

## To Roth or Not To Roth

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In 2009 taxpayers with a modified adjusted gross income of more than \$100,000 are not permitted to make Roth IRA conversions. In 2010, wealthy Americans will for the first time, qualify for a Roth IRA conversion regardless of their income. The compelling reason to pay attention to the change is that individual IRA owners who have modified adjusted gross incomes of more than \$100,000 can enjoy a huge potential windfall by taking advantage of the opportunity to convert their traditional IRA to a Roth IRA.

As most of you know, I have recommended Roth IRAs for young and old alike, because of their tax-free withdrawals and also the flexibility for extending withdraws up until your last beneficiary passes on. The change in conversion law is a great benefit for high income earners, but there are many rules that you should be aware of and it wouldn't hurt to talk to a financial advisor.

Whenever you convert an IRA to a Roth, you owe taxes on the amount converted, also if you have a nondeductible IRA they can only be converted pro rata with traditional deductible IRAs. If you do not have the cash in a taxable account to pay the taxes you should generally not convert; especially if you are not 59 1/2. Until the magic age you will have to pay a penalty if you take IRA funds to pay taxes. For 2010, there is a special provision: you can postpone your taxes and pay them in two installments over the next two years. But, tax rates can change and most likely will for high income earners in 2011, if not before.

One of the big benefits of Roth IRAs, either contributory or converted, is that you pay your taxes at a rate that is lower than it will be in the future. If you expect your rate to be higher in retirement, you can pay up front with a lower rate. While it is impossible to know what your rate will be in retirement, it seems likely it will be higher in the future. I know many retirees who have seen a major leap in their tax bracket when at 70 1/2 they have to start their "Required Minimum Distribution". Take a \$1,000,000 IRA, at age 70 1/2 the RMD would be \$36,500; what might that do to your tax rate. Since you do not know what will happen to tax rates in the future, you may want to hold some of your IRA in the traditional version and some in a Roth IRA.

The further off retirement or your need for the money, the bigger the payoff thanks to tax free compounding. Likewise, the less likely you are to need the money in retirement, the more valuable the Roth. Roths are not subject to the RMD mentioned above; therefore you can let them grow tax free until you bequest them to your beneficiaries. Even a non-spousal beneficiary is required to only withdraw the funds over their life expectancy, and then tax free.

Although I feel that Roth IRAs are for everybody, 2010 is the year for high income earners to take advantage of this opportunity.

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Gloria Steinem

## Ask the CFP®?

Vanguard is advertising that "costs matter", but does 1% vs. .2% really make a big difference in the value of my portfolio?

That is a timely question as the Journal of Financial Planning had a couple good articles about the impact of costs of different products, loads and advisors compensation models.

One of the advantages of Vanguard, or any low cost fund, is that YES costs do matter. If you were to fund a Roth IRA with \$5,000 per year and earn 7% before expenses for the next 30 years you would expect to have \$505,365 in your account. But if you have to pay an expense ratio of 1% it will reduce your return to \$419,000. The typical Vanguard charge of .2% would reduce your account to \$486,628. To me that \$67,000 difference does make a big difference. Furthermore, the mean charge for mutual funds is 1.17%, and some variable products charge as much as 3.75%.

As we have seen in the last couple years, the only thing that is certain in investing is the higher the expense charge the lower your return.