



## **New Rules for Roth IRAs May Pave the Way for a Smoother Retirement**

Historically, retirees have relied on three different sources to meet their retirement income needs:

- Social security
- Personal savings (including IRAs, employer-sponsored retirement plans, after-tax investments, and savings)
- Pension plans

Increasingly, however, Americans have had to rely upon their own personal savings to fund their retirement. The reasons for this include:

- Employers have discontinued their pension plans, shifting the responsibility for saving to individual employees.
- Increased life expectancy has contributed to an overburdened social security system that, according to numerous reports, is expected to become insolvent in our lifetime.

And now, the retirement savings game is about to change again. Are you prepared for opportunity?

### **Traditional vs. Roth IRAs**

Due to their favorable tax status and flexibility of investment choices, IRAs can be an effective investment vehicle for retirement savings. These accounts generally come in two flavors: Traditional and Roth.

- Traditional IRAs allow for pretax dollar contributions (i.e., pay taxes later; avoid them now).
- Roth IRAs allow for post-tax dollar contributions (i.e., pay taxes now; avoid them later).

There are different rules regarding the funding, eligibility, and deductibility of Traditional and Roth IRAs. With rules for Roth IRAs changing in 2010, it may be to your advantage to convert from a pay-later to a pay-now vehicle.

### **The new rules**

Through 2009, only individuals with adjusted gross incomes less than \$100,000 are able to convert qualified dollars to a Roth IRA. Beginning January 1, 2010, however, the \$100,000 limit will be eliminated, so individuals who were previously unable to convert to a Roth IRA will now be permitted to do so.

When you convert to a Roth, you pay income tax on the taxable dollars that are converted. One benefit of the new rules, however, is that amounts converted in 2010 will be eligible for a special tax option. Eligible individuals electing to convert in 2010 will be able to spread out the income tax payment in equal installments over two years. If they elect to defer taxes, they may pay 50 percent of the tax burden in 2011 (generally due on April 15, 2012) and the remaining 50 percent in 2012 (generally due on April 15, 2013). (Note that taxes due from conversions made after 2010 will be due in full in the year of conversion.)

### **Reasons to consider a Roth conversion**

There are many potential and attractive benefits of converting to a Roth IRA, but whether or not it makes sense for you will depend on your situation. You should always consult with a financial professional or a qualified tax advisor to determine the best way to invest for your future and to learn about applicable tax regulations and their impact on your investments.

**Tax-free withdrawals.** Because retirement can now span 20 years or more, tax-free withdrawals have become an attractive feature. When you do a Roth conversion, you are paying taxes today in order to receive a qualified, tax-free distribution in the future. One of the reasons to think about setting up or converting to a Roth IRA is if you believe your income tax rate is likely to be higher in the future than it is today.

You may take qualified tax-free distributions from a Roth IRA after you have had it for five years and when the distribution is for one of the following reasons:

- Age 59½ or older
- Death
- Disability
- First-time home purchase

**No required minimum distribution (RMD).** Unlike Traditional IRAs, Roth IRAs do not require that minimum distributions begin at age 70½. This allows those who do not need that income stream in retirement to pay the taxes now, keep all of the Roth IRA money invested beyond age 70½, and avoid the annual income tax burden that exists with RMDs.

**Hedge against rising income taxes.** Another reason to consider converting to a Roth IRA is the belief that income tax rates will be higher in the future than they are today. No one has a crystal ball, but it is conceivable that taxes will increase. When you look at marginal income tax rates over the past several decades, only once during a five-year period has the top marginal income tax rate been less than today's current rate of 35 percent.

**An effective estate planning strategy.** If your goal is to preserve assets for your heirs, then converting to a Roth may be an effective estate planning strategy. Because distributions from a Roth IRA are not required until a nonspouse beneficiary inherits the accounts, more assets can be preserved for future generations. And although nonspouse beneficiaries must take RMDs, they can generally stretch those distributions based on their life expectancy—and the income is free from federal tax.

## Questions to consider

There are many things to consider before making the conversion decision. A qualified professional can help you explore the following important questions:

1. **Do I expect tax rates to be higher or lower when I retire?**
2. **Do I have a large percentage of assets in Traditional IRAs?** If you have a concentration of assets in traditional IRAs, you may want to consider converting some of those assets as a way to hedge against future tax increases. Supplementing retirement with nontaxable income may increase the likelihood that you will be in a lower tax bracket during retirement.
3. **If I convert, can the conversion taxes be paid from a source outside of the IRA?** Using IRA assets to cover the tax bill will typically result in more taxes being paid and may involve early withdrawal penalties, depending on your age, so it is generally better to pay the tax owed with funds from outside the retirement account.
4. **Will I need access to the money within five years?** Remember the five-year requirement mentioned previously. If you think you will need access to the assets, then a Roth conversion may not be right for you at this time.
5. **Do I wish to leave tax-free income to my beneficiaries?** As previously mentioned, a Roth IRA can be used as an effective means of preserving assets for heirs.
6. **Do I have retirement accounts that have suffered losses?** You may have accounts with balances that aren't as high as they were prior to the market downturn in 2008. Converting these accounts to a Roth IRA while the values are low may result in a lower income tax.

Your answers will help your professional advisor(s) assist you in making the best decision. However you choose to fund your retirement, it is wise to be aware of the changing regulatory environment and how it may impact your future.

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