

Investment Time

Should You Convert to a Roth IRA? (Part 3)



Samuel N. Asare, MBA, CRPC, CMFC

By Samuel N. Asare, MBA, CRPC, CMFC

We must reiterate that our intention with this series is to discuss the salient points that you, as an investor, must understand and take into consideration as you decide whether or not converting to a Roth IRA is something that will benefit you and your family.

In this issue, we will begin tackling the tax issues surrounding these conversions.

How Is One Taxed on the Amount Converted?

The answer to this question depends on whether the contributions were made with deductible (pre-tax) or nondeductible (after-tax) funds.

Accounts With Deductible Contributions ONLY

Since the contributions, as well as growth up until the time of the conversion, have never been taxed, the entire converted amount is considered ordinary income in the year of the conversion. There is a special 2010 only exception which I'll discuss shortly.

By way of an example, say Peter used to work for XYZ Inc. and participated in

the company's 401(k) program by making pre-tax contributions. His 401(k) balance is presently \$100,000. Peter is no longer employed at XYZ and now wishes to convert the \$100,000 into a Roth IRA in 2010. The entire \$100,000 will be added to his income for this year (assuming he's not using the special exception). However, his taxes will be based on the applicable rate, depending on his taxable income.

It is hugely important that you pay close attention to our choice of words here. As we pointed out in our book, 5 Mistakes Your Financial Advisor Is Making, mistake #1 is still being made by tons of so-called financial advisors/experts: perpetuating the myth that your income always depends on how much money you earn.

Here's what we mean. Say Peter talks to a savvy strategist from Laser Financial Group, who helps him create legally allowable income offsets to reduce his \$100,000 gross conversion income down to \$50,000, or completely eliminates any taxable income. Peter would then owe tax on the lower amount (\$50,000 or zero), instead of the full \$100,000. We continue to help numerous clients to achieve similar results.

Accounts With Nondeductible Contributions ONLY

Such funds will owe tax only on the growth up until the time of conversion. Say

Mary contributed \$50,000 to a traditional IRA but did not deduct any portion of the contributions for tax purposes. If that IRA now has a balance of \$70,000, she will owe tax only on the \$20,000 gain. Again, it is important to consider the possibility of reducing or even eliminating those tax consequences.

Accounts With BOTH Deductible and Nondeductible Contributions

The law demands that taxes are paid on a "proportionate share" of the conversion. But what does this mean?

Assume that Katie's traditional IRA is currently worth \$100,000, and \$10,000 of her contributions were after-tax. Katie decides to convert \$10,000 to a Roth IRA. Only 10 percent (in this case \$1,000) of this \$10,000 will be tax-free, meaning she will be taxed on 90 percent (or \$9,000). By law, 10 percent of the account is tax-free, so 90 percent of the funds released are taxable. If Katie really wants to withdraw all \$10,000 tax free, she'll need to convert the entire \$100,000 and pay tax on 90 percent (\$90,000). Interesting, isn't it!

What Is the Special 2010 Exception?

NOTE: This arrangement applies ONLY to conversions completed in 2010. For such conversions, you may decide to either pay ALL of the taxes due in 2010 or split the amount converted – not the taxes due – EQUALLY between 2011 and 2012. These are the only options and they are non-negotiable.

Remember Peter from the earlier ex-

ample, who wishes to convert \$100,000 in 2010? He may recognize the full \$100,000 as income in 2010 or include \$50,000 as income in 2011 and \$50,000 in 2012. However, he cannot do the 50/50 split for 2010 and 2011 – yes, the law is that rigid.

Here is something you must consider as you decide whether to convert your retirement income to a Roth IRA. If you choose to do the 50/50 split in 2011 and 2012, your taxes will be based on your applicable rates in 2011 and 2012, not 2010 rates. As you may already know, the 2001 tax-cuts are due to expire at the end of this year, which means it behooves you to ponder where YOUR future rate is headed, beginning in 2011.

Look for more conversion-related tax information in Part 4.

Interested in converting your IRA/401(k) with little or possibly no tax consequences? Or do you simply need some advice deciding whether it even makes sense, given your situation, to convert? Please call (301) 949-4449 begin_of_the_skype_highlighting or visit www.LaserFG.com to schedule your free, no-obligation consultation today!

A senior financial strategist with Laser Financial Group, Samuel is an accomplished personal finance expert, a Chartered Retirement Planning Counselor, and author with years of experience in retirement-tax planning. He regularly contributes to and is featured by various media outlets, including TV and radio.

Live Entertainment and favorites for all!

For the Good Ole' Days!

2010 THURMONT

HERITAGE DAYS FESTIVAL

June 11, 12 & 13

14 Eyler Road, Thurmont MD

Friday June 11- Rick Hill with Acoustic Folk Music 6pm – 7 pm

Saturday June 12: Catoctin Promise Band (Christian Music) noon

Sterling Rust Band (Country & Oldies) 1:30 pm

Nationally travelled Johnny Cash & June Carter Tribute Show Saturday 6pm-8pm (tickets \$8 per person)

Sunday June 13: Rich Hill (Mountain Gospel Music) 10am

Home Comfort Bluegrass Band 12:30pm

National Recording Artist Ray Owen(Variety) 2:30pm

(tickets \$5 per person)

Bring a chair and a dance partner!



Free
Admission

Free
Parking

National Recording
Artist
The Ray Owen Show,
Sun 2:30pm

Johnny & June Cash
Tribute Show
Sat 6pm-8pm



Friday nite kick off at 6pm with Acoustic Folk Music with Rick Hill
Horse Soccer

Raffle Tickets and good home cooked food



Saturday's Fun

6:30 Breakfast served by Dougherty's Water Jug Cafe

7:30 am festival opens

9:30 am Line up begins for Tractor ride thru country

10am Saw mill demonstrations

Baking Contest Judging

(Enter your fav cake or pie in the baking contest entries must be in by 10am on Sat June 12)

12:30 pm Animal Stock Show

Cake & Pie sale

1 pm Beard Contest

2 pm Raffle call

2:30 pm Cross Watermelon Cut Sawing

8pm King & Queen Contest



Sunday's Fun:

6:30 am Breakfast served by Dougherty's Water Jug Cafe

7:30 Demonstrations begin

9:30 am Antique Car Show

Animal Showing by local 4H

10 am Raffle Draw

Noon Baby Contest

12:30 Pig Calling Contest

Tractor Games

1:30 pm Antique Car & Truck Parade

Raffle Calls

2pm Magic Metal Tractor Parade

3:30 pm Homemade Bench Sale

Sat & Sun include Pony Rides, Crafters, Flea Markets, Wagon rides and great food both days!

Call 301.271.2023 for more information