

# Money Management

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Money Management is a weekly column on personal finance prepared and distributed by certified public accountants.

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## **SHOULD YOU CONVERT TO A ROTH IRA?**

Converting a traditional IRA to a Roth IRA can offer greater flexibility in retirement. And, beginning this year, more taxpayers are eligible to make this conversion. However, there are both potential benefits and drawbacks to this step. As you review your retirement planning for the coming year, the New Hampshire Society of CPAs explains when and how a conversion makes sense.

### **ROTH vs. TRADITIONAL**

For 2010, the basic contribution limit for a traditional IRA is the lesser of a taxpayer's taxable compensation or \$5,000 per year (\$6,000 for people age 50 or over). If you and your spouse file jointly and are active participants in an employer retirement plan, you can each fully deduct contributions to a traditional IRA if your modified adjusted gross income (MAGI) is below \$89,000. The deduction phases out above this income level, and no deduction is allowed for those with MAGI of \$109,000 or

more. For single taxpayers, you can fully deduct your contributions if your income is below \$56,000, and the amount you can deduct is reduced for those with income up to \$66,000. Taxpayers whose deductible contribution is reduced or eliminated can make nondeductible contributions up to the amount of their basic contribution limit less any deductible contributions.

For Roth IRAs, the basic contribution limit for 2010 is also \$5,000 per year (\$6,000 for people age 50 or over). You can make a full contribution if you are married filing jointly and have 2010 MAGI below \$167,000. The amount you can contribute is reduced for higher incomes, with no contribution allowed for those with MAGI over \$177,000 or more. For single taxpayers, the phaseout threshold is \$105,000 and the phaseout ends if your MAGI is \$120,000 or more.

#### **HOW DEDUCTIONS WORK**

With a traditional IRA, you can deduct deductible contributions from your income in the year they are made—and the earnings on your account are tax free—but you pay taxes on the account distributions once you retire and face minimum distribution requirements beginning when you turn age 70½. With a Roth IRA, your contributions are not deductible now, but earnings are tax-free over the years (if the owner holds at least one Roth for five years). You are not required to take minimum distributions

by any set deadline. Roth IRA owners who are 59½ are not subject to the 10% early distribution penalty on withdrawn earnings.

### **THE ADVANTAGES OF CONVERSION**

Conversion to a Roth IRA may be appealing if you expect your tax rate to be higher when you retire or if you plan to leave your IRA to you beneficiaries, who will not have to pay taxes on the proceeds of a Roth IRA. The absence of minimum distribution requirements means you can dip into a Roth IRA in retirement as you need it, or not at all if you choose. Under new rules taking effect this year, there are no longer income limits on who can convert from a traditional to a Roth IRA, so this option is open to a wider range of taxpayers.

### **THE DOWNSIDE**

Conversion from a traditional to a Roth IRA can be costly, however, because you will have to pay taxes now on any deductible contributions in your traditional IRA that you move to a Roth IRA, as well as on the earnings from that investment, which could amount to a hefty sum. This step might be worth it if you believe the conversion will save you taxes in retirement, but it's tough to reliably forecast future tax law. One positive note is that if you convert this year, the income from the conversion will not be taxable in 2010. Instead, one-half will

be taxable in 2011 and the other half in 2012. If your retirement savings have dwindled because of market declines, it may be best to make the conversion now so the tax bite will be lower since your balance—and any earnings on it—are smaller than they might be in the future. If you decide not to convert, you can always make future retirement contributions to both kinds of IRA, as long as the total amount each year is within appropriate limits for your age and income level.

#### **TURN TO YOUR CPA**

Making retirement and tax decisions can be challenging, but your local CPA can help you decide what's best. Consult him or her on all the financial questions facing your family.