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FINANCIAL FOCUS



Your Accounting for a New Economy

Ask the Advisors

Can I convert my traditional IRA to a Roth in 2009?

With recent market declines, many investors are taking a new look at converting their traditional IRA to a Roth IRA. For many, the tax cost of converting has dropped significantly, making this a more attractive option.

You can convert your traditional IRA to a Roth IRA in 2009 if your modified adjusted gross income (MAGI) is \$100,000 or less. If you file a joint federal tax return with your spouse, the \$100,000 limit applies to your combined income. If you're married filing separately, you're not allowed to convert at all in 2009.

You generally have to include the amount you convert in your gross income for the year of conversion, but any nondeductible contributions you've made to your traditional IRA won't be taxed.

If you're not eligible to convert in 2009, there's always next year--literally, in this case. Starting in 2010 anyone can convert, regardless of income level or marital status. Plus, if you convert in 2010, you're allowed to spread the income tax hit over two years: you report half the taxable income from the conversion in 2011, and half in 2012. So, even if you're eligible to convert in 2009, you should discuss with your financial professional whether it makes sense in your particular case to wait until 2010 to convert in order to take advantage of this special tax rule.

If you're eligible, converting is easy. Simply notify your IRA provider that you want to convert your existing IRA to a Roth IRA, and they'll provide you with the necessary paperwork to complete. You can also transfer or roll your assets over to a new IRA provider.

Remember that you can also convert SEP IRAs (and SIMPLE IRAs that are at least two years old) to Roth

IRAs. And, if you're eligible for a distribution from your employer retirement plan (for example, a 401(k) or 403(b) plan), you may also be eligible to transfer or roll over those distributions to a Roth IRA, subject to these same conversion rules.

I converted my traditional IRA to a Roth in 2008--can I undo this?

In most cases, yes. If you converted your traditional IRA to a Roth IRA in 2008, before the recent market downturn, you may find that you now owe taxes on a conversion amount that's significantly higher than what your investments are now worth. If that's the case, you may find it advantageous to undo your conversion. The IRS refers to this process as a "recharacterization."

You may also want to recharacterize if you converted in 2008, and now find that you weren't eligible because your 2008 income is higher than you expected.

A recharacterization is essentially a do-over. You're treated as if you never converted your traditional IRA to the Roth IRA. You accomplish this by transferring the Roth IRA assets, and any earnings, back to a traditional IRA (in a trustee-to-trustee transfer if you're using a new traditional IRA provider).

To undo your 2008 conversion, you need to carefully follow these steps:

- Inform your IRA providers (the one holding the Roth IRA and the one providing the traditional IRA, if different) that you intend to recharacterize your Roth IRA to a traditional IRA. You must provide this notice on or before the date the assets are transferred back to the traditional IRA.
- Make sure the transfer is completed by the due date for filing your federal income tax return for 2008, including extensions. For most taxpayers, that can be as late as October 15, 2009. (If you've already filed a timely 2008 tax return, you can still recharacterize by making the transfer and filing an amended return by October 15, 2009. Be sure to write: "Filed pursuant to Section 301.9100-2" on your Form 1040-X.)
- Report the recharacterization to the IRS (see Form 8606 for more information).

If you undo your 2008 conversion in 2009, you generally won't be able to convert back to a Roth IRA until 31 days after the recharacterization.