Roth IRA Conversions

Currently, only taxpayers with a modified adjusted gross income of less than $100,000 are able to convert a traditional IRA to a Roth IRA. In 2010, however, this income limitation will be eliminated and high-income taxpayers may take advantage of the conversion option as well. This opportunity means that high-income taxpayers should examine the advantages and disadvantages of traditional and Roth IRAs to determine if conversion is an attractive option for them.

A traditional IRA is designed to defer the income tax on IRA assets until those assets are withdrawn, presumably during retirement. Subject to a few limitations, contributions to traditional IRAs are tax deductible, meaning the taxpayer gets a tax break at the time of contribution. However, distributions from the account are taxable at the time of distribution.

A Roth IRA works in the opposite manner. There is no income tax deduction for contributions to a Roth IRA, but all of the distributions from the account are free of income tax.

The conversion of a traditional IRA to a Roth IRA is treated like the distribution of the assets from the traditional IRA and the contributions of such assets to the Roth IRA. Accordingly, the distribution is taxable income but not deductible.

To determine if a Roth conversion is appropriate for you, you should consider the following:

- *Do you have liquidity to pay the income tax incurred upon the conversion?* A taxpayer has two options with respect to the recognition of income and payment of tax generated by the conversion. The taxpayer could recognize all of the income in 2010 (requiring liquidity sooner). Alternatively, the taxpayer could recognize one-half of the income in each of 2011 and 2012 (deferring liquidity needs but subjecting income to changes in tax rates). Regardless of the method chosen, the taxpayer will have a tax liability which must be satisfied in less than three years.
- *How much time will pass before you intend to use the assets in the accounts?* The longer the assets remain in the Roth account, the more tax-free appreciation can occur, making conversion more attractive.
- *What are your estate planning goals with respect to the account?* If you intend to minimize your use of the assets of the account during your retirement and instead intend to designate a charity to receive the account, it makes little sense to pay an income tax now that could be avoided entirely.
- *Will your income tax bracket drop after retirement?* If your income tax rate is expected to decline substantially, it may be more appropriate to skip the conversion

and pay the tax at the lower rate on distributions from the account rather than paying a tax at the higher rate on contributions to the account.

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Conner, Patrick T.	View Resume	314.552.6192	pconner@thompsoncoburn.com
Corbett, Thomas R.	View Resume	314.552.6022	tcorbett@thompsoncoburn.com
Cupples, Stephen E.	View Resume	314.552.6027	scupples@thompsoncoburn.com
Demeros, Georgia Loukas	View Resume	312.580.2303	gdemeros@tcfhlaw.com
Distler Hanzlik, Jodie E.	View Resume	312.580.2346	jdistlerhanzlik@tcfhlaw.com
Duncan, Laura M.	View Resume	314.552.6312	lduncan@thompsoncoburn.com
Gorin, Steven B.	View Resume	314.552.6151	sgorin@thompsoncoburn.com
Katzenstein, Lawrence P.	View Resume	314.552.6187	lkatzenstein@thompsoncoburn.com
Logan, Joseph P.	View Resume	314.552.6073	jlogan@thompsoncoburn.com
Ornduff, Jason S.	View Resume	312.580.2227	jornduff@tcfhlaw.com
Reuter Jr., Garrett C.	View Resume	314.552.6518	greuter@thompsoncoburn.com
Searfoss, Lacey R.	View Resume	314.552.6316	lsearfoss@thompsoncoburn.com
Thein, Jason P.	View Resume	314.552.6562	jthein@thompsoncoburn.com
Wald, Eileen M.	View Resume	314.552.6293	ewald@thompsoncoburn.com

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