What Is A Roth Conversion (And When Should You Do One?)

Scott A. T.: Broadcasting from One Dallas Tower, it's the Scott Alan Turner show, ready to help you get out of debt, save more money, retire early and become a financial rockstar. In the studio with me is producer Katie who finally has some chickens that lay eggs. On the show today, going to be answering your questions about money, business and life. This is your show, so if you have a question you would like answered on the show, visit goaskscott.com.

My daughter who is now 2 and a half has reached this stage in her life, and if you have kids, you may have gone through this, and if you're not, this is how it kind of works. For example this morning my wife got her dressed. I go to give her a hug and she's like downstairs. She thinks she's saying something, but she's not. There may be one or two recognizable words at the end of her sentence, and I tell her that. Say, "You're not saying anything. I don't know what you're talking about."

Today we're going straight into a question and at the end of it, and the reason we're doing that is because it was kind of long so I thought, "Well I'm just going to roll this at the front of the show because of its length," and at the end you might be thinking to yourself, "I heard you talking but I only understood a couple words of what you said," and that's okay. We got to get down into a little bit of the weeds today talking about investments, rolling over roth IRA's for a particular situation for a question that someone asked and it's all important stuff otherwise I wouldn't put it on here for everyone to listen to, and it was just a lot of material in a little bit of time, and it might seem like we're going off the reservation today but just bare with me for a few minutes and over time you'll understand this stuff 100 percent completely, I guarantee it. If you miss a couple of things today, that's okay. It's only for a few minutes and then we'll get into more of your questions, so let's roll it.

Jessica in Southern California is getting her employee ranch in a 403 B and asks if it's better to add more money to it or invest in an IRA. She says,

Jessica: "I'm in my early 40's, single, no kids other than the furry kind, and makes $70,000 gross. Listening to your show I learned that I need to pay attention to the fees and the 10 year returns. Looking at the prospectus, it looks like one of the funds is doing better than the others. The holdings concern me though. It lists companies like Microsoft, Philip Morris, Comcast, Home Depot, Amazon, et cetera. I heard you say that company stocks are risky. Since I'm very new to all this, I would like to understand better."

Scott A. T.: You're invested in mutual funds within that plan. What a mutual fund is, it's tiny little slivers of many, many companies, so when you see those companies listed, the Microsoft, the Phillip Morris, the Comcast, the Home Depot, et cetera, et cetera, et cetera, while those are stocks, a bunch of them are owned within a mutual fund. Everyone gets together, they pool their money and they mutually invest in that fund. It lowers the cost for everyone. Because you're in betterments and wealthfront already with your investments, you're already doing this, and that's okay. That's how mutual funds and that's how index funds work. That's exactly what you should be doing. Mutual funds and index funds, they diversify your money. When I mention the stock market, the S&P 500, that's 500 American companies, and they include Microsoft, Philip Morris, Home Depot, Amazon, et cetera, et cetera. There are 500 of them that they use to track how well the stock market is doing.

If you had to buy 500 stocks individually, that'd be super expensive. Most people, the vast majority, wouldn't be able to do it. Apple right now, it's 100 dollars for 1 share, but I can buy a share in a mutual fund because other people have pooled their money together, where I own a tiny slice of 500 different companies for much less money. That's how people are able to do it in their 401k plans or like your 403 B plans. That's the power of the mutual fund or the index fund and the power of diversification. If one of those companies does poorly, they go bankrupt, it's usually okay because you've got hundreds of other companies that are not doing poorly, so you don't blink. The other 499 in this case are still going strong.

In your 403 B, specifically to you, you're currently in a target retirement fund. I wouldn't change it, and here's why. The other fund you reference in your email are called A shares. That's a new term. I don't usually talk about this on the program but because you asked the question, we're going to dig into it a little bit. The reason I know that fund is an A share is because at the end of the name you gave me is a letter A. That's how you know. Even though the yearly expense ratio, which you listed on that information, is lower, it's half as much as the other ones that you're comparing it to, the other target day funds, an A fund means you're paying big bucks on the front end. When you're talking about A funds it means it's called front loaded. A fancy term for commission.

