

UNDERSTANDING ROTH IRA *conversion opportunities* **in 4 steps**

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Planning for a **Comfortable** Retirement

Determining when, or if, you should convert to a Roth IRA is an individual decision based on factors such as your financial situation, age, tax bracket, current investments and alternate sources of retirement income. This booklet will give you a brief overview of the basics.

Are you confident with your answers to these important questions?

- What is a Roth IRA?
- What is the difference between a Traditional IRA and a Roth IRA?
- What accounts are eligible to convert to a Roth IRA?
- How can a Roth IRA conversion help protect me from future income tax rate increases?
- What are the tax consequences of a Roth IRA Conversion?
- How can a Roth IRA conversion help provide a greater financial legacy for my beneficiaries?

What is a Roth IRA?

A Roth IRA is an individual retirement account from which you can withdraw your earnings completely tax-free any time after you reach age 59½, provided your account has been open at least five years.¹

What's the difference between a Traditional IRA and a Roth IRA?

Traditional IRA contributions are tax-deductible when certain requirements are met. With a Roth, contributions are not tax-deductible, but earnings can be withdrawn income-tax-free if you're at least 59½ years old and have had the Roth account at least five years. You also don't have to take required minimum distributions (RMDs) starting at age 70½, as you do with a Traditional IRA. An important side note: distributions from Roth IRAs cannot be used to fulfill the RMD from a Traditional IRA.

¹ IRS Publication 590 (<http://www.irs.gov/pub/irs-pdf/p590.pdf>)

Source: <http://www.rothira.com/traditional-ira-vs-roth-ira>

Here, we'll outline four steps to aid you in understanding Roth IRA conversion opportunities.

1 Know the *Basics*

What accounts are eligible to convert to a Roth IRA?

Because income limits were removed as of January 1, 2010, anyone is eligible to convert a Roth IRA. You might consider using this opportunity to convert one or more of your qualified retirement savings accounts to a Roth IRA for its tax benefits at retirement.

Source: American Association of Individual Investors

<http://www.aaii.com/financial-planning/article/new-rules-for-converting-to-a-roth-ira?adv=yes>

Convertible Accounts Include (but not limited to):

- Traditional IRAs
- Old 401(k) plans
- SEP IRAs
- Old 403(b) plans
- Old 457 plans

How can a Roth IRA conversion help protect me from future income tax rate increases?

The future is not always certain, especially when it comes to income taxes. However, a Roth IRA can be used as an option to protect you against future tax rate increases because the account grows tax-free and qualified distributions from the account are also tax-free. This means tax-free growth of your hard-earned money and tax-free income at retirement.

What are the tax consequences (if any) of a Roth IRA conversion?

A conversion from a Traditional IRA to a Roth IRA is taxable. The converted amount is treated as ordinary income, even if some or all of the growth in value of your traditional IRA was from an increase in the value of stocks or mutual funds. If all of your contributions to all of your traditional IRAs have been deductible, then the full amount of your conversion is taxable.*

Can I contribute current income to a Roth?

To qualify to contribute to a Roth IRA, your income must have been less than the level set by Congress (in 2012 it is less than \$125,000 for single filers and less than \$183,000 for joint filers).

Source: Plan It: Retire Ready Toolkit

http://planit.cuna.org/14953/article.php?doc_id=4557&print=y

Know the Basics *(Continued)*

Can I convert my Traditional IRA to a Roth IRA?

In 2010, people with incomes of more than \$100,000 became eligible to convert a Traditional IRA (or any other convertible accounts) into a Roth IRA regardless of their income. Those married and filing separately can also convert to a Roth IRA.

*Source: United States Senate Federal Credit Union
https://www.ussfcu.org/calculators/roth_conver_ira.php*

How can a Roth IRA conversion help provide a greater financial legacy for my beneficiaries?

A Roth IRA can also be effective as an estate-planning tool. Those pre-retirees and retirees who convert a Traditional IRA into a Roth IRA can reduce or eliminate the income tax their beneficiaries would otherwise have to pay on withdrawals taken from an inherited Traditional IRA.

After you die, your beneficiaries won't owe any income tax on withdrawals from the inherited Roth IRA. However, the account now falls under the same minimum-withdrawal rules as Traditional IRAs. Nevertheless, if your beneficiaries don't need the Roth IRA money right away, they can spread out those withdrawals over their lifetime while continuing to earn tax-free income on the remaining account balance.

