

# Roth IRAs



## The Roth IRA

*2009 and 2010*

Questions & Answers

## **What is a Roth Individual Retirement Account (Roth IRA)?**

A Roth IRA is a type of tax-preferred savings and investment account authorized by Internal Revenue Code section 408A. The Roth IRA allows you to accumulate assets for retirement purposes and for other purposes.

## **What are the tax benefits of a Roth IRA?**

A Roth IRA will produce tax-free income if certain rules are met. You or your beneficiary(ies) will not be required to include in income, for income tax purposes, a distribution paid from a Roth IRA, whether it be the return of a contribution or the account's earnings, if certain rules are met. In some cases, you may be eligible to claim a tax credit because of your Roth IRA contribution.

## **What is the basic concept of a Roth IRA, and what are the associated tax benefits?**

If you are eligible, you may make contributions, within limits, to the Roth IRA. You make these contributions with after-tax dollars. The earnings realized by the Roth IRA are not presently taxed, and if certain distribution rules are met, will never be taxed. For example, if you are age 42 on January 1, 2010, and you contribute \$1,000 a year for 34 years (2010-2043) to a Roth IRA, then your contributions of \$34,000 would accumulate to \$110,434.88 as of December 31, 2043, if an earnings rate of 6% compounded annually were realized. You and your beneficiary(ies) would not pay any federal income tax on the contribution amount of \$34,000 when distributed, because you cannot claim a tax deduction for your contributions. However, the great tax benefit to be realized from a Roth IRA is that you and your beneficiary(ies) will not have to include in your taxable income the earnings of \$76,434.88 (and subsequent future earnings) when distributed to you or your beneficiary(ies), as long as the distributions are qualified distributions, as defined later.

---

## **THE CONTRIBUTION RULES**

---

### **When do I have to establish the Roth IRA?**

You have until the due date (without extensions) for filing your federal income tax return, normally April 15, to establish and fund your Roth IRA for the previous tax year.

## **Am I eligible to contribute to a Roth IRA?**

You are eligible if you satisfy the following two requirements: (1) you have earned income or compensation; and (2) you meet certain income limitations. Be aware that you are eligible to make contributions to a Roth IRA even though you are age 70½ or older. For a given year, you may be ineligible to contribute to a Roth IRA, but still be eligible to contribute to a traditional IRA .

## **May I contribute to a Roth IRA after age 70½?**

Yes, no age limit is imposed for Roth IRA contributions. The only requirement is that you must have earned income for the year for which the contribution is made.

## **How much am I eligible to contribute to my Roth IRA for the 2009 and 2010 tax years if I will NOT be at least age 50 as of December 31?**

For 2009 you are eligible to contribute the lesser of 100% of your compensation, or \$5,000 as reduced by (1) application of the special income and filing status limitation rule and (2) any amount you contributed to your traditional IRA for the same tax year.

For 2010 you are also eligible to contribute the lesser of 100% of your compensation, or \$5,000 as reduced by (1) application of the special income and filing status limitation rule and (2) any amount you contributed to your traditional IRA for the same tax year.

## **How much am I eligible to contribute to my Roth IRA for the 2009 and 2010 tax years if I will be at least age 50 as of December 31?**

For 2009 you are also eligible to contribute the lesser of 100% of your compensation, or \$6,000, as reduced by (1) application of the special income and filing status limitation rule and (2) any amount you contributed to your traditional IRA for the same tax year.

For 2009 you are eligible to contribute the lesser of 100% of your compensation, or \$6,000, as reduced by (1) application of the special income and filing status limitation rule and (2) any amount you contributed to your traditional IRA for the same tax year.

