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Dear Clients and Friends:

I'm writing to fill you in on the rules for Roth IRAs, in case you are interested in setting one up.
While no deduction is available for contributions made to a Roth IRA, you may be entitled to a credit (saver's credit) against tax for your contribution. Earnings on the contributed amounts build up tax-free, and it's fairly easy to qualify for tax-free distributions for retirement. Here's how the Roth IRA works:

Contributions. For 2013, you can contribute up to $5,500 to a Roth IRA (as long as you have compensation for the year at least equal to the contributed amount). The $5,500 limit will be increased when the cost-of-living index warrants it. Individuals age 50 or older can make additional contributions of $1,000. Thus, the limit is $6,500 a year for people who will be age 50 (or older) before the end of 2013.

However, the maximum contribution allowance must be reduced by any contributions (deductible or nondeductible) you make to "traditional" IRAs.

There are some limits on Roth IRA contributions. For single taxpayers, if adjusted gross income (AGI) is $127,000 or more, no regular contribution can be made to a Roth IRA. If AGI is between $112,000 and $127,000, the $5,500 maximum contribution is phased out (reduced) according to a formula. For married taxpayers filing jointly, no contribution can be made if AGI is $188,000 or more, and the $5,500 maximum (per spouse) is phased out for AGIs between $178,000 and $188,000. For married taxpayers filing separately, the allowable contribution is phased out for AGIs between $0 and $10,000.

You may be allowed a credit against your income tax equal to a percentage of your Roth IRA contribution if your AGI doesn't exceed certain levels (which are much lower than the phase-out AGI levels above).

Contributions can be made to Roth IRAs even if you are a participant in a qualified plan and even if you reach age 70 $^1/_2$.

Distributions. "Qualified" distributions from a Roth IRA are tax-free. Thus, you can avoid tax on Roth IRA earnings forever (i.e., even at distribution). A distribution is qualified if made: once you reach age 59 $^1/_2$, upon death or disability, or (up to $10,000 per lifetime) for first-time homebuyer expenses. However, a distribution is not qualified if made within the five-year period beginning with the first tax year you made a contribution to a Roth IRA.

A nonqualified distribution is treated first as a nontaxable return of contributions. To the extent a nonqualified distribution exceeds contributions it is taxable and is also subject to a 10% penalty under the regular early withdrawal rules (i.e., the penalty will not apply if the distribution is made once you reach age 59 $^1/_2$, or upon death or disability, or in other limited circumstances).

Qualified rollover contributions. You may be able to roll funds over from a regular IRA into a Roth IRA so the post-rollover income can grow tax-free in the Roth IRA. (Converting a regular IRA into a Roth IRA is treated as such a rollover.) You can roll funds over from a regular IRA to a Roth IRA regardless of your AGI (unlike in years before 2010). Any funds rolled over to a Roth IRA will be taxed under the regular IRA distribution rules (as if there were only a distribution and no rollover). The 10%

early withdrawal penalty will not apply to the rollover. However, if rolled over funds are withdrawn within the five year period that renders them taxable, the 10% penalty will apply to the withdrawal.

Ordering rules apply if a Roth IRA contains conversion amounts (possibly from different years) as well as other contributions. The regular Roth IRA contributions are treated as withdrawn first and then converted amounts, starting with amounts first converted. Withdrawals of converted amounts will be treated as coming first from amounts already included in income. Earnings are treated as withdrawn after contributions. For these purposes, all Roth IRAs will be treated as a single Roth IRA.

In-plan Roth rollovers. For an applicable retirement plan, such as a 401(k) plan, that maintains a qualified Roth contribution program, a distribution to an individual from the portion of the plan that is not a designated Roth account may be rolled over in a qualified rollover contribution to the designated Roth account maintained under the plan for the benefit of the individual to whom the distribution was made. However, the rollover is not tax-free. Thus, an "in-plan Roth rollover" is a taxable distribution from an individual's plan account, other than a designated Roth account, that is rolled over to his designated Roth account in the same plan. Also, an applicable retirement plan that includes a qualified Roth contribution program may allow an individual to elect to have the plan transfer any amount not otherwise distributable under the plan to a designated Roth account maintained for the individual's benefit. The transfer is treated as an in-plan Roth rollover, which was contributed in a qualified rollover contribution to the designated Roth account. The tax-free treatment of rollovers that ordinarily applies does not apply to in-plan Roth rollovers. Instead, the amount that an individual receives in a distribution from an applicable retirement plan that would be includible in gross income if it were not part of a qualified rollover distribution must be included in his gross income.

Certain elements of the Roth IRA can be complicated. Nonetheless, many taxpayers can benefit significantly from Roth IRAs. Please do not hesitate to contact Cinda Brown, the sales and marketing director at the firm, 512-327-0909, extension 212 to schedule an appointment with a CPA to discuss tax planning strategies for your circumstances.

Sincerely yours,

Thomas Mangold

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