

# Roth IRA

Making the Most of the Roth IRA Opportunity

- Roth IRAs offer tax-free investment growth and retirement distributions
- Recent legislation will make Roth IRA conversions available to all taxpayers starting in 2010—regardless of income level
- If you'd like to lower your taxable income during retirement, you may want to consider getting ready to convert

# Roth IRAs: Expanded Appeal

Legislative changes will make the advantages of Roth IRA conversions widely available starting in 2010.

## Big Changes Coming, Courtesy of TIPRA

Starting in 2010, TIPRA (the Tax Increase Prevention and Reconciliation Act) will open the benefits of Roth IRAs to all taxpayers—regardless of income level—by removing the limits on who can convert Traditional IRA assets to a Roth IRA.

But until TIPRA changes things, not everyone is eligible to use Roth IRAs. If your adjusted gross income is too high, the Roth IRA is off limits. In 2010, TIPRA will make Roth IRA conversions open to anyone—regardless of income.

For investors with sizable assets and higher incomes, converting their Traditional IRA balances to a Roth IRA could create a significant tax advantage—and including Roth IRAs in a retirement savings strategy along with Traditional IRAs and non-IRA savings can help reduce the impact of future changes to the tax code.

We'll discuss how you can get ready to take advantage of what Roth IRAs have to offer, but first let's review how Roth IRAs work.

## No Taxes on Investment Growth— or Withdrawals

Roth IRAs allow you to invest your after-tax income, as long as you don't make more than the Internal Revenue Service (IRS) limits. Once you put money in a Roth IRA, you won't face mandatory withdrawals as with a Traditional tax-deferred IRA and you won't pay taxes on it again, even when you withdraw it. Of course, there are a few criteria to satisfy for withdrawals to be qualified. Investors must have held the account for at least five years and meet one of the following conditions: age 59½, first-time home buyer, disability or death.

## How Roth IRA Conversions Work

	Today	In 2010
<b>What you can convert</b>	You can convert assets from a Traditional IRA account to a Roth IRA account.	
<b>Income restrictions on converting</b>	You can't convert if your modified adjusted gross income is more than \$100,000 (for both single and joint filers).	No more income restrictions. Anyone will be able to convert—regardless of income level.
<b>Taxes on conversions</b>	If you've already taken a tax deduction on your Traditional IRA contributions, you'll need to pay taxes on the assets you convert.	The same rule applies, but if you convert in 2010, you'll be able to pay the taxes over the two years following your conversion. If you convert after 2010, you'll have to pay taxes in the year you convert.

# Is a Roth IRA a Good Idea for You?

Thanks to TIPRA, Roth IRAs will become an option for higher-income taxpayers who aren't eligible today.

Here's a brief summary of how the landscape will change in 2010:

- TIPRA will eliminate the income limit that determines whether you're eligible to convert your Traditional IRA balance to a Roth IRA. Essentially, anyone will be able to convert to a Roth IRA—regardless of their income level.
- The amount you convert to a Roth IRA will still be subject to taxes, but if you convert in 2010, you'll be able to pay your taxes on the conversion over the following two tax years.<sup>1</sup>
- If you convert from a Traditional IRA where you received a tax deduction or from a rollover IRA funded with money from a 401(k), you'll have to pay tax on the full conversion amount. If you convert from a nondeductible or partially deductible IRA, only the earnings and deductible contributions will be taxable, not your contributions that were nondeductible.

## Some Ways a Roth IRA Can Help You

You should look at the overall impact of converting to a Roth IRA very carefully. Everyone's tax situation is different, but Roth benefits are real and worth considering. Here are a few situations when converting to a Roth IRA might make sense for you:

**You want to shelter more of your assets from taxation.** By converting to a Roth IRA and paying the conversion tax from your other personal assets, you can shift more of your assets into tax-favored status. Let's say you're planning to fund a Roth IRA with \$2 million from a Traditional IRA. You'll owe a substantial tax

bill, but if you pay it from a taxable account instead of taking it from your IRA, the full \$2 million you convert can grow tax-free in the Roth IRA. If you pay the taxes from your Traditional IRA, you'll owe the IRS a 10% penalty on the distribution if you're under 59½ and don't have an exception, plus ordinary income tax.

**You made too much to participate in a Roth IRA before the TIPRA changes.** Many high-income taxpayers are currently ineligible to contribute to Roth IRAs, but starting in 2010, the TIPRA legislation will give many taxpayers access to the unique benefits of Roth IRAs—regardless of their income levels. This is a good time to think about whether Roth IRAs make sense for your retirement investments.

**You're a "tax pessimist."** Due to the growing cost of Social Security and Medicare for Baby Boomers, many taxpayers believe tax rates will only increase in the future. Converting to a Roth IRA would allow you to pay taxes now instead of later—your withdrawals in retirement will be exempt from taxes even if future tax rates are higher than today's.

