

Roth to Riches



With tax rates expected to go higher in coming years, it may make sense for you to convert part of an IRA to a Roth IRA.

The Benefits You Forgot, or Never Knew About- The primary advantage of converting an IRA to a Roth IRA, of course, is that the withdrawals from the latter are not subject to income taxes, as long as the money has been in the Roth for at least five years, and you have reached age 59½.

That bonus is even better than it sounds, for several reasons. First, Roth IRA distributions are one of the only sources of income that aren't figured into the formula that determines whether your Social Security payments are taxable. Second, a hefty Roth IRA balance will give you more flexibility in choosing sources of income in retirement, which could mean lower income taxes each year and therefore more income during retirement. Finally, as there is no mandatory distribution age for Roth IRA's, you will take out money from the accounts when it works best for you, rather than when the IRS life expectancy tables tell you to.

The only age-based withdrawal requirement for Roth IRAs is that inherited balances must be taken out according to the beneficiary's life expectancy. But even then, there will be no tax liability on the withdrawn amounts—which could be extended over several decades. And one more benefit to converting: subject to certain conditions, the amount converted may be withdrawn with no taxes or penalties, regardless of the owner's age, as long as at least five years have lapsed since the conversion (see IRS Publication 590 for more details).

Why Now?- Both optimistic and pessimistic IRA owners should be receptive to the idea of moving some or all of their IRAs to Roth IRAs. The doom-and-gloom-ers may foresee Uncle Sam taking a bigger chunk of personal income through higher tax rates in the coming years, making them eager to “buy” freedom from future taxes on withdrawals from retirement accounts.

More hopeful IRA owners may believe that even if tax rates remain the same, higher tax rates are still on the their personal horizons—due to an increase in individual earned income. Or, they could be among the those who believe that equity prices will rise in the future, and would prefer to pay taxes on today's values, instead of what will hopefully be much more money down the road.

A Money-Savings Mulligan- Say your confidence in rapidly-rising account values is premature, and the investments continue to tumble after the conversion to Roth IRAs. You can call for a “do-over” of the conversion, “recharacterizing” the IRA-to-Roth IRA transfer at the new, lower amount, and paying a new, lower tax bill in the process.

The deadline for a recharacterization is April 15 of the year after you perform the first conversion. But if you choose to apply for a six-month extension to your income tax filing deadline, you could have up to October 15th of the year after the conversion is made for the recharacterization.

A caveat, though: if you already have a Roth IRA in place and are interested in converting an IRA to the Roth as well, you may want to establish a new Roth IRA to receive the converted amount. Trying to recharacterize the conversion can get sticky, from both a tax and paperwork perspective.

Who Can and Can't Convert- Prior to 2010, you would have been precluded from converting IRAs to Roth IRAs if you made too much. For 2009, taxpayers must have modified adjusted gross income of less than \$100,000—whether they file married or single.

The best news is that in 2010, the income limit has been eliminated. There is the small matter of where to get the money for the taxes due. Ideally, you would have non-qualified accounts containing enough money to cover the ensuing bill from the IRS.

If the only way you can cover the taxes on the conversion is to take additional withdrawals from the IRA, you should probably refrain from making the move. Pulling more money out of the IRA to pay the IRS could mean an upward spiral of withdrawals that could tap the entire account.

More help- As you can imagine, converting an IRA to a Roth IRA is not a transaction that should be entered into carelessly. Interested IRA owners should bring their tax and investment professional into the discussion as soon as possible to better determine if a conversion is a good course of action for their situation.

Mark W. Feucht is a CERTIFIED FINANCIAL PLANNER™ practitioner and accredited tax advisor. His practice that is located in Fond du Lac specializes in financial services and tax planning & preparation. He can be reached at 920-921-6288 or mark.feucht@feuchtfinanccial.com.

Securities Offered through National Planning Corporation, Member SIPC/FINRA. Feucht Financial Group, LLC & NPC are separate and unrelated companies. This information is provided as a public service, and should not be construed as individual accounting or tax planning advice. For information on how these general principles apply to your situation, please consult an accounting or tax professional. NPC is not engaged in the business of rendering tax or legal advice. NPC is not to be held responsible for and may not be held liable for the adequacy of the information available.