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ASSET MANAGEMENT LLC

Resuscitating your IRA

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A primer on 2010 Roth IRA conversions

Has your **I**ndividual **R**etirement **A**ccount been neglected? You know what I'm talking about – that monthly account statement arriving in mothballs. The relatively nominal account you haven't made a contribution to since Reaganomics? Yeah, it's a financial zombie in need of a monetary transfusion. Well, we have just the remedy: converting your traditional IRA to a Roth IRA in 2010. Yes, we realize what year the calendar says so bear with us. Actually, our revitalization plan involves just 3 simple steps. Before we elaborate; a little background.

In 2005 the Tax Increase Prevention & Reconciliation Act (TIPRA) was enacted, among other things, to promote more personal retirement funding for taxpayers through their own contributions. The government realizes the day of corporate defined benefit pensions are quickly vanishing (thank Enron) and social security is anything but. So to compensate, politicians enacted TIPRA to encourage individuals to contribute not only to their corporate plans (401k's etc.) but also contribute to their forgotten IRA's. Makes sense: burden the individual, not corporate America with retirement funding. How do the Feds benefit? By encouraging IRA conversions to Roth IRA's, tax revenues are collected sooner rather than later. While not a free meal, it's not a raw deal either. Let's explain the strategy.

- Step One: Contribute to your IRA from 2006 thru 2010 with maximum contributions of $4,000 ($5,000 if over age 50). Contribution limits will be indexed starting 2008. You have until April 16, 2007 to maximize your 2006 contribution. Make the contributions even if non-deductible.

- Step Two: For tax years beginning 2009, TIPRA eliminates the income limitation that currently prevents some taxpayers from converting traditional IRA's to Roth IRA's. For 2007, this income limitation begins at $95,000 for single taxpayers and is phased out completely at $160,000 for married filing jointly. So after 2009, convert your traditional IRA to a Roth IRA.

- Step Three: Beginning in 2010 TIPRA will allow the amount of the conversion to be taxed in 2011 and 2012 – in effect, spread over 2 years instead of one. This tax break is available for 2010 conversions only. If you've made non-deductible contributions, only the earnings will be taxed. Additionally in 2010, an individual with a qualified retirement plan (401k) who is eligible to receive a distribution can roll it into an IRA and then convert the entire amount to a Roth IRA.

The payoff: once converted to a Roth IRA, the earnings/contributions grow tax free permanently. The younger you are, theoretically, the more advantageous. Let's make sense of this financial drivel with an applicable example.

JJ, age 50, wakes up one morning to ever graying temples and realizes retirement is rapidly approaching. He and his wife each have deductible IRA's worth $20,000. He makes non-deductible contributions of $5,000 to both accounts for 2006 through 2010. In 2010, each account is worth $60,000. They then convert each of their IRAs to Roth IRAs. Since $25,000 of each account was funded with non-deductible contributions, only the $35,000 difference in each will be taxable. This taxable amount will be prorated $17,500 in both 2011 and 2012. Going forward, the accounts will grow tax free – with tax free distributions, no minimum distribution requirements, transferable to heirs. It's all good from there on.

If you're considering this strategy, making non-deductible contributions now makes sense for most. While we can't broadly recommend this strategy for everyone – we'd be happy to evaluate on a case by case basis. Give us a call; there might be life for your moribund IRA after all.

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