

## Are You About to Fall Into A Huge Tax Trap?

By: Roger Shumaker, President of Retirement and Tax Solutions

*In 2010 the income limits on Roth conversions has been lifted and many people that were unable to convert before now have an opportunity to. This has created quite a buzz in the financial world, particularly amongst financial salespeople, about how you should convert all of your money now before taxes go up up up! While doing a partial or entire conversion for some may make sense, for many others it does NOT. Even for those that it does make sense, there are several traps that can await if things are not done carefully and strategically. In our office we have identified 15 Roth conversion traps that we often see people needlessly fall into, which often result in significantly higher tax burdens than necessary. Below is just one of the 15 Roth conversion traps we have identified and how to avoid it.*

Remember the movie *Ghostbusters*? Spengler repeatedly warns the other ghostbusters "Don't cross the streams!" One of the biggest tax traps you can step into with regards to a Roth IRA conversion is if you 'cross streams' by rolling 401k, 403b or other employer retirement plan money into an IRA in the same year you do a Roth conversion. While in the movie crossing the streams happens to work out as a Hail Mary option to defeat the marshmallow man, there is no chance that crossing streams will work out well for you when it comes to IRAs.

So why exactly is crossing streams such a disaster here? Well, because of the following formula that the IRS uses to calculate how much tax money you owe when you do a conversion:  $[(\text{total basis in ALL IRAs} / \text{total value of ALL IRAs}) \times \text{amount converted}]$ . Make special note that the formula uses the **total value of all IRAs at the end of the year** in the denominator to determine how much you will owe taxes on when you do a conversion. It does **NOT** include the value of any assets that you have in company sponsored retirement accounts such as 401ks and 403bs. If you roll your 401k/403b or other company sponsored retirement account to an IRA in the middle of the year you do a Roth conversion, then all of that rolled over money will now enter into that end of the year equation. This

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is bad... really bad. Making this mistake usually comes with a high to severe amount of tax consequences that are unavoidable and irreversible because of the way the formula works.

**Solution:**

While rolling over your old 401k, 403b, or other company sponsored retirement plan to an IRA may sound appealing for reasons such as having a much larger number of investment options, doing it in the same year you do a Roth conversion is a complete disaster. The two real options to avoid this mess is to either wait until January 1st of the following year (so that the money that is rolled over doesn't enter into the formula) to roll the money over to a traditional IRA or to roll over the 401k itself into a Roth IRA since it would then not affect the equation. This Roth conversion trap is a mistake we see all too often made by people trying to do rollovers themselves or by financial salesmen and financial 'product pushers' hungry to grab your 401k money and dump it into an IRA with their commission based products. This is one of the many reasons why we feel it is important to work with an independent fee based advisor that specializes in IRA/401k rollovers and conversions. Working with someone that does not know and does not keep themselves constantly up to date on some of the more intricate and quirky rules when it comes to IRAs, such as the one above, can cost you thousands upon thousands in unnecessary taxes.

*If you would like to learn the other 14 traps we have identified, you can request a complimentary copy of our report '15 Roth Conversion Traps... & How to Avoid Them' by simply rolling it on over to our website or by giving our office a call and asking for Mary Ann.*

Roger Shumaker can be contacted at 785-228-0222 or [www.RetireTopeka.com](http://www.RetireTopeka.com) with offices located at 5909 SW 28th Street Ste #100, Topeka, KS. He hosts 'Money Talk' heard Saturdays at 9:05 on KMAJ 1440 AM. Initial consultations are complementary.

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