
Sherwood Investment Services

Financial Planning & Investment Management

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The Savvy Investor

Should you convert your IRA to a Roth?

Background & Advantages

You can convert your IRA to a Roth IRA, regardless of your income level. Up until 2010, you were not allowed to do a conversion if your modified adjusted gross income exceeded \$100,000.

If you convert your IRA, you will have to pay income taxes on the amount coming from pre-tax contributions. So why convert? **Several significant benefits:**

- All money in your Roth grows tax free and you won't pay taxes on any money you remove in the future.
- You are not forced to take a required minimum distribution (RMD) every year (starting at age 70.5) as you would with the IRA.
- There are estate panning benefits.

The Problem

The determination of whether it is advantageous to convert is not as simple as the media generally implies. The general rule is that if you will be in a lower tax bracket in the future, then you should pay the taxes now at the lower rate and reap the benefits. Unfortunately, it is not that simple. **Like most generalized advice, it applies in some instances but not all. Your own situation might be different and should be evaluated to make sure you make the best decision.**

Factors to Consider

You are *unlikely* to benefit from converting your IRA to a Roth IRA if you use funds in the IRA to pay the taxes. Almost in every case, you will benefit only if the income taxes on the conversion can be paid with funds outside of the IRA. That way you have the entire IRA growing tax free. But this does not assure that you will benefit. **There are other factors to consider:**

- Your age, which determines your required minimum distributions.
- The timing (year by year) of any other withdrawals.
- The rate of return on your Roth, regular IRA and taxable account.
- Current and future tax rates, year by year.
- The 5-Year and age 59.5 rule: You must wait 5-years from the date of conversion *and* be over age 59.5 to be able to withdraw earnings tax-free and without penalty.

Changing Your Mind

You can undo your conversion one time, called a "recharacterization", as long as it is done before you file your 2010 tax return. You can do a second conversion with the same money only one time, provided you wait at least 30 days *and* at least until the next year.

Bottom Line

You may or may not benefit from converting your IRA to a Roth IRA. Making the wrong choice can be costly. Your individual situation should be carefully evaluated to avoid a costly mistake.

Would like to know if you will benefit from converting your IRA to a Roth IRA? Then please contact us.