

Qualified Retirement Plans

Practice Alert

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Roth Conversion – Decisions, Decisions!

The hot topic for 2010 is whether or not to convert your traditional IRA to a Roth IRA. Beginning January 1, 2010 the restriction on Roth conversions to those earning **more** than \$100,000 is waived and in addition the tax due on the conversion can be paid over two years, 2010 and 2011. There are several approaches to making this decision including the one where the voice in your head says I do not pay taxes any sooner than I have to. I prefer a more dollars and cents approach. Since there are so many moving parts, e.g. future tax rates, rate of return on investments, timing of withdrawals and amount of withdrawals, I would like to focus on two facts. First the tax can be paid over two years and second the Roth account is not subject to required minimum distributions (RMDs) although the beneficiary would be subject to the RMDs. Since the tax is paid over two years you have the use of one half of the tax due for one year. The illustration below reflects that benefit.

Balance	\$ 100,000	Federal Tax Bracket	35.00%	Rate of Return	7.00%
Tax Due	35,000				
Net to Invest	<u>\$ 65,000</u>				

End Of Year	Roth Conversion Value	Maintain Pretax IRA Value	End Of Year	Roth Conversion Value	Maintain Pretax IRA Value
1	\$ 88,275	\$ 107,000	11	\$ 139,225	\$ 210,485
2	\$ 75,729	\$ 114,490	12	\$ 148,971	\$ 225,219
3	\$ 81,030	\$ 122,504	13	\$ 159,399	\$ 240,985
4	\$ 86,702	\$ 131,080	14	\$ 170,557	\$ 257,853
5	\$ 92,772	\$ 140,255	15	\$ 182,496	\$ 275,903
6	\$ 99,266	\$ 150,073	16	\$ 195,270	\$ 295,216
7	\$ 106,214	\$ 160,578	17	\$ 208,939	\$ 315,882
8	\$ 113,649	\$ 171,819	18	\$ 223,565	\$ 337,993
9	\$ 121,605	\$ 183,846	19	\$ 239,215	\$ 361,653
10	\$ 130,117	\$ 196,715	20	\$ 255,960	\$ 386,968
				Tax Due	-
				Net to Spend	<u>\$ 255,960</u>
					<u>\$ 135,439</u>
					<u>\$ 251,529</u>

The first year of values under “Roth Conversion” includes one half of the tax due and the second year in that column is reduced by one half of the tax due. As you can see after twenty years the Roth conversion value is higher by \$4,431. This is the value of the investment gain on one half of the tax due growing over the illustrated period. The higher the rate of return the larger the differential would be. If tax rates go down by more than 1.15% the pretax IRA provides a higher value. The second known benefit is the ability of the Roth account to continue to grow tax free without required distributions potentially leaving more to pass on to heirs. The value of this benefit only continues for the life of the original account owner since the beneficiary is subject to required minimum distributions.

So when all is said and done the result of this exercise is in great part a function of the assumptions used to value the alternatives. Perhaps the voice in your head is the solution.

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