# How is my allowable contribution to a Roth IRA calculated?

There is a special formula which must be used, as described in the "Roth IRA Contribution Chart." The formula is as follows:

$$\frac{\text{AGI-Threshold Level} - \text{Phaseout Level}}{\text{Threshold Level} - \text{Phaseout Level}} = \text{Ineligible Contribution \%}$$

### 2009 Limits

<u>Tax-Filing Status</u>	<u>Threshold Level</u>	<u>Phaseout Level</u>
Single	\$105,000	\$120,000
Married/Joint Return	\$166,000	\$176,000
Married/Separate Return	\$0	\$10,000

### 2010 Limits

<u>Tax-Filing Status</u>	<u>Threshold Level</u>	<u>Phaseout Level</u>
Single	\$105,000	\$120,000
Married/Joint Return	\$167,000	\$177,000
Married/Separate Return	\$0	\$10,000

The result is the percentage which cannot be contributed to the Roth IRA. You must then apply this percentage to the maximum contribution amount and then subtract this amount from the allowed contribution amount to get the amount which you can contribute.

**Example** — Bob and Lynn Brown have adjusted gross income of \$170,000 in 2009, and file a joint tax return. Both are 47 years old. They wish to make contributions to Roth IRAs. How much can each contribute to a Roth IRA? Using the formula for a married taxpayer, filing jointly:

- Step 1  $\$170,000 - \$166,000 = \$4,000$
- Step 2  $\$4,000 \div \$10,000 = .4$
- Step 3  $\$5,000 \times .4 = \$2,000$  *Ineligible Amount*  
**(Note: \$5,000 is used, not \$10,000)**
- Step 4  $\$5,000 - \$2,000 = \$3,000$  *Eligible Amount*

This formula must be calculated separately for each spouse, but is based on their combined income. Bob and Lynn could each contribute up to \$3,000 to a Roth IRA in 2009, for a total contribution amount of \$6,000.

## What are the income limits for eligibility purposes?

If your income (and your spouse's income, if you are married) is too high, you will not be eligible to make a contribution to a Roth IRA. For 2009, if you are single, you become ineligible when your adjusted gross income is \$120,000 or greater. If you are married, and file a joint return, you become ineligible when the combined adjusted gross income (AGI) of you and your spouse is \$176,000 or greater. If you are married and file a separate return, you become ineligible when your adjusted gross income is \$10,000 or greater.

## The following Chart summarizes the special income and filing status rules for 2009:

### **Roth IRA Contribution Chart for 2009**

Amount of AGI and Filing Status

#### **Single, Head of Household or Qualifying Widow(er)**

Below \$105,000	Entitled to full contribution amount
\$105,000-\$119,999	Entitled to prorated contribution amount—use special formula*
\$120,000 or over	No contribution permissible

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$105,000/\$15,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

#### **Married Filing Jointly**

Below \$166,000	Entitled to full contribution amount.
\$166,000-175,999	Entitled to prorated contribution amount—use special formula.*
\$176,000 or over	No contribution permissible.

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$166,000/\$10,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

#### **Married Filing Separate Returns**

\$0-\$9,999	Entitled to prorated contribution amount—use special formula*
\$10,000 or Over	No contribution permissible

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$0/\$10,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

## May my spouse or I use the spousal IRA contribution rules to make a contribution to our respective Roth IRA?

Yes. One of you will be eligible to make a spousal contribution to a Roth IRA if the following rules are satisfied:

- You and your spouse must each have your own Roth IRA.
- You must be married as of the end of the tax year (i.e. December 31).
- You must file a joint income tax return.
- You must have compensation includible in gross income which is less than that of your spouse.

Your annual Roth IRA contribution will be limited to the lesser of (1) \$5,000/\$6,000, as applicable; or (2) the sum of your compensation which is includible in gross income for such year, plus the compensation of your spouse, as reduced by your spouse's contribution to his or her own traditional IRA and Roth IRA.

## To what extent may I be entitled to a tax credit for my IRA contributions?

You may be eligible for a tax credit for contributions you make to your traditional and/or Roth IRA. A formula is used to calculate your credit. Your credit may vary from \$1 to \$1,000, depending on the amount you contribute to your IRA, your filing status and your modified adjusted gross income. If you meet the following requirements for a given tax year, then you will qualify for this new credit:

1. Be at least 18 years of age as of December 31 of such year.
2. Not be a dependent on someone else's tax return
3. Not be a student as defined in Internal Revenue Code section 25B(c)
4. Have adjusted gross income under certain limits which are based on your filing status:

	<u>2009</u>	<u>2010</u>
Joint filers	\$55,500.01	\$55,500.01
Head-of-Household	\$41,625.01	\$41,625.01
All other filers	\$27,750.01	\$27,750.01

(including Married, filing separately)

5. Must not have received certain distributions which disqualify you from claiming the credit, or certain distributions which were made to your spouse.

