2006 Tax Legislation - Roth IRA Conversion Income Limit Repealed

Congress recently passed the Tax Increase Prevention and Reconciliation Act (Tax Reconciliation Act), which includes a provision to eliminate the income limit on conversions from a traditional IRA to a Roth IRA. In the past, in order to convert a traditional IRA to a Roth IRA, you could not have more than $100,000 of adjusted gross income in the year in which the conversion was to take place. This provision was applicable to both individual filers and married couples filing jointly. Under the new law, the income limitation has been repealed. Keep in mind, however, that this provision will be effective for tax years beginning after December 31, 2009.

A Roth IRA may be an appropriate vehicle for your retirement planning. The chief benefit of a Roth IRA is that, even though the IRA is funded with after-tax contributions, the earnings accumulate tax free over time and qualified distributions may be taken tax free. This is in contrast to a traditional IRA, which has the benefit of funding with pre-tax contributions and tax-free accumulation of earnings, but qualified distributions are subject to regular income tax rates at the time a distribution is made.

In the event you decide to convert your traditional IRA to a Roth IRA, the converted value of the IRA will be included in your gross income, subject to tax. However, for conversions occurring in 2010, unless you elect otherwise, the amount includible in gross income as a result of the conversion will be included ratably in 2011 and 2012. Note that if the converted amounts are distributed before 2012, the amount of the inclusion will be accelerated. In such a case, the amount included in your income in the year of the distribution will be increased by the amount distributed, and the amount included in income in 2012 (or 2011 and 2012 in the case of a distribution in 2010) is the lesser of 1) half of the amount includible in income as a result of the conversion; and 2) the remaining portion of such amount not already included in income.

If you have any questions about how this development applies to you, or about any other aspects of the recent legislation, please contact our office at your convenience.