

# Roth IRAs: To convert or not to convert, that is the question

BY SUSAN SLATER-JANSEN

If you've been consistently putting away money in a traditional Individual Retirement Account (IRA), you've enjoyed taking tax deductions for your annual contributions and watching the account's income and dividends accumulate without immediate tax consequences. But according to the law, you must begin taking Minimum Required Distributions (MRDs) after you reach age 70 ½. If you don't need the income and want to keep benefiting from the account's tax-advantaged growth, you might consider converting your traditional IRA to a Roth IRA.

There are many factors to consider, so the decision to convert a traditional IRA to a Roth IRA is best done in consultation with your professional advisors, including a trusts and estates attorney and your accountant. The primary difference between a traditional IRA and a Roth IRA is how your income is taxed. In a traditional IRA, your contributions are tax-deductible (within limits) but you have to pay income tax on the money you withdraw.

With a Roth IRA, it's exactly the opposite. Roth IRAs were created in 1997 as retirement accounts that could grow tax-free for people who otherwise couldn't contribute to a regular IRA – usually because they made too much money or were covered by an employer-sponsored 401(k) plan. So in a Roth IRA, contributions are made with after-tax income, but “quali-

fied” distributions are tax-free.

Federal tax law used to severely limit one's ability to convert a traditional IRA to a Roth IRA, but that changed with tax year 2010. No longer are conversions limited to individuals with a personal Adjusted Gross Income (AGI) of less than \$100,000. And, for the first time, married couples filing separately and showing any AGI can convert.

Now that more people have the option to convert a traditional IRA to a Roth IRA, it's something to consider as part of your overall estate planning. It can be a useful tool for people who already have a reliable and sufficient source of income, wish to leave more money to their heirs or do not want to begin taking MRDs at age 70½. In unfortunate circumstances, when the death of the account holder is imminent, it also can be done to reduce estate tax costs and to free heirs from the obligation to pay income taxes on post-death distributions.

The tricky part is that the conversion will trigger the income tax on the amount of the traditional IRA converted to a Roth IRA. You can dip into the account to pay the tax, but this will lead to less growth in the Roth IRA and more tax to pay up front. Therefore you should have another source of funds from which to pay the conversion taxes. You can offset the tax due if you have a large net loss carry forward or make a large charitable contribution during the same tax year.

Once the income taxes are paid at the time of conversion, no income tax will be due on “qualified” distributions, which

includes the growth on the converted amounts. Qualified distributions are defined as distributions that are made more than five years after the first contribution or conversion to a Roth IRA and made after the Roth IRA owner attains age 59½, dies or is disabled. There may be penalties for early distributions (e.g., 10 percent before the owner attains age 59½). The five-year period begins on the first day of the year of contribution or conversion and ends December 31 of the fifth year thereafter.

One important thing to remember: IRAs and retirement accounts do not pass under your Will, which means you have to specifically name a beneficiary on the IRA or retirement account's beneficiary designation form, otherwise the IRA or retirement plan document may specify who gets the benefit. For retirement plans, if your spouse is alive and you wish to designate someone else besides the spouse as beneficiary, the spouse has to sign an acknowledged consent on the beneficiary designation form as well. This rule does not apply to IRAs.

As with all aspects of estate planning, you should check with your own advisors before converting to a Roth IRA. In addition, laws change. Check with your advisors once a year to ensure your estate plan is up to date.

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