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Time to move the nest egg?

Changes in Roth IRA rules next year could benefit your retirement fund

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Having money means having choices, and soon the two or three people left in the U.S. with any kind of sizeable income will have to make one: whether to convert their IRAs.

Starting in 2010, high-income savers can convert their regular Individual Retirement Accounts to Roth IRAs. This allows them to pay taxes on the accounts now and forever escape taxes on future investment gains.

The timing couldn't be better for anyone who's seen their IRA balance drop in the market meltdown, since many personal finance experts expect tax rates to go up in the next few years. Converting a regular IRA to a Roth now allows savers to trim their tax bills two ways: They pay taxes on their temporarily lower balances now and do it at the current lower tax rates, instead of paying higher tax rates on bigger balances later, when their accounts have (we hope) regained their losses.

"With the almost certain prospect of higher tax brackets, if you have the ability to do a Roth you should be doing it," says John Carl, president of the Retirement Learning Center consultants in New York. "It's not about what you earn; it's what you keep."

Most financial planners find that the Roth IRA is just about the perfect retirement savings tool: a financial cross between a Swiss Army knife and skipping over the dreaded Income Tax space on the Monopoly board.

With a regular IRA, you contribute money and it grows tax-free until you make a withdrawal -- then the IRS wants its cut. You also get a tax deduction, if your modified adjusted gross income (or MAGI, which is what you're taxed on after your deductions and adjustments) is \$50,000 or less for single taxpayers, or \$75,000 for couples.

With a Roth, you miss the initial tax break by making your contributions with after-tax dollars -- but you get to keep all the investment gains tax-free.

A Roth also allows you to withdraw contributions (but not earnings) at any time if you run into financial trouble, and to pass unused money tax-free to your heirs. If you're buying a first house, you can take out up to \$10,000 of Roth contributions and earnings tax-free, and you can even continue to contribute to your Roth after you've stopped working.

For young savers, a Roth is a no-brainer, since workers are in lower tax brackets when they're starting out than when they retire. If saving in a Roth is combined with a pre-tax 401(k) plan at work, it gives savers the flexibility to tap both taxable and tax-free sources of income in retirement.

"It is more attractive to certain people than to others," Carl says, "but I don't think there's anybody in America who should not have a Roth in some way, shape or form."

One group of people for which a Roth hasn't been attractive is high-income earners. To contribute to a Roth your MAGI must be less than \$105,000 for single taxpayers (or up to \$120,000 for partial contributions) or \$166,000 (partial up to \$176,000) if you're married. That left high-rollers out. And while regular IRAs can be converted to Roths, that option was only available to households with income of less than \$100,000.

But starting next year, that limit goes away -- and in an even better deal, allows anyone to convert a regular IRA to a Roth to spread tax payments over two years. Anyone converting after 2010 will have to pay all the taxes at once.

"I'm advising my clients that if they pay the taxes out of their pocket, a conversion is going to be very beneficial," says David Aquilina, senior vice president of investments for Leonard & Co. in Troy. "All those dollars grow tax-free," Aquilina says. "That's the best benefit. There's nothing else like that."

There are only two roadblocks to converting: time and money. You can't withdraw earnings from a Roth for five years after age 59- 1/2 without triggering a 10 percent tax penalty, so if you're retiring soon and will need the money right away, a conversion will cost you.

You also need to be able to pay the taxes without tapping the IRA itself. If you take money out of a regular IRA before age 59- 1/2 , you also pay the 10 percent penalty, making a conversion a bad deal. If you're older than 59- 1/2 , that isn't a factor, Carl notes.

If you want to convert but can't pay all the taxes, you can convert a part of a regular IRA, leaving both taxable and after-tax accounts for your distributions, Aquilina notes. "It doesn't have to be an all-or-nothing situation."

If you do convert, check with a tax planner, Carl warns, since the calculation for your taxable balance includes all your regular IRA accounts, using a ratio of taxed to untaxed contributions.

The one danger to a conversion now is if your account drops after the conversion, Carl notes. In that case, you'll have a tax bill for the higher value at the time of the conversion, but end up with an account that's worth less. In that case, there's a one-year rollback provision that allows you to undo the conversion, then reconvert the account and pay taxes on the lower account value.

"It's a little Russian roulette," Carl says of the chance that the account value might drop, but with the rollback option, "It's a really neat little strategy."

Additional Facts

IRA limits

- **Under 50 years of age:** Contributions limited to the smaller of \$5,000 or the amount of 2009 taxable compensation. It can be split between a traditional IRA and a Roth.
- **50 years of age or older:** The smaller of \$6,000 or the amount of taxable compensation, which also can be split between types of IRAs.

Source: Internal Revenue Service