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GL 140-10 = GL 18 - Roth Conversion Quiz

Should I consider a Roth Conversion



How Do You Know When and If You Should Consider Converting a Traditional IRA to a Roth IRA?

What Type of IRA Do I Currently Own?

Most people own a Traditional IRA; if your IRA is a Roth IRA that will be clearly stated on your IRA account statement. Typically, a Traditional IRA is the default type of account. If you want a Roth IRA you need to inform the IRA Company. (In most cases if you are not sure what you have: It's typically a Traditional IRA)

What is the difference?

Traditional IRA: Your annual contributions to a Traditional IRA are "Pre Tax". Example; if you earn \$50,000 and contribute \$5,000 to your Traditional IRA you will pay current income tax on \$45,000 of earnings. Later (generally at your retirement time) when you take a Distribution from your Traditional IRA, the distribution is taxable. (I.e. You paid no income tax on the funds going in however, you will pay income tax when the funds come out.)

Roth IRA: Your annual contributions to a Roth IRA are "Post Tax". Example; if you earn \$50,000 and contribute \$5,000 to your Roth IRA you will pay current income tax on the full \$50,000 of earnings. Later when you take a Qualified Distribution from your Roth IRA, the distributions are income tax free on the total amount of the distribution (this includes the amount you contributed plus all the earnings). (I.e. You paid income tax on the funds going in however, you will pay no income tax when the funds come out.)

Required Minimum Distributions:

Generally the owner of an IRA must start taking a Required Minimum Distribution (RMD) by April 1, of the year following their 70½ birthday. However, if you own a Roth IRA there is no RMD. This means a Roth IRA keeps growing. It's like a giant snow ball racing downhill and getting ever larger for the rest of your life.

When referring to a Roth IRA what is a “Qualified Distribution”?

There are two tests you must pass for a Roth distribution to you to be considered a “Qualified Distribution” and avoid all income taxes.

- You must have obtained the age of 59½
- The Roth account must be 5 years or older (often called the five year clock)

Three Question – Roth IRA Conversion Quiz:

Doing a Roth conversion is no easy decision. On one hand the opportunity for **Tax Free Income for Life** is undeniably appealing. And every consideration should be given to the tremendous benefit of Tax Free Money. On the other hand no one likes to pay income tax today (even if it does mean tax free income in the future. Below we lay our XX question to help you decide what is best for you.

1. **Age:** The younger you are the better. A conversion today will have years, even decades to grow and compound all with tax free results. Generally, after age 65 we tend to be less enthusiastic about a Roth Conversion.
2. **Expected Investment Growth:** If you believe that you can make investments that will grow faster than the rate of inflation you may want to consider a Roth Conversation. There is an old saying in the IRA industry, “Would you rather pay tax on the seeds or on the trees.” For fast Growing assets a Roth IRA could save you tens of thousands.
3. **Expected Income Tax Rates:** What do you think will happen to income tax rates in the future? If you believe that tax rates will increase, a Roth Conversation (i.e. paying the income tax today) may be a bargain.

Note: If you do a Roth Conversion, income tax will be due on the amount of conversion.

However, there is no 10% penalty as there is if you were to take an early distribution. A Roth IRA is a very good idea for most people however, everyone is different and the decision to convert is yours alone.

Partial Conversion: Converting part of your Traditional IRA is an option. However, one should consider that would result in two separate IRA accounts (each with its own set of fees).