

Roth conversions



IRA basics: (simply stated)

- A taxpayer who makes a deductible contribution to a **traditional IRA** gets a tax deduction for the money contributed, the money grows tax-free, and is fully taxable when distributed. When the taxpayer turns 59 1/2, the money can be withdrawn penalty-free. When the taxpayer turns 70 1/2, mandatory distributions are triggered, and upon death, the remainder is taxed to the heirs.
- A taxpayer who contributes to a **Roth IRA** gets no deduction for the contribution, the money grows tax-free, and there is no tax or penalty on a withdrawal after 59 1/2. When the taxpayer turns 70 1/2, no mandatory distributions are triggered, and upon death the money in the Roth transfers tax-free.

Putting money in a Roth can remove it from taxation forever.

How to convert:

- Before 2010, only a taxpayer with income under \$100,000 could convert a regular IRA to a Roth by paying tax on the amount converted.
- Since 2010, any taxpayer regardless of income can convert to a Roth by paying tax on the amount converted.

Why convert?

- Qualified Roth distributions are tax-free, inherited tax-free, and not mandatory.
- A tax-free Roth distribution after retirement can keep a taxpayer in a lower tax bracket and possibly affect the taxation of Social Security.
- The tax savings occur after the account has grown in size.

Who should convert?

- Young people (money has time to grow)
- People who anticipate higher income in the future
- People who can afford to pay the tax
- People concerned about the mandatory distributions of traditional IRAs
- Those desiring tax-free inheritance
- Those who were phased-out of participation in the past due to high income

Rules:

- Converted money must remain in the Roth at least 5 years if you are under 59 1/2.
- You can directly convert a company 401(k) to a Roth as long as you are not still working for the company.
- A SEP or a Simple can also be converted, but a Simple requires 2 years of participation before conversion.