The power of Roth

Roth IRAs offer great benefits, even for those who think they don't qualify

Since Roth IRAs were first introduced in 1998, investors have been taking advantage of their many benefits: tax-free withdrawals; no age limits for contributions as long as you're earning income; and no required minimum distributions, which means account holders have added flexibility when it comes to bequeathing tax-free money to heirs. Perhaps even better, your money can compound for years and you won't have to pay taxes on the gains because these accounts are funded with after-tax dollars.

Just about anyone can contribute to a Roth or convert a traditional IRA into a Roth as long as they follow the rules. However, those who earn more than the modified adjusted gross income (MAGI) thresholds of $184,000 for couples filing jointly and $117,000 for individuals will be phased out from making direct contributions. But that doesn't necessarily mean you can't take advantage of the powerful benefits of a Roth.

Paths to Roth

High-income earners can tap into Roth benefits a few different ways. Here's how:

Standard conversion. First, you can always convert an existing IRA to a Roth. Just remember that you'll have to pay taxes on all monies that were contributed to the IRA on a pretax basis plus any gains.

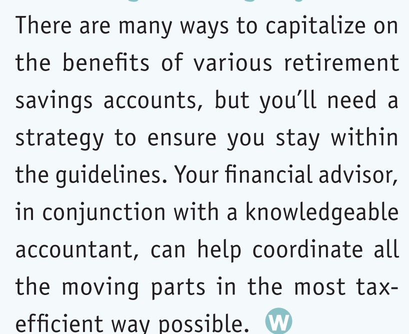
A different kind of Roth. If your company offers a Roth 401(k) option, it may be simplest to forgo the IRA strategy above and instead maximize your contribution (up to $18,000 for 2016) to that account, assuming you're satisfied with the investment choices offered. Like Roth IRAs, Roth 401(k)s are funded with after-tax dollars, offer many of the same benefits, and can be used as a source of tax-free income in retirement.

A nondeductible contribution strategy

1. Open a traditional IRA with a nondeductible contribution (up to the $5,500 annual limit for those 50 and under; $6,500 for those older in 2016). If your MAGI is higher than the Roth limits and you participate in an employer-sponsored qualified plan, you can't deduct the contribution.
2. Convert that traditional IRA into a Roth. The IRS removed MAGI limits on conversions back in 2010, but you must properly transfer the money within 60 days.
3. You can follow the same process each year that you earn too much to make a direct Roth IRA contribution.

From a tax perspective, this strategy works best if you have just the one IRA. If you have one or more existing IRAs, the IRS applies a complicated prorated tax formula to the total assets in those accounts to determine how much of the conversion is considered pre- or post-tax dollars. Be sure to talk to your tax and financial advisors before committing to this type of conversion.

Another option to help avoid additional taxes is to roll over pretax IRA balances into your traditional employer-sponsored qualified plan, if allowable. Do so before starting the conversion process; then complete steps 1-3.



Guidance goes a long way

There are many ways to capitalize on the benefits of various retirement savings accounts, but you'll need a strategy to ensure you stay within the guidelines. Your financial advisor, in conjunction with a knowledgeable accountant, can help coordinate all the moving parts in the most tax-efficient way possible. W

For 2016, those making more than $194,000 for couples filing jointly and $132,000 for individuals cannot make direct Roth contributions at all.

After the rule change in 2010, the amount converted to Roth IRAs rose more than 800%, to $64.8 billion, according to the IRS.

Unless certain criteria are met, Roth account owners must be 59½ or older and have held the account for five years before tax-free withdrawals are permitted. Additionally, each converted amount is subject to its own five-year holding period. Sources: investopedia.com; forbes.com

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