



2010 IRA-to-Roth IRA Conversion Opportunity

A recent act by Congress makes it possible for taxpayers to convert their traditional IRAs to Roth IRAs regardless of Adjusted Gross Income ("AGI") or filing status in 2010 only. If you currently own traditional IRAs, please read below to understand both the benefits and the drawbacks of this opportunity so you can determine whether a conversion makes sense for you.

Before 2010, taxpayers with a modified Adjusted Gross Income (AGI) higher than \$100,000 were not eligible for conversions, nor were married taxpayers filing separately. However, beginning in 2010 all taxpayers who currently own traditional IRAs are able to convert to Roth IRAs even if their AGI or filing status previously made them ineligible. This incentive will expire at the end of 2010.

Taxpayers might choose to convert their traditional IRAs to Roth IRAs for a variety of reasons. Roth IRAs have several advantages over traditional IRAs, including:

- Qualified Roth IRA distributions are tax free. To be qualified, they must be made after a five-year holding period has passed and after the accountholder reaches age 59 1/2, or on account of death, disability, or the qualified purchase of a first home.
- Roth IRAs are not subject to the required minimum distribution (RMD) rules that apply to traditional IRAs. Therefore, a Roth IRA accountholder who reaches age 70 1/2 does not need to begin taking distributions; the funds can continue to grow tax free until needed or passed on to heirs.
- Since qualified Roth IRA distributions are tax-free, an individual might be taxed in a lower bracket than if they were receiving taxable distributions from a traditional IRA.
- Qualified Roth IRA distributions do not affect the calculation of tax owed on Social Security payments, and they do not affect AGI-based deductions.

It is important to understand that an IRA conversion is treated as a taxable distribution, and will be taxed as ordinary income at your marginal tax rate. This means you will be taxed on the conversion now, but will not be taxed on qualified distributions later. That can be a significant tax advantage if the value of your Roth IRA has appreciated by the time you start taking distributions. You should note that, unlike a withdrawal from an IRA, a conversion does not trigger any 10-percent early withdrawal penalty.

Although conversion to a Roth IRA does result in immediate taxable income, special provisions for 2010 only give individuals the choice of recognizing their conversion income in 2010 OR averaging it over 2011 and 2012. This allows you to pay taxes on the converted amount over two years, instead of recognizing it all as income in one year. If you take this option, you will be taxed at the rates in effect for 2011 and 2012. Taxpayers who elect to spread conversion income over 2011 and 2012 should be aware there is proposed legislation which would raise the tax rate on the top tax brackets and could result in a higher rate than in 2010.

An IRA to Roth IRA conversion should be considered by individuals who:

- Can afford to pay the tax on the converted amounts from other sources;
- Anticipate being in a higher tax bracket in the future than they are currently; and
- Have a significant period of time before reaching retirement to allow assets to grow tax free and recoup money that may have been lost due to the conversion tax.

There are a significant number of tax and financial considerations which come into play when determining whether to convert your traditional IRA to a Roth. If you have any questions about traditional IRA to Roth IRA conversions, please contact your HB&K advisor.

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