



FINANCIAL *SYNERGIES*  
ASSET MANAGEMENT, INC.  
*Together, it's possible®*

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Sample Data  
P.O. Box 30607  
Palm Beach Gardens, FL, 33410

Dear FSAM Client:

For some investors, the stars aligned in 2010 for converting traditional IRAs into Roth IRAs. Previous income restrictions on conversions were removed, and you could spread the taxable income triggered by a 2010 conversion evenly over 2011 and 2012. So what about this year? The common misperception has been that the only opportunity for high income earners to convert was in 2010. Not so – you can still convert to a Roth IRA regardless of income. The only difference is that you can no longer spread the taxable income from the conversion over the subsequent two years. Before 2010, the conversion option was only available if your modified adjusted gross income was \$100,000 or less. There are currently no indications that Congress will reinstate this income restriction. Under the right conditions it might still be favorable for high income earners to convert.

A Roth conversion is treated as a taxable distribution from your traditional IRA because you're deemed to receive a taxable payout from your traditional IRA with the money going into the Roth IRA. A conversion will generally trigger a federal income tax bill, so this decision cannot be taken lightly. It may make sense to convert if you:

**Expect higher taxes in the future**

If you think that you'll be in a higher tax bracket after you retire, or if you plan to leave a substantial amount of your retirement assets to your heirs, you may want to consider a Roth IRA conversion. That's because you may pay lower taxes now than if you waited until retirement to begin taking taxable withdrawals. So you'll pay the current tax rates on the conversion income and avoid potentially higher future tax rates on the entire post-conversion increase in the value of the Roth account. That's because qualified Roth withdrawals taken after age 59½ are totally free of federal income tax. *Caveat: Nobody can predict what future tax rates will be, so the assumption that taxes will be higher in the future is just that, an assumption.*

**Have a long investment time frame**

The relative benefits of conversion will increase the longer your money remains in the Roth IRA because of the tax-free growth component. In general, the younger you are the more it may make sense. Conversion probably doesn't make sense if your time horizon is less than five years, as amounts withdrawn are subject to a 10% penalty within that period.

**Can pay the taxes on the conversion**

In most cases, you should avoid using proceeds from the conversion to pay the tax costs. Why? Because using proceeds reduces the amount that can potentially grow federally tax free in the Roth IRA, and offsets any tax savings that you may gain by converting. In addition, if you're under 59½, you'll pay a penalty, which will likely further reduce any benefit you might have received from the conversion. Instead, consider using cash or other savings held in non-retirement accounts to pay the tax liability.

There are also some special considerations when making a conversion decision. The extra taxable income triggered by a Roth conversion is added to your ordinary income from other sources (salary, self-employment income, short-term capital gains, alimony received and so forth). So, if you convert an IRA with a large balance, it could push you into a significantly higher federal income tax bracket. The conversion income also increases your adjusted gross income (AGI), which could trigger a bunch of unfavorable phase-out rules, such as the ones affecting the child tax credit and the college tuition credits. To avoid this, consider converting a large traditional IRA balance to Roth status in stages over time. A multi-year approach could prevent the extra income triggered by converting from pushing you into much higher tax brackets and negating too many AGI-sensitive tax breaks.

This is very important. Generally, converted assets in the Roth IRA must remain there for at least five years to avoid penalties and taxes. A distribution from a Roth IRA is tax free and penalty free provided that the five-year aging rule has been satisfied and at least one of the following conditions have been met: you reach age 59½, die, become disabled, or make a qualified first-time home purchase.

Obviously the decision to convert to a Roth IRA is one that requires great care and analysis. Please contact us if you would like to discuss the possibility of converting your traditional IRA to a Roth IRA. We'd be happy to talk with you.

Sincerely,

A handwritten signature in black ink that reads "Mike Minter". The signature is written in a cursive, flowing style.

Mike Minter, CFP®, CFS

