

## Retirement assets

# A Roth IRA can be a helpful tool, but it isn't for everyone

Estate and retirement planning are on people's minds these days, as the fate of the estate tax is up in the air and defined benefit pension plans are nearly extinct.

Retirement assets have traditionally been a primary source of charitable estate gifts because they are subject to income and (potentially) estate tax when passed to heirs at death. Recent legislation concerning Roth IRAs has introduced further planning options for taxpayers.

## SHOULD YOU CONVERT YOUR IRA TO A ROTH?

Although traditional individual retirement accounts offer tremendous opportunities for accumulating retirement savings, many people have accumulated funds in excess of what they will ever use. Required minimum distributions are mandatory after a certain age and are generally taxed as ordinary income, forcing retirees to draw upon their IRAs and pay taxes regardless of need.

The introduction of the Roth IRA in 1997 gave taxpayers a powerful alternative to the traditional IRA. While contributions to Roth IRAs are made with after-tax funds and are not deductible, their advantages include tax-free withdrawals for owners age 59½ or older, tax-free pre-retirement distributions for higher education or medical expenses, and no required minimum distribution.

Also, withdrawals from Roth IRAs are not treated as income.

While it has always been possible, with certain limitations, to convert traditional IRAs to Roth IRAs, recent legislation simplified these conversions. As of Jan. 1, 2010, Congress re-

moved the \$100,000 income limit on who can convert, and allows taxes on conversions that occur in 2010 to be spread between 2011 and 2012.

The question each taxpayer must now ask is whether a full or partial conversion makes sense for his or her situation.

Deciding whether to convert requires guesswork about one's tax bracket in retirement and potentially new government rules. Thus, many advisors recommend hedging one's bets by keeping retirement assets in accounts that are taxed in different ways.

There are several factors to consider:

- Are there sufficient outside funds to pay the conversion taxes? It is generally agreed that a traditional IRA should be converted to a Roth only if the owner has sufficient non-qualified funds available to pay the taxes.

- Is the estate taxable? Paying taxes to convert to a Roth IRA effectively reduces the taxes that will be owed on an estate. The Roth IRA serves as a valuable wealth transfer tool because account assets can grow and be distributed to the beneficiaries tax-free.

- What is the owner's current tax bracket? Will the income taxes payable on conversion push the owner into a higher tax bracket?

- What is the owner's projected post-retirement tax bracket? Anyone



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Nobles

who anticipates being in a higher tax bracket after retirement should consider converting to a Roth IRA, paying the taxes now so that post-retirement withdrawals can be made tax-free.

- What is the current IRA account balance? If a low-balance IRA is converted now and allowed to grow tax-free in a Roth, the conversion taxes paid by the owner now will likely be much lower than the income taxes he or she

would pay later when post-retirement withdrawals are made from the traditional IRA.

## SHOULD YOU CONTRIBUTE YOUR IRA TO CHARITY?

Adding to the complexity of the conversion conundrum is the question of charitable intent. Retirement assets such as traditional IRAs represent wonderful opportunities for the charitably inclined.

From a tax perspective, the most efficient use of IRA accounts is to use them to fund charitable estate gifts, leaving other assets to non-charitable beneficiaries.

As discussed above, lifetime distributions from IRAs are taxed as ordinary income. After death, retirement assets are generally considered "income in respect of a decedent." For larger estates, IRA funds may also be subject to estate tax, further reducing the value of the in-

herited IRA.

On the other hand, tax-exempt charities do not pay income taxes and therefore enjoy the full value of the IRA with its tax-deferred growth. Additionally, designating a charity as the beneficiary of a retirement account creates a charitable estate tax deduction.

If one plans to leave his or her retirement plan to charity, it doesn't make

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sense to do a Roth conversion. A charity inherits IRA assets free of tax; therefore, converting a traditional IRA to a Roth and paying the related taxes serves no beneficial purpose.

There are many factors to consider in deciding whether to convert a traditional IRA to a Roth — particularly for individuals with charitable intent.

**SHARON HETH** is vice president of charitable services at Allen Trust Co., which provides planning, compliance and investment management services to both charities and individuals. Contact her at [sharon@allentrust.com](mailto:sharon@allentrust.com). **CARRIE NOBLES** is vice president and trust officer specializing in fiduciary administration at Allen Trust Co. Contact her at [carrie@allentrust.com](mailto:carrie@allentrust.com).