

WILL YOUR ESTATE PLANNING BENEFIT BY CONVERTING YOUR IRA TO A ROTH IRA IN 2010?

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A new rule goes into effect on January 1, 2010 that will allow anyone, even those who earn over \$100,000 per year, to convert assets from a traditional IRA or a prior employer's 401(k) account into a Roth IRA. In the past, individuals earning in excess of \$100,000 were unable to convert their traditional IRAs to a Roth IRA. This new law provides additional flexibility for your long-term planning decisions.

Historically, a traditional IRA has allowed you to make tax deductible contributions to your retirement account. You could begin withdrawal at age 59½, but mandatory withdrawals were required at age 70, and when a withdrawal was made, the holder would pay taxes on the earnings withdrawn.

In comparison, contributions to a Roth IRA were not tax deductible when made, but there was no mandatory distribution required at any age, and once you started taking withdrawals, they were tax free.

Why a Roth IRA Conversion May Be Best For You

Although you may have dismissed the thought of converting your traditional IRA to a Roth IRA because you have heard that you will have to pay taxes on the ordinary income you convert, there may be several benefits if you do convert your traditional IRA. First, there is no requirement that you have to withdraw the money from your Roth IRA when you reach a particular age. Given the fact that individuals' life expectancy is increasing and your retirement savings may need to last for a longer period of time, a Roth IRA allows you to wait to withdraw your earnings until later in life.

Second, by paying taxes on the account balance at the present time, you will not have to pay

any taxes when you withdraw the money later in life and the earnings grow tax free while invested in the Roth IRA. After retirement, you will appreciate not having to pay those taxes, especially when your income will be less.

Third, the IRS allows you to reverse the conversion by October 15, 2011 and go back to your traditional IRA if you made the conversion in 2010. Thus, if the market drops precipitously and tax free earnings become less of an advantage, you can get the benefit of hindsight. Even if you paid taxes resulting from the conversion, the IRS allows you to receive a refund on the taxes.

Finally, remember that if you do not need to withdraw from your Roth IRA during your lifetime, your beneficiaries will receive the benefit of the account tax free. Although you have many factors to consider in your overall estate planning, this factor may tip your decision toward converting to a Roth IRA.

Maybe a Roth IRA Conversion is Not Right For You

There are always adverse factors to consider in making a wise decision, and the conversion of a traditional IRA to a Roth IRA is no exception. First, make sure you have accessible money today to pay the taxes that will be due on the ordinary income amount you convert. If this poses a problem, don't drop the analysis completely. You may want to consider converting only a portion of the traditional IRA until you have more disposable income to pay the rest of the income tax that will be due when you convert the rest of the IRA. Keep in mind that at the present time, your portfolios are probably lower than they were a few years ago, so the taxes you will have to pay will be lower than when the market rebounds and your portfolios are worth substantially more.

Second, exercise caution that the conversion does not place you in a higher tax bracket. If this is a concern, it still may be worthwhile to consider converting to a Roth IRA. Because the IRS allows you to spread out the income for the tax years 2011 and 2012, this factor may tip the balance in favor of a conversion.

Finally, understand that there is a penalty if you withdraw the converted amount within the five year period from when the conversion occurred. This may not be a great concern to you now, but remember that you will need to take a "hands off" approach to the money converted for this five year period to avoid a 10% penalty for early withdrawal.

Will This Issue Affect Your Estate Planning Goals?

Roth IRAs allow you to withdraw without considering future income taxes. Paying taxes on the income now, while the amount of that income may still be relatively low from poor stock market performance of recent years, and letting your Roth IRA thereafter grow tax-free may prove to be a beneficial estate planning tool. Talk to your advisers to see if this conversion will work for you and start off the New Year with a reasoned decision that may benefit you or your heirs in the future.

If you have questions regarding this article or would like to review your estate plan, please contact Bill Davis at Trainor Fairbrook. You may reach Mr. Davis at (916) 929-7000 or by email at wdavis@trainorfairbrook.com.