

ROTH IRA CONVERSION: IS IT A WORTHY IDEA FOR ME?

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A big financial planning topic being discussed for 2010 is the conversion of an IRA into a Roth IRA. In theory, it sounds great: distributions from a Roth IRA are tax free in retirement. But in practice, paying the taxes now may not make sense. This brief paper will answer, "when, under what conditions, does it make sense to convert an IRA into a Roth IRA". You may be wondering, "why all the buzz?" We offer some general thoughts and guidelines, and you are encouraged to review your situation with tax planners, investment and estate advisors.

The difference between a traditional IRA (contributory or rollover IRA) and a Roth IRA centers around the contributions made over the years. Traditional IRA contributions most often were made with pre-tax dollars and were deductible on your tax return, whereas Roth IRA contributions were post-tax contributions and not deducted on your tax return. For IRAs, both contributions and investment earnings thereon are generally taxed as ordinary income upon withdrawal. For a Roth IRA, there is no income tax on withdrawals. In the IRA, all monies are tax-deferred, with income taxes being paid when monies are withdrawn. Roth IRA withdrawals are tax-free, because the taxes were paid before the money was deposited (after-tax contribution). Also, the traditional IRA requires minimum distributions beginning at age 70.5 (which are taxable), whereas a Roth does not require minimum distributions.

Traditional IRA accounts and other 401K, 403b, 457, and profit sharing accounts may be converted into a Roth IRA. When converting, you will pay ordinary income taxes on the withdrawal amount (partial or total/whole). The tax rate you pay depends on many factors, but is most influenced by the amount of "income" converted when added to other ordinary wages and investment earnings. Conversions processed in 2010 are permitted to defer tax payments until 2011 and 2012 tax returns are filed (they can be paid with the 2010 tax return). But, caution is warranted, as tax rates for 2011 and 2012 may be higher than those current for 2010. Thus, the tax rate and/or amount of taxes owed on the conversion are key issues to understand.

Equally important to the tax "burden" is understanding the conversion "benefits", It is always important to understand the *purpose* of your IRA funds (will they be utilized for your retirement, or might you like to transfer wealth to future generations or even charity). Thus, purpose planning is important as the Roth conversion tradeoff is about paying taxes NOW and growing wealth tax-free (conversion); versus growing retirement assets tax deferred and paying taxes later (no conversion).

Simply put, it's all about purpose, time, and taxes. On page 2 is a simplistic decision tree that can allow you to preliminarily consider if an IRA conversion to a Roth might be right for you. If it appears appropriate, further detail discussion should occur with your tax, estate, and/or investment advisor.

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ROTH IRA CONVERSION: IS IT A WORTHY IDEA FOR ME? -CONTINUED-

Conversion Decision Tree:

- First: Are the IRA assets needed for retirement (living expenses)?
- Second: Will you be in a lower tax bracket in the future/retirement?
- Third: Do you have to use IRA monies to pay taxes on the conversion? (Or, do you feel uncomfortable using personal savings to pay the taxes incurred by conversion?)
- Fourth: Will a conversion have a detrimental impact on your current tax situation?
- Fifth: Will a conversion have a detrimental impact on other financial planning goals?

If the answer to all above is "no" – you would likely benefit from a Roth Conversion.

If the answer to any above is "yes" – consider further cost/benefits.

Generally, the conversion may be appropriate if taxes are paid with non-retirement (personal savings) money, AND, you have many years to invest the converted monies in the Roth IRA to earn back the money paid out for taxes. Time and investment returns determine whether you can recoup the dollars lost to paying the taxes related to conversion. If the IRA monies are needed for retirement, conversion may not be wise to pursue.

Conversion is not a simple decision; it is complex. You should seek professional advice utilizing facts personal to your situation.

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