Consumers Digest

AVOID BIG LOSSES ON ROTH CONVERSIONS

This year taxpayers no longer are required to have a modified adjusted gross income of [less] than $100,000 to convert a traditional individual retirement account to a Roth IRA. However, many folks plan to convert only their non-deductible IRAs, says Burk Rosenthal of Rosenthal Retirement Planning. "But if they have other IRAs, this could present a problem," he warns, because you must "pay tax on the conversion based upon the percentage of untaxed value in all non-Roth IRA accounts."

For example, take a person who has one IRA that has $80,000 from a 401(k) rollover and another IRA that totals $10,000 from $9,000 in after-tax contributions and $1,000 in gains. (None of that gain has been taxed.) You must "pay tax on the conversion based upon the percentage of untaxed value in all non-Roth IRA accounts," Rosenthal says. In this example, the total untaxed value of all non-Roth accounts is $81,000, which is 90 percent of the total $90,000 value of all non-Roth IRA accounts. Therefore, 90 percent of the IRA that is being converted will be included in taxable income, or, in this case, [$81,000]. To prevent double taxation, you must file IRS Form 8606 to apply the additional taxable basis ($9,000 in the above example) to the prior taxable basis (also $9,000) from after-tax contributions.

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