

The Roth Individual IRA Account

Is it right for you?

Topical Education for Today's Investor

INCOME TAXES

The Roth IRA, available since 1998, presents a potentially attractive alternative to the regular IRA long favored by many Americans as a cornerstone in their retirement planning efforts. That's because a Roth IRA may allow you to avoid future taxation of your retirement funds by making nondeductible contributions now.



The Roth IRA, available since 1998, presents a potentially attractive alternative to the regular IRA long favored by many Americans as a cornerstone in their retirement planning efforts. That's because a Roth IRA may allow you to avoid future taxation of your retirement funds by making nondeductible contributions now.

Rules of the Roth IRA

Following is a summary of the rules for Roth IRAs:

- **Unlike the traditional IRA, contributions to a Roth IRA are nondeductible** regardless of your income level or participation in a company-sponsored retirement plan.
- **Your contributions are limited to \$5,000 a year (\$10,000 for couples) in 2008.** The contribution limit begins to decline or “phase out” for single taxpayers with adjusted gross incomes (AGIs) of more than \$99,000 and for married couples filing jointly with AGIs of more than \$156,000. Individuals with AGIs in excess of \$114,000 (\$166,000 for married couples filing jointly) are not eligible for a Roth IRA. Special limits apply to married taxpayers who file separately. An individual's total contributions to all IRAs, Traditional and Roth, may not exceed the annual contribution limit (\$5,000 in 2008).
- **Contribution limits will increase in the years ahead** as the annual contribution limit will be adjusted for inflation. Older Americans (age 50 or older) are also able to make so-called “catch-up” contributions to a Roth IRA. The allowable catch-up contribution is \$1,000 per year but is not adjusted for inflation.
- **Your contributions to a Roth IRA may continue beyond age 70^{1/2}.** You are not required to start taking distributions from a Roth IRA at age 70^{1/2}, as you are with a traditional IRA, and you can continue to contribute as long as you have earned income. When a Roth IRA owner dies, however, his or her heirs must adhere to the same minimum-distribution rules that apply to regular IRAs.
- **Qualified distributions from a Roth IRA are tax free.** While your contributions to a Roth IRA are never tax deductible, your distributions may be tax free if you have owned the Roth IRA for at least five years and:
 - You are at least 59^{1/2} years old; or
 - Your withdrawal of up to \$10,000 (lifetime limit) is applied to a first-time home purchase; or
 - You die or become permanently disabled.

You may qualify for the “first-time home purchase” if you have not owned a home for at least two years before the date on the purchase contract or the date when construction started. You, your spouse, or a descendant or ancestor of either may qualify as the buyer.

- **The taxable portion of a nonqualified distribution is subject to a 10% tax penalty.** If you make withdrawals that do not meet the rules for a qualified distribution, you’ll owe taxes on all or a portion of the withdrawal. You must also pay a 10% penalty tax on the taxable portion of the withdrawal.
- **Penalty-free withdrawals are permitted for qualified education expenses.** If you are under age 59½ but have held the Roth IRA for five years, you may withdraw funds penalty free to pay for qualified education expenses for yourself or family members. You will have to pay income tax on the taxable portion of the distribution, however.
- **Retirement plan “rollovers” are permitted, but only from Roth-style plans.** If you are changing jobs or retiring, you can roll over funds from an employer retirement plan such as a 401(k) account directly to a Roth IRA, but only if it is a Roth-style plan. Beginning in 2008, however, direct rollovers from a non-Roth plan will be allowed. The rollover will be treated as a conversion, with income taxes due on all proceeds.

The Traditional IRA vs. the Roth IRA

When deciding whether a Traditional IRA or a Roth IRA is best for you, you’ll want to compare the after-tax dollars that would be available to you under each option. This will depend on many factors, including your tax bracket, how many years you have until retirement, and when you wish to begin making withdrawals. For many people, a Roth IRA will

result in more after-tax income during retirement because qualified withdrawals from a Roth IRA are tax free, while withdrawals from a Traditional IRA will be taxed.

For those whose contributions to a Traditional IRA are tax deductible and who are in a higher tax bracket today than they will be in during retirement, a Traditional IRA may be the smart choice.

