



Tax Briefs



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News Update on Tax Issues from SLGG

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In each issue, we cover various tax issues of interest to individuals and businesses.

An IRA Opportunity We Should All Be Considering

Time is quickly running out on the ability to make an individual retirement account (IRA) contribution for the 2007 tax year, and many people are still a bit confused about IRAs. There are different types and they may not always provide a current tax benefit if you exceed certain earned income limitations and are covered by a retirement plan at your work. Well, Congress has designed IRAs to make saving for retirement more attractive as the baby boomer population draws closer to retirement. It is now possible for anyone, regardless of income, to convert a Traditional IRA to a Roth IRA beginning in 2010.

A Roth IRA conversion is a wonderful retirement savings opportunity because the money withdrawn out of a Traditional IRA is taxed at your income tax rate, whereas Roth IRA withdrawals are completely tax-free as long as you have had it for 5 years and are at least 59½ years old when you withdraw it. The rules currently state that a high-income individual earning over \$100,000 is not eligible to invest in a Roth IRA. The 2010 law regarding conversions presents a great retirement savings opportunity.

So don't be confused about IRAs any more; one of the best retirement savings strategies may be to invest in a Traditional IRA between now and 2010. Then, in 2010, you can convert it to a Roth IRA.

Today's IRA choices are either a Traditional IRA or a Roth IRA. The Traditional IRA can be either deductible or non deductible. For 2007, the maximum contribution is \$4,000 — \$5,000 if you are 50 years old or older. These contributions need to be made by April 15, 2008. If you are not eligible to participate in a retirement plan at work, you may deduct your IRA contribution regardless of your income level. Otherwise, there are income limitations that restrict your ability to take the deduction. The limit for married couples is \$103,000 for 2007.

The income limit to make a Roth contribution is \$166,000 in 2007, but here is what most high income individuals miss — even if your income level exceeds those amounts you can still invest in a Traditional IRA and benefit from the tax deferred growth of the account. The drawback is that you can't deduct the contributions to your IRA, thus the name "Non-deductible Traditional IRA." This is simply a Traditional IRA that is not eligible for a tax deduction. The advantage is you don't have to pay tax on the contributions when you withdraw them, just the earnings.

APRIL 2008



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Until this rule changes, high income taxpayers have been excluded from the ability to invest in Roth IRAs, and the ability to convert a Traditional IRA to a Roth requires Adjusted Gross income to be less than \$100,000.

In 2010, the conversion limit of \$100,000 goes away, meaning that anyone can convert another IRA to a Roth IRA. So the winners here are high income earners, because they can now open a Non-deductible Traditional IRA and convert the money and earnings into a Roth IRA in 2010. Only the earnings would be subject to income tax at conversion. Congress has even made that better, as the law allows you to spread your tax bill over two years, 2011 and 2012. After that, you will be left with a completely tax free IRA account.

Let's look at an example: An individual under 50 years old decides to open up a Non deductible Traditional IRA investing the max for 2007 of \$4,000, and continues to invest the maximum in 2008 when limit rises to \$5,000, same in 2009 and 2010 (over age 50 limits are even higher). That is \$19,000 total. Let's say that account earns \$4,000 up until 2010, so the account value is at \$23,000. At conversion, only the \$4,000 of earnings would be subject to tax, and the associated tax can be spread over the 2011 and 2012 tax years.

After the conversion, the money grows tax free and if you want to withdraw some funds for any reason (after the 5 year holding period) you can take up to \$23,000 in the example above without any tax or penalty, even though you are under 59 ½ years old.

The "Stretch IRA"

Assuming you leave all of the money alone with an 8% rate of return for the next 20 years that money can grow to over \$110,000, completely tax free. If you don't need to use the money once you are retired, you can leave it to your heirs. A Traditional IRA requires you to start making withdrawals by age 70 ½.

Now you can see a non-deductible Traditional IRA can be a great retirement vehicle for you or your heirs. Remember that IRA contributions need to be made by April 15th to be allowed for the prior tax year, so time is running out quickly on potential 2007 tax year contributions.

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