ED SLOTT'S IRA ADVISOR

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TAX & ESTATE PLANNING FOR YOUR RETIREMENT SAVINGS

Special Issue

15 Roth Conversion Traps

The Roth conversion floodgates are open! But while the attraction of "tax free forever" can be powerful, Roth conversions can trigger unintended tax traps and financial problems that are not being addressed in the mounds of 2010 Roth conversion information that currently dominates the media.

In some cases, these traps may cause your clients to take a second look at when to convert, how much to convert, or even if they should convert at all. Certain tax and planning details should be addressed in every Roth conversion evaluation. Don't let your clients get caught by surprise by any of the items in our list below.

1. New Roth Accounts Need New Beneficiary Forms

The beneficiary form is, by far, the single most important estate planning document when it comes to IRAs – and Roth IRAs. It controls who will ultimately end up with the money and how long they will be able to keep it (the stretch). In fact, when you think about it, the IRA (or Roth IRA) beneficiary form really determines the ultimate value of that account.

While every custodian will have its own procedures for a conversion, a new account is generally established. Just like any other new retirement account, the new Roth IRA will need to have beneficiary forms submitted with it. What's more, not having beneficiary forms for a Roth IRA is even worse than not having them for a traditional IRA (although neither is good and should ever happen with your clients).

Roth conversions can trigger unintended tax traps.

Why? Absent favorable default provisions in the custodial agreement, an individual who inherits an IRA without being named (or is otherwise identifiable i.e. "children equally") on the beneficiary form will not be considered a designated beneficiary. In such a case, if the IRA owner died before their required beginning date (RBD), the account must be emptied within five years. If the IRA owner died after their RBD, the distributions may continue to be stretched over the IRA owner's remaining single life expectancy, had he lived.

But a Roth IRA has no required distributions! That means that a Roth IRA owner can never reach their RBD, so if

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