Investment Tip: Roth IRAs Provide Silver Lining to Market Downturn

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The economic downturn has provided an excellent opportunity to convert traditional IRA assets to Roth accounts, since equity holdings in IRA accounts are lower in value. The account holder has to pay tax on the converted amount (assuming the contributions weren't taxed in the first place), so the lower values provide an opportunity for less tax to be paid. Once shares are converted to a Roth account, they will grow tax-free, as long as the Roth requirements are met (such as the 5-year holding period).

Here's an example: Suppose the account holder purchased shares for a traditional IRA at $50 per share and those shares are now worth $10 per share. Those shares can be sold, and the funds can be used to purchase shares for a Roth IRA. Alternatively, the shares can simply be transferred from the traditional IRA to the Roth IRA.

The account holder will have to pay taxes on the conversion to a Roth, but the taxes would be 80 percent less than they would have been when the shares were purchased originally. As the economy improves and those shares grow in value, that growth will be tax-free because it's in a Roth IRA.

For some people, the Roth conversion can be even cheaper than before, if retirement or a job loss has reduced earnings and put them into a lower tax bracket.

There are a few details to watch when doing a Roth conversion, especially if you have both tax-deferred and taxable investments in your IRA accounts. So it's best to work with an advisor to be sure that you're doing the conversion properly.

Fiduciary - fi·du·ci·ar·y   adj.: An individual, company or institution that has a legal duty to put the interests of their clients above their own.