

It's Time to Discuss Converting your IRA to a Roth IRA

By Mark Charnet

Taxpayers earning over \$100,000 annually could not convert their Traditional IRA's into a Roth IRA until the end of 2009 and that day is rapidly approaching. Conversions beginning in 2010 and later, the \$100,000 AGI limit and the prohibition on conversion for those using the Married Filing Separately filing status will no longer apply. For conversions in 2010 only and unless the taxpayer chooses otherwise, the amount required to be included in income can be spread equally over 2011 and 2012 or can be paid in full in the current year. Distributions from qualified retirement plans, 457 plans, 403(b) plans and 401k plans may also be rolled over to a Roth IRA. As with the conversion of a traditional IRA, qualified plan conversions are taxable events, with gross income for the year of conversion being increased by previously deducted contributions plus net earnings (or minus net losses).

This is a very interesting opportunity and must be well thought out and planned for. If your existing IRA or qualified plan balance is relatively small or the majority of contributions in your IRA consist of non-deductible contributions, then converting is a good idea. If you have at least five years before making a withdrawal or you anticipate that your IRA will not be needed for retirement income with the goal of leaving it for your children and you have sufficient non-IRA funds to pay the additional income tax due as a result of the conversion, 2010 is your year to make the move. If you believe that your tax bracket during your retirement years will be the same or higher than your current bracket or you feel that tax brackets in general will be rising significantly, you are a logical candidate for a Roth IRA conversion.

On the other hand, if your tax bracket is anticipated to be much lower in retirement or your income in 2010 will be your best year yet, it will probably be bad advice to recognize the tax now by converting.

“Qualified” distributions from your Roth IRA are excluded from gross income and are not subject to federal income tax if it is made after a five-year waiting period and at least one of the following requirements is met: you reach age 59½, you die, become disabled or to pay for first-time-home-buyer expenses.

The earnings portion of a “non-qualified” distribution is subject to tax. To determine any taxable distribution, the funds are considered to be withdrawn in a specified order; any withdrawal is considered to come first from non-deductible contributions, which are not subject to tax. Conversion amounts are considered next and are not included in gross income, but may be subject to the 10% premature distribution penalty if the funds are withdrawn within five years of being converted. Once all contributions and conversions have been withdrawn, any remaining funds are deemed to be earnings and when distributed, are included in gross income.

If a taxable distribution is received prior to age 59½, a 10% penalty tax is added to the regular income tax due, unless one or more of the following exceptions apply:

- A distribution is made because of the death or disability of the account owner.
- A withdrawal is part of a scheduled series of substantially equal periodic payments.
- A distribution is rolled-over into another Roth IRA.
- A withdrawal is used to pay for deductible medical expenses.
- The distribution is used to pay for certain qualified higher-education expenses
- Amounts are withdrawn to pay for first-time homebuyer expenses of up to \$10,000.
- In certain situations, to pay health insurance premiums for unemployed individuals.
- Distributions by certain military reservists called to active duty after 09/11/2001.
- A distribution is transferred to a Health Savings Account (HSA).
- In case of an IRS levy on the account.

There are several other significant benefits of Roth IRA's.

First, contributions to a Roth IRA may be made even after the taxpayer has reached age 70½, as long as the taxpayer has compensation at least equal to the contribution, subject to the phase-out rules. Second, Roth IRAs are not subject to the mandatory required minimum distribution (RMD) rules during the life of the owner (triggered at age 70½) but, there are minimum distribution rules applicable to beneficiaries who inherit a Roth account. Third, Federal bankruptcy law protects assets in Roth IRA accounts, up to \$1,000,000. In future years, the \$1,000,000 limit will be indexed for inflation. Funds rolled over from qualified plans are protected without limit.

As you can see from this partial list of parameters, converting your qualified plan to a Roth IRA may or may not be in your best interest and you should seek help from your qualified tax-preparer and financial advisor to help make the final determination. Not mentioned in this article are the many fine investment opportunities available for both your Traditional IRA and Roth IRA. Space does not allow me the opportunity to elaborate, however, that doesn't mean I can't advise you, in fact, quite the contrary. You're just one phone call or email away from getting all of your questions and concerns about these investment opportunities answered and addressed by contacting me from the information at the bottom of this column and as always, without cost or obligation.

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