

Qualified Retirement Plans

Practice Alert

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2010 IRA to Roth IRA Conversion Rules

In 2010 taxpayers will be able to convert regular IRAs and qualified defined contribution plan accounts to Roth IRAs without having to comply with maximum compensation limits. Prior to 2010 taxpayers with modified adjusted gross income in excess of \$100,000 were not able to convert traditional IRAs to Roth IRAs. A conversion of a traditional IRA to Roth is subject to income tax but not the 10% premature distribution tax. For 2010 the \$100,000 compensation limit is eliminated. In addition married taxpayers filing separately can also convert to Roth IRAs.

The advantages of a Roth IRA includes tax free distributions if the distributions are qualified distributions, i.e. made after the fifth tax year in which the first contribution to the Roth IRA was made; made when the account owner is age 59½ or older; in the event of death, disability or the purchase of a home by a qualified first time buyer. In addition Roth IRAs are not subject to the lifetime Required Minimum Distributions (RMD) that traditional IRAs and qualified plan accounts must follow. Beneficiaries of Roth IRAs enjoy the same tax free distributions as the original account owner although the beneficiary is subject to the post death distributions as required by the RMD rules.

Since the primary benefit of converting is tax related those account owners that are near retirement are not candidates for a Roth conversion. In addition before a decision is made an analysis should be performed with a variety of assumptions including future tax rates, rate of return on investments and number of years before distributions will be made. Certainly if it is anticipated that tax rates will be higher in the future than the conversion makes sense if all other considerations point toward conversion.

As a further incentive for conversion the taxation of the distribution from the traditional IRA to the Roth can be deferred. Instead of including the income from the conversion in the year of conversion, i.e. 2010, half of the income can be declared in 2011 and half in 2012 unless the taxpayer elects otherwise. On the other side of the coin after 2010 the tax brackets above the 15% bracket revert to the pre 2001 rates, i.e. 39.6%, 36%, 31%, and 28% instead of 35%, 33%, 28%, and 25%. Those taxpayers in the highest bracket may want to include the conversion in their 2010 income in anticipation of higher rates in 2011 and 2012. Hopefully we will know well enough in advance what the likely tax rates will be going forward before a decision is made.

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