



Roth IRA Conversions -- Yes or No

by

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An opportunity begins on January 1, 2010, the potential of which is enormous. On that date, the \$100,000 annual income limitation expires for converting traditional IRAs to Roth IRAs or traditional 401(k)s to Roth 401(k)s.

The conversations are already heating up as to whether such conversions make sense. Some say yes; some say no -- but we say, "you can't tell until you test and compare the alternatives."

Let's examine the case of Aaron and Susan Tyler, ages 60/55. They intend to retire in five years and are in a 35% marginal income tax bracket. Their estate totals a little over \$6,100,000 and includes the following liquid assets (the balance consisting of their home and personal property):

\$ 1,000,000 Aaron's tax deferred IRA - assumed yield of 8.00% (RMDs* required)
2,000,000 Equities - assumed yield of 2.00% dividend; 6.00% growth
1,000,000 Certificates of Deposit - assumed yield of 4.00%
800,000 Municipal Bonds - assumed yield of 3.00%
500,000 Deferred Annuity - assumed yield of 8.00%
\$ 5,300,000 Total

**Required Minimum Distributions*

On January 1, 2010, it will cost \$350,000 ($\$1,000,000 \times 35\%$) in income taxes to convert Aaron's IRA to a Roth IRA. The conventional wisdom is that a Roth conversion makes sense only if funds other than an IRA withdrawal are available to pay the tax. Let's follow this logic and allocate \$350,000 from the Certificates of Deposit for the tax due on the conversion. This revises their liquid assets as follows:

