News Alert

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Roth Conversion - the "nitty gritty"

You've read all the hype, and now you're sold on the benefits of converting anything you can to a Roth IRA. Before you act, first consider some details.

The Basics

The "Roth concept" is that retirement savings are in after-tax dollars (i.e., no tax deduction for contributions), but growth on amounts in Roth accounts will be tax free. Yes, "tax free," not "tax deferred." Under traditional retirement accounts with tax deductible contributions accumulations are merely tax deferred. That is, they accumulate without taxation, but distributions are taxable. Distributions from Roth accounts are generally tax free provided the following requirements are met:

- The account owner first established a Roth account of the same type at least five years ago; and
- The account owner is over age 59½, has died, become disabled, or is a "first time" homebuyer.

Roth accounts are of two general varieties — IRA and 401(k). Roth 401(k) accounts may be available in the plan sponsored by your employer. The only way to create or contribute to a Roth 401(k) account is through deferral (i.e., salary reduction) contributions. It is not possible to have employer contributions to a Roth 401(k) account or to convert another account into a Roth 401(k) account.

Converting Roth IRAs

Since the inception of Roth IRAs in 1998, there has always been the possibility of converting a regular IRA into a Roth. Before 2010, however, there was an income limitation that precluded many people from doing a conversion. Whether filing a single or joint return, if your modified adjusted gross income was above $100,000, you were disqualified from converting a regular IRA to a Roth.

After 2009, the income limitation on conversions is repealed. Furthermore, any conversion made in 2010 does not generate immediate taxation (unless elected by taxpayer). Generally, half of the amount of taxable income generated by the conversion is included on the 2011 return and the other half on the 2012 return.

To read more about 2010 Roth conversions, please see our previous article (http://www.traviswolff.com/articles/roth-ira-conversion.pdf).

What's Next?

You may have talked with your CPA, and perhaps even had the comprehensive Roth analysis done. All signs point to "go." What's next?

First, consider all your regular IRAs. You may have one or a dozen, but for the purposes of determining the taxable amount of your conversion, they will all be aggregated. In fact, the aggregation occurs at the end of the year, regardless of when the conversion occurs. This can have significant consequences if a large swing in value occurs after the conversion, but before the end of the year.

What kind of assets are in each of your regular IRAs? What may be acceptable to you as an investment in a regular IRA may not be acceptable in a Roth IRA. Generally, Roth investments might be a bit more speculative with a bigger upside.

Additionally, on your Roth IRA, be sure to name a beneficiary (preferably a young one). If there is no named beneficiary on a Roth IRA, the account must be distributed within five years after the death of the account owner.

Roth conversion is not an "all or nothing" proposition. You may choose to convert only a portion of your regular IRAs. Further, if you have second thoughts, you may undo the conversion at any time until October 15 of the year following the year of conversion.

Contact

If you have questions regarding the Roth conversion or would like more information, please contact:

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