The Rennie Quarterly Return

Rennie & Associates
Financial Planning
Investment Planning

•••

Volume 2, Issue 3

December 31, 2009

Roth IRA Conversions in 2010

IRAs generally come in two flavors: Traditional and Roth. For most people, Traditional IRAs permit pre-tax contributions, tax-deferral of dividends and appreciation, but subsequent distributions are taxed as income. Conversely, contributions to Roth IRAs are after-tax, but dividends, appreciation and subsequent distributions are tax-free. The choice between the two is often distilled down to a "pay now [Roth], pay later [Traditional]" tax decision. However, there are other important considerations.

Conversions from a Traditional to a Roth are prohibited for those with income above $100,000. Thus, the choice between Traditional and Roth has historically been moot. However, 2010 tax law changes permanently remove this income limit.

Should I Convert?

The opportunity to convert is now available to all. Unfortunately, the factors affecting the conversion decision are quite complex. This newsletter highlights the two most important, though there are others.

Your Future View

As with most investment decisions, expectations about the future play a critical role in whether conversion from a Traditional to a Roth is likely to be beneficial.

Income Tax Rates

Income tax must be paid on all assets (except non-deductible contributions) converted to a Roth at the time of conversion. If tax rates are expected to be higher in retirement, conversion permits the payment of income tax at today's lower tax rates. Taxes due from conversions in 2010 can be split over the 2011 and 2012 tax years. Also, it is most beneficial if conversion taxes are paid from accounts other than the IRA itself.

No one can predict what changes may occur to the tax code in the future. However, some comfort may be gained from the knowledge that some or all retirement account distributions will be tax-free.

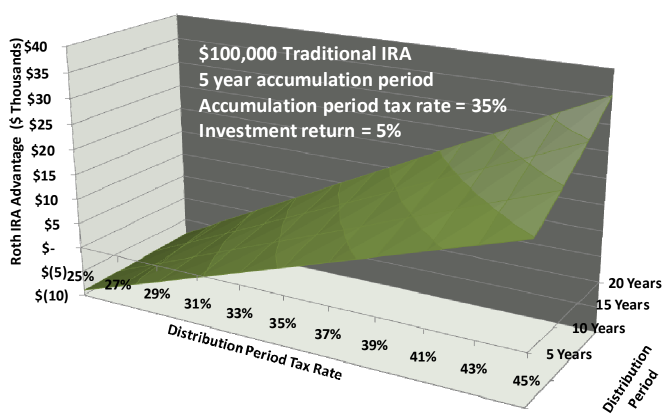
Distribution Timing & Length

To qualify for Roth tax-free status, distributions may not begin within five years of opening the Roth account.

In general, the longer the time span between conversion and final distribution, the more favorable a Roth becomes.

The graph below illustrates how the distribution period length and tax rates effect the after-tax advantage a Roth conversion provides. For example, a $100,000 Traditional IRA converted to a Roth, with distributions beginning in the 6th year following and continuing for 20 years, pays $35,284 more, over time, in a 45% marginal tax rate environment. If tax rates remain unchanged, the advantage falls to $13,559.

Roth IRA Conversion vs. Traditional IRA



Decision Tools

Rennie & Associates has developed a calculator to assist clients with conversion discussions and decisions. Other factors such as inheritance, partial conversion, and estate plans must be considered as well.

Online tools include:

- www.Fidelity.com/evaluator
- www.RothRetirement.com
- www.Schwab.com/roth
- www.Vanguard.com/rothconversion

E. P. Rennie, CFP®, CFA®
President

Gary B. Rennie, CFP®, AWMA®
Chief Executive Officer

1608 Galaxy Drive
Newport Beach, CA 92660

Phone: (949) 650-8622
Fax: (949) 650-6683

www.rennieandassociatesfp.com

Email: ecrennie@att.net

Our Two 1¢

"If you would not be forgotten as soon as you are dead and rotten, either write something worth reading or do things worth writing."

Benjamin Franklin

Quarterly Trivia:

What is the value of $1, adjusted for inflation, invested in gold at the start of the 19th century?

Roughly $1 – Source: Jeremy Siegel