

## Roth IRA conversion: 4 things you may not know



Many investors probably know that changes in federal tax law for 2010 make converting a traditional IRA to a Roth IRA worth a look. For example, if you convert to a Roth IRA this year, you can choose to spread the reporting of any taxable income associated with the conversion evenly across tax years 2011 and 2012 (an option that's available only this year), or you can report the income with your 2010 tax return.

If you're still unsure about whether to convert to a Roth, here are some lesser-known points that may help you decide.

### **If you're married and file a joint tax return, you and your spouse can convert your IRAs in 2010 and agree to disagree on when to report the income.**

If you and your spouse each have a traditional IRA, you can make separate tax-reporting decisions if you both convert to Roth IRAs in 2010. For instance, one spouse can choose to recognize income for 2010, while the other can defer until 2011 and 2012.

### **If you're retired, a Roth conversion may affect your Social Security benefits and Medicare premiums.**

After converting to a Roth IRA, you could see a one-year increase in the taxable portion of your Social Security benefits. Here's why: A conversion raises your total income for Social Security purposes, which is defined as half of your benefits plus any other income, including tax-exempt income—and this income level determines the taxable percentage of your benefits (0%, 50%, or 85%). However, distributions from a Roth won't affect the taxation of your Social Security benefits, which may help you in the long run.

Medicare premiums are a little different. They depend on your modified adjusted gross income (MAGI) from the previous two years, which means that your 2008 MAGI

determines your 2010 premiums. Because a conversion this year will increase your 2010 MAGI (if the income is reported this year), your Medicare premiums might rise in 2012. Note that most retirees pay the standard Medicare Part B premium—about 25% of the total cost—with the U.S. government paying the rest. If your MAGI exceeds certain levels, your premium will likely be higher.

### **A conversion could allow your heirs income-tax-free access to assets.**

Whether you have a traditional IRA or a Roth IRA, your beneficiaries will have to take annual distributions from the account—but with a Roth, they won't owe income tax on the distributions, whereas with a traditional IRA they would.

That's one of the big estate planning benefits of a Roth: By paying the income tax on the conversion today, you're passing on an asset without attached income tax liability. (Note that tax could be owed on earnings from a converted Roth IRA if you don't satisfy a five-year holding requirement.)

### **You have a chance for a "do-over" if you change your mind.**

You can undo a Roth IRA conversion through what's called a recharacterization, in which the amount of the conversion—plus any earnings or minus any losses—goes back into a traditional IRA. The deadline to recharacterize is April 15 following the year of conversion if you file your tax return by the due date, or October 15 if you file under an extension. If you're planning to reconvert to a Roth IRA later, remember that you must wait 30 days after the recharacterization or until the beginning of the next calendar year after the original conversion, whichever is longer.

Note: Consider consulting a tax advisor concerning your individual situation.