

Wickham Financial and Insurance Services

Graham Wickham
116 Margaret Ave.
Marietta, GA 30060
770-424-8711 x206
gwickham@wickhamservices.com
wickhamservices.com

Roth IRA Conversions

With the lure of tax-free distributions, Roth IRAs have become increasingly popular retirement savings vehicles. According to the Investment Company Institute, 19.1 million U.S. households (about 15.6%) owned Roth IRAs in 2013.

What are the general rules for funding Roth IRAs?

There are three ways to fund a Roth IRA--you can contribute directly, you can convert all or part of a traditional IRA to a Roth IRA, or you can roll funds over from an eligible employer retirement plan.

In general, you can contribute up to \$5,500 to an IRA (traditional, Roth, or a combination of both) in 2014 (\$6,500 if you'll be age 50 or older by December 31). However, your ability to make annual contributions may be limited (or eliminated) depending on your income level ("modified adjusted gross income," or MAGI), as shown in the chart below:

If your federal filing status is:	Your 2014 Roth IRA contribution is reduced if your MAGI is:	You can't contribute to a Roth IRA for 2014 if your MAGI is:
Single or head of household	More than \$114,000 but less than \$129,000	\$129,000 or more
Married filing jointly or qualifying widow(er)	More than \$181,000 but less than \$191,000	\$191,000 or more
Married filing separately	More than \$0 but less than \$10,000	\$10,000 or more

Unlike a traditional IRA, you can contribute to a Roth IRA even if you're 70½ or older. However, your contributions generally can't exceed your earned income for the year (special rules apply to spousal

Roth IRAs).

Important changes since 2010

Prior to 2010, you couldn't convert a traditional IRA to a Roth IRA (or roll over non-Roth funds from an employer plan to a Roth IRA) if your MAGI exceeded \$100,000 or you were married and filed separate federal income tax returns.

The Tax Increase Prevention and Reconciliation Act (TIPRA), however, repealed the \$100,000 income limit and marital status restriction, beginning in 2010. What this means is that, regardless of your filing status or how much you earn, you can now convert a traditional IRA to a Roth IRA. (There's one exception--you generally can't convert an inherited IRA to a Roth. Special rules apply to spouse beneficiaries.)

And don't forget your SEP IRAs and SIMPLE IRAs. They can also be converted to Roth IRAs (for SIMPLE IRAs, you'll need to participate in the plan for two years before you convert). You'll need to set up a new SEP/SIMPLE IRA to receive any additional plan contributions after you convert.

How do you convert a traditional IRA to a Roth?

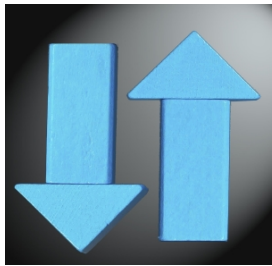
Converting is relatively simple. You start by notifying your existing traditional IRA trustee or custodian that you want to convert all or part of your traditional IRA to a Roth IRA, and the custodian/trustee will provide you with the necessary paperwork.

You can also open a new Roth IRA at a different financial institution, and then have the funds in your traditional IRA transferred directly to your new Roth IRA. The trustee/custodian of your new Roth IRA can give you the paperwork that you need to do this. If you prefer, you can instead contact the trustee/custodian of your traditional IRA, have the funds in your traditional IRA distributed to you, and then roll those funds over to your new Roth IRA within 60 days of the distribution. The income tax



With the lure of tax-free distributions, Roth IRAs have become increasingly popular retirement savings vehicles. According to the Investment Company Institute, 19.1 million U.S. households (about 15.6%) owned Roth IRAs in 2013.

(Source: 2014 Investment Company Fact Book)



If you make a Roth conversion and it turns out not to be advantageous (for example, the value of your investments declines substantially), IRS rules allow you to "undo" the conversion. You generally have until your tax return due date (including extensions) to undo, or "recharacterize," your conversion.

consequences are the same regardless of the method you choose.

