2010 Is the Year of the "Roth IRA" *by Steve Waas*

In the Fall edition of the Pension Press, Steve Waas, HMEPS' Financial Counselor, discussed Tax Season Dangers. Steve, who is a Certified Financial Planner, is available for individual meetings with participants, and also will be discussing financial topics in our newsletters to help participants better understand these important issues. This time the topic is "Roth IRA's".

Steve Waas
Financial Counselor

Because of an important change in the tax law taking effect in 2010, you will probably be hearing more and more about Roth IRAs. But before addressing exactly what this change is, I'd like to focus on one group of people that should learn about Roth IRAs regardless of this change: younger people.

If you are young and at a relatively early stage in your career, you simply must consider Roth IRAs as a savings vehicle.

Tax rates in the US are at historically low levels. Government deficits are growing rapidly. Also, a young, ambitious worker will – over the course of a full career – see raises and promotions. The conclusion is unavoidable: today's younger workers could face much higher tax rates when they are older than they currently experience.

What can you do about this? One thing that might help some young people (if certain requirements are satisfied) is to save money through a Roth IRA. When you do this, you effectively pay the tax now, at your current tax rate. And then when you tap into these funds in retirement, no taxes will be due - regardless of how much the account has grown. As far as funds in your Roth IRA are concerned, the higher tax rates you face in the future won't matter.

There are a variety of things you should consider when deciding whether or not to save this way. Also, it isn't available to everyone. Nevertheless, every young worker should give it serious thought.

Now, what happens in 2010?

Beginning in 2010 most people will be able to convert existing IRA funds into a Roth IRA. Prior to 2010 there were limits on who can do this, but these limits disappear in 2010. Generally this will be more relevant to older workers who have accumulated significant tax deferred savings. It is a potentially powerful, but quite complex, tool to manage your risk of higher taxes.

In a "Roth conversion," you pay taxes now on all the funds you convert. That's the bad news. The good news is that those funds are never taxed again, and no "required minimum distributions" apply at age 70 ½.

How do you balance the pros and cons of such a transaction? It's a task that requires careful analysis. Generally it should be considered for funds you don't anticipate needing for many years – or funds you anticipate passing on to the next generation. But even in these scenarios a number of factors must be analyzed. Ultimately, you would need to consult with a qualified tax or financial advisor to sort through all the implications.

However, if you'd like to have a preliminary discussion on the Roth and how it works, remember that free financial counseling is available at the pension office.

Financial counseling is available at the HMEPS office. Call 713-595-0100 to make an appointment. You can also email Steve Waas at swaas@hmeps.org to set up an appointment.

Why Do My Pension Cost of Living Adjustment (COLA) and Social Security COLA Differ?

Q. Why are my pension COLAs (Cost of Living Adjustment) and social security COLAs different?

A. All COLA's are certainly not the same. The HMEPS pension COLA is fairly simple. For Group A & B participants who were employed on or before 12/31/2004, pension checks grow at an uncompounded 3% annual rate. For those hired or rehired on or after 1/1/05, the rate is 2%. These rates are fixed regardless of what the actual inflation rate is in the economy as a whole.

The social security COLA, on the other hand, is directly determined by the actual inflation rate, as measured by the Consumer Price Index (CPI). So in 2009 the COLA was a hefty 5.8%, reflecting the steep price increases we saw in 2008 in energy and other goods. However, as recession gripped the nation, many of these prices have since plummeted. Fortunately, the law does not allow the Social Security COLA to be negative, so the 2010 COLA will be 0%. But because prices have to make up those declines before they begin to nudge the Social Security COLA higher, it is highly likely that the COLA will be 0% again in 2011.