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The Estate Planning Benefits of Converting a Traditional IRA to a Roth IRA

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July 2016

Under certain circumstances, converting a traditional IRA to a Roth IRA can be a simple and powerful strategy that eliminates the application of the required minimum distribution rules, allows for continued tax free growth of IRA assets, results in significant income and estate tax savings, and increases wealth.

Roth IRAs are not subject to the required minimum distribution rules that apply to traditional IRAs, allowing you to compound your IRA account income tax free for life. Upon conversion from a traditional IRA to a Roth IRA, you will have to pay federal and possibly state income tax on any accumulated earnings and tax deductible contributions. Although paying income tax sooner – rather than deferring payment – is contrary to conventional income tax planning, under appropriate circumstances, converting your IRA and prepaying the tax may be an effective income and estate planning strategy if you can afford to pay the tax with non-IRA assets. As the income tax will ultimately be paid either by you or your beneficiaries, prepayment on conversion removes the income tax dollars from your estate and is akin to making a gift to your beneficiaries with no gift tax consequences and without using any of your estate and gift tax exemption amount.

After death, in the event your spouse survives, he or she would generally be well advised to roll-over the Roth IRA to their own name, thus being treated as the owner of the account and naming your children as beneficiaries. By doing so, the surviving spouse would also not be subject to the required minimum distribution rules, allowing further compounding of the IRA account income tax free for the remainder of the surviving spouse's life.

Upon your spouse's death, your children would have to start taking required minimum distributions over their life expectancies. Because you converted your traditional IRA to a Roth IRA, the distributions will be income tax free to your beneficiaries as long as the conversion took place at least five years prior to the withdrawal dates. If the beneficiaries are financially able to take only the required minimum distributions, they can stretch the distributions over their life expectancy, thereby continuing to extend the tax free growth of the account. Both the original amount of the IRA at the time of conversion, as well as the accumulations, will never be subject to income tax.

Your marginal income tax rate vs. your beneficiaries' marginal income tax rates may be a factor to consider prior to converting a traditional IRA to a Roth IRA. However, the time periods when your beneficiaries will begin to take distributions, and their income tax rates at that time, are unpredictable. Therefore, factoring this in could be extremely imprecise. The extended income tax free compounding of your IRA, the estate tax savings upon prepayment of the income tax, and the value of an income tax free annuity to your beneficiaries are benefits that can be predicted with some degree of certainty.

Converting a traditional IRA to a Roth IRA will not make sense under all circumstances. For those who have a significant amount of assets in a traditional IRA, do not need distributions from an IRA for support, have sufficient non-IRA assets to pay the income tax upon converting to a Roth IRA, and desire to leave beneficiaries an opportunity to inherit a substantial annuity, a conversion may make sense.

If you have questions regarding the information discussed in this Alert, please contact the author **Laurence E. Fundler**, a member of the firm's **Tax, Trusts & Estates Department**.