

Is the New Roth IRA Right for You?

The Taxpayer Relief Act of 1997 has made retirement planning less onerous from a tax perspective. The Act repeals the 15% excise tax on excess distributions and accumulations. It also removes the 10% penalty for early withdrawals for higher education and, to a limited extent, for first-time home purchases. The Act may offer the greatest planning opportunity, however, in its creation of the Roth individual retirement account (IRA).

Although contributions are not deductible, a Roth IRA can be a better retirement planning tool than a regular IRA for several reasons:

- Qualified distributions are not subject to income tax or the 10% early withdrawal penalty. They are qualified if:
 - The account has been open for more than five years, and
 - Distributions are made after age 59^{1/2} or as a result of long-term unemployment, disability or death, or are used to buy a first home.

- Although nonqualified distributions coming from earnings in the IRA are taxed, distributions are treated as coming first from contributions, which are not taxable.
- No minimum distribution rules apply.
- Post-age-70^{1/2} contributions are allowed.

Establishing a Roth IRA

You can establish a Roth IRA by making a nondeductible contribution of up to \$2,000 per year, reduced by your contributions to all other IRAs held for your benefit. Otherwise allowable Roth IRA contributions phase out for individuals with adjusted gross income (AGI) between \$95,000 and \$110,000 and married couples filing jointly with AGI between \$150,000 and \$160,000.

Another option is to make a rollover of funds from a regular IRA. Rollovers can occur under the standard 60-day rollover rule. The amount rolled over will be subject to current income tax (spread over four years if done before 1999), but there will be no 10% early

withdrawal penalty. Rollovers cannot be made during a year your AGI exceeds \$100,000 (not including the amount rolled over).

This sounds good, but should you make a rollover to a Roth IRA and pay tax now? Consider the following example.

Case Study

John has a regular IRA and is considering rolling \$10,000 into a Roth IRA in 1998. He expects his AGI for 1998 to be \$80,000 and has \$2,800 in a taxable account that he can use to pay the tax resulting from the rollover. Assuming that John is now in and will remain in the 28% tax bracket, that the IRA will grow at 10% annually, and that the taxable account will grow at 7.2% after taxes, here is what John will have in 20 years if he:

Leaves \$10,000 in the regular IRA:

IRA (\$67,275, less 28% tax)	\$48,438
Taxable account balance	\$11,247
Total funds	\$59,685

Rolls \$10,000 into a Roth IRA:

IRA (paid out tax-free)	\$67,275
Taxable account balance	\$ 1,083
(\$2,800, less taxes of \$700 per year for four years, plus growth)	
Total funds	\$68,358

Should You Make a Rollover?

You may want to if:

- Your regular IRA has been open for a relatively short period of time and consists largely of nondeductible contributions.
- You do not expect to need to make withdrawals from the IRA to live on when you retire, and instead would prefer to let the amounts in the IRA build up tax-free after retirement.
- Even if you will need the distributions from the IRA when you retire, you still have a long time until retirement.
- You will be in at least as high a tax bracket when you need to take distributions from an IRA as you are in now.

You may NOT want to if:

- Your withdrawals may not be qualified distributions.
- You have a relatively short time until retirement and expect to make withdrawals from the IRA when you retire even though you will be under age 70¹/₂ at that time.
- You expect to be in a lower tax bracket when withdrawals begin than when rollover will be taxed.

Weigh Your Options

For John, the Roth IRA will be better. However, each situation is different and must be analyzed based on your circumstances. We would be pleased to assist you in determining if the Roth IRA is right for you, or to discuss other retirement planning opportunities created by the new tax law.