

What You Need to Know About Roth IRA Conversions in 2010

YOUR GUIDE TO THE 2010
IRA TAX LAW CHANGES

FROM THE EDITORS AT SMARTMONEY CUSTOM SOLUTIONS

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Dear Reader,

The year 2010 offers you an unprecedented opportunity. For the first time, you can convert traditional IRAs or other eligible retirement plans to a Roth IRA regardless of your income level or filing status. We are pleased to make this booklet available to help you determine whether converting is likely to help you achieve your own dreams for retirement.

To make the most informed decision possible about what's right for you, you need to understand how your retirement plan interacts with other aspects of your financial life, including income taxes, your current savings and your need for protection.

You may decide that the Roth's long-term benefits — particularly the ability to withdraw money tax-free during retirement — are worth the present-day expense. (Roth IRA conversions do come at a cost: You have to pay income taxes on some or all of the amount you convert.)

Our financial advisors can help put your decision in the proper context — and create a financial plan that can help lead you to a retirement that's everything you want it to be.

For more information about the Roth IRA conversion opportunity, contact your advisor. Or to find an Ameriprise financial advisor near you, please visit us at ameriprise.com.

Sincerely,

Kim M. Sharan
President — Financial Planning, Retirement & Wealth Strategies
Ameriprise Financial

“Life is not getting any cheaper for millions of American families... It’s only fair to let them keep more of their hard-earned money.”

—Senator William V. Roth
Roth IRA legislative sponsor (2000)

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INTRODUCING THE NEW AND IMPROVED ROTH IRA

The year 2010 will go down in the history books as a watershed year for the Roth IRA. The popular tax-free retirement account has been revised for the new decade. So while the Roth isn't really “new,” the opportunity to convert to one is considerably improved. Thanks to changes in the conversion rules Congress passed in 2006, even those with higher incomes can now participate. The Roth IRA will now be available to millions of previously ineligible taxpayers, even though the relaxed rules apply only to conversions and not to new contributions. **The net effect is to give every American taxpayer an unprecedented opportunity to participate in tax-free investing and saving.**

There are numerous advantages to converting in 2010. For starters, in the wake of the financial crisis you may have less money to convert. That could translate to having lower taxes to pay on the conversion. Yes, you will pay taxes on the conversion up front. But if you believe tax rates may rise, or want additional flexibility, it may be smart to pay now and enjoy tax-free withdrawals down the line, rather than pay later at the tax rate that will apply when you take distributions from your account.

*When special tax treatment was applied to Roth conversions in 1998, \$40 billion was converted. The next year, when there was no special tax treatment, less than \$4 billion was converted.**

Another advantage: The amount you convert from a traditional IRA or other eligible retirement plan to a Roth IRA is typically taxable immediately; however, you are eligible for a special tax incentive in 2010 only. If you convert in 2010, you can spread the income generated by the conversion over a two-year period in 2011 and 2012.

The Roth IRA isn't a one-size-fits-all solution for every investor. Deciding whether a Roth is right for you takes time, effort and sophisticated planning. This booklet will address some of the key issues you'll need to consider when evaluating whether to convert to a Roth. You should also talk to a financial or tax advisor about this important decision.

*Source: Investment Company Institute, August 2009. Numbers are approximate.

To determine whether a conversion is right for you, contact your financial advisor.

ROTH IRAs AT A GLANCE

There are significant differences between a Roth and a traditional IRA. Roth distributions are tax-free as long as you are over age 59½ and have had the account for at least five years. Contributions, however, are not tax-deductible when you make them.

Traditional IRA contributions are deductible if you meet certain criteria, but distributions are taxable at the prevailing rate for ordinary income and must begin by April 1st following the year in which you reach age 70½. Congress waived required minimum distributions (RMDs) for 2009.

With a Roth IRA, there is no requirement to take distributions at any age. This is a major advantage because the longer you can let the account grow and compound tax-free, the greater the long-term value of your portfolio. You may also have more tax-free money to pass to your heirs. Plus, you can continue to contribute to a Roth IRA after age 70½, if you have earned income. Traditional IRAs do not allow contributions in the year you turn 70½ or later.