**You want to leave some of your wealth behind for your children.** Traditional IRAs require that you withdraw a minimum amount once you reach 70½ and pay taxes on it, even if you don't need the money. Roth IRAs don't: if you don't need them, your savings stay invested, tax-free and available to pass on to your children, although your beneficiaries must take minimum distributions after your death.

<sup>1</sup>**An Added Benefit:** Defer Your 2010 Conversion Tax Payments: Starting in 2010, anyone—regardless of income level—will be able to convert to a Roth. And if you convert in 2010, you'll be able to make your tax payments pro rata in tax years 2011 and 2012—this means that you won't have to write the check until calendar years 2012 and 2013! Most likely, a portion of the tax due on this amount must be prepaid under estimated-tax payment rules. Be sure to consult your tax advisor.

# Important Tax Information About Conversions

## Conversion Taxes

When you convert your Traditional IRA to a Roth IRA, you'll have to pay taxes on the amount you convert, but you can convert part of your Traditional IRA, or even make multiple conversions spread out over time. By doing so, you might avoid liquidating your other investments—and possibly realizing taxable gains—to pay the conversion tax.

Partial conversions might also keep you from “creeping” upward into a higher tax bracket for some or all of your conversion taxes.

Even though you'll have to pay taxes on your Roth IRA conversion—maybe even at a higher tax rate—it may provide you and your family with meaningful long-term benefits.

You should also note that if you convert to a Roth IRA and withdraw from it before you reach age 59½ and before you've held it for five years, a 10% IRS penalty will apply. There are some exceptions, such as for first-time home buyers, disability or death.

## What Future Tax Laws May Hold

Taxes will always be around, and it's a safe bet that the government will always be tweaking the rules, and it's hard to predict what changes they'll make.

For example, Congress might decide to eliminate the Roth IRA, the Roth IRA conversion or the conversion for high-income taxpayers. It could reduce the tax rate on Traditional IRA withdrawals or reduce the taxation of earnings from dividends, capital gains or interest payments.

Although the government often gives relief to those who invested under the old rules with “grandfather” clauses, tax laws are fluid, so it's important to diversify the tax exposure of your retirement investments the same way you diversify your investments. A balance of Traditional IRAs, Roth IRAs and non-IRA savings can help reduce the impact of future tax-code changes.

## Things to Consider with Roth IRA Conversion Taxes

- You don't have to convert your entire Traditional IRA to a Roth IRA
- Partial conversions might help you avoid liquidating other investments to pay the tax
- Partial conversions may keep you from “creeping” into a higher tax bracket

# Getting Ready for the Roth IRA Opportunity

Roth IRAs offer important benefits, and more taxpayers than ever before will be eligible for them starting in 2010.

**Does Roth conversion work for you?** Your financial advisor in conjunction with your tax advisor can perform a simple analysis to determine if a Roth conversion makes sense for you. If it does, get ready to make the most of the opportunity, even if it hasn't arrived yet.

**Max out your IRA contributions.** You can't convert funds that aren't in a Traditional IRA, so it might make sense to maximize your contributions before the rules change (see listing at bottom of page).

Even if you can't claim a tax deduction for your contribution, funding your IRA may still make sense. When you convert a nondeductible IRA, you only pay taxes on your IRA earnings, not contributions—but the entire amount transfers.

## Maximum Contributions

	Age 49 and Under	Age 50 and Over
<b>2007</b>	\$4,000	\$5,000
<b>2008</b>	\$5,000	\$6,000
<b>2009*</b>	\$5,000	\$6,000
<b>Total</b>	\$14,000	\$17,000

\*This will be indexed for inflation.

**Get a handle on your IRA retirement savings.** Your IRA retirement savings may be scattered in more than one IRA. Consolidating them can make your retirement investments more efficient, but here's one more reason to consolidate—it can make it easier to decide if a Roth IRA conversion makes sense for you.

By consolidating your IRA retirement investments, you may find it easier to calculate the conversion taxes you'll owe. With this information, you can easily determine if you have enough money in your non-retirement accounts to pay the conversion tax, avoiding paying the taxes from your retirement assets.

If converting makes sense for you, consolidating will let you take full advantage of the conversion opportunity in 2010.

**Pay your conversion tax from your non-IRA assets.** This way, you won't reduce the funds you'll have at work in your Roth IRA later on: you'll keep more of your IRA money working for you. But pay careful attention to the taxes you'll face when you liquidate non-IRA investments, and the 10% penalty if you pay taxes from your IRA.

As with any important tax or investment decision, consult a financial professional who will consider your specific tax circumstances.

This is not, and you should not consider it to be, legal or tax advice. The tax rules are complicated and their impact on a particular individual may differ depending on the individual's specific circumstances. Please consult with your legal or tax advisor regarding your specific situation.

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