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Retirement and Estate Planning

Ruling could make Roth IRA conversions more attractive

Up-front taxes could be a deal breaker for many

By LAURA GLASSER

A new rule that opens up tax-free retirement accounts to high-income individuals could give the program a big boost. But some local advisers say the hype is much ado about nothing.

Starting in 2010, families with annual income of more than $100,000 will be able to convert their traditional individual retirement accounts to a Roth IRA. In a Roth IRA contributions are made with after-tax dollars, so distributions received upon retirement aren't taxed. While converting may benefit younger investors, experts caution that the resulting tax bill will be too costly for most.

Before this year, only those with less than $100,000 in annual income could convert.

Roth IRAs also don't require distributions to start when the owner is 70 ½ years old as traditional IRAs do, so retirees that don't need the money don't have to dip into their savings.

Paying taxes up front can be worthwhile for IRA holders that are a long way from retirement or think they'll be in a higher tax bracket when it comes time to take distributions, advisers said.

"The younger you are, the better it is, but the advantage of not having to take the money out at 70 ½ makes it even advantageous for those that are older," said Richard Reichler, counsel to Meltzer Lippe in Mineola.

Because account holders will have to pay taxes on all of their IRA earnings if they roll over to a Roth IRA, younger holders have more time to collect earnings going forward to offset the up-front costs, he added.

Michael Kresh of M.D. Kresh Financial Services said most wealthy individuals will decide to maintain their traditional IRAs despite the new regulation.

Also, since taxes almost always go up, when these high earners retire they can expect to be paying a higher tax rate. That means distributions from a traditional IRA will cost more, and paying tax on earnings now by converting to a Roth could save money on taxes going forward, Reichler said.

"Tax rates will go up even if Congress does nothing because at the end of this year the George W. Bush tax cuts, which were focused on people in the top 1 percent to 2 percent in terms of income, expire," he said.

Reichler said he expects a surge of higher-income clients to make the leap to a Roth IRA now that they have the option.

"We've done a couple of conversions already, but January is usually not the month that people act," he said, adding between now and April is when the influx should hit.

Other financial planners, though, don't think the change will significantly impact the Roth IRA market.

"When people choose to convert to a Roth IRA, they're agreeing to pay taxes today so as not to pay them tomorrow, which can amount to a lot of money," said Mark Snyder, head of Mark J. Snyder Financial Services in Medford. "Once people see the price they will have to pay, in most cases they'll decide it is not right for them."

Michael Kresh, head of M.D. Kresh Financial Services in Islandia, agreed that despite the hype, most higher-income individuals will stay put in their current retirement accounts.

"A lot of people have been talking about how this is the greatest thing since sliced bread, but if you're talking to people who make over $100,000 per year, the amount they've accumulated in their IRA is hundreds of thousands of dollars," he said, adding that means the tax bill to switch will be too high for a Roth to be appealing.

Kresh also said there's no guarantee that income taxes will go up, and many high earners won't want to take that gamble.

Both Kresh and Snyder said a Roth IRA only makes sense to a high-income individual if that person doesn't need the money to live on during retirement and plans to pass it to heirs. That way, the money will stay in the account for a significant amount of time and accumulate earnings to offset the upfront tax bill.

But Kresh said for the most part, he doesn't think he'll be recommending a Roth to many of his high-income clients.

"There's going to be a small surge and a lot of talk because it wasn't permitted before," Kresh said. "But most people, if they do the analysis correctly, will determine that just because they're eligible to convert, doesn't mean they should.