ROTH IRA ELIGIBILITY

Before 2010, anyone with modified adjusted gross income (MAGI) over \$100,000 was ineligible to convert an IRA or other retirement plan to a Roth IRA. Now, with those limits eliminated, any individual with a 401(a), 401(k), 403(b), governmental 457, SEP IRA, SIMPLE IRA (after two years of participation) or traditional IRA can convert.* Note that even though you can convert to a Roth IRA, you won't be able to make new contributions if your income is above the limits described in the chart on page 8. That means your converted Roth can grow only through investment appreciation or by making additional conversions.

You can make 2009 IRA contributions until April 15, 2010. The 2009 annual contribution limit is \$5,000 for people under age 50 and \$6,000 for those age 50 and over. The same limits apply in 2010.

*To convert a 401(a), 401(k), 403(b) or governmental 457 plan you must be eligible to take a distribution from the plan. Plans typically permit distributions when your employment terminates or you reach age 59½. Check with your plan administrator to see if you are eligible to convert.

ROTH IRA CONTRIBUTIONS

To make new contributions to a Roth IRA, you or your spouse must have earned income. This includes wages, commissions or self-employment income. This does not include pensions and annuities, investment income, dividends, capital gains and foreign income. **You don't need earned income to convert to a Roth IRA.**

If your income is too high to fund a Roth IRA and you're ineligible for a deductible IRA, consider funding a non-deductible traditional IRA and later converting to a Roth. This strategy works best if you don't have an existing pre-tax IRA. That's because converted amounts are taxed proportionately, even if the after-tax money is in a separate IRA.

Who Can Make Roth IRA Contributions?

Income limits may have been lifted on conversions, but the old rules still apply to new Roth IRA contributions.

Filing Status	Full Contribution		Partial Contribution		No Contribution	
	2009	2010	2009	2010	2009	2010
Single	Less than \$105,000		\$105,000 - \$120,000		\$120,000 or more	
Married Filing Jointly	Less than \$166,000	Less than \$167,000	\$166,000 - \$176,000	\$167,000 - \$177,000	\$176,000 or more	\$177,000 or more
Married Filing Separately	\$0		\$0 - \$10,000		\$10,000 or more	

GET READY TO CONVERT

So sharpen your pencils and roll up your sleeves. While removing the income limits for conversion is permanent, the ability to defer tax payments is available only in 2010 — a good reason not to delay conversion.

Here's how it works: Suppose you convert your traditional IRA to a Roth in 2010. The IRS considers the amount you convert to be income (unless you're converting after-tax contributions) and will automatically split it equally and apply half to 2011 and half to 2012, essentially giving you a three-year window to pay the tax. As an alternative, you can elect to have the entire amount taxed in 2010. If you don't make the conversion until January 2011, you must pay the entire tax when you file your 2011 tax return.

The rules get a little more complicated when the retirement plan you want to convert to a Roth IRA includes after-tax contributions. While you may have a special opportunity to convert these assets, it's a good idea to talk to your financial advisor for assistance.

Ultimately, whether or not you would benefit from converting to a Roth depends on three factors:

- 1 Your source of funds to pay the income tax that will be due on the conversion.
- 2 Your anticipated future income-tax rate at the time you make withdrawals compared to the rate you will pay on the conversion.
- 3 Your age and the amount of time until you need to withdraw money.

1 YOUR SOURCE OF FUNDS

The best time to pay the “conversion tax” is when your tax rate is low. If you expect your income to increase next year or expect tax rates to be higher, you may be better off paying the tax now at the current rate. How you pay this tax is critical to determining whether a conversion is a good strategy for you over the long term.

You can maximize your total portfolio return by paying the conversion tax without drawing money from the IRA itself. If you tap your IRA before age 59½ to pay the conversion tax, for example, the amount you withdraw will be taxable and you will generally trigger an additional 10% premature-withdrawal penalty. You will also reduce the amount of money available for tax-free compounding. Ask your financial advisor for help in identifying non-IRA assets you can use to pay the tax.

2 YOUR FUTURE INCOME-TAX RATE

Conversion is a good idea if you think your tax rate will be higher or the same after retirement, or if you believe tax rates generally may rise. Converting to a Roth IRA is generally not a good idea if you expect your tax rate to be significantly lower after you retire.

