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Roth IRAs:

A wealth transfer strategy

Some high net worth individuals have assets in Traditional IRAs and 401(k) plans that they no longer need to fund their own retirement. In many cases, they simply choose to leave them for their children to inherit. Unfortunately, these types of plans are poor wealth transfer vehicles because the owner is typically subject to required minimum distributions (RMDs) starting at age 73, and distributions to their beneficiaries could also be subject to ordinary income tax. The income taxable inheritance of a Traditional IRA may be even more inefficient if the beneficiary is in a higher income tax bracket than the presumably retired IRA owner.

By converting to a Roth IRA, the owner is able to eliminate RMDs and potentially leave their heirs a larger tax-free legacy.

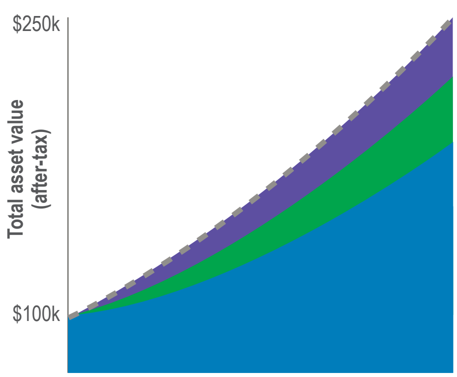
One example: Elizabeth, age 73

Elizabeth has a Traditional IRA worth $100,000. Elizabeth and her spouse do not need the IRA and wish to pass as much to their child as possible. They are in the 22% tax bracket and assume Elizabeth's IRA will grow 6% each year over the next 15 years.

Some of Elizabeth's options include:

1. Leave it as a Traditional IRA and use RMDs for leisure activities
2. Leave it as a Traditional IRA, pay RMD taxes with IRA assets, and reinvest RMDs in nondividend paying capital assets
3. Convert to a Roth IRA and withhold assets from the IRA to cover the conversion tax liability[1]
4. Convert to a Roth IRA and pay the tax liability with assets outside of the IRA[1]

Conversion to a ROTH IRA Can Pay Off



	Total lifetime RMDs	At death total asset value	Total taxes paid by the beneficiary (32% tax bracket)	After-tax amount distributed to beneficiary
Roth IRA[2] (Conversion tax paid with outside assets)	$0	$239,656	Tax-Free	$239,656
Roth IRA[2] (Conversion tax paid with IRA assets – assumes $22,000 of outside assets growing 6% for 15 years, step-up in cost basis at death)	$0	$239,656	Tax-Free	$239,656
Traditional IRA (Reinvest RMDs in nondividend paying capital assets – assumes $22,000 of outside assets growing 6% for 15 years, step-up in cost basis at death)	$85,629	$264,799	$36,572	$228,227
Traditional IRA (Spent RMDs – assumes $22,000 of outside assets growing 6% for 15 years, step-up in cost basis)	$85,629	$167,010	$36,572	$130,439

Of the four options in this example, converting the traditional IRA to a Roth IRA pays the largest distributions to Elizabeth's heir.

Elizabeth believes that in 15 years her traditional IRA will be worth only a little more than it is today and possibly would still be taxable to her adult child who earns a substantially higher income. By converting the traditional IRA to a Roth IRA today, and paying tax on the assets now at her lower rate, she can potentially leave a substantially larger tax-free inheritance to her child. By choosing the Roth conversion, she will need to pay approximately $22,000 of income tax in the year of conversion.

This illustration does not guarantee or predict actual performance and assumes that no additional distributions beyond the RMD are taken from these accounts.

Securities may lose value and are not insured by the FDIC or any federal government agency. They are not a deposit of or guaranteed by any bank, bank affiliate, or credit union.

A ROTH IRA conversion may benefit those who:

- Wish to leave assets currently held in a traditional IRA or qualified retirement plan tax-free to their heirs
- Will not need the funds held in a traditional IRA or qualified retirement plan for immediate retirement income
- May benefit from having access to tax-free income from the Roth IRA. (See IRS Publication 590-B for rules regarding qualified distributions and order of rules)
- Have outside assets to pay the tax liability assessed upon the Roth IRA conversion
- May want to leave retirement assets to a trust
- Have large income tax deductions, such as:
  - Pass-through business losses for small-business owners
  - Medical deductions
  - Charitable deductions

Roth IRAs are not subject to RMDs, allowing the assets to stay in the account without required annual distributions.[3] Over time this can be advantageous, creating a greater transfer of wealth than a traditional IRA. By doing a simple comparison, you will be able to evaluate the power of a Roth IRA conversion as a wealth transfer strategy.

Assuming the beneficiary and the original owner have the same tax rate, a Roth conversion will provide the same amount of proceeds at death. Also, a beneficiary in a lower tax rate than the original owner will receive less if the proceeds are converted to a Roth than if there was no conversion.

A ROTH IRA conversion may not benefit those who:

- Are closer to retirement, because they will have less time for the account to accumulate tax-free earnings
- Have traditional IRA assets held in an annuity contract with additional benefits (the Entire Interest Rule may apply to calculating the taxable conversion amount)
- Are currently enrolled in Medicare, or those who are age 63–64 and will be enrolling in Medicare at age 65 (additional taxable income could impact future Medicare premiums)
- Are in a higher income tax bracket than they expect their heirs to be

Transamerica can help with restricted beneficiary designations that control how your beneficiaries will receive the asset.

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[1] Non-qualified distributions could be taxable if received within five years of the conversion. See IRS Publication 590-B for ordering rules of distributions.

[2] These figures are based on the assumption that no RMDs are taken from Roth IRAs.

[3] Inherited Roth IRAs are subject to required minimum distributions (RMDs). Please consult with a tax professional.

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The tax costs with a Roth IRA conversion can be significant. Contributions are subject to taxes that were previously deducted, including any accumulated earnings. Clients may also be pushed into a higher tax bracket, especially if converting a large amount of money. Withdrawals prior to age 59½ are subject to ordinary income tax and a 10% early withdrawal penalty may apply. Please consult with a tax professional.

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