

## Tax Planning Tips to Know

In May 2006, tax law was passed that will affect most investors today. The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) received only brief attention in the news media, so some of its results were easy to miss.

The centerpiece of TIPRA is a two-year extension of the temporary lower tax rates on dividends and capital gains (through 2010). Dividends and long-term capital gains are taxed at a maximum 15% rate for Americans in the upper marginal income tax brackets. For taxpayers in the 10% and 15% brackets, the tax rate is 5% through 2007 and zero through 2010. Without the extension, dividend income would have been subject to rates up to 35%, and long-term capital gains would have been taxed at a maximum 20% rate in 2009.

Important changes to Roth IRA conversion rules were also included. Presently, only joint and single filers with modified adjusted gross incomes of \$100,000 or less are eligible to convert a Traditional IRA to a Roth IRA; income taxes are due on the amount converted. TIPRA changed the eligibility rules: beginning in 2010, individuals will be able to convert a Traditional IRA to a Roth IRA regardless of income or filing status. The new law also allows taxpayers who make the conversion in 2010 to spread the tax liability over two years (in 2011 and 2012).

A Roth IRA conversion strategy can be an especially beneficial consideration for retirees whose income, and thus income tax bracket, may be lower due to retirement. A Roth IRA conversion strategy is essentially a plan designed to convert pieces of a Traditional IRA to a Roth IRA over a number of years. Benefits of such a strategy include lower required minimum distributions (RMDs) on the Traditional IRA at age 70-1/2, the potential for greater tax-free income through dollars accumulating in the Roth IRA, and no required minimum distributions (RMDs) on dollars in the Roth IRA, a significant feature of the Roth plans. Of greatest interest to most retirees, however, is the potential of paying lower taxes overall as a result of the roth conversion strategy. While taxes may begin earlier as a result of the Traditional IRA pieces being converted, lower required minimum distributions may help the retiree avoid bumping up into higher tax brackets as a result of the annually increasing rate of withdrawals required under the Uniform Lifetime Table. Roth IRA conversion strategies can, and should, be re-evaluated annually to verify their tax implications and benefits.\*

\*When considering a Roth IRA conversion, it's important to also consider that distributions from Traditional IRAs are taxed as ordinary income and may be subject to an additional 10% federal income tax penalty if taken prior to reaching age 59-1/2. To qualify for the tax-free and penalty-free withdrawal of earnings, a Roth IRA must be in place for at least five tax years, and the distribution must take place after age 59-1/2 or be due to death, disability, or a first-time home purchase (up to a \$10,000 lifetime maximum).