In that particular fund you're paying 5.75 percent. 5.75 percent, that's huge. You're paying that commission to buy it on the front end, so every time you invest a hundred dollars, they take 5 dollars and 75 cents right off the bat, which means you're starting with 94 dollars and 25 cents each time. Big ripoff. I never recommend anyone buy into A funds or high commission based funds for that reason. The big commissions. It's like buying a brand new car and driving it off the car lot. As soon as you pull out of the parking lot of the dealer, it's worth 3 or 4 thousand dollars less. You're buying into A funds, as soon as you say, "Yeah, I want to buy that fund," well, now you're 5.75 percent less of whatever money you put into it. It adds up.

The alternative, buying something else that doesn't have that big front load, there are equivalents out there which let you get into something similar where you don't have to pay that big up front cost and the things do just as well. Now, your 403 B choices, they suck. They suck. There's no other way to put it, which is normal for most 403 B plans. There are very few exceptions. It's sad but it's true. I want you to look through your fund choices. Look for something that has the word index in it, and if you find anything, shoot me an email with that. We'll take a look at those. See what kind of performance and fees they have associated with them.

Jessica also included in her email, she says,

Jessica: "I asked the plan's sponsor about fees and they said the administration fees are paid by the plan's sponsor and are not allocated to plan participants."

Scott A. T.: Most qualified retirement plans, they have a yearly admin fee your employer is going to pay. For example, one of the companies I used to work in, started, we paid 1500 dollars a year to have a 401k plan. It's got nothing at all to do with the funds. That's just to get it up and running and keep it running every year fee. It's like a homeowner's association fee. It's got nothing to do with your property taxes, your home insurance, your mortgage or your interest. It's just the flat fee the employer pays, and in this case they don't pass it along to you. It's just the cost of doing business, but that particular admin fee that the person was talking about, your HR rep, whoever it was, has nothing to do with the expenses in the funds when you buy into those plans.

They're completely different things, so those expense ratios, the one point whatever percent it was, you're still paying those. The employer is not. That person that was that thousands of dollars they're paying each year for the administration fee just to have the plan, that's what they're paying for.

You've got to max out a roth IRA, 5500 dollars a year. That should be your number 1 priority. You get a 6 percent company match like you are now, and then next you max out the roth IRA. Those 2 together put you at a savings rate of just under 15 percent without the company match, which puts you in a pretty good place. Beyond that, if you have extra money to invest, here's what I would suggest. You want to sit down with a fee-only certified financial planner for a couple hours and you want to look at doing a roth conversion because you have a lot of money in your IRA's and you're going to pay taxes on that money in retirement. If you convert some of those IRA's to a roth IRA, the roth IRA goes tax free so you pay taxes on it now and then it grows tax free and then when you spend it in retirement, start pulling it out, you don't pay any taxes on it, which is good.

The law allows you to convert some of your IRA money to roth's, but in order to do that you have to pay the taxes on it now. It only makes sense under certain conditions. One, you have to be pretty well away from retirement, which you are, because you're young. Number two, you should pay the money out of pocket for the taxes, so if you have extra money beyond what you're investing now, the 6 percent and getting a fully funded roth IRA, if you had extra money, you could do some conversions and pay the money out of pocket. It doesn't make sense to do it ... I'm just going to make up a number.

Let's say you had a hundred thousand dollars in an IRA and you're in 25 percent tax bracket. If you converted that to a roth so that money could grow tax free, you'd spend 25 grand on it. That would reduce your investments if you paid it out of the IRA itself, and then you'd have 75,000 dollars in a roth IRA to grow tax free. The 75 grand would grow and grow and grow for 30 years and then whenever you retire and started pulling that money out, you would have already paid the taxes on it, but you make more money or you'd end up with more money if you had the 100,000 dollars in an IRA and you converted the whole thing over to a roth and paid the 25 grand in taxes out of pocket, which requires you to have 25 grand lying around in order to do that. If you do that, you end up with more money in retirement. It's kind of complex, it's kind of weird, but that's why you need to sit down with a fee-only certified financial planner, and they'll look at your situation, but that's something I might consider.

