

My Mega Roth Conversion: A \$212,000 Mistake?



[Editor's comment: *This is a republished post from [Physician on FIRE](#), a member of [The White Coat Investor Network](#). It illustrates the difficulties that occur when using today's tax rules to guess what tomorrow's rules might look like. The original post ran [here](#), but if you missed it the first time, it's new to you!*]

Prior to 2010, Roth [conversions](#) were off limits to most physicians or anyone else with six-figure income. In 2010, the rules changed and the \$100,000 AGI limit was eliminated.

The prevailing thought was that there would be a one-year window in which high earners could legally do a Roth conversion. From [one of the many articles](#) on the subject from back then:

"2010 is the only year that this exception is allowed. Starting in 2011 (unless congress changes it), it reverts back to the original way where all the tax is owed in that year."

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Mistake?



Guess what? Our federal government liked the tax revenue from all the 2010 conversions so much that the AGI limit was lifted permanently (for conversions only).

Of course, I didn't know that was going to happen. I will also admit to being a personal finance novice at the time. I knew that Roth money was good money and I wanted more [Roth](#) money. So I filled out some paperwork and converted our traditional IRAs and my [SEP IRA](#). **I wasn't going to let that one year window pass me by!**

Let's talk numbers. My wife and I had traditional IRAs worth a combined \$36,000 (\$30,000 of which was tax deferred, with \$6,000 in non-deductible contributions). The SEP IRA, after 5 years of tax-deferred contributions of \$25,000, \$45,000, \$45,000, \$49,000, and \$49,000 had grown to \$242,000.

To convert the whole lot to Roth, **I had to pay income taxes on \$272,000**. There was a provision (which no longer exists) to spread the tax pain over the following 2 tax years, so we took advantage of those interest-free loans. The conversion was made in 2010, but the taxes were paid in 2012 (2011 return) and 2013 (2012 return).

In 2012, with the addition of \$136,000 of "income" from half

of the conversion, we paid an extra \$53,557 in federal and state income tax. If that \$53,557 had remained invested in an S&P 500 fund, we would have seen a 114.2% return from April 2012 to January 2018 according to the [S&P 500 Dividends Reinvested Price Calculator](#). That money with four years of 12.2% annualized returns would be worth **\$113,000**.

In 2013, we similarly added \$136,000 to our taxable income on the [1040](#). The \$53,577 we paid in 2013 would have grown 85.1% in three years, a 14.1% annualized return. Had we not paid the tax, we would now have **\$99,000**. Thank you, bull market!

In summary, our calculated net worth would be \$113,000 + \$99,000 = \$212,000 higher today if I hadn't made the Roth conversion in 2010.

Have I Made [a Huge Mistake?](#)



Gob and his huge mistakes.

This is not a simple question to answer. Yes, our net worth would be a larger number if I hadn't made the conversion. But now I've got a lot more of that good Roth money that will (presumably) never be taxed again. More than five years have passed, which means I can withdraw the entire \$278,000 penalty-free and tax-free. Not that I would, but I could.

What Would it Cost to Convert Today?

In the 7-plus years since making the conversion in October of 2010, the S&P 500 is up 161%. The \$272,000 invested in the S&P 500 would have grown to \$709,000 (not precisely because [my Roth](#) holds different asset classes including [REIT](#), small cap value, and emerging markets).

Let's call it \$700,000 today. If it were still in the tax-deferred IRAs, to convert it all, I'd be paying the tax bill in one year rather than two. Converting \$700,000 at once with a high-income in a high tax state would create a **tax bill well over \$300,000**. Ouch!

Is There a Better Way to Make Roth Conversions?

Yes! Wait until you're retired (particularly if you plan to [retire early](#)). You can convert smaller chunks one year at a time when you are in lower income brackets. A good strategy is to fill the 12% bracket, and perhaps the 24% bracket with Roth conversions. Play around with tax software and see what works in your situation.



Making annual conversions to Roth will build a so-called Roth ladder, which is a great strategy to **access your 401(k) / IRA** money prior to age 59.5. Converted assets can be accessed

tax and penalty-free after it has seasoned in the Roth for 5 years (technically January 1st of the year 5 years later, so closer to four years if you convert late in the year).

So, Did I Make a Huge Mistake?

We make the best decisions we can with the knowledge we have at the moment. When I was 35, the thought of an early retirement hadn't crossed my mind. I thought 2010 would be my only opportunity to get my hands on more Roth money, before going back to many years of adding \$50,000 a year in tax-deferred retirement savings.

Knowing what I know now, having my eye on an early retirement, if I could fire up the flux capacitor and go back in time, I would advise my younger self not to make those conversions. "There will be time to make those conversions in a lower tax bracket when you're early retired", I would say. While in hindsight, it was probably not the best decision, I did the best I could with the information I had at the time.



Doc, could I borrow your ride?

The good news is I've since become an employee, and have been building up some [tax-deferred retirement savings](#). The 457(b) will be part of [our drawdown strategy](#) to help fund our monthly expenses in early retirement. The 401(k) will be rolled over to a traditional IRA, and year by year, slowly converted to

Roth. I'll still be able to take advantage of those Roth conversions in much lower tax brackets down the line. Unless the rules change. Again.

[note: this post was originally published in 2016, but updated in January 2018]

Did you take advantage of the "one-time opportunity" in 2010? What would you have done in my situation? Would you say I made a huge mistake?