# Roth IRA conversion not a good fit for all, tax expert says

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Starting next year, anyone can convert retirement savings into tax-advantaged Roth individual retirement accounts, but the much-touted switch isn't for everyone, a University of Illinois expert on tax and elder law warns.

Law professor Richard L. Kaplan says financial advisers are largely overselling the potential benefits of new rules that take effect Jan. 1, eliminating an earnings threshold that has kept many people from shifting into a Roth.

For the first time, individuals and married couples whose income from all sources - including salaries and investments - tops $100,000 will be able to convert to a Roth, whether from traditional IRAs or work-sponsored 401(k) or 403(b) accounts.

"This is a historic opportunity, but people really need to take a close look at the pros and cons because the conversion decision is more complicated than it appears," said Kaplan, who examined the swaps in an article that appeared in the *Daily* Tax *Report*, published by the Bureau of National Affairs.

He says supporters hail the move as a hedge against federal tax rates that could ultimately surge to bankroll big-ticket initiatives such as health-care reform, wars, deficit reduction or shoring up Social Security. Even without a new increase, tax rates will rise in 2011 after the Bush administration's 2001 and 2003 tax cuts expire.

By switching to a Roth, people can pay today's tax rate on the amount converted, rather than potentially higher rates later on as they withdrew money from traditional IRAs. Income can then compound tax-free because no tax is assessed when money is withdrawn from a Roth.

In addition, Roth accounts require no mandatory withdrawals after a person reaches age 70 ½, in contrast to other retirement savings plans. Consequently, more money can accumulate in a Roth for potential heirs.

Financial advisers say the timing of the new conversion rules is an added bonus because account values are withered by recession and will grow in a Roth - tax free - as the economy rebounds.

Kaplan says the advantages are significantly overstated, based on the "more robust analysis" in his article.

"Converting to a Roth has definite pluses, but there's also a huge drawback - you have to pay taxes today that could be deferred, and most people try not to pay taxes sooner than necessary," Kaplan said. "That pay-now requirement is a bitter pill to swallow, perhaps an insurmountable barrier for many people."

Even if tax rates rise, he says the tax consequences of converting to a Roth may be more than people would pay if they withdraw smaller amounts from traditional accounts over a period of years or even decades. That disparity can be even higher if the money ultimately will go to heirs who will be in lower tax brackets when they cash out the accounts.

Converting has added tax implications for older Americans, Kaplan said. Because the amount converted must be reported as income during that tax year, it can increase the amount of Social Security benefits that are taxable and boost the cost of means-tested Medicare benefits for highincome retirees.

"This conversion tax is not something people should try to calculate on the back of an envelope," he said. "The cost is going to be higher than most people realize once they consider all of the collateral consequences."

The pro-conversion bandwagon also overlooks the "opportunity cost" involved, said Kaplan, a member of the National Academy on Social Insurance and a delegate to the U.S. Department of Labor's National Summit on Retirement Savings in 2002.

"What could you do with that cash if you were not paying it to the government in conversion taxes?" he said. "Might the money be better invested in growth stocks or municipal bonds, or perhaps spent on the grandkids' college expenses or to pay for in-home care so you don't have to go to a nursing home?"

Kaplan also warns that the tax benefits of a Roth IRA can vanish at the whim of Congress. Laws governing the program can change, he said, just as the income threshold was lifted as part of the 2006 Pension Protection Act in hopes of fueling conversions to prop up the nation's sagging treasury.

"The biggest advantage of a Roth is that after the account has been maintained for five years, you usually do not owe tax on withdrawals, but that assumes Congress doesn't change the law in the future," he said. "They probably wouldn't tax what people put into a Roth a second time, but they could certainly change how withdrawals of earnings are taxed."

Source: University of Illinois at Urbana-Champaign (news : web)