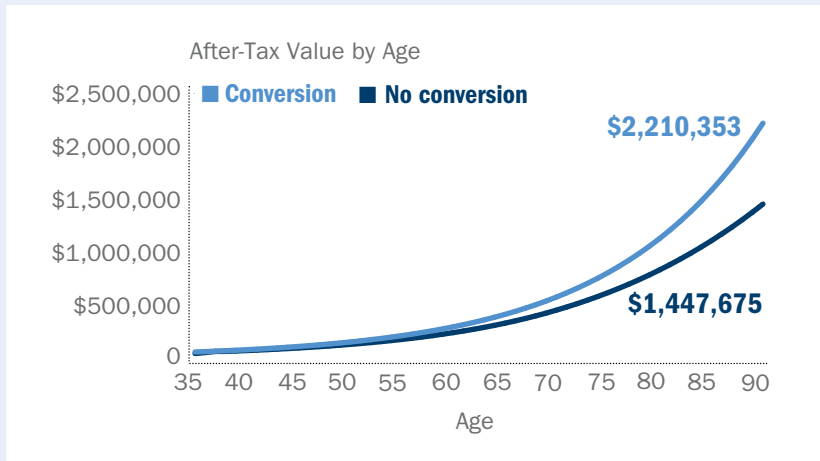
You may have concerns that the additional income from a full conversion might subject you to the Alternative Minimum Tax or push you into a higher tax bracket. It's also important to take into account the unintended consequences that may result from having more income.

Examples include having a portion of your Social Security benefits become taxable, potential increases in your Medicare Part B premium and losing certain exemptions and credits. Your financial advisor may recommend a partial conversion strategy to avoid these situations.

The Impact of a Rising Tax Rate

Consider a conversion if your tax rate will be higher.

This chart shows the effect of converting a \$50,000 traditional IRA to a Roth IRA at age 35. It assumes that the owner pays the taxes from non-IRA assets and is in the 28% bracket in 2011 and 2012 but will be in a 33% tax bracket in retirement. It also assumes a steady 7% compounded return on regular and retirement assets until taking a lump sum distribution at age 90. Based on these assumptions, converting to a Roth IRA would provide a benefit of more than \$750,000.



If you convert 100% of a traditional IRA to a Roth IRA in 2010, the total after-tax balance at age 90 would be \$2,210,353. If you do not convert a traditional IRA to a Roth IRA, and invest an amount equivalent to the tax that would have resulted from the conversion, the after-tax balance at age 90 would be \$1,447,675.

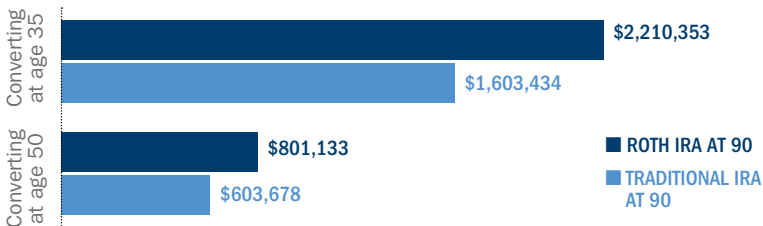
This is a hypothetical example intended for illustration purposes only, and does not represent the performance of any specific investment or portfolio, nor is it an estimate or guarantee of future value. RMDs are deposited into a side fund and grow at the specified annual rate of return. Amount(s) equivalent to any conversion tax that would be owed as a result of the Roth conversion are also deposited into the side fund and grow at the specified annual rate of return. Your tax rate may increase after retirement if you have additional income or if Congress changes applicable rates.

3 YOUR AGE AND YEARS UNTIL WITHDRAWAL

The number of years you have until you begin making withdrawals is another key factor in determining whether or not you should convert. **The more time you have to earn compound interest on tax-free assets, the more time you have to offset the tax you pay at conversion.**

15 Years Makes a Big Difference

This chart shows the effect of converting \$50,000 from a traditional IRA to a Roth IRA at age 35 versus age 50. The benefit of converting at age 35 would be more than \$600,000 while the same \$50,000 conversion at age 50 would be approximately \$200,000.



