We are in our late 70s. Should we convert our IRAs to a Roth?

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Q. My wife and I are in our late 70s and are living comfortably on our Social Security and Required Minimum Distributions. Most of our investments are in standard IRA accounts. I have been giving serious consideration to moving IRA assets into Roth IRA's. I know that I will have to pay income taxes if we make those moves and given the likelihood of increasing tax rates, what are the issues to consider and how do I plan so that I don't get hammered with taxes?
— Investor

A. There are many benefits to having a Roth IRA, including tax-free growth of the funds and eventually, tax-free withdrawals.

Roth IRAs are also not subject to Required Minimum Distributions (RMDs).

There are a variety of issues to be aware of before you proceed with a Roth conversion.

First, if you decide to proceed with converting some or all of your traditional IRAs to Roth IRAs, you will need to pay taxes on the earnings in the year of conversion, said Marnie Hards, a certified financial planner with Aznar Financial Advisors in Morris Plains.

"Please keep in mind that the calculation is based on all of your retirement accounts combined," she said. "You cannot cherry pick the accounts that have less embedded gains."

Hards offered this example.

If you have $100,000 in various retirement accounts with $20,000 of basis — after-tax contributions — you would have $80,000 of gains. So any conversion will result in taxes due on 80% of the amount converted.

If you decide to convert $20,000 of your IRA this year, you would be responsible for paying taxes on $16,000 of the conversion at your current ordinary income tax rates, she said.

Ideally, you would use funds from sources outside of your IRA to pay the taxes due as a result of the conversion, Hards said.

Also, she said, it's important to carefully calculate the impact this conversion will have on your overall tax situation because increases in taxable income can have an impact on other items you may not consider.

For example, as a married couple filing jointly, you would be subject to "Income Related Monthly Adjustment Amounts," also known as IRMAA, if your income exceeds $176,000. This would result in higher monthly Medicare premiums, she said.

It is also important to consider where you are living in retirement.

"If you expect your state income tax rate to change, this is something that should be factored into your analysis," she said. "If you are moving to a state with a lower tax rate or no income tax, you may want to wait to convert until you have moved."

A Roth conversion may also be an opportunity to pass on more to your heirs because they won't have to pay taxes on the Roth IRA distributions, Hards said.

"But consider that if your heirs are in a lower tax bracket than you are, it may actually make sense to leave the funds in the traditional IRA under the assumption that they will pay lower taxes on their distributions in the future than you might pay on your conversion now," she said.

It makes sense to meet with an accountant who can help you to run the numbers, she said.

"It may make sense for you to make small conversions each year to keep your tax bracket low and avoid any sort of income related adjustments to your Medicare premiums," she said. "If your tax rates do go up in the future, then you would benefit from paying taxes at a lower rate now."

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