If you are not eligible to participate in a company-sponsored retirement plan, you can make deductible contributions to a Traditional IRA regardless of your income level, up to \$5,000 in 2008. Deductible contributions may be reduced or eliminated for individuals who participate in a company-sponsored retirement plan, based on their incomes.

The Traditional IRA

The Traditional IRA may still provide an advantage over the Roth IRA to those who maximize its benefit. Here’s how: You invest the tax savings from your IRA deduction in a regular account each year and let that account grow along with your IRA. Assuming your tax rate drops in retirement, this could yield more of a tax-adjusted benefit than a Roth IRA.

Conversion of a Traditional IRA to a Roth IRA

In creating the Roth IRA, Congress included provisions for converting a Traditional IRA to a Roth IRA. You must have a modified AGI of \$100,000 or less to qualify for a conversion to a Roth IRA (this limit is scheduled to be eliminated in 2010). Since the investment earnings and capital gains in your Traditional IRA have not been taxed yet, the government will take its share at the time

of the conversion. If you have a nondeductible, Traditional IRA, its earnings will be taxed but the amount of your contributions will not. The withdrawal from your Traditional IRA will count as income but will not affect your eligibility for a Roth IRA (or the \$100,000 income limit) or trigger the 10% penalty usually imposed on early withdrawals.

Which Is Right for You?

If you have a Traditional IRA and are considering converting to a Roth IRA, here are a few factors to consider:

- **A Roth IRA may be more attractive the further you are from retirement.** Why? Because the longer your earnings can grow, the more income you may have that is never taxed. On the other hand, if you convert to a Roth IRA close to retirement, your investments may not have much time to compensate for the associated tax bill.
- **If your regular IRA contributions are nondeductible, you may be better off with a Roth IRA.** That's because the distributions of earnings from your regular, nondeductible IRA will eventually be taxed. The qualified distributions from a Roth IRA will not.
- **Your current and future tax brackets will affect which IRA is best for you.** For example, if you are currently in a high tax bracket and expect to be in a much lower tax bracket during retirement, a regular IRA

could be the best option. Why? Because you may be able to claim a deduction on your contributions now and then pay taxes on future distributions at the lower rate later. Keep in mind that some experts say you could still come out ahead with a Roth IRA if you can fund it for at least 12 or 15 years before retirement.

- **Given the ever-changing tax landscape and uncertainty about the future tax environment,** some advocate diversifying your IRA assets between regular IRA and Roth IRA structures, if practical. Having retirement assets in both may provide the most flexibility to manage your future income and tax situation.

As you can see, there is no easy answer to the question, "which IRA is best for me?" As with any major financial decision, careful consultation with a professional financial advisor is a good idea before you make your choice. In addition to helping you with calculations and projections, a financial advisor is also likely to know what, if any, changes or clarifications have been made to the complex new tax laws. Remember, your retirement could last 20 years or more. How you live tomorrow could depend on the choices you make today.

The information contained herein is general in nature and is not meant as tax advice. Consult a financial advisor and tax professional as to how this information applies to your situation.

Points to Remember

1. Roth IRA contributions are nondeductible, but qualified withdrawals are tax free.
2. Individual contributions to all IRAs are limited to \$5,000 in 2008. Note that this amount will increase in the years ahead, adjusting for inflation.
3. You may continue contributions to a Roth IRA after age 70^{1/2}, and there are no mandatory withdrawals.
4. You can make penalty-free withdrawals from a Roth IRA before age 59^{1/2} for a first-time home purchase or if you die or become permanently disabled.

For more information, please consult with your financial advisor.

Important Additional Notes

IRS Circular 230 Disclosure: This is not intended to provide legal, tax or accounting advice. Any statement contained in this communication (including any attachments) concerning U.S. tax matters is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties imposed on the relevant taxpayer. Clients should obtain their own independent tax advice based on their particular circumstances.

This material is provided for educational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities.

The information contained in this presentation is not intended to be used as a general guide to investing, or as a source of any specific investment recommendations. This presentation makes no implied or express recommendations concerning the manner in which any client's account should or would be handled, as appropriate investment strategies depend upon the client's investment objectives.

This presentation is for the general information purposes only. It does not take into account the particular investment objectives, restrictions, tax and financial situation or other needs of any specific client.

Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. We have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources.

Opinions expressed are current opinions as of the date appearing in this material only. No part of this material may, without prior written consent, be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorized agent of the recipient.