

Dear Client:

With the recent turmoil in the stock market, many people would rather not think about taking a hard look at investment strategies for retirement. However, with legislation that will go into effect in 2010, along with some speculation on near-term tax rates, taxpayers can make some smart choices now that can really pay off at retirement age.

Gross Income Limitation Removed

Prior to 2010, individuals can only convert a traditional IRA to a Roth IRA if their modified adjusted gross income is \$100,000 or less. For 2010 and forward, taxpayers can convert their traditional IRAs (and funds from certain other eligible retirement plans) to a Roth IRA regardless of their income level. The new legislation also removes the requirement for married couples to file jointly to be able to make this conversion.

Traditional IRA vs Roth IRA

Most people are familiar with IRAs. Some are even aware that there are two kinds of IRAs: traditional IRAs and Roth IRAs. In a traditional IRA, participants can contribute \$5,000 per year (\$6,000 if age 50 or older). Whether or not the contribution is deductible depends upon the adjusted gross income of the taxpayer(s). If you are allowed to deduct the contribution, then any distributions - including your original contributions plus earnings - are taxable. If you are not allowed to deduct contributions, then only the earnings portion of any distribution is taxable.

In a Roth IRA, contributions are not deductible. However, all distributions - whether from original contributions or earnings - are not taxable. Therefore, taxpayers who convert a traditional IRA to a Roth IRA will not need to pay tax when the Roth IRA distributions are made. Also, a Roth IRA has no minimum distribution requirement when the account holder turns 70 1/2, as does a traditional IRA.

Tax Considerations

The initial conversion does have tax effects. An IRA conversion is treated as a taxable distribution, taxed as ordinary income at your marginal tax rate. Although this accelerates the taxable income that you would eventually pay on distributions from a traditional IRA, the future appreciation in the account grows tax-free. Also, for conversions made in 2010, a taxpayer can spread the income over two years: 2011 and 2012. This gives the taxpayer time to put aside money to pay the tax due without having to liquidate any of the retirement account assets.

After 2010, conversions can be made, but the tax will be due with the tax return filed for the year of conversion. Keep in mind that after the tax on the conversion is paid, all of the growth in the account can be distributed tax-free after the taxpayer reaches age 59 1/2. (Please note that there is also a five-year holding period that must be reached before tax-free distributions of earnings can be made.) Also, if you convert at the beginning of a tax year (say January 2010), you have

until you file your tax return for that year (up to October 15, 2011 if you extend your 2010 tax return) to recharacterize the converted funds if the account balance declines.

What Can Be Done in 2009?

Taxpayers with modified adjusted gross income of \$100,000 or less for 2009 need to consider whether or not a conversion in 2009 makes more sense than a conversion in 2010. If made in 2009, the entire amount converted is taxed in 2009, as opposed to the two-year spread allowed for a 2010 conversion. The decision should be based on the taxpayer's current tax rate and anticipated future tax rates. Another factor to consider is that in 2009 the market is depressed, which means that your account balance is probably lower, which equals less tax.

Also, it is anticipated that the tax rates will be going up in the next year or two. Therefore, it could cost more to defer the tax hit on a conversion. You also can convert partial amounts, so you do not have to convert an entire account all at once. You can spread the conversion over as many years as you choose and take advantage of marginal tax rates.

You can also make a traditional IRA contribution in 2009 in anticipation of converting it in 2010. The tax consequences of this are dependent upon existing IRA accounts and the character (deductible vs. nondeductible) of the accounts.

There are many other considerations to take into account when making this decision. If you think that a Roth conversion is right for you, please call our office to discuss your personal tax ramifications. If the Roth conversion makes sense for you, you will need to work with your broker to get your account(s) changed.

Sincerely yours,

Freeman & Williams, LLP

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