

Roth reasoning



By Vijay J. Marolia, MBA

During this time of year, many of us have taxes on our minds (bringing frowns to our faces). In the aftermath of the financial crisis, incomes and property values have decreased sharply, putting downward pressure on tax revenues. And with government spending at all-time highs,

Uncle Sam needs all the help he can get.

Part of that help will come from the taxes due on Roth conversions. Roth IRAs, one of the most beneficial retirement accounts available to Americans, were once beyond the grasp of those with high incomes. The main advantages have to do with the tax-favored growth and tax-free distributions offered by the Roth IRA (assuming all requirements are met). They are also exempt from RMDs (Required Minimum Distributions) meaning that you are *not* forced to take out any money earlier than you want to – unlike traditional IRAs.

Starting this year, anyone, regardless of income, will be able to convert traditional IRAs and qualified retirement accounts into Roth IRAs. This may sound trivial, but it could have enormous implications for your retirement and estate planning. But rather than bore you all with rules and regulations governing the process (there are many and they are very boring), let's just talk about some reasons why you may or may

not want to consider this opportunity. Please keep in mind that this is an important conversation you need to have with both your tax *and* financial advisor.

Will I need this money to provide income during retirement?

Converting to a Roth is most beneficial for those who do *not* need the money to fund their retirement and will likely be leaving the assets to their beneficiaries. The longer the money can be allowed to grow, the more beneficial the Roth conversion will be. If retirement is right around the corner, and the funds in question will be needed for income, then the conversion may not make as much sense.

Will I be able to pay the taxes on the conversion with funds outside my retirement accounts?

The biggest obstacle for people thinking about converting will be the tax bill. Converting makes more sense for those with sufficient assets outside of their retirement funds to pay the taxes due. Remember, the taxes can be spread over the next two years if the conversion is done this year (2010).

Will I be in a higher or lower tax bracket in the future?

The answer to this question is a function of two variables: 1) income, and 2) tax rates. For example, we know that next year federal income tax rates will go back up to prior levels, bringing the top marginal federal income tax rate to 39.6 percent from today's 35 percent. For taxpayers in the top marginal tax rate, that means that even if their income stays constant, the tax owed on the income will increase. Therefore, they must project not only what their income will be in the future, but also what will happen to tax rates in that time. As you may recall from my last column, our view on taxes is that they are likely to increase. For those who will most likely remain in the top tax brackets even after retirement, and who feel that tax rates are headed higher, it may be better to pay at today's rate.

We have covered only a few of the issues and questions investors will face when deciding on whether converting to a Roth IRA makes sense. It is imperative that you talk with your accountant and financial advisor to discuss all the other variables that may have an impact on your decision. For families with taxable estates, your estate-planning attorney should also be involved in the discussion. Start the discussion today, and tomorrow you'll sleep better knowing what's best for you and your family.

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