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VOLUME 19 | EDITION 02

Delaware Valley | Leading Wealth Advisor
Sterling Investment Advisors Ltd.
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"Is a Roth IRA conversion right for me?"

By Timothy E. Flatley

2010 offers a unique opportunity for high net worth families. Starting this year, the income limitations on Roth IRA conversions have been removed. This is a chance to have the government take less of what you and your heirs have. To determine if it makes sense to convert to a Roth IRA, let us examine its features.

A Roth is a retirement account similar to a traditional IRA in that earnings grow tax deferred, and you are penalized on withdrawals prior to age 59½ unless certain conditions are met. However, some key differences make the Roth IRA an attractive option in many situations. The major distinction is that Roth IRA contributions are made with after-tax dollars, and the distributions are not taxable as long as you are 59½ and have the account for at least five years.

The tax-free distributions create some considerable advantages down the road. No minimum distributions are required; that enables the funds to keep growing until they are withdrawn. If you do not exhaust all of the funds, your beneficiaries will enjoy tax-free distributions. It is worth noting that post-death distribution rules apply to the Roth IRA in the same manner as traditional IRAs; however, the distributions are entirely tax free.

If you withdraw the funds during your lifetime, the distributions are not included in modified adjusted gross income for the purpose of determining taxability of Social Security benefits. The importance of this is that you can withdraw the amount needed to supplement your Social Security income without creating tax headaches. Many people have a significant amount of wealth in taxable retirement accounts, so it can be highly beneficial to have a source of tax-free retirement income.

You may be asking yourself why you have not considered this in the past. The reason is that you likely did not qualify due to relatively low income limitations. Although the income limitations still apply to Roth contributions, they have been lifted in 2010 for Roth conversions. You should take the time to consider a conversion this year because the opportunity may never be better.

The most significant factor in evaluating a Roth conversion will be the tax ramifications. Depending on the conversion size, there could be a substantial impact on your income for the year. Although the impact may be felt in the short term, the long-term tax savings may considerably outweigh the costs.

While there is a lot to contemplate, the potential benefits absolutely make it worthwhile to explore this opportunity with a professional.

SEVEN ROTH CONVERSION FACTS

01 You have the option to incur the tax burden fully in 2010 at the current rates, or you can split it evenly between 2011 and 2012 at those years' rates. Conversions after 2010 are taxed fully in the year of conversion.

02 The ideal situation would be to have money in a non-retirement account to pay the taxes, thus maximizing the balance that is growing tax deferred.

03 A conversion can be very attractive if you anticipate your tax bracket will stay the same or increase in the foreseeable future.

04 There is no age limitation.

05 401(k) accounts can be converted provided you are eligible to access the funds.

06 Partial conversions are an option.

07 You have the ability to reverse the conversion until October 15 of the following year.

This information should not be construed as specific financial advice. Please contact a financial advisor to determine the right strategy for your portfolio.

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