ED SLOTT'S IRA ADVISOR

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TAX & ESTATE PLANNING FOR YOUR RETIREMENT SAVINGS

Make Roth IRA Conversions Less Taxing
Finding Conversion Cash Now… Before Tax Rates Increase

Historians may look back at 2010 as the year of volcanic eruptions, oil spills, and a Super Bowl win for the New Orleans Saints. To many advisors, though, 2010 will be best known as the Year of The Roth IRA Conversion. In future years, when tax rates increase, advisors will be measured by what planning they did before the low tax rates of 2010 expired. Roth conversion tax planning for many clients will be more expensive and less effective after 2010.

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After years of income limits, Roth IRA conversions have been opened up to all taxpayers, including the high-income clients who stand to gain the most from such maneuvers. What's more, there are two reasons to convert a traditional IRA to a Roth IRA in 2010, rather than in a subsequent year:

1. Possible tax deferral

Clients who convert in 2010 can choose between two payment options. They can pay all the tax on their 2010 tax return or they can split the taxable income from the conversion evenly between their 2011 and 2012 tax returns. This ability to split conversion income is a unique opportunity that's available only for 2010 Roth IRA conversions. It is also the default provision. If clients want to include all the income from a 2010 Roth conversion on their 2010 tax return, they will need to make that election when they file.

2. Low tax rates

Under current law, tax rates are scheduled to rise in 2011. The top federal income tax rates of 35% and 33% will rise to 39.6% and 36% respectively.

It's possible that today's tax rates for lower-income taxpayers will be retained. However, most observers believe that Washington's steep budget deficits will lead to tax increases on taxpayers with incomes over $200,000, at the very least.

Therefore, clients who convert a traditional IRA to a Roth IRA in 2010 and choose to include the conversion income in 2010 may wind up paying tax at the lowest rates they'll ever see. After the conversion, clients will avoid required minimum distributions (RMDs) while allowing the account to grow income tax-free for both the Roth IRA owner and their beneficiaries.

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