

Be Aware of the 5 Year Clock – Roth IRA Conversion



Do you think the decision to convert to a Roth IRA is an easy one? The advantages of a Roth over a traditional IRA include withdrawals of principal and earnings free of income tax. Also, heirs don't pay income tax on withdrawals from inherited IRAs. But...you must pay ordinary income tax on each dollar converted. Paying taxes now diminishes the prospect of conserving principal, but consider the notion of higher taxes in the future. The benefit of converting this year is the ability to spread the tax bill over two years, splitting it between your 2011 and 2012 tax returns.

There are separate rules for a conversion of an IRA to a Roth IRA vs. an existing Roth IRA. Earnings can be withdrawn tax free without penalty after five years and a qualifying event such as turning 59 1/2. Many investors don't understand that there can be multiple five year clocks running simultaneously that apply to Roth IRA withdrawals. A five year clock starts the day a Roth IRA is opened and funded. If an investor is younger than 59 1/2 when a particular conversion is completed and withdraws money before the clock associated with that conversion runs out, he or she will be hit with a 10% penalty.

Call us today to see if a Roth Conversion is right for you.