

## Converting a Traditional IRA to a Roth IRA

Have you seen an article about converting your IRA to a Roth IRA? Many financial companies are running ads encouraging people to “convert”, hoping to cash in on the big “opportunity”.

The reason it has become the topic du jour is because of several changes to the rules that occurred this year. First is the elimination of the income limitations to qualify for a conversion. Previously, if your modified adjusted gross income was greater than \$100,000 you could not convert; but this was eliminated for 2010. Do keep in mind that there are still income limitations in place for new Roth contributions. In 2010 only, you have the ability to choose whether to pay all the tax on the conversion in 2010 or spread the conversion income in 2011 and 2012. The caveat to remember with this option is that there are several tax breaks that are set to expire at the end of 2010 which will likely increase the tax you will pay thereafter. Another change is the ability to do a conversion for those who file their return as married filing separately. Lastly, non-spouse beneficiaries are now allowed to rollover benefits from a qualified plan to an inherited traditional or Roth IRA. Once an account is considered an inherited traditional IRA it cannot be converted to a Roth.

But before we all rush to pay some taxes now in order to avoid them later, let's consider for whom it really makes sense.

***So who should take advantage of the new rules and convert?*** Following are a few circumstances where conversion might make sense:

1. If you believe that your future tax rate will be the same or higher than it is now, you may want to go ahead and pay the tax now and allow the account to grow tax free from this point forward. Of course you need to have the liquidity to pay the tax now with funds that are not part of the conversion.
2. If you don't think you will need your IRA assets to fund your retirement. With a Roth there is no Required Minimum Distribution (RMD) requirement. Thus your assets can grow tax-free in the Roth versus tax-deferred, as in the traditional IRA.
3. If you have higher deductions or reduced income in 2010.
4. People in low tax brackets who will leave their IRA to heirs who are in higher tax brackets.

### ***Who should probably not convert?***

1. Those who do not have the ability to pay the taxes with funds outside the Roth.
2. If you believe that your future income tax rates will be the same or lower than they are now. The additional income in the years in which you do a conversion can have other extenuating tax consequences like the phase out of itemized deductions or becoming subject to AMT.
3. If you expect to leave a large amount of your IRA to a charity, there is no need to convert since you would not pay income tax on that amount and your estate will get the charitable deduction whether it comes from a Traditional IRA or a Roth IRA (assuming that we do return to having an estate tax, which is all but assured).
4. If you are under 59 ½ and you believe you may need the money within the next five years you would not want to do the conversion because there is a five year holding period for each conversion and if you withdraw funds before then you might pay a 10% penalty.

Each person's circumstances are different so you should consult us and/or your tax advisor before initiating a conversion to make sure that it is in your best interest. Also keep in mind that you can do partial conversions and you can do them in multiple years. Let us know if you would like to discuss this in more detail.