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Conversion of a Traditional IRA to a Roth IRA

As you may know, as of the beginning of this year, all individuals are now eligible to convert a traditional IRA into a Roth IRA.

For many individuals with higher incomes, a frustrating income tax rule prevented contributing to, or converting a traditional IRA to a Roth IRA, due to an income threshold limitation. Fortunately, beginning with the 2010 tax year, individuals of all income levels will be permitted to convert their retirement accounts into Roth IRAs, allowing them to take advantage of various intrinsic benefits that exist within these accounts.

A Roth IRA differs from a Traditional IRA mainly in its treatment of contributions and withdrawals. There is no tax deduction for funds contributed to a Roth IRA, but withdrawals from the account are tax-free. In addition to the obvious benefit of earning tax-free investment income, Roth IRA holders have access to valuable tax and estate planning opportunities inherent to this type of account.

Conversion to a Roth IRA will accelerate a tax liability, as taxes must be paid on all funds that exceed the tax basis in the year of conversion. However, for a 2010 conversion only, 50% of the taxes due on the conversion will be deferred until 2011 and the remaining 50% will be deferred until 2012. Because the tax implications cross over multiple years and potentially a person's lifetime, there are several opportunities which may be beneficial to a person's long-term financial and estate planning goals.

Benefits of a Roth IRA Conversion:

- Tax-free growth in the account
- Tax-free withdrawals from the account
- No required minimum distributions after the age of 70 ½
- Taxes paid on conversion to a Roth IRA can further reduce the participant's taxable estate
- Flexibility allows for a partial conversion or conversion to multiple new accounts
- Ability to re-characterize back to a Traditional IRA until October 15 of the year following conversion
- Tax-free distributions to secondary beneficiaries over their lifetime

Factors to Consider When Contemplating a ROTH IRA Conversion:

- Whether the participant's future marginal tax rates are expected to increase or decrease
- Whether non-IRA assets are available to pay the taxes due upon conversion
- Whether the participant will need to withdraw IRA assets during his/her lifetime
- Whether the participant will be subject to estate taxes
- Whether the participant plans on leaving the IRA assets to family or to charity
- The rate at which the IRA assets are expected to appreciate over time
- The taxpayer's age and life expectancy
- The timing of the conversion

If you would like us to analyze the potential benefit of making the conversion (including the projected change in value of the assets after the conversion), please contact us.

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