

401K, Pension, IRAs: To Convert or Not to Convert?



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Gaining a thorough understanding of all the options available for retirement saving and planning is no small task. Whether you're considering moving your 401k, your pension savings, or converting to a Roth IRA; it is important to make sound decisions – today's choices often determine your future retirement income. Converting a traditional Individual Retirement

Account (IRA) account into a Roth IRA is of particular interest at the moment because of new 2010 IRS rules. Talking with a financial planner could save you time in the short term and money in the long term, but here are some options to explore now:

Retirement Plan Options

Rollover/Conversion

One of the best options may be to rollover your existing retirement funds since you retain control of where you move your retirement investments. You can avoid the 10% premature distribution penalty tax if you are under the age of 59-1/2 and keep your money in a tax deferred account.

- Rollover to a self directed IRA: This option offers the maximum choices and investment options.
- Rollover to new employer's plan: The appeal of this choice varies based on the investment vehicles allowed by the new employer.
- Rollover to a Roth IRA (Roth Conversion): If the value of your retirement plan or Traditional IRA has recently declined, you will owe less in taxes upon a conversion to a Roth IRA. Later, if the market heads back up, any earnings in the Roth account will accumulate tax free and remain so for future qualified distributions.

Stay the Course

You could keep money in your current plan if the plan allows this. It may not have adequate investments to choose from, so be sure to evaluate the plan thoroughly. This may be a good short-term choice while you get settled into your new job.

Cash out

There are potentially huge tax consequences to consider if you cashing out. Proceeds are taxed as ordinary income with an additional potential 10% penalty, so be sure to consult a tax

advisor. It is important to remember if you sell out now, there is no chance to recoup any lost market value.

What is a Roth?

A Roth IRA may help you save for retirement by offering tax-free earnings accumulation and withdrawals. Roths also offer tax-free withdrawals of contributions at any time.

What is a Roth Conversion?

A Roth conversion allows the transfer of some or all of your traditional IRA, into a Roth IRA where principal and earnings can grow tax free. A conversion is used to take advantage of Roth IRA's income tax benefits. With a traditional IRA, you might qualify for a tax deduction up front for your contribution, but then you pay income taxes on any withdrawals. With the Roth IRA, you do not get a tax deduction when you contribute, but you do not have to pay tax on the original contributions and/or Roth conversion amount when you withdraw the funds in retirement. The deferred earnings are also tax free, provided you follow IRS rules.

What's New in 2010

- An important new rule for January 1, 2010 – no adjusted gross income limitations for eligibility to convert a traditional IRA to a Roth IRA.
- If you are planning to convert in 2010 (only), you can split the federal tax liability into two tax years – due 2012 and 2013.
- You don't need to convert all in one year – you can spread it out over multiple years, which may lessen the income tax burden.
- You can use IRA funds to pay taxes on a conversion, but most advisors do not recommend this – you should consider using non-retirement money.
- Beginning January 1, 2010, 401k participants may convert directly to a Roth IRA – subject to plan rules.
- If you have made a non-deductible contribution to a traditional IRA it may make sense for you to convert. Since it is a non-deductible contribution, the converted principal should not be taxable, but the deferred earnings would be.

Why Convert? – There are sound reasons to convert to a Roth IRA. You can withdraw amounts tax-free

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(earnings included) if your Roth IRA has been held for at least five years and you are at least 59 ½ years old. Even if a withdrawal is made before the account is open for five years, the withdrawals are treated as coming first from contributions and are therefore still not taxable as long as it doesn't dip into earnings. Minimum distributions after age 70 ½, which were previously required for traditional IRAs, are not required for Roth IRAs. The entire account can pass tax-free to heirs (still subject to estate taxes if applicable). Since Roth distributions aren't taxable, they are not included in "modified adjusted gross income" for purposes of determining social security benefits subject to income tax. You can also reverse a conversion at any time up until October 15th of the year following the conversion, (filing, plus extension deadline) if you need to.

It is important to note that if you opt to convert to a Roth IRA, you will trigger income taxes. Be sure to consider all of the tax consequences. This may subject your Social Security income to tax and/or increase your tax bracket. Again, keep in mind you do not need to convert all in one year and can spread the conversion out over multiple years to lessen the income tax burden.

To Convert or Not to Convert?

Those who could benefit from converting to a Roth IRA include:

- People who believe they will be in an equal or higher tax bracket in retirement when they would be withdrawing from their traditional IRA.
- Investors interested in leaving income tax free inheritances.
- Anybody that doesn't need the additional income that required minimum distributions will force.
- People that can afford to pay the taxes on the conversion now.

Can You Rollover Your Pension?

If you have a pension, research rollover options (if any) and compare what are referred to as pension-max opportunities. Re-evaluate your retirement timing and your needs for the long-term before making an irrevocable election based on the here and now. Be sure

to keep any plan information from jobs you have left if you will be entitled to a pension.

This is an important decision. Many people's retirement savings are their largest asset. Take some time to do the work and explore all your options – doing this will help get you closer to your retirement goals and give you financial confidence.

Helpful Resources:

Information about Roth IRAs

<http://www.irs.gov/retirement/article/0,,id=137307,00.html>

Information about 401K Rollovers

<http://www.irs.gov/retirement/article/0,,id=160469,00.html>

For more information on transitioning employment benefits or selecting a financial advisor, check out these resources:

<http://www.clutewealthmanagement.com/resources.html>

<http://www.irs.gov/retirement/participant/index.html>

<http://paladinregistry.com/>

<http://www.fpanet.org/plannersearch/search.cfm>

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This information is not intended to be a substitute for specific individualized tax, legal or investing planning advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.

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