**401(k) vs. IRA: The Real Roth Conversion Question**

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For some clients, moving traditional retirement funds into a Roth account may seem like a no-brainer—but once the decision to convert is made, choosing whether to use a Roth IRA or Roth 401(k) can have potentially significant repercussions. While the typical goal of a Roth conversion—reducing tax liability during retirement—can be achieved with either account, that’s where the similarities end. In order to fully achieve the client’s goals, it’s the *dissimilarities* between these two Roth varieties that can make all the difference.

**Why Use a Roth IRA?**

One important characteristic of a Roth IRA conversion is the client’s ability to undo the transaction through a recharacterization transaction that moves the funds back into the traditional account, eliminating the tax liability that the initial conversion created. This option is unavailable if the client chooses to convert to a Roth 401(k).

If the client’s account performs poorly in the months after the conversion takes place, or if the client otherwise finds that he or she can’t pay the tax bill that results from a Roth conversion, the client has until October 15 of the year following the conversion to recharacterize the funds. Once a Roth 401(k) conversion takes place, however, the client is required to pay the associated taxes regardless of any events that occur post-conversion.

Further, a client who converts to a Roth IRA is able to escape the IRS’ required minimum distribution (RMD) rules so that the funds in the account are permitted to grow tax-free over a longer period of time. Clients who use Roth 401(k)s are required to comply with the RMD rules when they turn 70 ½, possibly reducing the account’s growth potential if the client doesn’t need to access the funds. A client who plans to use the Roth account as a wealth transfer vehicle may also prefer the Roth IRA because the entire account value can be passed to the client’s heirs upon his or her death.

Clients who anticipate that they will need access to the funds before retirement should also consider how the application of the “five year rule” could impact the tax-free availability of these funds. To access the funds, a qualifying event must have occurred *and* the Roth must be at least five years old before a qualified distribution is permitted. However, if the client has multiple Roth IRAs, only *one* of the client’s IRAs must be five years old before a tax-free withdrawal is permitted. With a Roth 401(k), the particular account must be five years old or a penalty tax will apply.

**The Roth 401(k) Difference**

Importantly, while high-income clients convert an IRA to a Roth IRA, post-conversion contributions may be limited or blocked entirely because of the income limits that apply to Roth IRA contributions (but not to Roth 401(k) contributions). In 2014, the ability to make contributions to a Roth IRA begins to phase out for married clients with income over $181,000 ($114,000 for single clients). Roth IRA contributions are completely blocked for married clients who earn over $191,000 and single clients who earn over $129,000.

Therefore, for high-income clients who wish to contribute directly to their Roth accounts after the conversion, a Roth 401(k) conversion is the only option.

Stronger creditor protection rules also apply to Roth 401(k) accounts. While Roth IRAs are protected under state law, the rules that apply in some states offer much less in the way of creditor protection than can be found in others. Roth 401(k)s are always protected by ERISA-mandated federal creditor protection rules regardless of where the client lives.

**Conclusion**

The benefits that can be attained through funding a Roth account make the conversion decision simple for many clients. Despite this, it’s important to remember that when it comes to deciding between a Roth IRA and a Roth 401(k), the substantial differences between the two account varieties cannot be overlooked.