

 **The Blue Summit Report**

Is it a good time to convert to Roth IRA's?

If your retirement assets took a beating in the recent stock market decline, converting an IRA to a Roth IRA may be one of the best tax strategies this year and could save you a fortune in taxes. But you need to understand the rules and play the game right.

It's a good time to convert if you believe the market is as low as it will go, with the comfort that you will actually have a chance to change your mind later! The Roth can be a real bargain, allowing any increase in account value from that point forward to be earned tax-free. When you do the conversion, you must pay income tax on the amount you are converting. This can be the whole account or a portion of it. But, subject to certain restrictions, no tax is assessed when the money is withdrawn. You also avoid the mandatory 70 ½ distributions (waived in 2009), which can leave more for your beneficiaries if you don't use the money yourself.

How much you benefit from the conversion will depend on how the investments do subsequently, but there is great potential. If the investment springs back, not only will the appreciation be free from income tax, but if tax rates increase in later years (which seems likely), you will have done the conversion at today's lower rates.

First available in 1998, Roth IRA assets grow and are withdrawn tax-free since the money deposited already has been taxed. In contrast, a traditional IRA is tax deferred and you'll pay taxes on the entire balance when monies are withdrawn. But deposits into traditional IRAs may be tax deductible. If you are contributing to an employer plan, you must meet certain income limits.

Example:

Let's say you've wanted to convert to a Roth IRA for years but never did. Back then, your account was worth \$100,000 and you would have paid taxes on the entire amount. But the value has fallen to \$60,000 today. If you're a long-term investor and believe the investment would rebound, converting to a Roth would save you from paying taxes on \$40,000.

Income Limit for Conversion - \$100,000 in 2009, NO limit after 2010

For many people, the income limit for conversion has been the main hurdle. In 2009, you can only convert traditional IRAs to Roths if your adjusted gross income does not exceed \$100,000 and you're willing to pay taxes up front. The ceiling applies to both singles and married couples filing jointly. Those who earn less this year than in the past, perhaps because of a layoff or a business setback, may qualify for the first time to do a conversion.

However, beginning in 2010, any taxpayer will be able to convert an IRA to a Roth IRA regardless of the level of his or her income. Furthermore, one-half the income from a Roth conversion in 2010 will not be taxable until 2011 and the other half will not be taxable until 2012, unless you elect to report it all in 2010.

Recharacterization Rules – You can change your mind!:

For those who regret converting, because their account value falls below the amount at time of conversion, the IRS provides an exit. You can take back each conversion - called a recharacterization - by Oct. 15 of the year following your conversion. Let's say you converted to a Roth in May 2008, you have until Oct. 15, 2009 to tell the IRS you changed your mind and chose to switch back. Once you have recharacterized, you are not permitted to do another conversion with the same assets until the following year or 30 days after the first conversion, whichever is longer. However, if you still have other money in a traditional IRA, you can get around the rule by converting funds out of the other IRA.

5 Year Hold Rule:

You do have to hold the converted assets in a Roth for five years or until you turn 59½, whichever comes first, to make penalty-free withdrawals of your converted amounts. Each conversion has its own five-year clock. If you've already reached age 59½ and you convert traditional IRA assets to a Roth, you can withdraw the assets you convert at any time without worrying about a five-year deadline or penalties.

Other IRS Guidelines:

Traditional IRA deductibility (if contributing to an employer plan) - 2009 modified AGI limits:

- Joint - More than \$89,000 but less than \$109,000
- Single - More than \$55,000 but less than \$65,000

2009 Limits for contributions to a Roth (not conversion):

- Joint - More than \$159,000 but less than \$169,000
- Single - More than \$101,000 but less than \$116,000

2009 Roth-IRA Max Contribution Amount

- \$5,000 under 50
- \$6,000 50 or over

For more information:

(619) 698-4330 or

info@bluesummitinvest.com

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Judith L. Seid, CFP®
President & Founder



Shane G. Johnston, AIF®
Vice President

Blue Summit Financial Group, Inc

(888) 698-4330

www.BLUESUMMITINVEST.com