Money Matters

The Independent Press
June 3, 2009

Question of the Month:
How to solve the IRA squeeze?

By Aaron Skloff

Q: Based on our household income we are unable to make Roth IRA contributions. Can we convert our Traditional IRAs into Roth IRAs?

The Problem – Income Limits on IRA Contributions and Conversions. If you are provided an employer sponsored retirement plan, have income over $109,000 and file jointly, you cannot deduct Traditional IRA contributions.

This leaves you with two choices:
1) a nondeductible Traditional IRA that will defer taxes until required minimum distributions (RMDs) are required or
2) a Roth IRA that will completely avoid taxes.

While the Roth IRA is clearly the better choice, you are disqualified from contributing to a Roth IRA if your joint income exceeds $176,000. This leaves you with only one option, a nondeductible Traditional IRA. To make matters worse, you cannot even convert a Traditional IRA to a Roth IRA if your household income exceeds $100,000.

The Solution – Convert in 2010. Starting in the year 2010, the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) allows you to convert your Traditional IRA to Roth IRA regardless of income. If you convert in 2010, you'll be able to spread the tax impact over 2011 and 2012.

No Free Lunch. Like all Traditional IRA withdrawals, a conversion is a taxable event. However, once you convert to a Roth IRA all capital gains, dividends, and interest are tax free while in the Roth IRA and upon withdrawal. Based on the massive federal deficit, there is a high probability that income tax rates will rise over the next three years. By converting in 2010, you lock in your income tax rate, without concern of what rates may jump to in 2013.

Note. Aaron Skloff, Accredited Investment Fiduciary (AIF), Chartered Financial Analyst (CFA), Master of Business Administration (MBA) is CEO of Skloff Financial Group, a Registered Investment Advisory firm based in Berkeley Heights. He can be contacted at **www.skloff.com** or **908- 464-3060**.