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The Rush to Roth IRA Conversions in 2010

Virtually anyone can take advantage of this tax law loophole.

2010 will be an extraordinary year for tax law, a tax year so potentially advantageous that we may never see its like again. One probable 2010 phenomenon: a wave of high-income and high net worth individuals converting traditional IRAs to Roth IRAs. Here's why 2010 represents a great year to make that move.

Income limits: gone. Today, you have to pass an income test before you can convert a traditional IRA to a Roth. If your modified adjusted gross income (MAGI) is more than $100,000, you can't do it. This limit has long frustrated high-income taxpayers.[1]

In 2010, it's a whole different story – there is NO income test. Anyone with any MAGI can make the conversion.

While you still can't contribute to a Roth IRA if your 2007 MAGI exceeds $166,000 (joint filers) or $114,000 (most single filers), it is the conversion that is important. [2]

Potential advantages: considerable. Many high-salaried people have rolled old 401(k) assets from old jobs into traditional IRAs. In 2010, they can convert them to Roth IRAs, which will mean:

- Tax-free growth of these assets[3]
- Tax-free withdrawals of these assets someday (assuming they are 59½ or older and the Roth IRA is more than 5 years old)[3]
- No minimum distribution requirements once you turn 70½ [3]
- An eventual reduction in their taxable estate[4]

Taxes: deferred. Of course, you will pay taxes on a Roth IRA conversion. But if you do this in 2010, you don't have to pay them right away. Unless you elect otherwise, the taxes on the conversion will be spread out over the 2011 and 2012 tax years.[5] In effect, this gives taxpayers the ability to delay full payment of any tax due until 2013.

The non-deductible IRA option. Some high-income earners have opened non-deductible traditional IRAs with the intent of converting them to Roth IRAs in 2010.

While a traditional IRA has no contribution phase-outs due to income, high-income taxpayers can't deduct their IRA contributions like the middle class can. For tax year 2007, for example, the deduction phase-outs (this is MAGI) start at $83,000 for joint filers and $52,000 for single filers and heads of households.[6]

If you don't qualify to make a deductible IRA contribution or a Roth contribution, the non-deductible IRA lets you make a permissible "end run" to build some assets that can "go Roth" in the near future. If the tax law changes taking effect in 2010 stay in place for years to come, you will be able to open a non-deductible IRA annually (as long as you keep earning income) and convert it to a Roth each year.[7]

Why would Congress give IRA holders a break like this? The simple answer: quick revenue for the federal government. In 2010, a LOT of cash will be pumped into the Roth IRA program, and that will result in a LOT of taxes as a result of the conversions (a short-term revenue boost).

Ready for 2010? Whether you do or don't convert a traditional IRA into a Roth in 2010, you will want to know about the changes in tax law affecting IRAs and other retirement savings vehicles, and your estate and your investments. Before you make a move with your IRA, talk to a qualified financial advisor or tax professional who understands the coming rules modifications.

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How Much Income Will You Really Need?

Many people underestimate lifestyle costs, medical expenses and inflation.

What is enough? What is not enough? If you're considering retiring in the near future, you've probably heard or read that you need about 70% of your end salary to live comfortably in retirement. This estimate is frequently repeated … but that doesn't mean it is true for everyone. It may not be true for you.

You won't learn how much retirement income you'll need by reading this article. You'll want to meet with a qualified retirement planner who can help you plan to estimate your lifestyle needs and short-term and long-term expenses.

That said, there are some factors which affect retirement income needs – and too often, they go unconsidered.

Health. Most of us will face a major health problem at some point in our lives – perhaps even multiple or chronic health problems. We don't want to think about that reality. But if you're a new retiree, think for a moment about the costs of prescription medicines, and recurring treatment for chronic ailments. These minor and major costs can really take a bite out of retirement income, even with a great health care plan. While generics have slowed the advance of prescription drug costs to about 1-2% a year recently,[1] one estimate found that a 65-year-old who retired in 2007 would need $215,000 to pay for overall retirement health care costs – up about 7.5% from 2006.[2]

Heredity. If you come from a family where people frequently live into their 80s and 90s, you may live as long or longer. Imagine retiring at 55 and living to 95 or 100. You would need 40-45 years of steady retirement income.

Portfolio. Many people retire with investment portfolios they haven't reviewed in years, with asset allocations that may no longer be appropriate. New retirees sometimes carry too much risk in their portfolios, with the result being that the retirement income from their investments fluctuates wildly with the vagaries of the market. Other retirees are super-conservative investors: their portfolios are so risk-averse that they can't earn enough to keep up with even moderate inflation, and over time, they find they have less and less purchasing power.

Spending habits. Do you only spend 70% of your salary? Probably not. If you're like many Americans, you probably spend 90% or 95% of it. Will your spending habits change drastically once you retire? Again, probably not. Most people only change spending habits in response to economic necessity or in pursuit of new financial goals. People don't want to "live on less" once they have had "more".

Social Security (or lack thereof). In 2005, SSI represented 39% of a typical 65-year-old retiree's income. But by 2030, Social Security may only replace 29% of that income, after deductions for Medicare premiums and income taxes. Since 1983, retirees earning more than $25,000 in SSI have had to pay income tax on a portion of their benefits.[3] This is all presuming Social Security is still around in 2030.

So will you have enough? When it comes to retirement income, a casual assumption may prove to be woefully inaccurate. Meet with a qualified retirement planner while you are still working to discuss these factors and estimate how much you will really need.

Citations.
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- ❑ I need to guarantee some of my hard earned savings in these turbulent times. Please help me protect and shield my retirement assets.
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