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CONVERTING TO a Roth IRA could benefit many investors, but there are several things to take into consideration before making the move.

Roth IRA Conversions

3 things to consider before making the move

"The avoidance of taxes is the only intellectual pursuit that carries any reward."

— John Maynard Keynes

JIM BURNS

CONTRIBUTING WRITER



To Roth or not to Roth? That is, should individuals convert their traditional IRA to a Roth IRA in 2010?

With the annual April 15 tax deadline fast approaching, this is a question that many investors should be asking themselves, their accountants and their financial advisors. Unfortunately, according to Barron's magazine, many investors are unaware of, or unwilling to explore, this unique opportunity.

First, it is important to know the structural differences between a traditional IRA and a Roth IRA.

Essentially, a traditional IRA allows people in certain income groups to contribute money to this retirement account tax free. For example, if you made \$40,000 during the past year and put \$5,000 into an IRA, you would pay income tax on only \$35,000 of your earnings. Your money can then grow, tax free, as long as it is held in the account.

However, when you begin to withdraw money after age 59½ (there is a 10 percent penalty on withdrawals from any IRA before this age), that money will be taxed as income at your ordinary income tax rate.

A Roth IRA, by contrast, does not provide the individual with a tax-deductible contribution. Any contributions to a Roth IRA are made with after-tax dollars. The beauty of this account is that when you withdraw money from the Roth, none of it — including capital gains and dividends — will be taxed. Again, this assumes you do not withdraw money until age 59½ and the Roth has been open for at least five years. It is your money to spend free and clear!

In short, for the investor with a longer-term time horizon, the Roth IRA is the far superior choice because you will not pay taxes when you need the money.

Since 1998, when the Roth IRA was created, there have been income and other restrictions that have kept many taxpayers from converting

their traditional IRA to a Roth IRA. However, the \$100,000 income ceiling for a Roth IRA conversion has been repealed for only 2010, so those with an eligible rollover distribution from their company's retirement plan or an IRA can convert that plan to a Roth IRA.

So, should you Roth?

I think there are three important factors to consider before converting.

■ **You should have a longer-term investment horizon with the money once you convert.**

According to John Carl, president of the Retirement Planning Center, in Minnesota, for anyone up to the age of 58, converting to a Roth IRA is a no brainer. The reason is that the advantage of the Roth IRA is the ability of your money to compound — tax free, not simply tax deferred. Therefore, the longer you give your Roth money to compound without withdrawals, the better.

■ **You should pass on the conversion if you don't have assets readily available to pay the income taxes.**

When you convert your traditional IRA, or even an old 401(k), to a Roth IRA, the money will be added to your taxable income, although the tax on it can be paid over two years. You probably do not want to sell quality investments to pay the tax; you should have the money available from non-IRA sources.

■ **The Roth makes sense if you would like to pass the money to your heirs.**

Another key difference between the two retirement accounts is that with a Roth IRA, you do not have to take mandatory distributions when you turn 70½. So, if you don't need the money in your IRA, by converting to a Roth, you prepay the taxes for your heirs, who will inherit those assets tax free.

It is important to note that the rules are varied and complex, so consult your accountant before making any move.

However, with tax rates almost certain to rise over the next few years, a conversion to a Roth IRA probably makes sense for a lot of people. I, for one, will convert this year.

Jim Burns is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment. Reach him at jburns@jwburns.com.