Stonefield Josephson Academy

# Tax Alert

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# Plan Now for Next Year's Elimination of Income Limitations for IRA-to-Roth IRA Conversions

**Current law**
In 2009, only taxpayers with an adjusted gross income of $100,000 or less may convert a regular, SIMPLE or SEP IRA (as well as qualified plan funds) to a Roth IRA. A conversion from a regular IRA to a Roth IRA is taxed as if the funds were withdrawn and not rolled into another IRA. The conversion is not, however, subject to federal and California premature distribution penalties.

**New law beginning in 2010**
Beginning in 2010, all taxpayers, regardless of their income, will be eligible to convert traditional IRAs and qualified plans to Roth IRAs.

**Advantages of a Roth IRA**
Once converted, unlike those of regular IRAs, distributions from Roth IRAs are tax-free as long as they meet certain qualifications (i.e., made 5 years after the establishment of the IRA and after age 59 ½, etc.). In addition, Roth IRAs are not subject to the lifetime required minimum distribution rules after age 70 ½, as are traditional IRAs. This allows more time for funds to grow tax-free, thus maximizing your investment return. In addition, since the distributions are tax-free, they are not considered for calculating the tax on your Social Security payments and have no effect on AGI limitations, such as the 7 ½ percent floor on medical deductions.

**Should you convert to a ROTH IRA?**
Key considerations include: a) how many years you anticipate investing the funds within the Roth IRA before taking distributions to allow the recoupment of cash used to pay the increased tax as a result of the conversion, and b) whether you anticipate being in a higher tax bracket in the future. You also should consider where the funds used to pay the increased tax are coming from. For example, will you need to liquidate securities at a gain or deplete qualified retirement plan assets? You may also consider converting to a Roth IRA in 2010 if your income and/or the fair market value of your IRA has been negatively impacted by current market conditions, as the cost to convert is less than what it otherwise would be under a better economic climate.

**Special rules for 2010 conversions**
A unique income tax rule applies for Roth IRA conversions in 2010 that should be taken into account. Unless you make a special election, none of the gross income from the Roth IRA conversion will be included in income in 2010; instead, fifty percent of the income will be picked up

in 2011 and the remaining fifty percent in 2012. Thus, you must factor in not only what you project your taxable income to be in the next three years, but what you feel is likely to happen to tax rates under the proposals being considered by the current administration, such as healthcare reform. If nothing changes, after 2010 the top tax bracket will increase to 39.6% from 35%.

## Actions to consider in 2009

If you decide to convert to a Roth IRA, consider:

- Continuing to make deductible IRA distributions, if eligible. You will reduce this year's tax bill and will not have to pay any increased tax until 2011 and 2012.

- Making non-deductible IRA contributions and rolling over the account next year at no tax cost if you are currently ineligible to make deductible IRA contributions.

- If your circumstances suggest that it would be more beneficial to convert to a Roth IRA next year and forgo the deferral of the income to 2011 and 2012, you may want to accelerate income into this year and postpone deductions until next year if your anticipated Roth IRA conversion would otherwise push you into a higher tax bracket next year.

## Conclusion

If you are a high income taxpayer with a traditional IRA or qualified plan, there may be considerable tax and economic advantages to converting it to a Roth IRA in 2010. While the variables are many, we would be happy to meet with you to determine whether the decision would be right for you. We can also run the numbers for you under various scenarios to determine your best course of action.

**For more information or if you have questions, please call or email Maureen Cronin, Principal – Tax Group, at 949.777.1202, mcronin@sjaccounting.com, or contact any professional on your Stonefield Josephson client service team.**
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