Again, roth conversion, network's based on the longer you have to retirement, the lower tax bracket now versus the tax bracket that you're going to be in retirement, the better it is to a conversion now rather than wait. Pay the taxes now, money grows tax free. If you have any other questions, feel free to ping me back. Thanks, Jessica. Finally, congrats on going to the Guns N' Roses concert. I am way jealous, though I do bet Axl Rose is going to show up 2 hours late, so wear comfortable shoes. Rock on.

Next question is from a different Jessica. Jessica says,

Jessica: "Truth be told, I feel like I'm being buried alive. I'm a single mother of 2 so there isn't a whole lot of cash flow left at the end of each month to pay more than the minimum payments, and I know I'm just spinning my wheels as the interest rates pile on. Please help."

Being a single mother is definitely quite a challenge. I try to challenge each of you every day, or at least give you something new to try, a way to save, to encourage you. I sent Jessica a link to my article, how to get out of debt simply in 4 steps. It's a starting point if you've never tried to get out of debt or you just don't know how. You don't know what that first step is. Once you've had a chance to digest that information, I emailed her back, I said, "I want you to write me back," and I gave her a date, 5 or 6 days away. "I want you to tell me what you've tried, what you're currently doing and email me your action plan. I'll critique it and offer you feedback."

Scott A. T.: Passive listeners will be left wondering a year from now why am I still in the exact same place as I am today?

You heard a lot of great cat stories on the show but you'll be on the plateau. In life, you spend a lot of time on the plateau. There are ups and there are downs, but more often than not we are on the plateau, so it's sad for me when I get people who start out with the right question, like Jessica, a cry for help, I do my best to encourage them and reply them and I'll answer them sometimes at great length, and I never hear back from them. Someone who is in striking distance of turning the corner, someone who has the potential to get out of debt, retire early, safe her house, save her car, save her whatever, and they just let it slip by, and we say to ourselves, "I'll get to it someday."

Then you get listeners like Jordan who you've heard on the show several times. He's champing at the bit to get going, or Rafael, number 1 question writer, they will ask and ask and ask and ask. Asking is great. If you ask better questions you'll get better answers, but the word that comes after "ask" in the dictionary is "act," if you're reading the dictionary backwards, anyway. You get the point. The opportunity is in front of you. Don't hesitate. Jessica, I hope, someday, you'll reply back.

If you have a question you'd like answered by me, the website is goaskscott.com. That's how you can get in touch with me. Drop me a note. I want to hear from you, just to say. Introduce yourself. Ask me a question about money, business or life. That's what I'm here for. I'm here to help you.

Thanks to Rich Bean for supplying our bumper music today, of our special bumper music from Rich.

Let's say you buy a $1,000 new TV, that's an expensive TV, or $1,000 sofa, or perhaps $1,000 dinning room table. That's a lot for a dining room table, too. 1,000 bucks for a sofa ... Maybe that's something that you'd buy. Someday you've decided, "I've had enough. I'm ready to get rid of it." You decided you're going to sell it for $2,200. Whoa! Whoa, wait up Scott, how can I sell it for more than I paid for it? That's is, you can't. If you use one of these 0% down, 0% interest, $0 initial payment plans, that's what you could end up paying. Dana, who wrote in to me recently. She bought something at Haverty's Furniture, the initial price was $1000 and now the balance is $2,200 that she has to pay off. "It was great and interest free," she writes, "but we were unable to pay it off, so all the interest came back." The interest rate is 29.99%, almost 30%.

When you get into one of these deals that interest rate, which you don't pay upfront, is going to be charged to your account from the date of your purchase. If you don't pay that promotional purchase price, in full within the 3, 6, 12 months, 18 months, 24 months, whatever it is. You've got to have those minimum monthly payments in there, as well. Every $1,000 becomes $1,300 after 366 days. It grows from there because of the monthly interest charges and the late fees if you don't pay the minimums. You miss a payment, you'll be paying a pretty penny. Interest rate jumps from 0%, that introductory rate, up to 20, sometimes 30% in this case and it's always retroactive from when you first bought it. That interest starts adding up from day 1. It's a very, very, very, very expensive mistake to make and a lot of people do it.