Because of the complexity of this credit, you will want to review IRS Publication 590 for a complete explanation.

---

## ROLLOVER CONTRIBUTIONS

---

### If I receive a distribution from one Roth IRA, may I roll over the funds to a second Roth IRA?

Yes. Distributed funds, unless rolled over, would need to be partially included in income as discussed below. The purpose of a rollover is to change an otherwise taxable event into a nontaxable event. The rules which govern a "Roth-to-

Roth" rollover are the same as for a rollover from one traditional IRA to another traditional IRA. You must comply with the 60-day rule and you are only entitled to one such rollover within a 12-month period.

### **May I roll over funds from a qualified plan, a governmental 457 plan, or a section 403(b) plan to a Roth IRA?**

Beginning with tax year 2008, such rollovers are permitted. Such rollover will be a Roth IRA conversion contribution.

### **May I roll over or convert part or all of my traditional IRA to a Roth IRA?**

A conversion is accomplished by having funds distributed from a traditional IRA and rolling them over to a Roth IRA within 60 days. This can be done internally at your financial institution, or by transfer of the traditional IRA funds at one institution to a Roth IRA at another institution.

Under current rules, in order to convert a traditional IRA to a Roth IRA, your income, or, if married, your and your spouse's combined adjusted gross income must be \$100,000 or less in the year of the conversion, and, if married, you must file a joint tax return.

In 2010, these conversion requirements will be repealed, and any individual, regardless of income or filing status, will be able to convert funds from a traditional IRA to a Roth IRA.

**Special tax relief for conversions made in 2010.** If you perform the conversion in 2010, a special rule allows you to include 1/2 of the distributed amount in income in 2011, and 1/2 in 2012. No taxes will be owing on the conversion amount in 2010. However, if you desire, you may include the entire amount in income in 2010. If you perform the conversion after 2010, this special tax relief will no longer be available, and the entire amount distributed from the traditional IRA must be included in income in the year the conversion is made.

Whatever conversion method is used, the custodian/trustee of the traditional IRA will prepare a Form 1099-R to report the distribution, and the custodian/trustee of the Roth IRA will prepare a 5498 to report the conversion contribution.

### **Why might I want to convert my traditional IRA to a Roth IRA?**

You may find it advantageous to incur the tax consequences of a present distribution in order to qualify to earn the right to have no taxation when the earnings are ultimately distributed from the Roth IRA.

## **What are the tax consequences of receiving a distribution from a traditional IRA and “rolling over” the distribution to a Roth IRA?**

In general, the amount distributed to you from your traditional IRA will be included in your income in the year of receipt and will be subject to income taxes for that year. The 10% premature distribution excise tax, however, will not be owed, even if you are younger than age 59½.

---

## **THE WITHDRAWAL RULES**

---

### **When may I start to withdraw money or assets from my Roth IRA?**

You may begin withdrawals at any time. However, you will want to understand the income tax consequences of taking distributions at certain times.

### **Must I commence required minimum distributions from my Roth IRA at age 70½?**

No. The required minimum distribution rules for living accountholders (age 70½ or older) do not apply to distributions from a Roth IRA.

### **What distributions from a Roth IRA will be tax free?**

“Qualified distributions” will be tax free. To be a qualified distribution, the distribution must occur after you have met the five-year holding requirement, and the distribution is made to you (1) after you have attained age 59½, (2) after you have become disabled, (3) because of a first-time home purchase, or (4) to your beneficiary after your death.

### **When will I have met the 5-year rule?**

The five-year period is considered to start on January 1 of the year for which the first contribution to a Roth IRA is made. All Roth IRA contributions, including rollovers, are aggregated for purposes of satisfying the 5-year rule. Exception: a distinct five-year period applies to inherited Roth IRAs.

