IS A ROTH CONVERSION FOR YOU?

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A Roth Conversion is when you take all or part of the balance of an existing Traditional IRA and move it to an IRA. You might consider converting to a Roth IRA to enjoy tax-free withdrawals, watch your money grow tax-free for longer, leave a tax-free inheritance to your heirs, and get into a Roth IRA even though your income is too high.

It's important to know whether or not you qualify to convert funds from a traditional IRA to a Roth IRA. Guessing incorrectly may have serious consequences; the conversion of funds from a Traditional IRA to a Roth IRA is considered a taxable distribution, subject to federal income tax, and a possible penalty.

The fact that you qualify to convert funds from a traditional IRA to a Roth IRA doesn't necessarily mean you should; consider the following factors before making a decision.

Questions	Factors to Consider
Can you leave your funds in your Roth IRA for at least 5 years?	• If you convert a traditional IRA to a Roth IRA, and then make a non-qualified withdrawal within 5 years of the conversion, the earnings you withdraw will be subject to income tax, and your entire withdrawal may be subject to a 10% penalty unless an exception applies (age 59½, etc.).
Can you leave your funds in your Roth IRA for at least 10 years?	• Generally, converting funds to a Roth IRA makes sense if you plan to leave the funds in the Roth IRA for 10 years or more. • If you plan to take distributions from the Roth IRA within the next 10 years, make sure converting funds is in your best interest.
Will you pay the tax that results from converting funds with outside (non-IRA) funds?	• Converting traditional IRA funds to a Roth IRA will result in federal income tax due on those funds (to the extent that those funds consist of investment earnings and tax-deductible contributions). • Paying the tax due with IRA funds reduces the amount that grows tax free in the Roth IRA. • IRA funds used to pay the tax may be subject to additional income tax and possibly a penalty. • Paying the tax due with non-IRA funds allows more dollars to be funneled into the tax-free Roth IRA.
Do you expect to be in the same or in a lower or higher income tax bracket when you eventually take IRA distributions?	• If your tax bracket remains the same and you pay the tax that results from converting funds with IRA dollars, the conversion may have no tax consequence. • If you'll be in a lower tax bracket when you take IRA distributions, paying tax now on converted funds at your present (higher) rate may not be very appealing. • If you'll be in a higher tax bracket when you take distributions, you can convert funds to a Roth IRA now and pay tax at your present (lower) tax rate, and distributions will be tax free later (assuming you qualify for tax-free withdrawals)
Can you live comfortably in retirement without taking IRA distributions?	• You can keep contributing to the Roth IRA after age 72, as long as you have sufficient earned income. • Unlike a traditional IRA, you aren't required to take annual minimum distributions from a Roth IRA after age 72 or at any time during your life. • Assuming 5 years have elapsed from the time you established any Roth IRA, your beneficiary receives Roth IRA funds free from federal income tax (but not necessarily from federal estate tax) when you die.
Does your traditional IRA consist of any nondeductible (after-tax) contributions?	• You've already paid federal income tax on any nondeductible contributions to your traditional IRA, so these dollars are not subject to federal income tax when you convert funds to a Roth IRA. • After you convert funds, future investment earnings on your Roth IRA will accrue tax free.

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When you die, will federal estate tax be due?	• When you die, the value of your IRA (traditional or Roth) will be included in your taxable estate to determine if federal estate tax is due. • When you convert funds from a traditional IRA to a Roth IRA, you pay federal income tax on your IRA funds now rather than later. • The money you use to pay the tax now effectively removes those dollars from your taxable estate, potentially reducing your federal estate tax liability after your death.
Will you apply for financial aid in the next few years?	• The money you use to pay the tax now effectively removes those dollars from the assets to be considered in determining your child's eligibility for financial aid.
Are you currently receiving Social Security benefits?	• The portion of your Social Security benefits that is taxable in any year depends on your income and tax filing status for that year. • Excluding any nondeductible contributions, funds that you convert to a Roth IRA are treated as taxable income to you for that year. • If more of your Social Security benefits will be taxed as a result of converting funds to a Roth IRA, factor in the additional tax cost to you. • Balance this cost against the fact that distributions from Roth IRAs, in addition to being tax free, are not currently counted in determining the taxable portion of your Social Security benefits.
Does your state follow the federal income tax treatment of Roth IRAs?	• If your state does not follow the federal income tax treatment of Roth IRAs, you must factor in the way that your state tax treatment will affect your situation.
Does your state provide Roth IRAs with protection from creditors equal to that provided to traditional IRAs?	• Up to $1,362,800 (and in some cases more) of your total IRA assets, Roth and traditional, are protected under federal law in the event you declare bankruptcy. State law may provide additional creditor protection, but the protection given to funds in Roth IRAs may be less than that given to funds in traditional IRAs. • If you have a significant percentage of your assets in IRAs and you are at risk of being sued by creditors, you should consider your state's degree of creditor protection for each type of IRA.