



MARKETING INTELLIGENCE

Report

Take a New Look – Roth IRA Conversions

Changes Beginning in 2010

Through the end of 2009, only taxpayers with modified adjusted gross incomes of \$100,000 or less were eligible to convert their traditional IRAs and qualified retirement plans to an after-tax Roth IRA. However, beginning in 2010 every taxpayer is eligible to convert to a Roth IRA due to the TIPRA provision (Tax Increase Prevention and Reconciliation Act of 2005) that eliminates the \$100,000 income restriction. In addition, taxpayers who convert in 2010 have the option to report all of the income in 2010 or report one-half in 2011 and one-half in 2012. Using IRA or qualified retirement plan proceeds to pay the tax due on the amount converted may subject these proceeds to both income tax and the 10% early withdrawal penalty.

What is a Roth IRA Conversion?

A Roth IRA conversion is a tax reportable movement of assets from a traditional IRA, SEP-IRA, SIMPLE IRA, or other eligible retirement plan [i.e., 401(k), 403(b), and governmental 457(b)] to a Roth IRA. Upon conversion to a Roth IRA, income tax is payable on the taxable portion of the amount converted.

Deciding to Convert or Not to Convert

There are many factors to consider before deciding whether or not to convert to a Roth IRA, but for many people the answer may be *yes*. If assets are held in a Roth IRA for at least five years and the investor is at least 59½, then all distributions from a Roth IRA, including earnings, are 100% tax-free. With retirements stretching out 20 or 30 years, the value of tax-free withdrawals becomes an increasingly attractive feature of a Roth IRA.

When converting, taxpayers may:

- Enjoy tax free income in retirement – keeping taxable income low, even when tax rates increase
- Accumulate wealth in later years because required minimum distributions are not required for Roth IRA owners
- Re-characterize (or undo) the Roth conversion by October 15 of the following year after the conversion
- Avoid the potential of higher income tax rates in the future due to either taxpayer's increased income or increased tax rates
- Pass assets to beneficiaries income-tax-free (if properly structured, beneficiaries may stretch the inherited Roth IRA over their own life expectancy)

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Roth IRA Conversions

Paying Conversion Tax Liability

To maximize the power of tax-free growth, taxpayers should consider paying the income tax attributable to the conversion from assets other than the traditional IRA. For taxpayers who choose to pay the conversion income tax liability from the traditional IRA, income tax on any of the distribution not rolled to the Roth IRA will be recognizable income and, if they are under 59½, a 10% federal tax penalty may apply.

Two-year Averaging of Taxes for a 2010 Conversion

As the law is today, the highest income tax rate in 2010 is 35% and the highest income tax rate in 2011 and 2012 will be 39.6%. Although the answer may appear obvious, taxpayers should review other sources of taxable income for these years. Taxpayers should speak with their tax advisor before deciding.

Tax Loss Harvesting

Various types of losses can be used to offset Roth conversion income, including: net operating loss carry-forwards, charitable contribution carry-forwards, and business and other ordinary losses. For example, taxpayers with a 2010 net operating loss carry-forward of \$75,000 and a \$50,000 itemized deduction for 2010, can effectively do a \$125,000 (\$75,000 + \$50,000) Roth conversion in 2010 that is completely tax-free. Be aware that passive losses cannot offset the income from a Roth IRA conversion.

Social Security Benefits

Currently, qualifying Roth distributions are not included in the taxpayer's income for determining the amount of Social Security income that will be subject to income taxes.

Variable Annuities and Withdrawal Benefits for Life

A Roth IRA funded by a variable annuity, along with an optional guaranteed minimum withdrawal benefit that guarantees payments for the life of the annuity owner, can offer guaranteed lifetime income that is tax and penalty free.

Who is a Prime Candidate?

In summary, a person meeting any of the following criteria may be a prime candidate for a Roth IRA conversion:

- Current IRA balance is low in value (low in taxes)
- Current tax rates are relatively low or expect that future tax rates will be higher
- Planning to transfer tax-free assets to beneficiaries
- Have a long time horizon before retirement

If a Roth IRA is a right fit, many investments options are available, including mutual funds, a variable annuity, or a fixed annuity. It's important to be aware that IRAs are already tax-deferred. A variable or fixed annuity contract should be used to fund a Roth IRA in order to benefit from the annuity's features other than tax deferral. These features include lifetime income and death benefit options. With a variable annuity, investors also have the ability to transfer among investment options without sales or withdrawal charges.

Before deciding to convert a traditional IRA to a Roth IRA, investors should consult a tax advisor and financial professional regarding their particular circumstances. These professionals will be able to provide advice and discuss in further detail the future income goals, investment objectives, and the investment products suitable to each individual situation.

Roth IRA Conversions

Variable annuities are long-term investment vehicles designed for retirement which are subject to investment risks, including the possible loss of principal invested. The account value is subject to market fluctuations so that, when withdrawn or annuitized, it may be worth more or less than its original value. Typically, variable annuities have mortality and expense charges, account fees, investment management fees, administrative fees, termination provisions, holding periods, and charges for special contract features. In addition, annuity contracts and special contract features have exclusions and limitations. It is possible to lose money in a variable annuity purchased with an optional rider. Optional riders may be irrevocable and may expire without use.

All product guarantees are based on the financial strength and claims paying ability of the issuing insurance company.

Early withdrawals may be subject to surrender charges. Withdrawals of taxable amounts are subject to ordinary income tax and, if made before age 59 ½, may be subject to a 10% Federal income tax penalty. Withdrawals will also reduce the guaranteed benefits and account value.

Variable annuities and mutual funds are offered by prospectus only which can be obtained by contacting your financial advisor. The prospectus contains information about the product's features, risks, charges and expenses, and the investment objectives, risks and policies of the underlying portfolios, as well as other information about the underlying funding choices. Read the prospectus and consider this information carefully before you invest.

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For More Information

To learn more, please contact:

Jeffrey D. Dattolo
CFP, CLU, ChFC
Partner
908.603.1256
jdattolo@
AtlasAdvisoryGroup.com

Atlas Advisory Group, LLC
21 Commerce Drive, Suite 301
Cranford, NJ 07016
908.276.0096
908.276.0038 Fax
www.atlasadvisorygroup.com