When is a Good Time For Roth Conversion?

In life, you often get second chances — and the same is true with investing. To illustrate: You might not have been able to contribute to a Roth IRA during your working years due to your income level, but you may get that opportunity as you near retirement, or even when you are retired — through a Roth conversion.

Why is a Roth IRA desirable for some people? Here are the key benefits:

• *Tax-free withdrawals* — You put in after-tax dollars to a Roth IRA, so you can withdraw your contributions at any time, free of taxes and penalties. And if you've had your account for at least five years and you're at least 59½, you can also withdraw your earnings free of taxes.

• *No RMDs* — With a traditional IRA, you'll have to start taking withdrawals — called required minimum distributions, or RMDs — when you turn 73, or 75 if you were born in 1960 or later. But there's no RMD requirement with a Roth IRA — you can essentially leave the money intact as long as you like.

• *Tax-free legacy for your heirs* — When your heirs inherit your Roth IRA, they can withdraw the contributions without paying taxes or penalties, and if the account has been open at least five years, they can also withdraw earnings tax free.

But even if you were aware of these advantages, you might not have been able to invest in a Roth IRA for much of your life. For one thing, you might have earned too much money — a Roth IRA, unlike a traditional IRA, has income limits. Also, a Roth IRA has only been around since 1998, so, in the previous years, you were limited to a traditional IRA.

As you approach retirement, though, you might start thinking of just how much you'd like to benefit from a Roth IRA. And you can do so by converting your traditional IRA to a Roth. While this sounds simple, there's a major caveat: taxes. You'll be taxed on the amount in pre-tax dollars you contributed to a traditional IRA and then converted to a Roth IRA. (If you have both pre- and after-tax dollars in your traditional IRA, the taxable amount is based on the percentage of pre-tax dollars.)

If you have large amounts in a traditional IRA, the tax bill on conversion can be significant. The key to potentially lowering this tax bill is timing. Generally speaking, the lower your income in a given year, the more favorable it is for you to convert to a Roth IRA. So, for example, if you have already retired, but have not started collecting RMDs, your income may be down.

Timing also comes into play with the financial markets. When the market is going through a decline, and the value of your traditional IRA drops, you could convert the same number of shares of the underlying investments and receive a lower tax bill or convert more shares of these investments for what would have been the same tax bill.

Finally, you could lower your tax bill in any given year by stretching out your Roth IRA conversions over several years, rather than doing it all at once.

You'll want to consult with your tax advisor before embarking on this conversion — but if it's appropriate for your situation, you could find that owning a Roth IRA can benefit you and your family for years to come.

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