"Roth IRA conversion can give battered retirement accounts a boost"

By Jeffrey N. Berman, for the *Baltimore Business Journal* - 12-04-09

Since its inception in 1997, one of the most powerful tools in the retirement investor's toolkit has not been available to those with relatively high adjusted gross incomes. That will change in 2010, when the federal government will lift the income limit for making Roth IRA conversions.

This welcome change arrives just in time for baby-boomers who are on the verge of retirement--and wondering how to rebuild the wealth lost in last year's stock market swoon. The newly accessible Roth IRA gives those who are a few short years from retirement, as well as those decades away from it, a good reason to revaluate their financial planning strategies.

A Roth, as opposed to a Traditional IRA, can potentially save a retiree tens of thousands of dollars for two principle reasons: First, future earnings taken after the age of 59½ become tax-free once the account has been held for at least five years; and second, account owners are not required to take minimum distributions once they reach the age of 70 ½. As a rule of thumb, the sooner one rolls over into a Roth, the more money one saves in the long run.

For over a decade, individuals and couples with adjusted gross incomes over $100,000 have not been permitted to roll Traditional IRAs or 401(k) funds into Roth retirement accounts. That cap disappears on January 1. Although people with adjusted gross incomes over certain amounts will still be prevented from contributing to Roths ($120,000 for individuals, $176,000 for married couples), 2010 may be the optimum time for high-income earners to convert existing nest eggs into Roth IRAs.

We say it *may be* an optimum time because there is always a price to pay for the conversion. Namely, a sizeable portion of a converted Traditional IRA or 401(k) (earnings and all deductable contributions) will become subject to taxation.

In many cases, it's well worth paying the piper today to secure much greater tax savings in the years to come. One silver lining to be found in a recession-battered retirement account is that rolling it into a Roth will cost less than it might have in 2007. In other words, converting diminished assets will yield a diminished tax for Uncle Sam.

It's worth noting that, in addition to the current account holders, their heirs may eventually benefit from the decision to take advantage of the Roth IRA. A key feature of the Roth is that its earnings become tax-free for beneficiaries. There are a few caveats: non-spouse beneficiaries are required to take Required Minimum Distributions (RMDs) from the account during their lifetimes. But these distributions may be income tax-free, whereas all earnings and deductable contributions withdrawn from an inherited

Traditional IRA will be taxable. Leaving a Roth IRA to a child, and especially a grandchild, would tremendously grow your family's wealth and legacy.

The fact that some investors expect tax rates to increase in the years to come is another reason to consider converting to a Roth IRA. The taxes due upon conversion would be paid at the lower current rate, whereas withdrawals from Traditional IRA in future retirement years would be taxed at a potentially higher rate.

If you do switch to a Roth in the months to come, it is advisable to pay any ensuing taxes from cash outside of the retirement account to prevent dipping into the IRA itself. If the tax bill is uncomfortably large, know that only in 2010 will the IRS allow you to spread that tax over two years-- 2011 and 2012. Doing so will make sense if tax rates remain the same or decline after 2010. If tax rates go up, it may make sense to foot the entire bill in 2010.

Another way to lessen the immediate tax bill for conversion is to convert portions of a Traditional IRA over several years. This approach would have the disadvantage of delaying the benefits the Roth affords, but it would offer the benefit of lessening your tax bill in 2010.

For high-income earners who can afford to pay the initial price of conversion, next year may be the right time to take advantage of this fortuitous change in tax policy. We cannot be sure how long the Roth IRA will remain open to all investors. The federal government is facing severe future deficits; the pressure on Congress and the President to raise taxes will likely increase over time. Vehicles that can protect hard-earned nest-eggs deserve serious consideration.

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