I just looked online at Ashley Furniture, another big furniture store, 29.99% interest down there in the mice-type. The stores know their products are expensive. These deals exist to make you think you can afford the small monthly payments. $3,000 living room set doesn't seem that much when you've only got to pay 100 bucks month for it. $100, I can afford that. If you can't afford to buy it in cash, you can't afford it. You don't believe me, ask Dana who's paying $2,200 for $1,000 piece of furniture. If you want a real deal on furniture where should you go? Craigslist. Craigslist is loaded with deals. You'll find pretty much exactly what you're looking for if you're patient, usually at half to 75% off what you'll find it for in the store.

Great example, Katie found a 8 seat ... I think it was 8 seat breakfast table, it was from Crate and Barrel, originally. She found it on Craigslist brand new, I think it listed for 8 or 900 bucks, she picked it up for $200 off Craigslist. That was a deal. Now, back to your questions.

Ryan asks,

Ryan: "How can I stick with my plan when my friends and girlfriend all want me to spend?"

Scott A. T.: Easy, make more money. Just got to make more money and then you can spend more. No. Even when you make more or if you're in a relationship, you're in the good times, money is always going to be one of the biggest sources of arguments among couples. When finances are tight and you're in a relationship, clashes are still going to happen over the different spending styles you might have. If you're from a family of savers, your friends, your girlfriend come from a family of spenders, going to be clashes like you mentioned. You get 2 different groups here, you've got your nagging friends and then you've got your nagging girlfriend. All my friends they want me to jump off the financial abyss. They want me to go right along with them. You, Ryan, have got to look out for you, because your friends are not going to fund your retirement.

Have fun while you can but budget for your fun. Maybe you take one weekend trip per month instead of 4 or whatever you guys do on the weekend you do a little less. You go out for 1 beer instead of 5, again, not assuming that you're drinking, but if that's something that you do. Set your boundaries in advance with your friends and then everyone knows what to expect. You go out on the weekends, an example, say, "All right, I am going to stay out till 10 and then I'm going to head home because I want to get a good night's rest." Example would be time boundary. Sometimes you will get called "the stick in the mud". Katie calls me the stick in the mud all the time but it's good to live a life of balance. Balance doesn't mean equal, though, in this case. You define your balance because you have to do what's important for you. You define what makes up the scale. You define what your priorities are. You define what the weights are. It can be more weighted more heavily in your favor, it's your balance and you're defining it.

With your girlfriend, you guys are just not on the same page. You want to reflect on what you want that relationship to look like in a year or 5 years. If you're just in it now to have fun, nothing more, you try to explain the situation and what's important to you and ask your girlfriend what's important to her? If you're dating or you're in marriage and you've got financial differences, you've got to come to some type of compromise that you both agree on. In a relationship you're never going to agree on every spending decision, it just doesn't happen. You have to meet somewhere in the middle and do some compromising. If you are thinking more long term, I would seriously ask if this is someone who plans on changing into a saver down the road, or someone that's going to want to blow your paycheck every week, after week, after week? It's pretty clear if you match a saver and a spender, you're going to end up with a lot of arguments about money.

It's tough to get somebody to change until they're ready to change. To get somebody to change you have to inspire them to change. You can't argue them into it, you can't nag them into it, and you can't manipulate them into it because then they're going to hate you. But know this, it is possible to change a spender into a saver. I was a spender in college. I was a spender after college and I became a saver, so it's possible. Katie, my wife, always smart with the money, always a saver. It's important to talk with your girlfriend about, "Hey, what are your big goals? Do you think you want to travel someday? Do you want to own a business, perhaps? Do you want to go get an additional degree later on?" Then ask them, "How do you think you're going to get there?" Until someone understand the decision set they're making today impact what's going to happen tomorrow, they're extraordinarily unlikely to change.