### **Does the law define the order for distributions?**

Yes. The law mandates the following order for distributions: (1) from regular/annual contributions; (2) from conversion contributions on a first-in-first-out basis and (3) from earnings. The order is determined as of the end of the taxable year, and each category must be exhausted before the next

is used. With respect to a conversion contribution, it is treated as being made first from the portion, if any, that was includible in gross income as a result of the conversion.

### **What Roth IRA distributions will be taxed?**

To the extent that a nonqualified distribution is the return of the earnings on your contributions, you will need to include this distribution amount in income and pay the related tax.

### **May I withdraw the basis in my Roth IRA at any time without tax or penalty?**

Normally, yes. Even though you may not have met the 5-year requirement, you may withdraw your basis at any time without being taxed on the amount. Because of the tax-ordering rules, the first funds distributed from a Roth IRA are your basis. Because a Roth IRA is funded with after-tax dollars, you will not be taxed again on this amount.

It is possible that a financial institution may impose an early-withdrawal penalty for a Roth IRA. Such penalty would be indicated in the information you received when you established the Roth IRA.

### **Could a Roth IRA be used to save for a down payment on a first home?**

Yes. A Roth IRA would be an excellent savings vehicle to accumulate funds to purchase a first home. A maximum of \$10,000 may be used once in person's lifetime to purchase a first home. Your basis, as discussed earlier, is always available tax free, plus any earnings on the account withdrawn after the 5-year period has been met will be tax free upon distribution if used to purchase a first home (or used for any other qualifying expenditure). A husband and wife who each have their own Roth IRA would each be allowed the \$10,000 tax-free withdrawal to purchase a first home.

### **Are there advantages to funding a Roth IRA instead of placing funds in a normal savings account?**

As with a normal savings account, you are allowed to remove your basis from a Roth IRA tax free at any time. However, with a normal savings account, you will have to include any interest earned in your taxable income for the year (whether you withdraw it or not). The interest in a Roth IRA grows tax free, and will never be taxed if used for a qualified expense after the 5-year period has been met. The five-year period begins January 1 of the year for which you make your first contribution.

## **Will the 10% additional tax ever be assessed?**

Yes. If you are not yet age 59½ (and none of the other exceptions apply at the time you withdraw funds from your Roth IRA), then you will be liable to pay the 10% additional tax if you withdraw income and it is taxable. You may also have to pay the 10% additional tax if you do a conversion before attaining age 59½ and then you take a subsequent distribution within a 5-year period when none of the exceptions to the 10% tax apply. A separate 5-year period applies to each conversion and commences on the date of the distribution.

## **Are there exceptions to the age 59½ rule?**

Yes. You may qualify for an exception if you are in one of the following situations. (1) You have unreimbursed medical expenses that are more than 7.5% of your adjusted gross income. (2) You are disabled. (3) You are the beneficiary of a deceased Roth IRA owner. (4) The distributions are not more than your qualified higher education expenses. (5) You use the distributions to buy, build, or rebuild a first home. (6) The distribution is of contributions returned before the due date of your tax return. (7) The distribution is due to an IRS levy. Refer to IRS Publication 590 for more information and additional exceptions.

## **Are there rules which allow me to correct or undo a Roth contribution?**

Yes. You may correct a Roth contribution by either withdrawing it according to the withdrawal of excess contribution rules or by recharacterizing your Roth contribution according to special recharacterization rules.

## **What happens to my Roth IRA after I die?**

The funds or assets in your Roth IRA will be paid to your designated beneficiaries in any way which either you or they select, as long as the required minimum distribution rules for inherited Roth IRAs are satisfied over the beneficiary's life expectancy. As mentioned previously, your beneficiary will generally be able to maintain your Roth IRA as an inherited Roth IRA so that there will continue to be tax-free earnings for many years after your death. In some situations, a surviving spouse may wish to elect to treat the deceased spouse's Roth IRA as his or her own Roth IRA. In this case, the surviving spouse would not be required to take any required distributions.