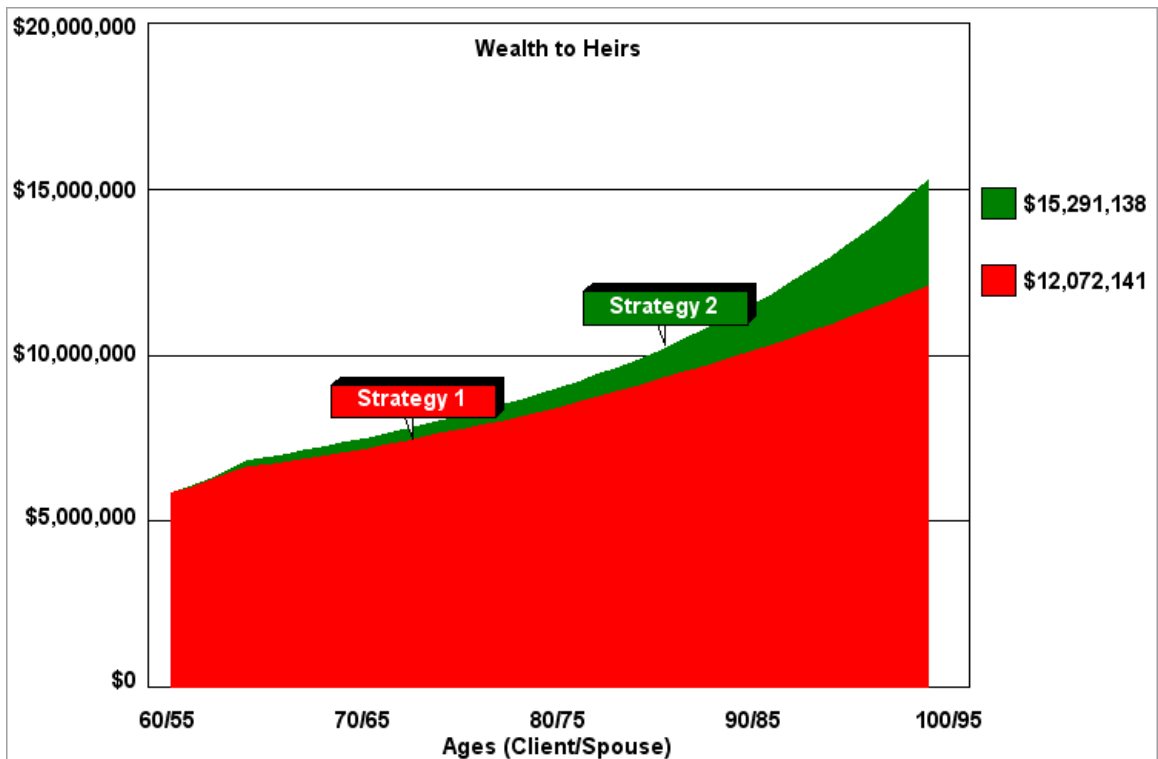
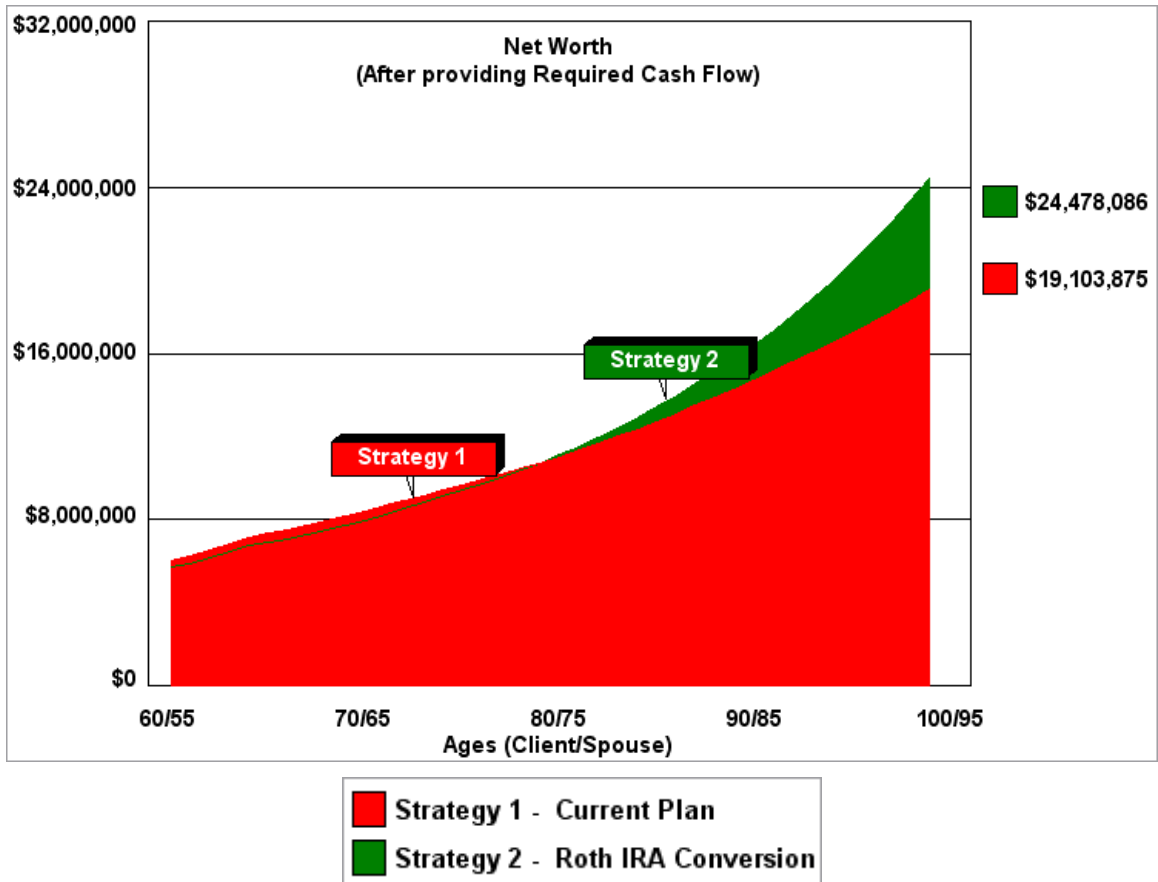
\$ 1,000,000 Aaron's tax free Roth IRA - assumed yield of 8.00% (no RMDs required)
2,000,000 Equities - assumed yield of 2.00% dividend; 6.00% growth
650,000 Certificates of Deposit ($\$1,000,000 - \$350,000$) - assumed yield of 4.00%
800,000 Municipal Bonds - assumed yield of 3.00%
500,000 Deferred Annuity - assumed yield of 8.00%
\$ 4,950,000 Total

