



Is a Roth Conversion  
Right for You?

# In the Circle

Financial Concepts and Strategies for  
Your Business, Your Life

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# Your Guide to Converting to a Roth IRA

Thinking about converting a traditional IRA, 401(k), or 403(b) retirement account to a Roth IRA? Before you start, let us first compare and contrast Roth IRAs and the other types of retirement accounts.

**1** When you make a contribution to a traditional IRA, 401(k) or 403(b) retirement account, you typically do so with pre-tax or tax-deductible dollars. As you take distributions from the account(s) (typically after you turn 59½), the IRS treats these as ordinary income subject to income tax in the tax year in which they are taken. These accounts are enticing because you will not pay income tax on the money that you contribute to the accounts, or on the money that your investments earn, until a time when you may be in a lower tax bracket than when you made the contributions. Also, the distributions are treated as ordinary earned income rather than as dividend/interest income or capital gains income.

**2** When you make a contribution to a Roth IRA, it is made with post-tax dollars, that is, dollars which you have or will pay income tax in the tax year in which the contributions are made. However, as you take distributions from the Roth IRA(s) (typically at any age beyond 59½), the IRS doesn't treat them as taxable income, and so they are tax-free. A Roth IRA Has several enticements. Both the return of the investment in a Roth IRA and the earnings made on that investment are taken without the income being subject to any type of tax earned, dividend/interest, or capital gains. Distributions from a Roth IRA can be taken without any concern for your current tax bracket since they are not constrained by any time frame, minimum frequency or amount. One deterrent to a Roth IRA is that you must hold on to the account for five years and must be older than age 59½ before you can take qualified (untaxed) distributions from the account.

**3** In order to convert a traditional IRA, 401(k) or 403(b) retirement account to a Roth IRA, you must take a distribution of the assets of the initial account(s) and treat it as ordinary income for tax purposes before depositing the assets in the Roth IRA.

**4** Prior to tax year 2010, you couldn't convert a traditional IRA, 401(k) or 403(b) retirement account to a Roth IRA if your Modified Adjusted Gross Income (MAGI) was greater than \$100,000, or if your tax filing status was Married Filing Separately. Starting in 2010, these restrictions are lifted. If you execute the conversion in 2010, you can declare the distribution from the initial account as income on your 2010 tax return, or declare half as income on your 2011 tax return and half on your 2012 tax return.

## Spreading The Tax Burden Example

An example, based on the assumption that 2011 and 2012 have the same tax brackets and rates as 2010

- Terry Smith
- 47 years old
- Single
- 28% Tax Bracket
- Taxable income (without conversion): \$108,500
- Wants to convert a traditional deductible IRA worth \$124,000 to a Roth IRA



If she treats the distribution as strictly 2010 income, she will need to pay an additional \$37,868 in taxes.



If she treats the distribution as spread across 2011 and 2012, she will need to pay an additional \$34,720 in taxes; \$17,360 in 2011 and \$17,360 in 2012.

# Is a Roth Conversion Right for You?

Answer these questions to determine if a Roth Conversion is right for you:

- Can you pay the income tax on the conversion assets without using any of the distribution from the initial retirement account? → If you can, executing the conversion may make sense, but check with your tax advisor for details about penalties.

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- Will you work beyond age 70½? → If yes, then you may have to take distributions from your traditional IRA, 401(k) or 403(b) retirement account before you really want to. If the assets reside in a Roth IRA, you can start taking distributions when you want (subject to the 5-year “waiting” period), not when the IRS says you must.

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- When you convert assets from one of the pre-tax retirement accounts to a Roth IRA, you will treat the distribution from the initial account as ordinary income, and pay tax on it. → In order to avoid any underpayment penalties, you will need to increase your federal withholding from your paycheck and/or increase your quarterly estimated tax payments.

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- If you convert your traditional IRA, 401(k) or 403(b) retirement account to a Roth IRA in 2010, should you treat the distribution from the initial account as income in 2010, or treat it as income spread across tax years 2011 and 2012? Before you decide, you need to answer the following questions:
  - Do you expect to have sufficient auxiliary funds to pay the tax on the distribution in 2010? If not, you may need to take the second treatment option.
  - Will treating the distribution as strictly 2010 income push you into another tax bracket? If not, you may want to take the first option, in order to avoid the possibility of increases in the tax rates in 2011 and beyond.
  - If treating the distribution as strictly 2010 income will push you into another tax bracket, will treating it as income spread across tax years 2011 and 2012 avoid pushing you into another tax bracket? If spreading the income across the two tax years saves you from a higher tax bracket, you may want to take the second option despite the greater uncertainty (at this time) in the 2011 and 2012 tax rates. If spreading the income across the two tax years doesn't prevent you from moving into another tax bracket, you may want to take the first option.

# The Roth IRA Advantage

## Is a Roth Conversion Right for You?



**Over 36 months to pay**  
A January conversion would allow you over thirty-six months to pay the tax on the conversion.



**The payout last longer**  
With smaller distributions, the payout from the Roth IRA should last longer than the payout from a similarly funded traditional IRA.



**Control over the timing and amount**  
You have greater control over the timing and amount of the distributions you take from a Roth IRA.



**Tax free income**  
The IRS does not tax as income the earnings on the capitalization of the account.



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