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# Is the Roth IRA Conversion for Me?

You have heard about the Roth conversion law for 2010. It's in the news and everyone is talking about it. Beginning in January 2010, anyone can convert a traditional IRA (qualified retirement plan) to a Roth IRA without any income limitations. Under the new law, you can also elect to defer paying the tax on the conversion until 2011 and 2012. Prior to 2010, an individual could only convert an IRA to a Roth IRA if his or her modified adjusted gross (MAGI) was below $100,000.

In March of this year, we wrote an initial Roth conversion article called "To Roth or Not To Roth." In that article, we asked you to consider whether a Roth conversion would be right for you. Now, 2010 is almost here and we want to ask you again, "Is the Roth IRA conversion for you?" Will you be better off after converting your IRA to a Roth or would you be better off staying where you are? The answer to the question is "It depends." There are some key factors that you must consider before making a decision to convert or not convert.

**Advantages and Disadvantage**

The potential advantages to the conversion:
- The principal (converted amount) of the converted Roth can be withdrawn tax-free at any time. Generally, withdrawal of the growth is tax-free without penalty after age 59½.
- There are no required minimum distributions during your lifetime.
- Withdrawals by your beneficiaries are generally income tax free.
- You can make penalty-free early withdrawals for qualified expenses such as disability or a first home.

The major disadvantage of the conversion is that the taxable amount of the traditional IRA you convert (deductible contributions plus earnings) is fully taxable as current income at your current tax rate. Most individuals who convert will need time to recoup from the upfront tax hit that comes with the conversion.

**Reasons to Convert and Reasons Not to Convert**

Reasons to convert
- I will have a higher tax rate in retirement than I have now.
- I cannot predict the tax rates but I have more than 10 years to retirement and tax rates are likely to increase.
- I have sufficient assets to live on and plan to leave the Roth conversion account to my heirs.
- I have sufficient funds outside of my IRA to pay the taxes on the conversion.

Reasons not to convert
- I am leaving my estate or IRA accounts to charities.
- I have children who will be going to college in 2011 or 2012 and I will be applying for federal financial aid in the near future.
- I will experience a significant tax event that will increase my income
- I have Net Unrealized Appreciation (NUA) from employer stock in my 401(k) account that I was going to convert to a taxable account.
- I do not have funds outside of my IRA to pay taxes.
- I will begin withdrawals from the Roth IRA within the next 2-3 years.
- I would elect to defer the taxes on the conversion but I believe or know that my tax bracket will increase in 2011 or 2012.

**Some Examples**

Example One
You are a 65-year-old retiree. You have a daughter who is 40 years old. You have an IRA worth $100,000 invested at 6%. Your daughter is the beneficiary of the IRA. You have other assets to support your retirement and you will most likely not need the $100,000 in this IRA for your retirement. You are in the 25% effective federal and state tax bracket. You pay the taxes (approximately $25,000) on the conversion from funds in your taxable account so the value of the Roth IRA is $100,000 after conversion. You pass away at age 90. Your daughter, now 65, will inherit a Roth IRA valued at $429,187. She will be able to take tax-free distributions from the IRA for the rest of her life. If you had not done the conversion, your daughter would have inherited a $429,187 traditional IRA and a taxable account of $107,297 (the $25,000 you paid in taxes that would have grown at 6% to 107,297). Based on a complete distribution of the traditional IRA at your death and a federal plus state tax rate of 40%, your daughter would pay $171,718 in taxes on the traditional IRA. In this example, the Roth IRA conversion saves $64,422.

Example Two
You are an 85-year-old retiree with children and grandchildren. You have an estate worth approximately $4,500,000. As part of your estate, you have a traditional IRA value at $700,000 invested at 6%. You have other assets to support your retirement and you will most likely not need the $700,000 in this IRA for your retirement. You are in the 30% effective federal and state tax bracket. You pay the taxes (approximately $210,000) on the conversion from funds in your taxable account so the value of the Roth IRA is $700,000 after conversion. In addition to providing a tax-free source of income to your heirs, you have reduced your taxable estate by $210,000 (the taxes you paid). If the federal death taxes are 40% and the state death taxes are 16%, you have saved your family from having to pay a 56% tax on at least $210,000 (the tax on the converted IRA).

Example Three
You are 35 years old, married with two children. You and your wife work and you make sufficient income to support your lifestyle. You have a federal and state combined tax bracket of 28.8%. You have a traditional IRA valued at $25,000 invested at 8%. You also have sufficient funds in a savings account to pay the taxes on the conversion (approximately $7,200). If you make the conversion now, the value of the Roth IRA at age 70 will be $369,634. You will be able to withdraw funds from the account tax-free for your retirement. If you do not convert the IRA, the traditional IRA will be valued at $369,634 but you will be required to take minimum distributions from the account whether you need them or not and you will be required to pay taxes on the distributions at a tax rate that is currently unknown.

It is nice to work with examples. By setting up examples, we can see the potential benefits and problems in a specific situation. You should not use the above examples as a basis for making a conversion. These examples and this article should be a framework for you to begin discussions with your financial advisors (planners and tax advisors).

In summary, we would like to add a note of caution. The tax rules for Roth IRAs must stay as they are now for these strategies to work. There are additional nuances within the law that may affect you and your decision. Do not make this decision by yourself. Discuss it with your professional advisors before you commit to making the conversion.