

## What You Need to Know Now About Roth IRA Conversions

Many people have traditional individual retirement accounts (IRAs). The key benefit to traditional IRAs is that assets are invested and allowed to grow tax free until the account holder withdraws funds in retirement. These withdrawals are required when you reach age 70 ½ and thus are known as required minimum distributions (RMDs). Depending upon your particular tax situation, contributions to a traditional IRA may have been tax deductible when made. Many traditional IRAs are established when employees convert a 401(k) plan from a former employer into a rollover IRA account.

In 1998, the Roth IRA came into existence. It is similar to traditional IRAs in that the assets are allowed to grow tax free. What makes the Roth IRA different is (1) contributions are never tax deductible, (2) there are no RMDs and (3) withdrawals are tax free. No RMDs means you can leave the assets to grow tax free if those assets are not needed in retirement.

The tax law allows taxpayers to convert a traditional IRA into a Roth IRA, subject to income limitations. In 2010, this income limitation is lifted, so this is an opportunity for higher income earners to consider whether a Roth conversion is right for them.

If your retirement assets decline in value following the Roth conversion, you have until the extended due date of your return to re-characterize the conversion and avoid paying income tax if done properly in a trustee-to-trustee transfer. If a conversion is re-characterized, the Roth IRA assets return to status as traditional IRA assets. Additional limitations apply.

If you choose to convert a traditional IRA to a Roth IRA in 2010, you have the option of including the net asset value in income in 2010 or 50% in both 2011 and 2012. If you made nondeductible contributions to a traditional IRA, you have basis and will not pay tax on that amount in a conversion. While at first glance, it may seem obvious to defer paying taxes until 2011 and 2012, you should be aware that as federal tax law stands today, rates are set to increase in 2011.

So, should you convert? Here are some questions to consider –

- Will your tax rate in retirement be higher or lower than currently?
- Did you make nondeductible contributions to your traditional IRA?
- Will you need to draw on these assets in retirement?
- Do you think tax rates will rise in the future?
- Do you currently have a taxable estate?
- Would you like to leave your heirs assets they would not need to pay income taxes on?
- Do you have the funds to pay the tax on the conversion without using retirement assets?
- Will the recognition of income as a result of the conversion result in an adverse tax effect currently, such as phased out itemized deductions, taxable social security income or disallowance of tax credits?

Now is a good time to start thinking about whether a conversion is right for you. If you have any questions, please contact your Tonneson + Co representative for more information.

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