



New rules expand
Roth IRAs' benefits
to more people

Roth IRA conversions

By Don Sadler

OVER THE PAST few decades, Individual Retirement Accounts (IRAs) have become a bedrock retirement savings tool. An estimated 46 million U.S. households own IRAs—that's 40 percent of all households in the country—with assets totaling \$4.1 trillion.

In 1997, Congress made a good thing better by creating a new type of IRA that many experts say is even better than the original. Known as Roth IRAs, these allow contributions to grow tax-free, not just tax deferred as in a traditional IRA.

What's the difference?

With a traditional IRA, contributions may be tax deductible, depending on your income and whether you're covered by an employer retirement plan. However, you must pay income taxes on the money when you take it out during retirement, and withdrawals must begin before you reach age 70½.

With Roth IRAs, you cannot deduct contributions on your current tax return. However, you don't have to pay taxes on the money when it's withdrawn, as long as you wait until after age 59½ to take it out.

"Roth IRAs may offer greater potential for long-term investors because they are not subject to taxes on withdrawals," explains Victoria Collins, senior managing director with First Foundation Advisors in Irvine, California, a Costco member who helps clients consider the pros and cons of Roths compared to traditional IRAs.

The Costco Connection

If a Roth IRA is not right for you, Costco Services offer several other programs that can help you reach your financial goals. Information about high-yield online savings accounts from Capital One Direct Banking, and online investing and small-business 401(k) plans from ShareBuilder, can be found on Costco.com. Just click on "Services."

But there's one big catch: If you earn too much money, you can't open or contribute to a Roth IRA. This has prevented many self-employed individuals and small-business owners from enjoying the unique benefits of this popular retirement vehicle.

No small change

At the beginning of this year, though, these income limits were removed for conversions of traditional IRAs to Roths. "Under the right circumstances, converting from a traditional to a Roth IRA can be a great deal," says Suzanne Durbin, a financial adviser and partner with GV Financial Advisors in Atlanta who has been advising clients about Roth IRA conversions. "It's an opportunity for many high-income individuals to enjoy the benefits of Roth IRAs for the first time."

There is one significant drawback to making a Roth IRA conversion: Taxes must be paid on the value of the IRA at the time of conversion. However, you can pay the tax over two years (in 2011 and 2012) if you complete your conversion this year. "This can be an excellent planning tool," says Collins.

Some people figure they'll just pay the tax out of IRA assets, but, depending on your age, this may not be a good idea. Why? If you're under age 59½, a 10 percent penalty will be assessed on IRA assets that aren't rolled directly into the Roth. "Therefore, the best candidates for a conversion are individuals who have enough money in a liquid account to pay the taxes," says Durbin.

Pay the tax now ... or later?

From a tax-planning standpoint, the timing may be good to complete a Roth conversion this year—while the value of many accounts is still down from their peak and before tax rates go up, as many economists expect.

In general, those with longer time horizons may benefit the most from a Roth conversion. "They get the most bang out of tax-free

growth, and there is more time to recover the money they paid in taxes," says Collins.

But there can be advantages for older individuals as well, especially when it comes to estate planning, since the requirement to start taking money out by age 70½ doesn't apply to Roths. "So you can let the account value grow for many years and leave it to your heirs, who can also enjoy tax-free distributions from the account," Durbin notes.

"To convert or not to convert—it's not a simple question," says Collins. "There's no rule of thumb that fits everybody, so people really need to talk to their CPA [certified public accountant] or financial adviser to determine what makes the most sense for them." ☐

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Roth IRAs at a glance

ALTHOUGH INCOME LIMITS have been lifted for converting a traditional IRA to a Roth IRA, they still apply to opening and funding Roths. If you earn more than \$120,000 this year and you're single, or \$176,000 if you're married and filing jointly, you cannot open or contribute money to a Roth IRA.

In 2010, you can make total IRA contributions (both traditional and Roth combined) of up to \$5,000, or \$6,000 if you're age 50 or older.

For more information on

Roth conversions, visit www.irs.gov and enter "Roth IRA conversions" in the search box. Another good online source is www.rothira.com.

