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Should You Convert to a Roth? Pros Weigh In

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When would you like a tax break -- today or tomorrow?

That's always been the question to answer when deciding between a deductible traditional retirement account (IRA, 401(k), or otherwise) and a Roth retirement account. But this year, even more people are asking that question, since from 2010 onward, current tax law allows anyone to convert a traditional account into a Roth. The converted amount will be added to your income, raising your taxes (either this year or spread over 2011 and 2012, your choice), but the money henceforth grows tax-free (assuming Congress doesn't tinker with the rules).

So should you convert?

We put that question to a group of fee-only financial advisors from the Garrett Planning Network. Here's what they had to say:

"Conversion may be appropriate in the following situations: You expect your tax bracket to be higher once you retire; you have sufficient non-retirement dollars available now to pay any resulting tax liability; you have a long time horizon until you plan to retire; or you would like to leave a financial legacy to your children."
-- Deborah Winterhalter, CFP, Warrenville, Ill.

"Wealthy retirees or those with large pensions who aren't likely to need their required minimum distributions (RMDs) for their retirement living expenses may want to convert and pay taxes as a 'gift' to their beneficiaries -- typically children or grandchildren. Also, those who have made nondeductible contributions and therefore have IRAs that can be converted without a lot of taxable income should consider conversions. The rules are complex and individuals need to make sure they understand them or work with a competent tax advisor."
-- Leisa Brown Aiken, CFP, CPA, Chicago, Ill.

"Much of the Roth discussion focuses on whether a retiree's taxes will be lower or higher in the future. Obviously, this requires some speculation on things beyond our control. However, one thing we can do to take more control of our future tax rate is to have a more balanced portfolio (with a blend of tax-deferred and tax-free assets). Many clients have accumulated significant tax-deferred assets. At some point, RMDs may keep these folks in a higher tax bracket indefinitely. These folks should strongly consider converting some of these assets to Roth IRAs, enabling them to draw income from both pools later, and reduce taxable income. Keep in mind, the conversion itself could drive your tax rate much higher today. So generally, one should think in terms of making multiple, smaller conversions to manage the tax consequences. Better yet, plan to make a conversion strategically during a low tax year."
-- Garry Good, Bloomington, Ill.

"The argument that I hear for doing it is that tax rates will be higher when you retire. The counter argument is that the government will take away the tax free benefit of Roth. We don't know any of this and it's foolish to try to guess what Congress will do. There is a real financial benefit for investors in their 20s and 30s as they have enough time to recover the tax they paid on the conversion. The calculators out there are too simple as they only consider the value of the converted IRA against a traditional IRA. They overlook that the money to pay the tax on the conversion has to come from somewhere, so it's possible that even though your IRA balance is bigger when you die (a benefit?) your overall wealth could be smaller."
-- Frank Boucher, CEBS, CFP, Reston, Va.

"Yes, you should consider it especially since you can recharacterize [i.e., undo the conversion] and not pay tax if you structure the conversion correctly."
-- Frank Remund, Beaverton, Ore.

"A high-net-worth client or one with a high income should possibly consider it, since they are likely to easily be able to afford the tax bite on the conversion and since there are estate planning benefits. But even then, should they pay tax at a 33% marginal tax rate on the conversion, only to potentially find themselves in a 25% tax bracket during retirement? It really all comes down to tax diversification. Taxes are likely to increase in the future, but as clients retire, their income will decrease. So who can predict what the tax rate will be for that particular level of income? The best we can do is structure the client's savings and investments in a variety of taxable, tax-deferred, and tax-free accounts."
-- Kathleen Campbell, Ft. Myers, Fla.

"The 2010 Roth IRA conversion opportunity is advantageous if a person: 1) thinks their tax rates will be higher in retirement than they are now; 2) wants to leave money to heirs tax-free; 3) sees the value in tax-diversification (some money in tax deferred accounts and some in tax-free accounts); 4) has a special tax situation, for example low earnings in 2010 with prospect of higher earnings in the future."
-- Steve Juetten, CFP, Bellevue, Wash.

"I personally think that taxes are going to have to rise significantly over the coming years and that the individuals who traditionally have not been able to convert should consider it. These are people who obviously are in higher tax brackets and will most likely bear the brunt of these increases. Individuals who have at least 12 years until they plan on taking money from their converted accounts should see a huge benefit."
-- Michael Miller, CFP, Mansfield, Tex.

Confronting the conversion question

As any good financial advisor will tell you, everyone's different, so keep your own circumstances in mind as you decide whether to convert to a Roth. If you need a little professional help, visit the Locate an Advisor area of the Garrett Planning Network website. For a limited time, advisors with a Motley Fool logo next to their names are offering a 10% discount to Fool readers.

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