Is the conversion to a tax free Roth IRA worth the loss of \$350,000 paid to the IRS? Let's see . . .

Note: Although Aaron's current IRA is sizable, the strategy outlined in the following pages will work with a traditional IRA of any size provided other funds are available to pay the income tax.

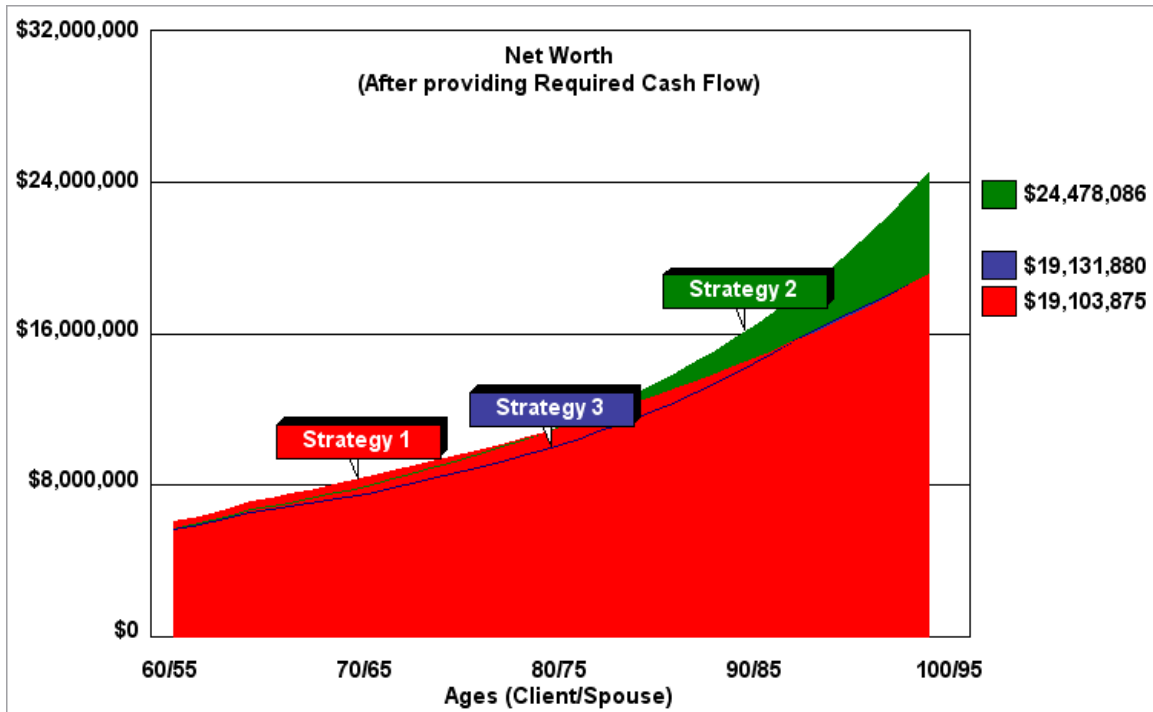
Note: The analytical tool for the graphics on the following pages is InsMark's Wealthy and Wise[®].

Even though there is an immediate loss of \$350,000 in conversion taxes paid, the Roth IRA increases long-range Net Worth by almost \$5,400,000 and Wealth to Heirs by over \$3,200,000.

