Want a New Convertible in 2010? Think ROTH
Part I of II

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Think outside the box – a new car is nice for a few months, but we all know that it's a terrible investment. With baby boomers anxiously looking toward retirement, *my* version of the 21st century's "uber" status symbol is a well-funded retirement plan! To me, having a healthy, growing retirement account that is non-taxable, actually earns money, *and* doesn't require a monthly coupon payment is always a home run!

How is this possible? I'm glad you asked! This year, anyone who has retirement funds has a unique opportunity to build up a substantial Roth IRA account balance. First, let's make sure we all understand the difference between a Roth and a traditional IRA. You typically put money into a traditional IRA by setting up an account with an investment advisor, bank, or mutual fund company. Your contributions, subject to certain limits, are a tax deduction to you. These investments grow and you pay tax when you begin taking them out of your account ("distributions"). You must begin taking distributions, whether or not you need them, no later than April 1 of the year following the year you turn 70-1/2.

A Roth IRA is set up basically the same way *except* that your contributions are not tax deductible. The advantage is that you do not pay taxes on your withdrawals (subject to certain age and timing limits) no matter how much your account has grown. This means the income you earn on your investments is tax-free, which can add up to a significant amount over time! Also, you are not required to take distributions from your Roth at *any* time during your life. This is a big benefit for those trying to lower their tax bill in retirement or for those who plan to leave their IRA to their heirs. Your heirs must pay income taxes on a traditional IRA, but not on a Roth – another significant advantage.

I am – and always have been – a big proponent of Roth IRAs for my clients. However, you can currently contribute only $5,000 annually ($6,000 if you're age 50+), so it can be hard to build a significant balance, especially if you're older. Until this year, Congress has allowed taxpayers to "convert" traditional IRA funds to a Roth IRA by paying taxes on the balance converted, but only if their modified adjusted income ("MAGI") is below $100,000. This has eliminated many taxpayers until now.

Beginning in 2010, the $100,000 income limit has been eliminated, which presents a very exciting opportunity for investors. Not only that, but Congress has also given taxpayers the option of delaying payment of taxes on the conversion for two years, which presents some really interesting planning possibilities. Trust me – this is big, so big that I am spreading this discussion over two months to give you enough information to make informed decisions.

For the remainder of this article, we'll examine important points about converting. Next month, I'll go over reasons you may want to convert – and reasons you may *not* want to do so.

Beginning in 2010, anyone will be eligible to convert retirement funds to a Roth. The income limits for annual contributions will remain in place, however. This means that married couples with a MAGI over $177,000 are prohibited from contributing to their Roth ac-

counts (the single limit is $120,000). TIP: this problem can be avoided by contributing to a *nondeductible* IRA and then converting it to a Roth. Another bonus is that those who are married and filing separately can now convert to a Roth.

A special advantage for a 2010 conversion is that the IRS is giving you the option to delay paying the taxes on the conversion for two years. This works is as follows: on each separate Roth account that you convert, you will choose whether to a) pay all the taxes due for the year of conversion or b) report the income in the following two years – half in 2011 and half in 2012. Potentially, you could convert on January 1, 2010 and delay payment of related income taxes until April 16, 2012 (½) and April 15, 2013 (the remaining ½). You will have up until the due date of your extended tax return (October 15, 2011) to decide when you'll pay the taxes.

To clarify, separate Roth accounts are not separate mutual funds held within the same Roth IRA account. They have separate account numbers and may be kept with different custodians (one at Vanguard and another at Fidelity, for example). Having more than one IRA account can be a very good idea for many reasons, which I will discuss at greater length next month.

You can also make a partial Roth conversion. In other words, you can convert only a part of your IRA to a Roth, depending upon various factors, such as how much income taxes you can afford to pay. Should you do this, a "pro-rata rule" (discuss this with your CPA) will apply. Because this will require detailed recordkeeping and computations, you might consider employing a CERTIFIED FINANCIAL PLANNER™ who is also a CPA or who has a close relationship with your CPA.

SEP-IRA's, SIMPLE-IRA's, and nondeductible IRAs also qualify for conversion. I see this as a great opportunity to convert nondeductible IRAs, especially if they are still suffering from a poor economy. If you have money in a 401(k), find out if you can roll it to an IRA so you can convert. You should also check with your employer to see if your plan allows in-service distributions so that you can convert some of those funds now.

What if you convert and then the bottom drops out of the market (again)? Good news - you have options! Next month, we'll discuss planning options, including recharacterizations, to help you decide if a new "convertible" is the good vehicle for you in 2010!