Roth IRA Conversion Could Mean Tax-Free Retirement Income

By Arthur Rottenstein, Registered Principal

There can be advantages to holding your retirement funds in a Roth IRA instead of a traditional IRA. Your contributions (which must be made with after-tax money) to a Roth grow tax-deferred. Roth accounts are not subject to annual required minimum distributions and any qualified distributions you – or your beneficiaries – decide to take will be tax-free. Until now, however, only those with an annual modified adjusted gross income of less than $100,000 were allowed to convert existing IRA funds into a Roth account.

On New Year's Day, that rule will change. The income cap for conversions will disappear. Those who do convert can elect to split the resulting federal income tax bill (conversion amounts are treated as ordinary distributions) between 2011 and 2012 instead of taking the hit in 2010. If you wish, you can scale back the tax bill by converting only a portion of your traditional IRA holdings to Roth accounts.

The timing could be particularly advantageous. Because of recent market declines, the value of your traditional IRAs may be lower than before, a fact that potentially reduces the federal tax bill on your conversion. Consider also that current federal income tax rates are at historic lows – but may be rising after 2010 – and you can easily see why 2010 may be the ideal time for a change.

If you'd like to discuss whether converting to a Roth could enhance your overall retirement or estate plan, I would be happy to assist. Please don't hesitate to give me a call.

The option to spread federal income taxes over two years applies to 2010 only. For conversions occurring after 2010, the federal income taxes must be paid in full the following tax year going forward. Unless certain criteria are met, Roth IRA owners must be 59½ or older and have held the IRA for five years before tax-free withdrawals are permitted. Additionally, each converted amount may be subject to its own five-year holding period. Converting a traditional IRA into a Roth IRA has tax implications. Investors should consult a tax advisor before deciding to do a conversion.

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Arthur Rottenstein is a Registered Securities Principal with Raymond James Financial Services in Boca Raton. He has been helping people with financial planning since 1982. Please feel free to call Arthur at 954.341.7209 or email arthur.rottenstein@raymondjames.com. Please also feel free to visit his website at coralspringsfinancialplanner.com.