

## Wealth Strategies: What's a Roth IRA Conversion?

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Does this sound like a fairy tale to you? Invest your money today, let it grow with no current tax liability, cash it out years from now, and pay no taxes on that growth.

You get to go to the ball, get your glass slipper back, and marry the prince. Like any good tale, there are some plot twists.

Retirement investment vehicles take many forms, and two popular options are the traditional IRA and its newer sibling, the Roth IRA. Both have tax implications, but they are literally years apart. With a traditional IRA, the growth in your investment dollars is not subject to current income tax – an immediate advantage on your return. And, depending on your income, you may receive an immediate tax deduction, effectively letting Uncle Sam make part of the contribution for you. However, you will pay income tax on future distributions you take from these accounts.

The Roth is almost the opposite idea. Created in 1997, the Roth IRA allows investors to put money into a retirement account and offers a different advantage: the growth of the funds is not taxed currently or at the time of a qualified withdrawal – usually retirement at age 59-1/2 or older. You're also permitted to make a withdrawal to buy a first home or to pay for secondary education. A Roth IRA contribution is not permitted for everyone; persons or married couples who earn more than a certain amount of money are not eligible to contribute.

In 2010, legislation revised some of the rules for Roth IRA investments. Specifically, new laws removed the income restrictions for conversions, or transferring money from an IRA to a Roth IRA. (The income limits for Roth IRA contributions, while indexed to inflation, were not changed.) The new conversion rules created a whole new opportunity for higher income investors.

The bottom line: Tax-free growth is now potentially available to everyone. You're probably thinking, "Where do I sign up?"

The catch? Although it's an excellent strategy for certain people, it's not the best option for everyone. Now you may ask, "Is it a good strategy for me?"

It depends. Consider two simplified scenarios:

Scenario One:

Situation: Your joint adjusted gross income is above \$179,000, so you cannot make a deductible IRA contribution or a Roth IRA contribution. You do not have an IRA.

Solution: You can make a non-deductible contribution to an IRA of up to \$6,000 (if you are age 50 or over).

Even Better Solution: You can immediately convert this IRA to a Roth IRA.

Taxes: Since you did not receive a tax deduction when making the IRA contribution, you will owe no taxes when you convert this money to a Roth IRA.

Scenario Two:

Situation: You have a large 401(k) at your current employer and an IRA worth \$100,000. You also have \$50,000 in your savings account. You expect your joint taxable income to be \$150,000, putting you in the 28% marginal tax bracket, but you are concerned that you may be in a higher tax bracket after you retire.

Solution: You decide to convert \$50,000 of your IRA to a Roth IRA. (Remember you do not have to convert the total balance of your IRAs. Partial conversions are allowed.)

Taxes: Because you have never paid taxes on the money you converted, the full \$50,000 would count as additional income and you would owe ordinary income tax of \$14,000 (28% of \$50,000) on the conversion. However, the benefit of potentially never paying taxes on this money (or its growth) again could far outweigh the upfront cost. And, maybe even more valuable, you never have to take a required minimum distribution during your lifetime.

Our goal is not to impress you with our mastery of investment minutiae or worse, confuse you. Roth IRA conversions are a specific strategy for diversifying your long-term investments and expanding your options in the future.

Whatever the laws are, there will always be plusses and minuses to any move that you make or decide not to make. We are here to help you find the right solution for you.

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