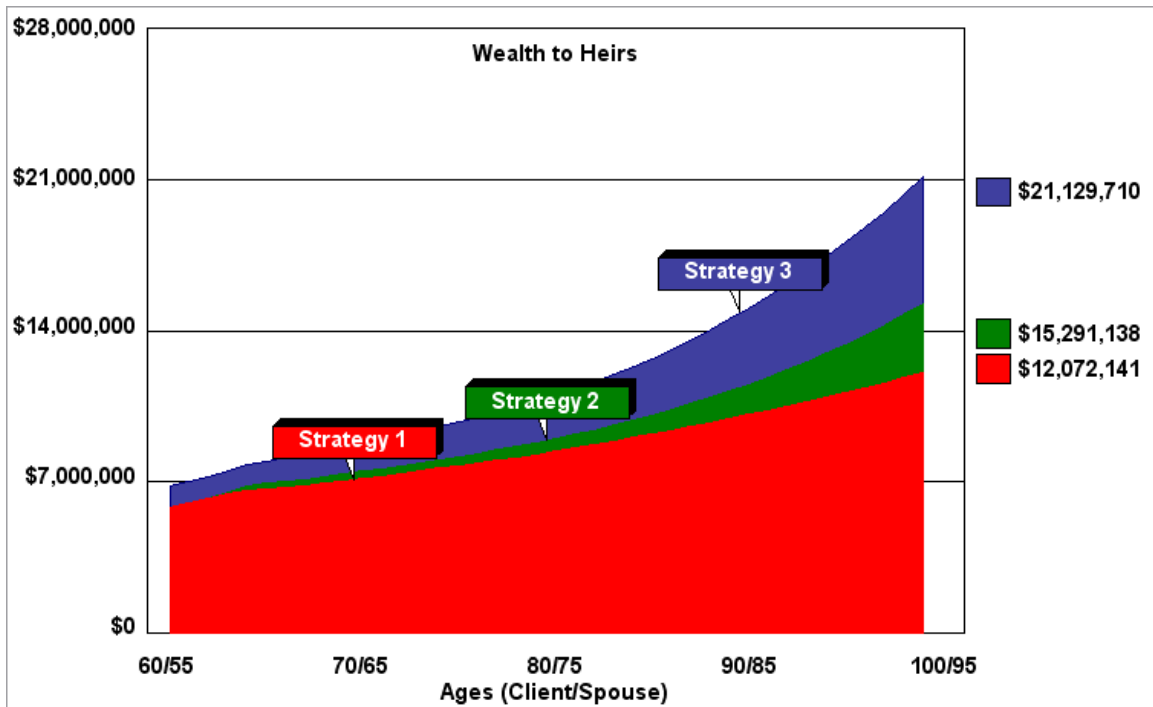


Calculations throughout this presentation include the same spendable retirement cash flow for Aaron and Susan -- \$150,000 a year increasing by 3.00% as an inflation offset.

