

Here's Another Reason to Do a Roth IRA Conversion. Your Heirs Will Thank You.

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By Neal Templin
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If you're planning to leave a tax-deferred account to your children, you may be able to save them a lot of money by doing Roth conversions while you're alive.



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Suppose you have a \$2 million tax-deferred account and your two children are equal heirs. Each will receive \$1 million of tax-deferred assets when you die. They have to empty it in 10 years, paying taxes on each dollar as it comes out of the account. So if your children inherit a tax-deferred account while at the peak of their earning years, they could face federal and state tax rates as high as 50%, says David Frisch, a Melville, N.Y., certified public accountant and financial advisor.

In such a case, you should compare your marginal tax rate to that of your children to decide if a Roth conversion makes sense, Frisch says. If it involves large amounts of money, you'll probably have to do the conversion over several years to avoid pushing yourself into a higher bracket.

"By doing a conversion now and paying tax, you're making an indirect gift," he says, "because now your heirs don't have to pay that tax."

If there is a large estate in excess of the \$12.06 million lifetime exemption, Roth conversions can also be winners, Frisch says. Suppose you have a \$15 million estate, including a \$10 million tax-deferred account and a \$5 million after-tax brokerage account.

If you die, your estate will be subject to roughly \$1.5 million in estate taxes because it's over the limit, Frisch calculates. In addition, your heirs will have to pay taxes when they empty the \$10 million tax-deferred account over the next decade. If they're in the 40% bracket, that's an additional \$4 million in taxes.

Now suppose you instead converted the entire \$10 million in the tax-deferred account to a Roth IRA, using the money in your brokerage account to pay \$4 million in taxes. When you died your heirs would owe no further taxes and receive a \$10 million Roth IRA and \$1 million brokerage account.

"In scenario 1, you're netting \$9.5 million," Frisch says. "In scenario 2, you're netting \$11 million."

Still Frisch cautions there are situations where a Roth conversion doesn't make sense. Suppose you're in the 37% bracket, and your child is in the 22% bracket. "Then it makes sense not to do the conversion and have the child pay the tax," Frisch says.

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