Assumptions: 28% tax bracket in 2011/2012 and at retirement. Taxes are paid from a non-retirement account. Investment returns 7% annually until taking a lump sum distribution at age 90. All dollar figures are after tax.

This is a hypothetical example intended for illustration purposes only, and does not represent the performance of any specific investment or portfolio, nor is it an estimate or guarantee of future value. RMDs are deposited into a side fund and grow at the specified annual rate of return. Amount(s) equivalent to any conversion tax that would be owned as a result of the Roth conversion are also deposited into the side fund and grow at the specified annual rate of return.

30 to 60 years of potential tax-free growth can result in a sizeable inherited Roth IRA.

You might be a good candidate for a conversion if you are the original owner of a traditional IRA, don't expect to need the money you convert to a Roth and plan instead to leave it to your heirs. On the other hand, the older you are, the less sense it may make to convert to a Roth.

ROTH FOR ESTATE PLANNING

If you are contemplating converting to a Roth, you should take into account its potential use as an estate-planning tool. Since there is no minimum distribution requirement during the life of the original owner, the money in the account can continue to compound tax-free. After the owner's death, the surviving spouse can roll the IRA over to their own Roth and is not required to make withdrawals either. This maximizes the account's earnings potential.

It's common for Roth IRA beneficiaries to be the owner's children and grandchildren, who will often have a long life expectancy after the IRA owner's death. Once a non-spouse beneficiary inherits a Roth, that beneficiary is required to take minimum distributions over his or her life expectancy. Contribution and conversion assets are distributed first and are always tax free, while distributions of earnings are tax free as long as the five-year holding period beginning with the original owner has been met.

SPECIAL FEATURES FOR UNCERTAIN TIMES

Still not sure if conversion is right for you?

Consider these special options for ensuring you end up with the right type of IRA for your circumstances:

Recharacterization – One of the best features of a Roth IRA conversion is the ability to “undo” it. If new information comes to light or market conditions change, you can “recharacterize,” which simply reverses the conversion and turns it back into a traditional IRA. The deadline for doing this is October 15th of the year following the year you convert.

Reconversion – If, after recharacterizing, circumstances arise (such as a decline in the market value of your traditional IRA) that make conversion back to a Roth IRA desirable, the IRS will allow you to “reconvert” your recharacterized traditional IRA back into a Roth. You

Women and Roth IRA Conversions

Women generally live longer than men, on average* – so they may benefit more from a Roth IRA conversion.

A woman who outlives her husband typically sees her tax status change from “married filing jointly” to “single.” The result can be a higher tax bill if her income doesn’t fall significantly. For example, in 2010, a couple with adjusted gross income (AGI) of \$67,000 would pay a top tax rate of 15%. But a single filer with \$67,000 AGI would pay a top rate of 25% – and it would apply to almost half her income. A traditional IRA could make the problem worse. Those accounts require

can't reconvert in the same tax year as the original conversion. But if you recharacterize in the following year, you can reconvert after 30 days. Because of these rules, the two-year tax treatment for 2010 conversions isn't available for a reconversion.

Recharacterization by Asset Class – A more sophisticated strategy involves converting specific asset classes or investments into separate Roth IRAs. This allows you to recharacterize just that asset class or investment if they are affected by the market. You have less flexibility if you hold multiple investments in a single Roth IRA because the investments must be recharacterized proportionally.

Partial Conversion – If market performance still has you unsure of when to convert your IRA, the IRS will permit partial and gradual conversions of assets into a Roth. Partial conversions may also avoid pushing you into a higher tax bracket by spreading the income over several years. You pay tax only on the amount you convert.

minimum distributions (RMDs) each year after age 70½ – so a woman would have to withdraw money and pay tax on it, even if she doesn't need the income.

A Roth IRA could help her manage her tax bill. The accounts don't impose RMDs, so she could leave the money in place indefinitely. And when she does take withdrawals, they'd be tax-free. To determine whether a Roth conversion suits your personal circumstances, consult a financial advisor.

– Craig Brimhall, Vice President, Retirement Wealth Strategies,
Ameriprise Financial

*Source: Diversity Best Practices/Business Women's Network



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