By John Spoto

To Roth or not to Roth?

That is the question investors are asking.

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A widely held financial tenet is that the longer you can defer paying taxes the better, because the money otherwise devoted to taxes will continue to work on your behalf.

Converting an existing traditional IRA to a Roth defies this principle in that it deliberately accelerates tax payments. The prudence of doing so is hotly debated and the topic has attracted even greater attention since Congress lifted income restrictions on Roth IRA conversions, allowing anyone with a traditional IRA to convert to a Roth regardless of income or wealth.

Traditional and Roth IRAs have the same annual contribution limits. They both receive favorable tax treatment and allow you to begin withdrawals at age 59½ without penalty. Beyond this, there are big differences.

Subject to income limitations, traditional IRA contributions are tax deductible and account balances grow tax deferred. They are taxed when distributions are taken, which can be no later than age 70½. In contrast, a Roth account owner makes contributions with after-tax money. Once the contribution is made, however, there is no requirement to take distributions from a Roth IRA. You can let the account grow tax free for as long as you want, even passing on the balance to an heir.

The decision of whether to convert is dependent upon current and future tax assumptions, as well as your goals and financial resources. Let's look at three central considerations for determining if a Roth conversion is right for you.

1. CURRENT VS. FUTURE TAX BRACKETS

Future taxes are an important factor in your decision, albeit a difficult one to determine with accuracy. If you expect to be in a higher tax bracket when making withdrawals, a Roth conversion could result in a larger after-tax portfolio than a traditional IRA because the advantage of a Roth's tax-free growth and distributions will outweigh the cost of paying taxes now.

2. SOURCE OF FUNDS TO PAY CONVERSION TAXES

What money you use to pay income taxes on the amount converted is important. If you pay the taxes from your traditional IRA or another retirement account, you will lose the potential benefits of tax-free growth on that amount. To make matters worse, if you're under 59½ you can get hit with a 10 percent federal early withdrawal penalty. Conversely, using taxable (non-retirement assets) to pay the taxes has the effect of increasing the size of the IRA.

3. INVESTMENT TIME HORIZON

Unlike a traditional IRA, Roth owners are not obligated to begin taking required minimum distributions at age 70½ or anytime during their lifetime. You can keep the money growing tax free. The longer the money stays in the account the more time it grows without the drag of taxes. This increases the likelihood of recouping the taxes paid on the amount converted, making the conversion a good idea. This means a Roth is an excellent estate planning tool if you don't expect to spend all your assets during retirement and plan to leave the balance to heirs.

It is impossible to know with certainty the economic results of a Roth conversion. However, you can draw some reasonable conclusions by doing your homework. The opportunity to preserve and increase your lifetime wealth and pass down a financial legacy to your heirs should provide a great incentive. NOB