Of course, you will have to pay tax on any accumulated earnings and tax-deductible contributions when you make the Roth conversion. But this may not be a bad thing, as long as you can pay the tax out of non-IRA assets. When you pay the taxes due upon conversion, you effectively prepay income taxes for your beneficiaries without owing any gift tax or using up any of your valuable estate-tax exemption, assuming you are susceptible to an estate tax. Plus, prepaying the income taxes reduces the size of your taxable estate—perhaps also a good thing.

Can I withdraw from a converted Roth IRA without penalty?

Roth IRA conversion dollars may be withdrawn at any time without penalty as long as you're 59½ years of age and have held the account for at least five years. There are other exceptions to distribution rules for penalty free pre-59½ distributions including disability, death and in some cases, the purchase of a first home.

To Roth or not to Roth?

Is a Roth IRA for you or should you stick with a Traditional IRA? Roth IRA conversions aren't for everyone. It's important to thoroughly understand your specific situation before you decide. There are several tax and estate planning considerations, pro and con, to be evaluated when deciding whether to convert to a Roth IRA. Possible factors that should be considered are listed next.

Understand your **Conversion Options**

- Generally, you shouldn't convert to a Roth IRA if you can't pay the tax on the conversion from a source outside of the IRA. Not only does this reduce the amount of the conversion resulting in less tax-free money, it also can cause an early distribution penalty if not over age 59½.
- A partial conversion may be an option. A partial conversion to a Roth IRA allows you to convert a portion of an existing IRA and avoid pushing into a higher tax bracket in the year of the conversion.
- When do you retire? Usually, the older you are (or closer you are to retirement), the less sense it makes to convert a Traditional IRA to a Roth. You'll have less time for the tax-free growth to make up for what you paid in taxes on the conversion.
- Do you anticipate your tax bracket to increase or decrease in the future? If you expect to drop into a much lower income tax bracket after you retire, a conversion may not make sense. You will have to pay income tax on the conversion at your current high rate. Instead, let the money compound in your regular IRA and pay taxes at your lower rate in retirement. However, if your tax rate is only expected to drop after retirement, conversion might be the right move.

It's important to understand these are merely rules of thumb. In most cases they give the right results, but your particular situation may call for a different option. Consult with a qualified tax adviser to understand what's best for your situation and needs.

Recognize the **3 Advantages of Converting**

The benefits of converting assets to a Roth IRA vary by each individual. A Roth conversion may not be beneficial to some, while it may benefit others greatly. Below, we summarize some of the key benefits of converting a Traditional IRA to a Roth IRA.

Ready, Set ... Retire!

1. Potential for Greater Net Income and Withdrawals

A Roth IRA offers you the potential for greater net income than a Traditional IRA. Because the withdrawals, subject to the requirements, are income-tax-free on a Roth IRA, you receive more dollars in your pocket instead of a portion of the withdrawal being taxable as with a traditional IRA.

Suppose you have a Roth IRA with a \$10,000 balance. If you meet all the rules, you won't pay tax when you withdraw that \$10,000, and all the earnings it generates. Compare a Traditional IRA with the same balance. When you withdraw that \$10,000 you'll pay a percentage of that amount and its earnings to the IRS.

2. No Required Minimum Distributions (RMDs)

This is another benefit that can permit you to accumulate much greater wealth in your later years. Rules for the Traditional IRA require you to begin receiving minimum distributions when you turn 70½. Even if you don't need those distributions, they are still a required annual (and taxable) distribution. The minimum distribution rules don't apply to a Roth IRA until after the owner dies. A Roth IRA owner who survives well past age 70½ may leave a much greater amount of wealth to children or other beneficiaries as a result of this rule. For this reason, a Roth IRA conversion could pay off handsomely.

3. Income-Tax-Free Inheritance for Beneficiaries

If your beneficiaries receive a Traditional IRA, they'll have to pay income tax on the amounts withdrawn. The value of what you transfer to them is reduced by the amount of the taxes. Your beneficiaries get to keep the 100% of the amounts they withdraw with a Roth IRA, which can be a significant financial advantage to them in the long run.

In addition, the conversion to a Roth will reduce your taxable estate by the amount of income tax you pay to convert. This may reduce estate taxes for your heirs.

Take *Action*

To better understand your retirement needs, it is important you work with a qualified financial or insurance professional—someone you trust, someone who will listen to your needs and answer your questions. Your retirement well-being depends on making the right decisions today to create a more secure future for tomorrow.



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Determining when (or if) you should convert to a Roth IRA is an individual decision based on factors such as your financial situation, age, tax bracket, current assets and alternate sources of retirement income. Your unique circumstances help determine what's right for you.

Respond and learn how life insurance and annuities can be used in various planning strategies for retirement.

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