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NEWSLETTER

PENDING CELESTIAL LINEUP? ROTH IRA ROLLOVER INCOME LIMIT ELIMINATED FOR 2010

The year 2010 is getting a lot of attention from a number of financial planners as the "Year of the Roth Rollover." Sort of like the depiction of Earth, Moon, and Sun in perfect alignment in the movie **2001**, **A Space Odyssey,** several financial events are scheduled to occur next year that may deserve notice from relatively affluent taxpayers.

First of all, the $100,000 household adjusted gross income limit that currently prevents a rollover of money to a Roth IRA will not apply during 2010 per existing law. In addition, those who choose to roll over retirement money to a Roth IRA in 2010 are allowed to pro rate the associated 2010 income tax payment over years 2011 and 2012. Finally, Bush Administration tax cuts are scheduled to expire at the end of 2010, resulting in higher tax rates starting in 2011.

So, how do these events line up as an action plan? If (1) your household income is over $100,000, (2) you think Roth IRAs are an attractive retirement income or estate planning tool, and (3) you have after-tax funds available to pay the taxes on extra 2010 taxable income, a rollover to a Roth IRA may be in your future. However, in addition to the virtually certain 2010 events described above, we must throw in a couple of uncertainties: future income tax rates and whether Congress will allow future Roth IRA distributions to continue to be tax free indefinitely.

As you may know, Roth IRAs were created back in 1997 and named after the Delaware senator who headed the Senate Finance Committee at the time. They involve paying income taxes on money as you earn it and then depositing the money into a Roth IRA. In addition to making regular deposits to a Roth IRA, distributions from tax qualified retirement plans can be transferred to one. Both accumulated investment earnings and principal can be paid out from a Roth tax free as long as you follow a few simple rules. One rule is that the taxpayer must have had a Roth IRA in place at least five years before distributions begin and a second is that the IRA holder must have reached age 59 ½, died or become disabled. No minimum distributions are required at age 70 ½ for the IRA owner or spousal beneficiary. This creates a useful estate planning tool. In contrast, if the Roth funds are inherited by a non spouse beneficiary, they are required to take annual distributions over the remainder of their expected lifetime. NRS has a calculation tool on our web site that permits a numerical comparison of the Roth retirement account vs. the Traditional retirement account.

Individuals who have traditional IRAs may consider converting them to a Roth IRA in 2010, particularly if they have been prevented from this action in the past due to adjusted gross incomes above $100,000. In addition, participants in retirement plans sponsored by their employer (including owners) will be able to declare the distribution as currently taxable and transfer the money to a Roth IRA. Some financial planners are urging that individuals get early access to their employer's profit sharing plan money while they continue working so that the money can be rolled over to a Roth IRA. Generally, this strategy works much better if the individual has assets outside of the plan that can be used to pay the current taxes on the distribution. If a substantial part of the distribution is used to pay taxes, this diminishes the amount left to grow and compound in the tax free Roth vehicle. Federal tax law generally limits distributions during continued employment from money purchase and defined benefit plans prior to age 62. Also, employee contributions to a 401(k) plan are not allowed to be paid to an active participant until age 59 1/2., and most profit sharing plans would need to be amended to offer in-service distributions.

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In general, Roth IRAs compare favorably with Traditional IRAs if the individual receiving the distributions pays a higher income tax rate than the rate paid when the income tax is paid on the distribution to the Roth. Since the average retiring worker will be receiving less taxable income after retirement that he or she did before retirement, anticipating higher future taxes involves anticipating future increases in the tax rates themselves. Given the current economic environment of tax stimulus payments and anticipated increases in the cost of funding health care and Social Security, odds are pretty good that income tax rates will go up, rather than down. But long term prognostications can be tricky. For example, what if future federal and/or state revenue is chiefly financed from sources other than the personal income tax?

A second tough question has to do with whether Congress will be able to ignore what is destined to become a very large accumulation of wealth that is off limits to taxation. While some argue that such a change amounts to double taxation, Congress did just that in the 1980's. Social Security was reformed so that 85% of benefit payments can be subject to income tax. Obviously, there is no such thing as a "sure thing" when predicting the future of tax law.

In spite of the uncertainties, a number of individuals will use the Roth rollover approach next year. The only real question is whether that move will turn out to be the boon as touted by some advisors.

PPA PLAN DOCUMENT AMENDMENTS NEEDED SOON

As we have mentioned in past articles, the various changes made in the tax law by the Pension Protection Act of 2006 ("PPA") must be incorporated into retirement plan documents by the end of the 2009 plan year. This requirement applies to both defined benefit and defined contribution plans, although defined benefit plans have many more provisions (e.g. new funding rules and benefit restrictions for underfunded plans). At NRS, the process will begin very soon and employers who do business with us will be notified as to the specifics in the coming few months.

It is important to note that adoption of the PPA amendment *cannot* be delayed until the employer's tax filing due date because the deadline was incorporated right into the law. For calendar year plans, that means adoption no later than December 31, 2009.

We are pleased to report that the amendments we will be issuing will include not only all of the necessary PPA provisions, but also the necessary provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART"). This avoids the need for a separate amendment that would otherwise be required in 2010. Most of the elements of the Worker, Retiree, and Employer Recovery Act of 2008 are also included in this upcoming "omnibus" amendment. In addition, for those defined benefit plans that need it, we plan to include a Normal Retirement Age amendment (see July 2009 newsletter) at the same time.

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