



## Retirement Planning Options: Roth IRA

Everyone wants a golden retirement. But saving for retirement is no easy task. The baby boomer generation is graying. More and more people are approaching retirement age. With Social Security's assets being consumed and the number of workers that will support it shrinking, we will have to rely more on our personal savings when it's time to retire.

Today, we have a myriad of options to help each of us prepare for the golden years. Yet, without a specific plan of action, many people find themselves falling short when it is time for them to live off of their life's work.

Some of the most powerful retirement strategies are Annuities, Modified Endowment Contracts and the Roth IRA. This article discusses the Roth IRA.

Take the time to review your options, and ensure that you're prepared when it's your turn to retire.

### Roth IRA

Roth IRAs, unlike traditional IRAs, have a simple premise: you pay income tax going in, rather than when you pull out.

Named for Sen. William V. Roth from Delaware, the Roth IRA represents an enhanced level of flexibility for people saving for their retirement.

The Roth IRA is a type of account that you establish through a qualified broker. Any contributions that you make to your Roth IRA are considered "after-tax," and cannot be deducted from your tax return. However, when it is time for you to draw money from your account, you will not pay income taxes on the growth of your account. If you're in a high tax bracket, that can amount to tremendous savings.

The Economic Growth and Tax Relief Reconciliation Act of 2001 restricts the annual amount you can contribute. Annual contribution limits for **traditional** and **Roth IRAs** are capped at \$5,000 in 2009 for those under age 50. Those age 50 or over can contribute \$6,000 in 2009. These contribution limits are now indexed to inflation. (Annual contribution limits for traditional and Roth IRAs are capped at \$5,000 in 2009. (Keep in mind, if you decide to take distributions from either a Roth, or traditional IRA, prior to retirement and age 59½, the funds will be taxed as ordinary income and may be subject to a 10% federal income tax penalty. This applies only to the withdrawal of earnings from a Roth, which you must own for at least five years. The principal is not taxed.)

If you have a 401(k) or 403(b) savings plan, EGTRRA allows contributions of up to \$16,500 in 2009, an increase of \$1,000 over the previous year. The limit for those in 457 plans is also \$16,500 in 2009. The contribution amounts for all three of these retirement savings plans will be indexed annually for inflation. (You may, however, be limited by your employer in the amount you can contribute, based on a percentage of your compensation.)

Just like a traditional IRA, Roth IRA accounts can hold stocks, mutual funds, and other types of investments. Retirement-minded investors, looking to build their nest egg, can open a Roth IRA brokerage account and invest it like they would any other account. However, unlike other types of brokerage accounts, your broker will usually ask you to pick a designated beneficiary for your Roth IRA funds, should you pass away with the account open.

People who are still working and are eligible to contribute more have to think about what kind of IRA they should contribute to. This is especially true if you have already accumulated a large IRA, perhaps from the rollover of a retirement plan, and if you want to know whether you should convert that pot of money into a Roth IRA.

If you have accumulated a large traditional IRA, you can elect to convert the entire account to a Roth IRA. Upon conversion, you must declare the entire IRA taxable balance as taxable income and pay taxes on it in the year of conversion. From that point on, the IRA is federal income tax-free during compounding, and federal income tax-free when you pull money from it (if you have held the Roth IRA for at least five years, you are age 59 1/2, or meet other requirements).

If you are a mature American with a large IRA, you have a big decision. Should you convert your nest egg to a Roth IRA? In many cases, it makes sense. If you qualify for a conversion, you may save thousands of dollars for both yourself and your heirs.

**Better to Pay Now or Later?** Are you better off waiting to pay taxes, or paying them now? For many, paying your taxes owed now is the smart thing to do. Forget the math... just know that politicians like to spend other people's money. After all, Uncle Sam could collect his pound of flesh later, or just a few ounces now. Traditionally, the U.S. Government prefers to collect its money now, even if the long-term goal is more reduction of the budget deficit.

In this era of budget balancing, politicians need collections today to show that they are working hard to keep the budget balanced. Looking long-term, Congress may have problems later, but only after our hard-working politicians are probably long-gone. Congress' short-term outlook can be turned around to work for you. Even if you already own a traditional IRA, you can convert it to a Roth IRA. For existing IRA owners, there are restrictions on conversions. For instance, you can convert only if your AGI (Adjusted Gross Income) is no more than \$100,000 in the year you make the switch, assuming you're single or married filing jointly.

Who should not convert their existing IRA to Roth? If your tax bracket is higher now than your heirs' tax bracket will be when the money is spent. Also, be very careful if you aren't sure about falling under the \$100,000 ceiling. Converting and then discovering later that your income was higher could blow up in your face, creating significant tax penalties.

From an estate planning standpoint, if your main goal is to accumulate as much as you can and leave it for your heirs, conversion can make a lot of sense. Traditional IRA owners must begin taking distributions by age 70 1/2. However, Roth IRAs require no minimum distributions each year during the life of the IRA owner, nor on the life of the IRA owner's spouse. If you want to keep your money growing on a tax-preferred basis longer, then the Roth IRA may hold your solution.

**A Look at the Numbers.** Suppose you own \$20,000 of growth stocks in a qualified IRA, and you believe that you it will be worth \$60,000 by the time you spend it.

For simplicity, you are in a 36% tax bracket now, and expect to be in the same bracket in the future.

If your assumptions are correct and you leave your IRA alone, the IRA will grow to \$60,000. After paying \$21,600 in taxes, you will have \$38,400 of spendable cash after taxes.

But suppose, in the beginning, you made the conversion to a Roth IRA. You convert, using \$7,200 from the account itself to pay the immediate tax bill. The remaining \$13,600 triples to \$38,400.

The two outcomes are identical. In this scenario, there's no difference between the two... unless you were under age 59 1/2, in which case money taken from the Roth IRA account to pay tax would also be subject to a 10% early withdrawal penalty.

However, there is another option. Suppose you convert to a Roth IRA in the beginning, and come up with the \$7,200 in initial taxes from some other source of cash that would not have qualified for tax-deferred compounding.

Assuming the same growth rate, your Roth IRA would have tripled in value to \$60,000 (a full \$21,600 more). Best of all, the entire amount would be income tax-free when you needed to make withdrawals... plus, there would not have been a 10% tax penalty on money taken from the account if you were under age 59 1/2.

Sure, you're missing that \$7,200 from your outside account, and that money could have grown. However, its growth would've been stunted by the fact you were paying taxes on the income all along.

Remember: in this case, the "time value of money" is definitely on your side. The Roth trade is a bad one for Uncle Sam, and a good one for you.