New Research Analyzes Benefits of Roth Conversion

By Editor Test *Wed, Mar 17, 2010*

In 2008, IRA assets totaled some $3.6 trillion, 95% of which was in traditional IRAs, according to the Center for Retirement Research at Boston College.

A new research brief from the Center for Retirement Research at Boston College demonstrates that converting assets from a traditional tax-deferred IRA to a tax-free Roth IRA is most likely to benefit people who:

- Expect their income tax rates to rise after they retire.
- Want to defer withdrawing money from their IRAs longer than the rules for traditional IRAs permit.
- Wish to boost their total IRA balances more than the restrictions on their annual contributions will allow.

The brief, “Should You Convert a Traditional IRA Into a Roth IRA?,” by Richard W. Kopcke and Francis M. Vitagliano, indicates how large the potential market for Roth conversions in 2010, when could be.

“In 2008, the assets in IRA accounts totaled $3.6 trillion,” they write. “These balances exceed, by significant margins, the assets held in defined benefit pension plans and in other defined contribution plans. Traditional IRAs account for more than 95% of total IRA assets.

These conversions will appeal to those who are likely to find that the mandatory distribution rules for traditional IRAs force them to withdraw their balances too soon. Roth accounts give retirees who have adequate financial resources more latitude for making withdrawals in the most favorable manner.

The study also suggests that Roth IRAs enable retirees to leave a larger bequest to their spouses or other heirs. “This option should be particularly valuable to people who expect their IRA savings to provide retirement income for dependents,” the brief said.

Beginning this year, the Tax Increase Prevention and Reconciliation Act of 2005 allows all workers with traditional IRAs to transfer all or part of their balances into Roth IRAs without restriction.

People who have 401(k) plans with former employers can participate as well. The balances in 401(k) plans can be rolled over into traditional IRAs, without penalty or restriction, once people stop working for the sponsoring employer.

Those who hold old 401(k) accounts can convert these balances directly into Roth IRAs, as provided in the Pension Protection Act of 2006. People who convert their balances must include the amount of their transfer in their taxable income.

Those who make transfers in 2010 have the option of paying the tax entirely this year or including half the transfer in taxable income in 2011 and half in 2012. In the future, the tax must be paid entirely in the year of the transfer.