

Roth IRA Conversions: Is it right for you?

On January 1, 2010, the rules for Roth IRAs changed. Thanks to the Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA"), higher income individuals with an adjusted gross income (AGI) of more than \$100,000 are eligible to convert to Roth IRAs for the first time. In 2010, and for all subsequent tax years, AGI limits go away and **all taxpayers will be permitted to convert their retirement assets to a Roth IRA.**

ROTH CONVERSION CONSIDERATIONS:

1. The current market provides a low-cost conversion opportunity

Retirement accounts generally grow tax deferred, and investors will eventually have to pay taxes on the value of those retirement accounts. Investors who have accounts that decreased based on market conditions might choose to recognize the income-tax liability now. For example, an IRA worth \$100,000 in 2008 may now be worth \$60,000. By converting the \$60,000 retirement account to a Roth IRA, the taxpayer is locking in his tax liability at the lower amount. Should the \$60,000 Roth IRA eventually recover its losses and grow back to \$100,000, the taxpayer will have avoided paying taxes on the \$40,000 difference.

Example of Roth conversion

IF THE ACCOUNT GOES UP

January 2010	October 2011
\$60,000 account value	\$100,000 account value

**Keep the Roth,
no additional taxes due**

What if the Roth IRA continues to lose value after the conversion?

A retirement account converted to a Roth IRA can be recharacterized back into a traditional IRA with no tax consequences. A recharacterization resets the account as if the conversion never took place, and can be done up to the tax filing deadline, plus extensions. For example, if an investor converts her traditional IRA to a Roth IRA in January 2010, she will have until October 15, 2011 to decide whether to keep the IRA as a Roth. That's 21½ months! So if the account goes up, she converted at a good time. If the account value goes down, she can undo the Roth conversion.

Example of Roth conversion

IF THE ACCOUNT GOES DOWN

January 2010	October 2011
\$100,000 account value	\$60,000 account value

**Recharacterize the Roth, no taxes due and
reconvert to a Roth at the \$60,000 sum***

* A waiting period of at least 30 days applies before reconverting.

2. Tax-free stretch

One of the more compelling reasons to convert retirement assets to a Roth IRA is that the beneficiaries of the IRA can stretch the account tax-free over their lifetime. Similar to traditional IRAs, the beneficiary of the Roth IRA can stretch the IRA by taking only the required minimum distribution (RMD) each year over his or her life expectancy. However, unlike the traditional IRA, the Roth IRA permits the undistributed amount to continue to be invested and grow tax-free, as opposed to merely tax-deferred, over the beneficiary's lifetime.

For example, assume a 70-year old with a \$100,000 IRA would like to leave as much as possible to his 40-year-old daughter at death. Assuming he did not need the money for his own retirement needs and took only his required minimum distribution at age 70½, died at age 86, the account grew at 6% and the daughter stretched the traditional IRA, she would have received a total of \$734,994 of after-tax distributions over her lifetime.

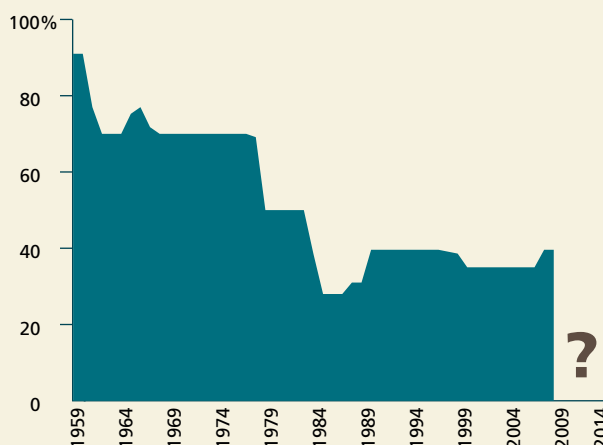
However, had the Traditional IRA been converted to a Roth IRA prior to the father's death, the daughter would have received a total of \$1,072,383 of distributions, or 46% more, over her lifetime.¹ Tax-free lifetime investing can be powerful, indeed!

3. Hedge against increasing income-tax rates

For decades, the United States had a top marginal tax rate as high as 50%, 70% and 90%. As a matter of fact, for the past 50 years there have only been five years (1988 to 1992) where the top marginal tax rate was less than the current 35% rate. Considering the current

budget deficits and the costs of the bailouts and stimulus, many believe that income-tax rate increases are inevitable. If you share that belief, then you may wish to convert to a Roth IRA now and take advantage of today's historically low income-tax rates, rather than wait until the income-tax rates are higher and the value of the retirement account may be increased.

Top marginal tax rates for the past 50 years



Source: Pension Protection Act of 2006.

ROTH CONVERSION DISCUSSION POINTS

Whether you should convert to a Roth IRA and if so, how much you should convert are important decisions to make. Factors to consider include investment timeline; available assets to pay the resulting income taxes; current income-tax bracket; anticipated income-tax bracket in retirement; and whether income tax rates might be lower or higher in the future. Whether a Roth conversion makes sense will depend on some of these factors and each individual's specific financial and estate planning goals and objectives. Investors should discuss these factors with their financial advisers to decide if a Roth IRA conversion is right for them.

For information on how to convert to a Roth IRA, contact your financial adviser or John Hancock Funds at 1-800-225-5291.

¹ The daughter's distributions will be deemed to start at age 58 and continue until age 88, which is the number of years equal to the single life expectancy of the IRA holder as determined in the Single Life Expectancy Table. Upon being removed from the IRA, the after-tax value of the RMDs are deemed deposited into a taxable investment vehicle that earns the same rate of return as the Traditional IRA. The conversion tax is paid from assets outside of the IRA and an equal amount will be added to Traditional IRA projections as a "balancing account". The rate of return used to calculate projections is hypothetical and selected by the person entering the data. It does not represent the performance of any specific security and there is no guarantee that the selected rate of return can be achieved. Rates of return will vary over time, particularly for long-term investments.



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