Roth IRA has been around for several years, but only those with less than \$100,000 of (federal) modified adjusted gross income have been able to do so. Beginning in 2010, that income limit has been lifted. And for tax payers at *all* income levels, the federal tax bill on amounts converted in 2010 can be deferred and paid in two installments over 2011 and 2012.

By way of recap, Roth IRAs carry some unique advantages:

- earnings accumulate tax-free
- no age limits on contributions
- no required minimum distributions (RMDs), and
- contributions can be withdrawn tax and penalty-free at any time

A Roth IRA conversion is not an “all or nothing” deal—you don't have to convert your entire IRA. In fact, a useful strategy may be to convert in 2010 only the amount that will use up your income tax bracket, avoiding a shift into the next higher bracket. Then you might consider the strategy again for another conversion “wave” in 2011, and so forth.

For example, in 2009 a married couple filing jointly can have taxable income up to \$137,050 (\$82,250 single filer) and still be in the 25% federal tax bracket. So, if they anticipate 2010 taxable income of \$110,000, they might convert \$25,000 in 2010 to Roth IRAs and owe only 25% to the IRS. Similarly, a couple with anticipated 2010 taxable income of \$52,000 might convert \$15,000 to a Roth IRA and still stay within the 15% federal tax bracket.

Who might benefit from a Roth IRA conversion?

- Those who believe their personal circumstances—or the government's appetite for tax revenue—will place them in a higher future tax bracket.
- Account owners who are unlikely to need their IRA in retirement and plan to leave the funds to children or grandchildren, who could then stretch future distributions (and potential account growth) over their own life expectancy once they inherit.
- Investors whose IRAs are still down in value due to the recent market decline (or which drop again with another market correction). The smaller the conversion amount, the smaller the tax bill.
- Those who have non-IRA money with which to pay the taxes due. The potential benefit of conversion loses effect if taxes must be paid out of converted amounts.
- Taxpayers with business losses or tax credits that they're unable to use unless they trigger additional taxable income to offset.

As with all retirement planning and tax strategies, there are many factors to consider. Be sure to consult a qualified professional.

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