PRS PENSION REVIEW SERVICES Bi-Monthly Report

January - February 2010 Volume 19 Issue 1

Qualified Plan Distributions, Traditional IRAs, and Roth IRAs

Introduction

As you may know, starting in 2010, the rules for converting a Traditional Individual Retirement Account (IRA) to a Roth IRA (Roth Conversion) or rolling a Qualified Plan Distribution into a Roth IRA have favorably changed. One change is that there is no longer an income threshold. Prior to 2010, only individuals with an Adjusted Gross Income that did not exceed $100,000 could convert. Some of the items that you may want to consider when deciding whether or not to convert are discussed in this newsletter.

Taxes

Qualified Plan and Traditional IRA contributions and investment earnings are tax deferred. Tax deductions are taken when amounts are contributed, and taxes are paid when amounts are distributed, which can be many years later. However for Roth conversions, taxes are paid at the time of the conversion. Future Roth distributions may not be taxed if certain conditions are met.

Although it may not be intuitive, it is relatively easy to show that if tax rates and your income bracket remain the same, then the deferred taxes paid on Qualified Plans and Traditional IRA distributions will be the same as the taxes paid at the time of the Roth conversion. It follows that if tax rates increase, then it may be better to pay taxes now at the lower tax rate by converting to a Roth IRA.

In considering tax rates, state and local income taxes should be included in the analysis. Keep in mind that if you live in a state that defers taxes on Qualified Plan and Traditional IRA distributions, such as New York, then the state (and local) taxes can be avoided by moving or changing your state of residence to a state that does not tax such distributions, such as Florida.

Continued on back

Interest Free Loan

There is another favorable change, which only applies for 2010 Roth conversions. For these conversions, the taxpayer has the choice of paying the Federal Income Tax in 2010, or half in 2011 and the other half in 2012.

Because the taxes paid will depend on your 2010, or 2011 and 2012 taxable income, you should consult with your accountant or tax advisor regarding when it is better to pay the conversion tax. With a 2010 Roth conversion, and if you elect to pay taxes in 2011 and 2012, the Federal Government is in effect giving you an interest free loan starting from the date of the conversion to the dates that the 2011 and 2012 taxes are paid.

Conclusion

There are many "what if" questions that can be asked about whether or not it makes economic sense to convert a Qualified Plan Distribution or a Traditional IRA to a Roth IRA.

Considerations in deciding whether to convert to a Roth IRA:

- Do you expect tax rates will increase?
- Will your taxable income remain at the same level as your current income?
- How will your State of residence tax retirement income?
- If you decide to convert in 2010, should taxes be paid in 2010, or partially in 2011 and 2012?

We will be happy to discuss any questions you may have regarding this newsletter.

Pension Review Services
445 Broad Hollow Road   Ste 8
Melville, NY 11747
Phone: (516) 694-5500 Fax: (516) 694-5501
www.pensionreviewservices.com
e-mail: info@pensionreviewservices.com