Roth IRA Conversion Fact Sheet

The Roth conversion presents a unique opportunity to investors looking for tax-free income during retirement. All individuals, regardless of income, are allowed to convert as much or as little of their IRA and eligible employer-sponsored plan assets as they want, so with some careful planning, this strategy can help maximize future retirement savings and add another layer of tax diversification to your portfolio.

IMPORTANT DATES TO REMEMBER

January 1, 2015: First day to convert to a Roth IRA for 2015 tax year

April 15, 2015: Due date for 2014 income tax return, with no extensions (**Please note:** Not a deadline for doing a Roth conversion)

October 15, 2015: Last day to recharacterize a 2014 conversion

ROTH IRAS: THE BASICS

Key features

- Contributions are made with after-tax dollars, and withdrawals of your contributions can be taken at any time, tax- and penalty-free.
- Earnings grow free of federal and state taxes, provided certain conditions are met.
- There are no required minimum distributions (RMDs) when the account holder turns age 70½.
- Qualified distributions are tax- and penalty-free after five years,[1] provided one of the following conditions is met. The account holder:
  - Is age 59½ or older
  - Incurs a disability
  - Is a first-time homebuyer (up to $10,000 lifetime limit)
  - Passes away
  - Uses them for qualifying medical expenses or higher education

Who can convert to a Roth?

Any taxpayer can convert traditional, rollover, SEP-, or SIMPLE IRA (after the two-year period) assets, as well as eligible employer-sponsored plan assets, to a Roth. Also, thanks to the passage of the American Taxpayer Relief Act of 2012, those with access to a qualified plan containing a Roth provision will also have the opportunity to convert their contributions at any time, without the need of a triggering event. The conversion amount is reported and taxed as a distribution for the conversion year.

The tax implications of conversion

There is one very important rule to keep in mind when it comes to converting to a Roth: federal and state income taxes must be paid on any portion of the conversion that has not already been taxed.

[1] Distributions are taken from the nontaxable portion first. Only when all contributions have been withdrawn will any earnings or conversion assets be distributed (subject to tax and an early withdrawal penalty, unless an exception applies).

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So, when considering a conversion, you must understand the tax implications and how you will pay the taxes incurred.

- If an account has been funded with both nondeductible and deductible contributions, federal income tax is owed on the previously untaxed amounts.
- Under the pro rata rule, the calculation for taxes owed on the conversion is based on the ratio of nondeductible contributions to the market value of the account. For IRAs, all account balances are aggregated, not just the account being converted. In other words, if nondeductible assets are converted from a traditional IRA to a Roth IRA, and you hold other IRAs, it is assumed that the conversion amount comes prorated from the aggregate amount of money in all of your traditional IRAs.

Formula for calculating tax-free amount:
Nondeductible contributions ÷ Total value of all IRAs = % of conversion amount that is tax-free

TO CONVERT OR NOT TO CONVERT
Because there are many factors to weigh when considering a conversion, to help make the decision, here are several important questions:

1. **Do you want to pay taxes now or later?**
   - Income tax is owed on any taxable portion of the amount converted.
   - A Roth IRA conversion may push you into a higher tax bracket.

2. **Do you expect that your income tax bracket will be higher at or during retirement, or do you expect tax rates to increase?**
   - If the answer is yes, it may be beneficial to do a full or partial conversion now.
   - If the answer is no, it may not be prudent to convert.

3. **Can tax on the conversion amount be paid from a source other than the IRA?**
   - It's generally better to pay taxes with non-IRA assets because tax payments from the IRA itself could be looked at as early distributions and therefore be penalized.
   - A partial conversion may be beneficial if the client cannot pay the entire tax burden.

4. **Will you need to access the money within the next five years?**
   - Distributions taken prior to the five-year holding period may be subject to taxes and penalties.

5. **Do you intend to leave tax-free income to beneficiaries?**
   - Because there are no RMDs beginning at age 70½ with a Roth IRA, conversion may be a good strategy for accumulating assets for future generations.
   - Heirs may receive a tax-free inheritance. (**Please note:** Beneficiaries other than a spouse would be required to take minimum distributions).

Other considerations

- A Roth conversion must be executed by December 31; individuals have until April 15 of the following year to pay taxes on the conversion.
- If it is discovered that the taxpayer was ineligible to convert, or changes his or her mind about the decision, recharacterization (i.e., a do-over) must be effected by October 15 of the year following the conversion.

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