TD Ameritrade

FAQs
Roth IRA Conversions

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What is a Roth IRA conversion?

A Roth IRA conversion is a type of transaction in which you elect to move or convert some or all of your Traditional IRA savings to a Roth IRA.

What are the tax consequences of a Roth IRA conversion?

The amount you convert to a Roth IRA is typically taxed as ordinary income in the year of conversion (except for amounts representing basis in your existing plan). If you are under age 59½, the 10 percent early distribution penalty tax does not apply to the amount you convert, however, additional distributions taken to pay conversion taxes may be subject to the 10 percent early distribution penalty unless you qualify for a penalty exception.

How can a Roth IRA conversion help protect me from future tax rate increases?

When you convert retirement savings to a Roth IRA, you pay taxes in the year of conversion based on the current federal income tax rates. Once converted to a Roth IRA, future earnings generally accrue on a tax-free basis thereby providing protection from future tax rate increases.

Do tax rates have to go up significantly for me to benefit from a Roth IRA conversion?

No. While the potential benefits of a Roth IRA conversion vary significantly depending on each individual's circumstances, in many cases, a Roth IRA conversion can yield significant benefits even without anticipating a significant increase in future tax rates. This is especially true for individuals who have non-IRA resources available for paying the taxes on a Roth IRA conversion.

Is there any benefit of a Roth IRA conversion if tax rates stay the same (or actually go down) in the future?

While one of the key advantages of a Roth IRA conversion is its ability to help you hedge against future tax increases, this is not the only potential benefit of a Roth IRA conversion. For example, unlike Traditional IRA savings, Roth IRA savings are not subject to mandatory distributions beginning at age 70½ and, therefore, can provide valuable extended tax shelter if you are hoping to pass some or all or your retirement savings on to your heirs.

How can a Roth conversion potentially help me provide a greater financial legacy to my heirs?

When you convert retirement savings to a Roth IRA, you pay taxes in the year of conversion based on the current federal income tax rates. Once converted to a Roth IRA, future earnings generally accrue on a tax-free basis (versus a tax-deferred basis as with Traditional IRA savings).

What's more, unlike Traditional IRA savings, Roth IRA savings are not subject to mandatory distributions at age 70½. Because Roth IRA assets are not subject to mandatory distributions during your lifetime, the Roth IRA allows you to extend the tax-sheltered life of your retirement savings, which can potentially result in a greater financial legacy for your heirs.

What changed in 2010 with Roth IRA conversions?

Prior to 2010, individuals or couples with modified adjusted gross income (MAGI) in excess of $100,000 (as well as married individuals who file separately) were ineligible to convert retirement savings to a Roth IRA. The Tax Increase Prevention and Reconciliation Act (TIPRA), enacted on May 17, 2006, removed the eligibility restrictions for Roth IRA conversions, effective January 1, 2010. As a result of TIPRA, beginning in 2010, anyone with eligible retirement plan (including Traditional IRA) assets is generally able to convert to a Roth IRA.

In addition, IRA owners and plan participants who converted in 2010 had the option of including the taxable conversion amount in income ratably over two years (2011 and 2012), or including the entire amount in income for tax year 2010. For example in 2010, Tom converted his Traditional IRA to a Roth IRA. The value of the Traditional IRA at the time of conversion was $200,000. Normally, Tom would have included the full $200,000 (no basis) in income for tax year 2010, however, because of the special tax option available for 2010 conversions, Tom could have included $100,000 in income for tax year 2011 and $100,000 in income for tax year 2012, unless he elected to include the entire $200,000 in income for tax year 2010.

Conversions: Eligibility

Which of my assets are eligible for conversion to a Roth IRA?

Assuming you meet the basic eligibility criteria for converting, your Traditional IRA assets, including contributions made to your Traditional IRAs under Simplified Employee Pension (SEP) plans, maybe converted to a Roth IRA. SIMPLE (Savings Incentive Match Plan for Employees) IRA assets may also be converted to a Roth IRA as long as it has been at least two years since you first received a SIMPLE IRA contribution under the employer's SIMPLE IRA plan.

In addition, eligible distributions from qualifying employer retirement plans may be converted to your Roth IRA. Qualifying employer retirement plans include qualified plans (e.g., 401(k) plans or profit sharing plans), governmental 457(b) plans, 403(b) arrangements, and 403(a) arrangements.

May I convert my required minimum distribution (RMD) from my existing plan to a Roth IRA?

No. Required minimum distributions (RMDs) may not be converted. However, once an RMD is withdrawn, the plan participant may generally convert all or a portion of the remaining plan balance.

May I convert to a Roth IRA even if I do not have earned income?

Yes. You do not have to have earned income to be eligible to convert existing retirement plan savings to a Roth IRA.

I have after-tax basis in my Traditional IRA; may I convert just the after-tax amount?

No. It is not possible for you to convert only Traditional IRA basis. If only a portion of your IRA is converted, the conversion is pro rata representing a portion of the assets subject to taxation and a portion that represents the return of basis. For purposes of calculating the return of basis, you must treat all of your Traditional and SIMPLE IRAs as one IRA.

TD Ameritrade does not provide tax advice, and each investor's situation will be unique. We strongly recommend you consult a qualified tax-planning professional with regard to your personal circumstances.

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