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Limits on Roth IRAs set to end – should you convert?

by Correy Stephenson

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For the first time, as of Jan. 1, 2010, individuals with an adjusted gross income of more than $100,000 can convert an existing IRA or 401(k) account into a Roth IRA.

Estate planning attorneys should contact their clients about this opportunity, and lawyers should consider whether to take advantage of the change for their own retirement plans.

Previously, only those who made under $100,000 could convert to a Roth IRA.

The Tax Increase Prevention and Reconciliation Act of 2005 **abolished the income limit** as a means of raising revenue, but the change doesn't take effect until 2010.

Ed Slott, a CPA in Rockville Centre, N.Y., who publishes "Ed Slott's IRA Advisor," said he plans to convert all of his savings to a Roth IRA.

"This is great for lawyers and for their clients," he said. For a lot of people, "their largest single asset is their 401(k) or IRA plan and doing a conversion to a Roth can have a huge impact."

Unlike a traditional IRA, a Roth IRA is an account where the funds will accumulate tax-free and are also distributed tax-free, explained CPA and estate planner Michael J. Jones of Thompson Jones in Monterey, Calif.

The change is also a great opportunity for lawyers to get clients back in the office, noted Bernard Krooks, an estate planner and partner at Littman Krooks in Manhattan and White Plains, N.Y.

"People don't like to do estate planning, but [the change] is a perfect hook for lawyers to touch base with their clients and talk about the possibility of a conversion and use it as an opener to talk about other items, like the estate tax changing," he said.

(Read more about the possible changes to the estate tax: **Congress grapples with estate tax reform).**

Considering a conversion

Estate planning attorneys and CPAs agree that the decision to convert to a Roth IRA should be individualized, based on several factors.

While the benefits can be significant, "it's important to put [the conversion] into the context of a total financial plan," advised Jones.

• **Taxes up front** .

The biggest downside to converting: having to pay tax up front, Slott said. Because contributions to traditional IRAs get a tax deduction, you must pay the taxes due on those initial contributions as well as on any growth in the IRA.

Therefore, "the ideal candidate for a conversion is someone with the outside funds to pay the taxes," said Robert S. Keebler, a CPA at Baker Tilly and chair of the firm's Financial and Estate Planning Team in Green Bay, Wis.

Slott suggested that if there isn't enough money to pay for all of the taxes, an individual can convert some of his or her 401(k) or IRA to a Roth, or at least a portion he can pay the tax on without having to tap into the fund itself.

"It's not all or nothing," he noted. "Do what you can."

• **Length of time.**

"When do you think you'll need the money?" is an important question to ask yourself, said Slott. A Roth IRA is a long-term undertaking, in part because it doesn't allow withdrawals for five years, but also because the tax-free benefit increases over time.

Conversion to a Roth IRA "is for people who can keep [the money] in the account long term," Slott said.

As a general rule, younger workers are good candidates for a conversion, Krooks noted, because they will get "an even bigger bang for the buck."

• **Plan ahead.**

Jones said it is important to start the conversion as early as possible, especially if the IRA has assets in it besides cash and marketable securities.

"If there is real estate involved, you will need to change the title, the insurance and update the tax information," he said. "It's important to make sure that the property gets properly from point A to point B."

• **Two-year tax deferral.**

Paying the tax up front is made slightly easier by the fact that the government has included a one-time option allowing individuals to defer the tax payments. Even if you choose to convert in January 2010, you can wait to pay half the taxes due until 2011 and the other half in 2012.

Keebler cautioned, however, that tax rates might be higher in 2011 and 2012, which could be a downside to taking the spread.

• **Money-back guarantee.**

Still unsure about whether or not to convert? The government has sweetened the deal by allowing those who convert and lose money to "re-characterize."

An individual who converts and changes his or her mind for any reason can reverse the conversion and convert back and get all taxes back if they don't like the outcome.

For example, if an individual converts a $300,000 regular IRA into a Roth but the value drops to $210,000, he or she can re-characterize it back into a regular IRA and get the taxes back, Keebler explained.

For that reason, "most people would be well-advised to extend their [2010] returns until Oct. 15, 2011 and then make the election about whether or not to re-characterize," at the latest time possible, he suggested.

And even if you do opt to re-characterize, the government allows you to convert back to a Roth IRA again, Keebler noted.

Estate planning

Estate planning attorneys advising clients should address Roth conversions "as part of an estate plan now," Slott advised. "Because a Roth IRA has no required distributions, an account can just grow and it can be an income-tax free asset to pass on to children or grandchildren."

Because estate planning attorneys tend to have wealthier clients who probably make more than $100,000, Roth conversion was never an option before, Slott said. "These people are probably perfect candidates for a conversion."

Questions or comments can be directed to the writer at:
correy.stephenson@lawyersusaonline.com

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