

# What is a Roth IRA Rollover?



Nicholas Libock  
February 2010

The ability for individuals to roll over from a 401(k) plan to a Roth IRA, starting this year, has been a topic of much discussion. If you are a married couple filing jointly or a single taxpayer earning less than \$100,000 (modified adjusted gross income) per year, you were able to participate in Roth IRA rollovers for the 2009 year. For 2010, individuals earning over \$100,000 can benefit from the individual financial planning regardless of their filing status. The concept is simple.

Individuals may elect to receive a distribution of traditional pretax 401(k) salary deferrals, matching and employer contributions, and roll the funds over to a Roth IRA plan. After receiving the distribution, an individual pays current taxes on the distribution amount.

The funds rolled over then accumulate without being subject to future income taxes (tax-free).

Individuals deciding whether or not to begin a Roth rollover must consider numerous issues, including their level of taxation in 2010 and their anticipated level of taxation in retirement.

## **Advantages of a Roth IRA distribution include, but are not limited to:**

- No future individual income taxes are paid on distributions from a Roth IRA, and funds grow tax-free.
- Unlike traditional IRAs and 401(k)s, funds in a Roth IRA is not subject to the minimum

required distribution rules that start at age 70 1/2. Thus, if an employee retires at age 68, the funds can keep growing tax-free in a Roth IRA even after the retiree reaches age 70 1/2.

- Significant amounts may be transferred to spouses and children without being subject to income taxes, depending upon estate and state tax issues.

## **Issues to consider are as follows:**

- An employee may pay taxes in 2010 on the full amount of the Roth IRA rollover. Some practitioners believe that the lowest effective tax rate will be available for highly compensated employees in 2010. Most highly compensated individuals will pay alternative minimum taxes at a 30% tax rate in 2010.
- Individuals can choose to have the amount received in 2010 taxed over two years in 2010 and 2011, and not be required to file a tax return until April 15, 2011 for the 2010 tax year. Thus, an individual can decide whether or not they wish to spread the income taxes over two calendar years, with hindsight to determine whether tax rates have increased significantly as of Jan. 1, 2011.
- The 10% excise tax on early withdrawals does not apply to direct Roth IRA rollovers. To perform a Roth IRA rollover, a distribution event must exist, ie: an employee termination from an employer or turning age 59 1/2.

*Any advice in this summary concerning a federal tax issue is not intended or written to be used, and cannot be used by any taxpayer, for the purpose of avoiding any tax penalties that can be imposed by the Internal Revenue Service, or for promoting, marketing or recommending any tax-related matters addressed herein in accordance with IRS Circular 230.*

*Nicholas S. Libock can be reached at [NLibock@LibockandAssoc.com](mailto:NLibock@LibockandAssoc.com)*