

Lawyers advise clients of Roth IRA conversion deadline

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Published: October 8, 2010

Despite a looming deadline for special rules on converting retirement money to a Roth IRA, many clients - and even lawyers - have not taken advantage of the offer.

Whether they are waiting until the last minute to decide or are gun-shy about writing a big check to Uncle Sam for the income tax on the conversion, lawyers say many taxpayers remain on the fence.

“Even if it makes sense, I’ve had clients look me in the eye and say ‘You think I’m gonna write a check to the government?’ For many people, you can show them numbers up the wazoo, and they still won’t do it,” said Bernard Krooks, an estate planning attorney in New York, N.Y.

But even if clients are reluctant to act, every estate planning attorney should have the “Roth conversion” conversation with their clients - if only to make sure heirs don’t later come back and say, “‘Why didn’t we do this in 2010?’” said Ed Slott, a CPA in Rockville Centre, N.Y., who converted all of his six-figure savings into a Roth IRA earlier this year.

Roth IRAs allow an investor to grow retirement money tax free. 2010 was the first year that income caps were removed for those who want to convert money from a 401(k) or traditional IRA into a Roth IRA. The conversion counts as a distribution triggering ordinary income tax on the amount.

Although the income caps have been permanently removed so that Roth conversions can be done anytime, Dec. 31 is the deadline for taking advantage of special rules allowing an investor not to report any conversion income in 2010 and split up the income tax evenly between 2011 and 2012.

“That deal is only for 2010 conversions. It’s one reason to act before year end,” said Slott.

Another reason to convert now is that tax rates are predicted to be higher next year and beyond, especially for those in higher tax brackets who benefit from the new rules.

Big savings, but no slam-dunk

Even with the enticing benefit of tax-free growth, converting to a Roth is not for everyone.

“It’s far from a no-brainer,” said Krooks.

One of the first considerations is whether the person is converting the money for his or her own retirement or to pass it on to children or grandchildren. A person nearing retirement age won’t have enough time to grow the money to make up for the conversion tax hit.

But “if your goal is to leave a nest egg for your children or grandchildren, there’ll be a heck of a lot more money if you bite the bullet and pay the taxes now,” said Krooks.

Anybody who has to dip into the IRA funds to pay the conversion tax should forget about doing the Roth conversion.

“You don’t want to go broke converting,” said Slott. “This is tax planning.”

A person’s tax bracket will also play into the decision about whether to convert.

Those in the higher tax brackets are more willing to take the big tax hit now, knowing that their taxes are most likely going up if they wait until next year.

“For higher income clients, with tax increases Roth conversions will be more expensive. It doesn’t mean they can’t do it later, but it will likely cost more,” said Slott.

People in the middle brackets who are choosing to convert in 2010 are opting for splitting up the income, paying half of the tax in 2011 and the rest in 2012, said Barry Picker, a CPA and principal at Picker & Auerback in Brooklyn, N.Y.

“Middle class people are definitely interested in splitting it into two years because if they do all in one year, it could put them in a higher bracket,” he said.

A person who starts out in the 28 percent tax bracket, for example, and converts \$100,000 this year would, with the added distribution income, be taxed partially at 28 percent, partially at 31 percent and partially at 33 percent. However, if that person splits the income over the next two years, it’s more likely to be all taxed at 28 percent, Picker said.

But some clients are still balking at paying a tax now that their heirs can pay later on.

“I’ve had clients say, ‘I have to pay a tax now so they don’t have to pay it later? Eh, let ‘em pay it later,’” said Picker.

Regardless of whether a client chooses to convert, lawyers should present the option.

“Even if the parents don’t do [the conversion], I would have them write it down so they or their heirs can’t say, ‘You didn’t tell me,’” said Slott.

Have something in the game?

Roth conversions may be tailor-made for the indecisive, containing some of the most unique features of the Internal Revenue Code.

First, you don’t have to convert all of your retirement money in one year; you can do it little by little every year.

“We have people who convert \$10,000 or \$20,000 every year going forward,” said Picker.

Second, if you change your mind about the conversion, you have until Oct. 15 of the following year to change your mind or “re-characterize,” and get your taxes back.

“It’s like betting on a horse after the race is over,” said Slott.

Lawyers planning their own estates should consider converting at least some money to a Roth, he said.

“For their own financial security, lawyers should protect themselves from a higher tax rate in the future by having something in the game,” said Slott.

As the fourth quarter gets under way and the deadline nears, Slott expects more 11th-hour conversions.

But like many of his clients, Krooks, the estate planning attorney, admits the jittery economy has prevented him from converting to a Roth and paying the conversion tax this year.

“I sat down and looked at my own situation, and even though the numbers seem to work, I said, ‘No thank you, I’m not writing that check right now,’” he said.

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