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Should You Convert Your Traditional IRA to a Roth IRA?

Change in tax law for 2010

A Roth IRA is powerful retirement planning vehicle. Roth IRAs have many benefits. The earnings on contributions are tax free and qualified distributions from a Roth IRA account are not subject to income tax. Additionally, Roth IRAs may be funded after the owner attains age 70 ½ and there is no required minimum distribution for the original owner. If you leave your Roth IRA to your children, they won't pay any tax on withdrawals either. They will however be subject to required minimum distributions based on their life expectancies.

However, many investors are denied access to Roth IRAs because their income is too high. Currently, the income limit for married couples is \$176,000 and for singles it is \$120,000. Converting a traditional IRA to a Roth IRA requires an even lower income limit of \$100,000.

In 2010, the income limit applied to Roth conversions goes away allowing anyone to roll their traditional IRA into a Roth IRA. At the time of conversion, you must include the fair market value of the IRA in your income. In 2010, individuals may elect to average their conversion income over the next two years. Therefore, by converting, you are choosing to pay tax today to save tax in the future.

Generally, we try to defer taxes as long as possible. However, the IRA conversion will be an effective strategy for people who expect their future tax rates to be higher than they are in 2010. In addition, the greater the expected rate of return on your investments, the more likely a conversion will benefit you. For many, their IRA investment value is at a low point. Also, you must consider the amount of time you have until you retire. The further you are from retirement, the greater the benefits of converting. Anyway you look at it though; you must have cash available to pay the increased tax due in 2011 and 2012. Remember, you don't have to convert 100% of your traditional IRA funds.

If you decide to pay tax now and enjoy tax free growth for the rest of your life, 2010 is the year of the Roth for you. If you want to maximize your conversion, make sure you make your non-deductible IRA contribution for tax year 2009. The conversion of these amounts will have minimal tax consequences since you will have a cost basis equal to the contribution amount and earnings, which are taxable, will be minimal given the short amount of investment time.

If you need more information, or would like to discuss this further, please contact us at Delisi & Associates at 724-832-8585. You can also email your questions to maryh@delisiassociates.com.