



Prudent Investing

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Tax-Free Investment Earnings for Life!?

Recently passed tax legislation allows wealthy individuals with Individual Retirement Accounts (IRAs) to convert their balances to Roth-IRAs starting in the 2010 tax year. It isn't often that a long-term tax savings technique, such as a Roth-IRA conversion, is available to taxpayers without some sort of income cap. Even though the legislation is not effective until 2010, there are some actions that you may be able to take now to maximize your tax benefits when Roth-IRA conversions are available.

First, some background on Roth-IRAs. Roth-IRAs are one of the best vehicles around to accumulate long-term wealth for you and your family. If you meet some fairly simple guidelines, **the earnings from a Roth-IRA are not subject to income tax...ever!!** You read that correctly--under current tax law, earnings from a Roth-IRA may never be taxed during your lifetime. In fact, **a Roth-IRA can be passed along to your spouse, who can continue to enjoy the same tax-free benefits; and, in many cases, a Roth-IRA can be passed along to your children, providing them with the same tax-free benefits.** The tax-free accumulation feature of a Roth-IRA can make a big difference in the financial well-being of you and your family. For example, a \$100,000 Roth-IRA investment earning 7.2% per year for 30 years would grow to more than \$800,000. Under current tax law, this \$800,000 could be withdrawn from the Roth-IRA income-tax free.

So why doesn't everyone have a Roth-IRA account?

Unfortunately, the laws regarding contributions to a Roth-IRA severely limit who is eligible. Additionally, the original law restricted the ability to convert traditional IRAs to Roth-IRAs to lower and middle income taxpayers. Fortunately, recent legislation will allow a greater number of taxpayers to utilize the power of a Roth-IRA. The *Tax Increase Prevention and Reconciliation Act of 2005* now allows individuals to execute Roth-IRA conversions regardless of their income level.

Who can contribute annually to a Roth-IRA?

Taxpayers with earned income and whose modified Adjusted Gross Income (AGI) does not exceed the following thresholds are eligible to make a full annual Roth-IRA contribution:

Single - \$95,000
 Married Filing Jointly - \$150,000

Annual Roth-IRA contribution limits are as follows:

Tax Year(s)	Age 49 or younger	Age 50 and older
2006 and 2007	\$4,000	\$5,000
2008 and beyond	\$5,000	\$6,000

Allowable contributions are reduced by any regular IRA contributions that are made during the tax year. The contribution amount is also reduced as a taxpayer's Adjusted Gross Income (essentially the income on the bottom of page one of your Form 1040) exceeds the above thresholds.

I am not eligible to make an annual Roth-IRA contribution and I won't be eligible to convert my IRA to a Roth-IRA until the \$100,000 or less income requirement is lifted in 2010! What can I do now?

- If you have a qualified retirement account with a former employer, you might consider rolling this plan into an IRA so that you can convert the IRA into a Roth-IRA in 2010. If you rollover your qualified plan balance from your former employer's plan into your current employer's qualified retirement plan, you won't be able to convert this money to a Roth-IRA. Current law only allows you to convert an IRA to a Roth-IRA. A qualified plan (such as a 401(k)) account cannot be converted to a Roth-IRA.
- If you are self-employed, consider setting up and contributing to a SEP-IRA. In 2010, you can consider transferring the balance in your SEP-IRA to a Roth-IRA.
- If you have earned income, you may want to consider making annual deductible (if eligible) or non-deductible IRA contributions in years 2006-2010 and converting your IRA balance to a Roth-IRA in 2010. Upon conversion in 2010, you would owe income tax on the earnings inside the non-deductible IRA, and on the total conversion amount for the deductible IRA. If you make non-deductible contributions to an IRA, for tax and record-keeping purposes, we recommend that you set up a separate IRA to hold current and future non-deductible IRA money. For some taxpayers, it may not be worth the hassle of setting up and contributing relatively small amounts (\$4,000-\$6,000 per taxpayer per year) to an IRA with the hopes of converting the balance to a Roth-IRA in 2010.

Annual IRA contribution limits are as follows:

Tax Year(s)	Age 49 or younger	Age 50 and older
2006 and 2007	\$4,000	\$5,000
2008 and beyond	\$5,000	\$6,000

We recommend consulting a tax advisor before making IRA contributions, as the eligibility rules are complex and you will want to have a full understanding of any changes that you make to your investment plan.

How can I determine if a Roth-IRA conversion may be appropriate for me?

Again, we recommend that you consult your tax advisor before moving forward with a Roth-IRA contribution or conversion. Your tax advisor can assist you with the multi-year tax and cash flow considerations relating to a Roth-IRA conversion.

What is a Roth 401(k) Plan?

A Roth 401(k) Plan is similar to a Roth-IRA and might be offered by your employer. We recommend that you consult with your employee benefits department to determine whether your employer has added a Roth 401(k) feature to your company's retirement plan.