Calculating the conversion tax

When you convert a traditional IRA to a Roth IRA, you're taxed as if you received a distribution, but with one important difference--the 10% early distribution tax doesn't apply, even if you're under age 59½. However, the IRS may recapture this penalty tax if you make a nonqualified withdrawal from your Roth IRA within five years of your conversion.

If you've made only nondeductible (after-tax) contributions to your traditional IRA, then only the earnings, and not your own contributions, will be subject to tax at the time you convert the IRA to a Roth. But if you've made both deductible and nondeductible IRA contributions to your traditional IRA, and you don't plan on converting the entire amount, things can get complicated.

That's because under IRS rules, you can't just convert the nondeductible contributions to a Roth and avoid paying tax at conversion. Instead, the amount you convert is deemed to consist of a pro rata portion of the taxable and nontaxable dollars in the IRA.

For example, assume that your traditional IRA contains \$350,000 of taxable (deductible) contributions, \$50,000 of nontaxable (nondeductible) contributions, and \$100,000 of taxable earnings. You can't convert only the \$50,000 nondeductible (nontaxable) contributions to a Roth, and have a tax-free conversion. Instead, you'll need to prorate the taxable and nontaxable portions of the account. So in the example above, 90% (\$450,000/\$500,000) of each distribution from the IRA (including any conversion) will be taxable, and 10% will be nontaxable.

You can't escape this result by using separate IRAs. Under IRS rules, you must aggregate all of your traditional IRAs (including SEPs and SIMPLEs) when you calculate the taxable income resulting from a distribution from (or conversion of) any of the IRAs.

Some experts suggest that you can avoid the pro rata rule and make a tax-free conversion if you take a total distribution from all of your traditional IRAs, transfer the taxable dollars to an employer plan like a 401(k) (assuming the plan accepts rollovers), and then roll over (convert) the remaining balance (i.e., the nontaxable dollars) to a Roth IRA. The IRS has not

yet officially ruled on this technique, so be sure to get professional advice before considering this.

Using conversions to make "annual contributions"

Unfortunately, TIPRA didn't repeal the income limits that may prevent you from making annual contributions to your Roth IRA. But if your income exceeds these limits, and you want to make annual Roth contributions, there's an easy workaround: you can make nondeductible contributions to a traditional IRA, as long as you haven't yet reached age 70½. You simply make your annual contribution first to a traditional IRA, and then convert that traditional IRA to a Roth. There are no limits to the number of Roth conversions you can make. (But again, you'll need to aggregate all of your traditional IRAs--including SEPs and SIMPLEs--when you calculate the taxable portion of the conversion.)

Employer retirement plans

You can also roll over non-Roth funds from an employer plan (like a 401(k)) to a Roth IRA. Prior to 2010, the income limits and marital status restrictions also applied to employer plan rollovers to Roth IRAs (commonly referred to as conversions). As with traditional IRA conversions, TIPRA removed these restrictions beginning in 2010, and now anyone can roll over funds from an employer plan to a Roth IRA, regardless of income level or marital status. Like traditional IRA conversions, the amount you convert will be subject to income tax in the year of conversion (except for any after-tax contributions you've made).

Is a Roth conversion right for you?

The answer to this question depends on many factors, including your current and projected future income tax rates, the length of time you can leave the funds in the Roth IRA without taking withdrawals, your state's tax laws, and how you'll pay the income taxes due at the time of the conversion.

And don't forget--if you make a Roth conversion and it turns out not to be advantageous (for example, the value of your investments declines substantially), IRS rules allow you to "undo" the conversion. You generally have until your tax return due date (including extensions) to undo, or "recharacterize," your conversion. For most taxpayers, this means you have until October 15, 2015, to undo a 2014 Roth conversion.

IMPORTANT DISCLOSURES

Broadridge Investor Communication Solutions, Inc. does not provide investment, tax, or legal advice. The information presented here is not specific to any individual's personal circumstances.

To the extent that this material concerns tax matters, it is not intended or written to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Each taxpayer should seek independent advice from a tax professional based on his or her individual circumstances.

These materials are provided for general information and educational purposes based upon publicly available information from sources believed to be reliable—we cannot assure the accuracy or completeness of these materials. The information in these materials may change at any time and without notice.