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Start maximizing clients' IRA contributions

By Ed Slott
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Two tax laws scheduled to take effect in the near future will combine to create new opportunities for your clients to convert their traditional individual retirement accounts and company plan balances to Roth IRAs.

The Tax Increase Prevention and Reconciliation Act, signed into law May 17, allows people to convert their traditional IRA balances to Roth IRAs beginning in 2010 by removing the income and filing-

status restrictions. In addition, Congress has included an attractive payment plan to encourage IRA owners to convert.

Currently, if you are eligible to convert, the conversion income is taxed in the year of the conversion. But for conversions done in 2010, the taxes can be spread ratably over two years and included in income for 2011 and 2012.

That isn't a typo: No tax will be due in 2010 (the year of the conversion). That is like getting an interest-free loan to build a tax-free savings account.

Then, under the Pension Protection Act of 2006, company plan funds can be converted to Roth IRAs — beginning in 2008 — without first having to roll those funds over to an IRA and convert to a Roth IRA from there. Even though these provisions don't take effect for a while, there are planning moves that can be made now.

Advise clients to start maximizing IRA contributions. Deductibility of the contribution shouldn't be an issue, since paying the tax now means that less tax is paid at the time of the conversion.

You should encourage clients

to stuff all they can into non-deductible traditional IRAs, which can be converted in 2010, regardless of income.

As much as I don't like non-deductible IRAs, because of the tax reporting, this is a time I will recommend them if the intention is to convert those funds into Roth IRAs in 2010. The more you have in a traditional IRA (deductible or non-deductible), the more that can be converted in 2010, taking advantage of the generous tax payment plan.

However, even if you convert in 2010, you can't just convert the non-deductible IRAs to a Roth IRA and pay no tax at all. If you have other IRA funds (even in other accounts), then you have to factor in those funds, and some funds converted will be taxable based on the amount of the tax-free funds compared with the total amount in your IRA.

Review all the IRAs and company retirement plans that clients now have and see if contributions to those plans are

being maximized. Encourage clients to contribute as much as possible to all their plans, knowing that in 2010, any funds in company plans, traditional IRAs, or SEP or SIMPLE IRAs can be converted, and the tax won't have to be paid until 2011 and 2012.

Clients who are thinking about doing a large Roth conversion soon should consider waiting until 2010 to do it so they can spread the tax bite over two years instead of paying it all at once.

Clients who plan to do a conversion in 2010 have five years — 2007 to 2011 — to accumulate the funds necessary to pay the income taxes on the conversion.

This tax law doesn't affect the income limits for contributions to a Roth IRA. Those limits still stand but can easily be bypassed in 2010 and later years by making a traditional IRA contribution and then doing a conversion to a Roth IRA in the same year.

Let clients know about these new tax incentives to set up Roth IRAs, and remind them of the long-term tax advantages of a Roth IRA. The tax is paid upfront — and they get this one-time break to get a free ride for 2010 and not have to pay the tax until 2011 and 2012 — and the account will grow income tax free forever.

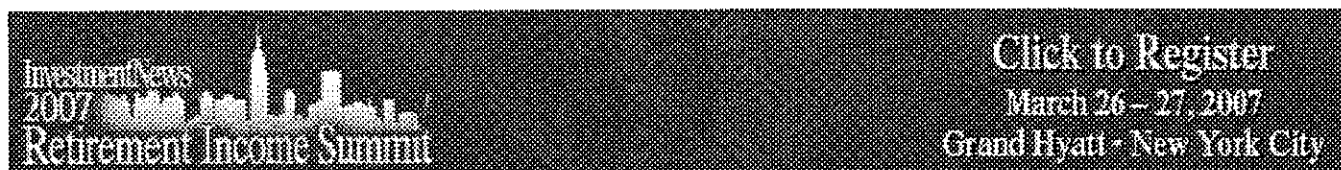
Also, there are no lifetime required distributions for Roth IRA owners, so the funds can keep growing income tax free forever and be passed on that way to beneficiaries.

Roth IRA beneficiaries who are non-spouses must take required minimum distributions, but the distributions generally will be tax free and can be stretched over their lifetime, providing a tax-free legacy.

As tax rates rise, which is very likely, the value of tax-free Roth IRAs will skyrocket.

Ed Slott, a certified public accountant in Rockville Centre, N.Y., has created The IRA Leadership Program and Ed Slott's Elite IRA Advisor Group to help financial advisers and insurance companies become recognized leaders in the IRA marketplace. He can be reached at irahelp.com.

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