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*A Registered Investment Advisor

Retirement Issues to Watch in 2010

Recent years have seen a flurry of legislation impacting retirement plans. Here are some of the more significant changes that take effect in 2010.

Nonspouse rollovers must be permitted

The Pension Protection Act of 2006 allowed, for the first time, nonspouse beneficiaries to make a direct rollover of inherited funds from an employer plan to an IRA. While the provision seemed fairly straightforward at the time, confusion arose as to whether plans were actually required to allow these rollovers. Congress addressed this in the Worker, Retiree, and Employer Recovery Act of 2008-- beginning in 2010, employer plans must let nonspouse beneficiaries make a direct rollover to an IRA if they so choose. The new law also clarified that prior to 2010 employer plans could, but were not required to, allow the rollovers.

IRA conversions for (almost) everyone!

Beginning in 2010, if you own a traditional IRA, you'll be able to convert it to a Roth IRA. The income limits and marital status requirements that previously applied to Roth conversions were repealed by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

In addition, if you convert a traditional IRA to a Roth IRA in 2010, you'll be able to report half the income on your 2011 tax return and half on your 2012 return. Or, if it's to your benefit, you can instead elect to include the entire amount in income on your 2010 return. It's up to you.

If you inherit a traditional IRA from your spouse, and you elect to treat that IRA as your own, you'll also be able to convert the inherited IRA to a Roth IRA in 2010, regardless of your income or marital status. Nonspouse beneficiaries, however, still can't convert an inherited traditional IRA to a Roth.

Note that the income limits for contributing to a Roth IRA haven't changed for 2010. If your income is high enough, your ability to make regular contributions to a Roth IRA in 2010 may be limited, or even eliminated. The ability to convert a traditional IRA to a Roth without income limits, however, provides a potential workaround--you can make your annual contribution to a traditional IRA, and then immediately convert that traditional IRA to a Roth. You'll have to aggregate all your traditional IRAs when calculating the tax effect of the conversion, so speak with a financial professional first to make sure this strategy works for you.

Employer plan conversions for everyone!

Beginning in 2008, employees and beneficiaries were permitted for the first time to essentially "convert" employer plan distributions by rolling the funds over to a Roth IRA. This was allowed, however, only if the payee satisfied the income and marital status limits that applied to traditional IRA conversions. The elimination of those restrictions by TIPRA, described above, also applies to distributions from employer plans--so beginning in 2010, anyone who receives an eligible distribution of non-Roth funds from an employer plan can roll those funds over to a Roth IRA, regardless of income or marital status. This applies even to nonspouse beneficiaries--but only if the transfer to the IRA is done in a direct rollover.

Here comes the DB(k) ...

Beginning in 2010, "small employers" (those that generally employ at least 2 and no more than 500 employees) can adopt a DB(k) plan-- a single plan that incorporates both a 401(k) plan and a defined benefit plan (including a cash balance plan). A single trust is used, but there is separate accounting for the defined benefit and 401(k) portions of the plan.

The plan must meet certain benefit, contribution, vesting, and nondiscrimination requirements. In return, the plan will be exempt from top-heavy rules and certain 401(k) testing.

Because the DB(k) plan is one plan instead of two, it is expected that the plan will be simpler to administer and less costly than maintaining two separate plans. This, in turn, may provide an incentive for employers to begin offering defined benefit plans to their employees in addition to 401(k) plans. Whether this proves to be the case, however, remains to be seen. ly secure one.