



**Alan Werba, CPA, CFP®**  
*Managing Member*

**Barbara Davis, EA, MS**  
*Senior Advisor*

**Aaron Rubin, CPA/JD**  
*Investment Advisor*

3055 Olin Ave., Suite 2000  
 San Jose, CA 95128

408 260-3109

## ROTH IRA 2010 — To Convert or Not to Convert?

Unless Congress changes the rules, you will be eligible as of January 1, 2010 to convert funds from your traditional IRA to a ROTH IRA regardless of your adjusted gross income (AGI). In addition, conversions made in 2010 (and only in 2010) can spread the conversion tax liability evenly over two tax years. Many of you have been asking, should I convert and, if so, how much makes sense? Let's analyze this decision in detail.

The tax on traditional IRAs is deferred until you withdraw funds from the IRA account. On the other hand, ROTH IRAs grow and distribute funds on a tax-free basis rather than tax deferred. However, funds converted from traditional to ROTH are taxable. If you convert \$100,000 and your combined Federal and state marginal tax bracket is 35%, you will owe \$35,000. With such a large tax on this lump sum transfer, are you really better off? The answer will vary based on a variety of factors.

The younger you are, the more advantageous a ROTH IRA conversion is likely to be, since you are invested on a tax free basis for a longer time period. However, your marginal tax bracket at time of conversion and at retirement are more significant factors to consider. Let's look at some examples.

Al Young has the biggest gain because he has the longest time horizon. (Unfortunately in the real world most 40 year olds have less saved, so they don't have much to convert.) Al's results would be different if his assumed tax rate at retirement was lower than his current rate. No one can predict future tax rates, but the long time horizon is a definite advantage.

When Bo Middle retires in 15 years, he expects a high tax rate, so conversion improves his situation by \$62,000. Bo's twin brother Cal expects his retirement tax bracket to drop sharply, so conversion would actually COST Cal \$35,000. As you draw nearer to retirement you may be able to better estimate your retirement tax bracket.

Even the Senior cousins can see that tax bracket is a major factor in their conversion decision. However, you must remember that you will not be drawing either IRA as a lump sum at age 65. Instead you are likely to take a series of monthly or annual withdrawals. Furthermore, you may leave a significant portion of your IRA to your children or other beneficiaries, so the time horizon and tax brackets to consider are yours and theirs.

Here are some reasons you may want to convert:

1. You expect your retirement tax bracket (and your heirs') to stay the same.
2. Your tax rate is low and your heirs' tax rates are high.
3. You are young enough that your time horizon will likely give you a gain.
4. You want to leave a non-taxable legacy to beneficiaries. The ROTH transfers income tax (but not estate tax) free and has no required minimum distributions (RMDs) until it becomes an inherited ROTH IRA.
5. You need to access funds before you reach age 59½. You can do so with ROTH IRAs without the onerous rules of Sec. 72(t). However, be careful because withdrawals in the first 5 years could be subject to a 10% early withdrawal penalty.

	Al Young	Bo Middle	Cal Middle	Debra Senior	Ed Senior
Ages	40	50	50	60	60
Years until retired	25	15	15	5	5
IRA balances converted	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000
Marginal tax rate — current	37 %	37 %	37 %	37 %	37 %
Marginal tax rate — retired	37 %	37 %	20 %	20 %	37 %
Annual rate of return *	7 %	7 %	7 %	7 %	7 %
Tax on conversion	\$74,000	\$74,000	\$74,000	\$74,000	\$74,000
ROTH value at retirement	\$1,085,487	\$551,806	\$551,806	\$280,510	\$280,510
Traditional IRA after tax	\$683,857	\$347,638	\$441,445	\$224,408	\$176,722
Separate account (tax defer)	\$217,663	\$141,372	\$141,372	\$91,821	\$91,821
Total — no conversion	\$901,520	\$489,010	\$582,817	\$316,229	\$268,543
Gain/(Loss) on conversion	\$183,967	\$62,796	\$(31,011)	\$(35,719)	\$11,967

\* These are hypothetical illustrations and not promises of future performance.

6. You want tax-free income during retirement.
7. You wanted to convert in the past, but your AGI was always too high to do so.

Here are reasons you may NOT want to convert:

1. Your retirement income tax marginal rate is likely to fall sharply.
2. Your income tax bracket is much higher than your heirs'.
3. You plan to leave your IRA to charity, so no income tax will be paid on the residual balance at your death.

4. The thought of paying one dollar of income tax before it's absolutely essential will give you a fatal heart attack.

You can expect lots of press coverage to this topic over the next twelve months. I hope this information demonstrates that the decision is complex, but there are some key factors to consider. The bottom line is you should make your choice based on your own reasons and your own tax rate estimates. If you want to review your situation with us, let's put it on the agenda for our next meeting.

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Name: (855) 555-1234  
Phone: (555) 555-5678  
Fax:  
Email: aadviser@advisorco.com  
Address: 123 Main Street  
Suite 1  
Anvtown, CA

**Personal Information**

Name: Carl Client  
Address: 123 Green Street  
Anvtown, CA

If this information is incorrect, please contact your advisor.

**Login Information**

Email Address:

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