

2010: The Year of the Roth Conversion? (Take 2)



Edward J. Smith
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Starting in 2010, anyone, regardless of income, can convert retirement plan assets to a Roth IRA

The number of Google searches for information about Roth IRA conversions has increased dramatically recently. In fact, search data reveals that the number of people searching for the phrase “Roth IRA conversions” more than tripled between January and November 2009.¹

This surge in interest about Roth IRA conversions is hardly surprising considering that starting in 2010, all taxpayers, regardless of income, are eligible to convert tax-deferred retirement assets to a Roth IRA. Prior to the change, the law prevented taxpayers with household incomes above \$100,000 from converting assets to a Roth IRA.

If you are among the nearly 50% of Americans who believe their own taxes are going to increase, you may be interested in the possibility of a tax-free income that a Roth IRA conversion can bring.²

A Roth IRA is a retirement savings vehicle that differs from tax-deferred retirement accounts such as traditional IRAs and most employer-sponsored retirement plans. With a Roth IRA, you make contributions with after-tax dollars, but qualified withdrawals after age 59½ are tax-free. Furthermore, a Roth IRA does not require minimum annual withdrawals after age 70½. It should be noted that there are still annual income limits in place for determining eligibility

to *contribute* to a Roth IRA. The income limitation was eliminated only for conversions.

To qualify for the tax-free and penalty-free withdrawal of earnings and amounts converted to a Roth IRA, the account must be in place for at least five tax years and the distribution must take place after age 59½ or as a result of death, disability, or a first-time home purchase (\$10,000 lifetime maximum).

Taxing Choices

When you convert tax-deferred assets from a traditional IRA and/or a former employer's 401(k), 403(b), or 457 plan, the amount you convert in a given year needs to be declared as income on your tax return. If you are younger than age 59½ and pay the taxes from money that is not in the tax-deferred account (the recommended option), you can avoid a 10% federal income tax penalty.

Fortunately, you have options when it comes to paying the taxes on a Roth IRA conversion. In 2010 only, you can convert eligible retirement assets to a Roth IRA without having to claim the amount as income on your 2010 tax return. If you elect to do this, you must declare half of the converted amount as income in 2011 and the other half as income in 2012. In this way, you wouldn't have to start paying taxes on a 2010 Roth IRA conversion until April 15, 2012.

However, by deferring the taxes on a 2010 conversion, the converted amount will be taxed at the income tax rates in effect in 2011 and 2012. As it stands, tax rates are scheduled to increase in 2011. Unless Congress acts to avert the tax rate increase, the taxes on Roth IRA conversions will be higher after 2010.

Also consider whether converting a sizable amount to a Roth IRA could move you into a higher tax bracket. If so, you may decide to convert smaller amounts over a period of several years.

If you have IRAs into which you have made both deductible and nondeductible contributions, the tax implications of a Roth IRA conversion can

become complicated. It may be prudent to consult a tax professional.

You Can Change Your Mind Later

If you change your mind after utilizing a Roth IRA conversion, you can elect a “do over,” called a *recharacterization*. The assets would be converted back to tax-deferred status and you can file an amended tax return seeking a refund of the income taxes you paid on the conversion. In order to qualify, you must recharacterize the funds before October 15 of the year following the year in which you converted. Roth IRA conversions offer the potential for tax-free income in retirement for taxpayers at all income levels. If you want more information about converting to a Roth IRA, call today. It’s critical to review your individual situation before making a decision about moving important assets.

- 1) *InvestmentNews*, November 16, 2009
- 2) Rasmussen Reports, September 3, 2009

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Edward J. Smith, FSS

Registered Representative
Atlantic Partners Financial Group
Member of John Hancock Financial Network
One Huntington Quadrangle, Suite 3N05
Melville, NY 11747
phone: 631-390-2658
fax: 631-752-2566
edwardsmith@jhnetwork.com
www.edwardsmith.com