

Roth IRA Conversion: Is the Time Right?

Even with all of the current economic uncertainty, there is still some good news: you can still take advantage of the opportunity to convert your tax-deferred IRA (traditional, SEP or SIMPLE) and qualified 401(k) plan to a Roth IRA.

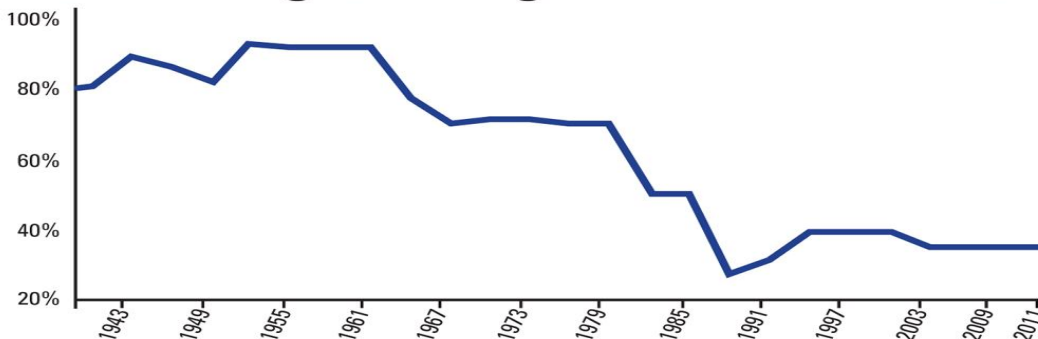
Why Convert Now?

One of the many tax law changes that occurred in late 2010 was the permanent removal of the previous income limitations for conversions of tax-deferred IRAs to Roth IRAs. For those who are not familiar, a Roth conversion consists of converting an existing tax-deferred IRA to a Roth IRA by recognizing income on the assets that are converted. The most immediate and obvious benefits of conversion are that your Roth IRA will accumulate future earnings tax-free while also allowing for tax-free withdrawals during your retirement and for your heirs. There are several compelling reasons why you should consider taking advantage of this unique tax planning opportunity: future tax considerations, the ability to assist with estate planning and market based reasons.

Future Tax Considerations

As evidenced by the chart below, our current highest marginal income tax rates are near historic lows. With our recent economic downturn and ongoing debt concerns, it is quite likely that marginal income tax rates will increase in the short term. By converting to a Roth IRA, you can choose to recognize income at current lower tax rates rather than potentially paying a higher tax rate on distributions at the time of your retirement. A conversion makes particularly good sense for individuals that are in the middle of their careers and/or those who expect to remain in the same relative tax bracket for an extended period of time. Roth conversions present the dual benefit of paying the tax liability during your peak earning years while also ensuring that your future distributions are tax-free. In the alternative, individuals who are retiring in the immediate future may not be good candidates if they expect their taxable income to decrease dramatically, thus putting them in lower tax brackets going forward.

Historical Highest Marginal Income Tax Rates



Source: Eugene Steuerle, The Urban Institute; Joseph Pechman, Federal Tax Policy; Joint Committee on Taxation, Summary of Conference Agreement on the Jobs and Growth Tax Relief Reconciliation Act of 2003, JCX-54-03, May 22, 2003; IRS Revised Tax Rate Schedules

Another important tax planning opportunity is the ability to offset Roth conversion income with existing net operating losses (NOL), an ordinary loss or a business loss. Even if you do not have these types of losses, we can present creative strategies to assist with the tax liability related to a Roth conversion. One such strategy is the use of a conservation easement charitable deduction to reduce your Roth conversion income. For 2011, this is a particularly effective deduction since it is only limited to 50% of adjusted gross income, thus allowing you to reduce your taxable income by 50%.

Estate Planning Assistance

Another benefit to a Roth conversion is the ability to create a larger tax-free asset that you can pass to your children at death. This is accomplished since you are not required to take required minimum distributions (RMDs) which would normally be required after you turn 70 ½. Instead, you can leave all of the assets within the Roth IRA to accumulate over your entire lifetime. At your death, your children will inherit the Roth IRA and they will start to take distributions over their entire lifetime. This provides a tax-free annuity of sorts for your children.

Market Based Opportunities

Finally, depending on the nature of your IRA investments, it may make sense in our current down market to take advantage of depressed stock prices by converting. This reasoning assumes that economic conditions will improve over time, thus allowing your Roth IRA to appreciate tax-free. Regardless of your investment performance or feelings about our current markets, IRAs and 401(k)s are long term investments which can certainly benefit from long-term tax-free appreciation.

Factors to Consider

Now that we have examined some of the pros and cons of Roth conversions, it is time to recap the key factors which you should consider when determining whether a Roth conversion is appropriate for you:

- Asset diversity (i.e., qualified vs. non-qualified, liquid vs. illiquid)
- Traditional IRA or 401(k) fair market value
- Time horizon
- Current and future cash flow needs
- Current marginal tax rate versus projected future marginal tax rate
- The ability to pay the income tax on a conversion with non-qualified funds
- Estate planning objectives

One final issue to consider is that Georgia law does not protect Roth IRA assets from creditors. Georgia law states that distributions from a traditional IRA (not Roth) are exempt from bankruptcy only to the extent necessary for the support of the debtor and any dependent. Similarly, traditional IRA accounts are protected from levy and liens, whereas Roth IRA accounts are not.

Buyer's Remorse

One very important aspect of Roth conversions is your ability to “recharacterize” or reverse the entire process. Any Roth conversion may be recharacterized up until October 15th of the year following conversion. This allows for a long period in which you can monitor tax rates, your personal finances and your investment returns to determine whether your Roth conversion was truly the right decision.

For more information on this topic or to discuss whether you are an appropriate candidate for a Roth conversion, please contact:

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