

Increase Retirement Savings with a Roth IRA

By Scott Brookes, AIF®

The Roth IRA conversion rules changed in 2010. Before this year, taxpayers with adjusted gross income greater than \$100,000 were not eligible to make a Roth IRA conversion. The new rules eliminate that income limit, now allowing anyone to convert.

With this new opportunity, you may be able to add additional dollars to your retirement savings using a little known Roth IRA conversion strategy.

Non-Deductible IRAs are the secret. If you aren't eligible to make a tax-deductible or Roth IRA contribution this year and if you have no money in existing IRAs, SEP-IRAs and Simple IRAs, then you should consider making a non-deductible IRA contribution. (There are no income limits for contributions to non-deductible IRAs.) You can then make a tax-free conversion of this non-deductible contribution to a Roth IRA. If you are married, you can do the same for your spouse. This is a great way to double your tax-free IRA savings.

Individuals under age 50 can contribute up to \$5,000 (\$6,000 if age 50+) in 2009 and 2010 to an IRA.

Considerations of which to be aware:

Pro-rata tax treatment for existing IRA assets – In calculating the taxes due on a Roth IRA conversion, you must include the proportionate amount of tax-deferred money relative to the amount held in all of your IRAs (including SEP and Simple IRAs). You cannot specify to convert only the after-tax IRA money to a Roth IRA.

Roll your traditional IRA into your 401(k) - Because of this tax treatment, if you have IRA assets, a good strategy may be to roll your pre-tax (deductible) IRA money to your company's 401(k) or Profit Sharing plan if your plan allows it. This leaves your IRA accounts holding only after-tax (non-deductible) dollars which can then be converted tax-free to a Roth IRA. This strategy is most effective if you complete this rollover the year prior to initiating any Roth conversions. Your Certified Financial Planner™ or tax advisor can assist you with the timing and details of this strategy. Also, make sure you like the investment options in your 401(k) before you move a large sum of dollars into it. You may have to separate from service to get the money back out again. Check your plan to see if in-service rollovers are allowed.

How it Works:

1. If you have pre-tax money in your IRAs, roll it to your 401(k).
2. Assuming you have \$5,000 or more in taxable wages, make a non-deductible contribution to an IRA for the prior year by April 15th.

3. Convert your non-deductible IRA to a Roth IRA immediately so as to avoid garnering any growth prior to conversion (this way the conversion remains tax-free and any subsequent growth is tax-free as well).

Call your Certified Financial Planner™ or tax advisor to review your situation and initiate a plan of action.

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