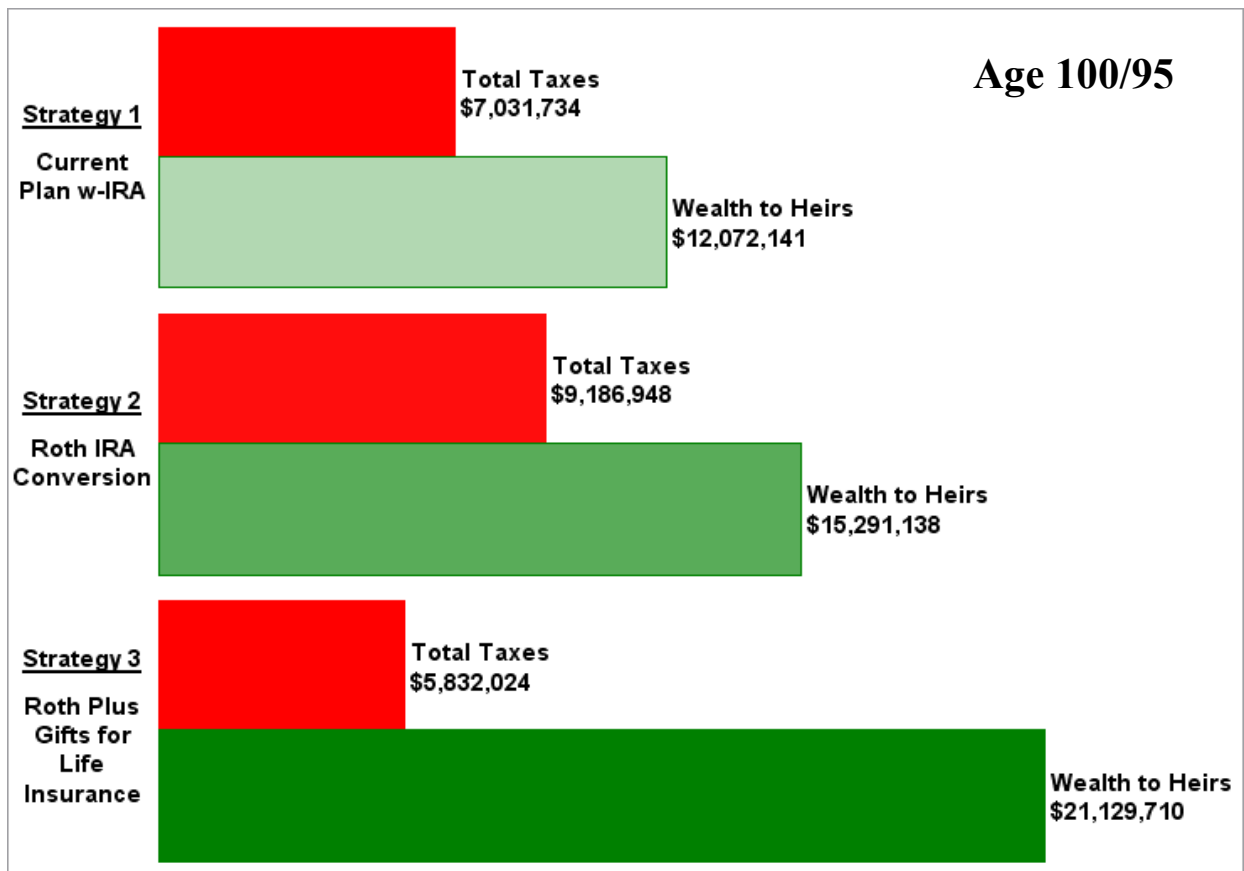
In order to improve Wealth to Heirs, an alternate approach uses the increase in Net Worth to fund annual gifts of \$30,000 to pay for \$1,000,000 of trust-owned life insurance. Long-range Net Worth in Strategy 3 is on a par with Strategy 1, while long-range Wealth to Heirs in Strategy 3 is over \$9,000,000 greater than Strategy 1.



- Strategy 1 - Current Plan w-IRA
- Strategy 2 - Roth IRA Conversion
- Strategy 3 - Roth Plus Gifts for Life Insurance



Below is another way to look at the powerful results.



In the coming months, you will hear various opinions of the validity of Roth IRA conversions, virtually all of them made without taking into account their effect on overall Net Worth and Wealth to Heirs. There are no hard and fast conclusions that make the analysis easy, and the financial dynamics must be tested for each case.

CPA/Attorney James Lange, has an excellent book, *Retire Secure: Pay Taxes Later - The Key to Making Your Money Last* (2nd Edition). Available on www.amazon.com, it covers Roth IRA Conversions in Chapter 7 and confirms the conclusions reached in this article.

[Click here](#) to review the comprehensive reports from which the graphics were developed, and advisers who would like access to the analytical software (Wealthy and Wise[®]) used for this article, please contact InsMark at 1-888-InsMark (467-6275).

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