

Should I Consider a Roth IRA?

By Eric Hormel, CPA and Dan Monaghan, CPA

Beginning in 2010, a new opportunity exists for previously excluded high income taxpayers to convert a traditional IRA to a Roth IRA. For previous years, and through 2009, taxpayers with more than \$100,000 in modified adjusted gross income were ineligible for conversion. In 2010, Roth IRA conversions will be available to all taxpayers without limitation.

The Roth IRA offers many advantages over a traditional IRA including:

- All distributions are income tax free if the Roth IRA is over five years old.
- The principal can always be withdrawn tax free.
- When a Roth IRA is inherited by a beneficiary, all distributions continue to be income tax free.
- There are no required minimum distributions when a taxpayer reaches 70½. (Distributions are required at age 70½ for a traditional IRA.)

There is a catch: conversions from a traditional IRA to a Roth IRA are treated as taxable distributions in the year of transfer. For 2010 only, there's a special rule in place that allows a taxpayer to recognize 50% of the conversion income in 2011 and the remaining 50% in 2012. Taxpayers may elect to have the entire rollover amount taxed in 2010 if it is anticipated that their tax rate will increase in 2011 and 2012.

Additionally, as of 2008, participants in qualified retirement plans like 401(k)s have the option of a direct rollover from their plan to a Roth IRA. Previously, participants were required to roll over balances to a traditional IRA and then subsequently convert to a Roth IRA. The same rules currently governing Roth IRA conversions will apply to direct rollovers from a retirement plan to a Roth. Direct rollovers for in-service withdrawals are only available if your retirement plan allows for them, so check with your company's HR department to determine if a rollover is an option. Generally in-service withdrawals, if allowed by the plan, are for participants who are at least 59½ years old.

The decision to convert to a Roth IRA should not be based solely on income tax concerns. We recommend discussing any potential rollover with your financial advisor, estate planning attorney and your CPA before any decision is finalized. Even though you have to pay current income tax on the amount you convert to a Roth IRA, it still might make sense to convert if:

- You think you will be in the same or a higher tax bracket when you withdraw the funds;
- You have a long time horizon to maximize the benefits of the tax free growth; **and**
- You can pay the tax from sources other than your IRA, such as from regular taxable brokerage or bank accounts.

These are not the only considerations. Depending on your situation, you may also want to take into account the following:

- Has your current IRA decreased in value and do you expect significant growth in the near future? If you convert your IRA now, all appreciation will escape income tax.
- Will you be changing your state of residency? If you are currently an Oregon resident, but plan on retiring to a state with no income tax, like Washington or Nevada, a rollover might not make sense. The opposite is also true. If you are living in a state that has no state income taxes and later move to a state that has a state income tax, it may make sense for you to convert when there are no state income taxes.
- Do you want additional flexibility in determining distributions from your IRA? While there are required minimum distributions with a traditional IRA beginning at age 70½, no distributions are required with a Roth IRA until it has passed to a non-spouse beneficiary.

You are able to convert either a portion or the entire amount of your traditional IRA to a Roth. For those taxpayers that are not projected to be in the highest income tax bracket in 2010, doing some tax planning with your CPA to determine the tax consequences of a potential conversion is a must.

Your CPA can help you model the effects of converting varying amounts of your IRA and can discuss the impact on your marginal tax rates. Nevertheless, if you're in the highest brackets and expect to stay that way throughout retirement, it could still make sense—especially if you're convinced that tax rates will continue to rise via legislation no matter how much you make.

Even though taxes are important, everyone should consider converting a traditional IRA as part of their overall estate plan, especially if there is no projected need for the funds during the owner's lifetime. Although the Roth IRA will still be included in the taxpayer's gross estate, the account will likely grow larger (because there are no required minimum distributions) than it otherwise might under traditional IRA distribution rules—leaving more for heirs to withdraw income tax free over their lifetimes. A major advantage over a traditional IRA is that the income tax paid at the time of conversion will reduce the owner's gross estate. The benefit of this is that the account owner is prepaying income tax on behalf of future beneficiaries without it counting as a taxable gift.

Just because you can do a Roth conversion in 2010 doesn't automatically mean you should. Likely, if a Roth conversion didn't make sense before 2010, it probably won't after. However, in the right circumstances, converting to a Roth

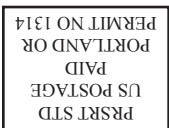
IRA can be a powerful income and estate planning strategy. For obvious reasons this is a very complex decision that is specific to each individual. Before making a decision to convert, be sure to talk with your CPA and other professional advisors to determine if a Roth IRA conversion makes sense for you.

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