Sometimes it's helpful to get the point across by having your friends, or your girlfriend, help you solve one of your financial problems, even though you might already know the answer. Say you want to go on vacation in 2 years but you're not sure how you want to save up for that. Have them help you figure out how you're going to get there. Now, you know how you're going to get there, but by them walking through it and may see that, "Well, maybe taking out the credit card debt and paying it off is not such a good idea if we have to pay 18% interest on it for the 2 years after that and a $2,000 vacation becomes a $4,000 vacation." Then the gears start turning, then they start learning. They might start getting the point of how this stuff works. That's one way to do it. Spending is fine as long as you're investing first and paying off your debts. You've got to do what's right for you first and it may take time for them to get on board with your spending personality. Thanks, Ryan and good luck.

Back in 46 1/2 seconds. You're listening to Scott Alan Turner.

Hey nation, Scott Alan Turner here. Now, for those of you that are my long time listeners, you know I'm not one of those guys on the radio promotes every product that shows up on their desk. You're never going to hear me trying to get you to buy high fructose corn syrup or recommending you buy the DVD collection for Star Trek: Deep Space Nine. No. I have a name to uphold to you, the Rock Star Nation. If I were to recommend something to you, I would tell you about Spoon City. Many of you are sitting there right now listening to this mindless drivel at home eating a bowl of cereal for breakfast. Unless you're like my 2 year old's using their hands, you're using a spoon to shovel in those chocolate marshmallow sugar-O's. Spoon design has remained unchanged for hundreds of years, until now. The fine folks at Spoon City have come up with the first ergonomic spoon to take your eating experience and health to a whole new level. Eating with a non-ergonomic spoon can cause side effects such as headache, nausea, cramping, bloating, lightheadedness, stuffy or runny noses, chest pain, and in some rare case spontaneous combustion. Head down to your local Spoon City today, your mouth deserves the best.

Welcome back. Hey, if you got a question that I can answer on the show, the website is goaskscott.com, shoot me an email, get on the show.

Sammi is newly married and condensing 2 households, 2 sets of bills, as well as 2 sets of debt and it's overwhelming.

Sammi: "Found your show during a search on the topic of eliminating debt. The 'where to begin' is as overwhelming as the 'how to begin'. How do I begin to mesh the 2 lives debt?"

Scott A. T.: When Katie and I were married we had 2 homes, 2 sets of furniture, 2 lives, one cat, my cat, and 2 sets of finances that we had to merge into one. There were some discussions ... we won't call them heated, we'll say they were loving chats. The first year of marriage is fun and challenging. I would sit down, carve out a couple hours; get your credit card bills together, your investments, your pay stubs, pull your credit cards for free at annualcreditreport.com, go through those with a fine-tooth comb. You're just gathering information. Then you want to write down all your household expenses. It's a good time to use a budgeting tool, you can use Mint, it's free. Here is our electricity, utility bills, car loans, insurance, just gathering. Figure it all out.

You want to figure out what your fixed expenses are like your car phones, your cell phones. Then you also want to figure out what your discretionary and variable types of spending are; your eating out, your groceries, your clothing budgets. Also, you want to have equal amounts of blow money. Not a lot if you're paying off a ton of debt, but you got to have a little because you're newly married, you got to have some fun. You don't want to be miserable for months and years while you're paying off the debt. Then you figure that amount is based on your comfort and based on all this other information that you're gathering, you pick that amount and you both agree that you're going to stick to it. Now, why do we do that? Because you're going to argue less and there's not going to be any resentment if you both have equal amounts.

Forget about who makes more money, especially men, if you're listening ... Well of course men are listening. You may have a spouse who does not work. Maybe she's in school, maybe she's taking care of the kids. If you want a lousy marriage tell your wife you're getting $200 a month because you earned the money and she gets $20 and see how far that gets you: hint, not very. Hope you enjoy sleeping on the couch. Not you specifically, Sammi. Make sure it's equal because the marriage should be equal. Then you've got all that information, you want to decide who is going to manage the money. That's a task when you're getting started. It's going to be a good amount of work each week to keep that up to date until you get in the groove, get things running smoothly, and figure out how to do the budgeting each month.

Primarily, it'd be one person entering the transactions each week, paying the bills, or you can have one person managing the budget software and one person responsible for paying all the bills. You just gotta make sure you know who's doing what and they're doing it each week so that you don't get behind, you don't have late payments, you don't get off track. You can divide up the work or you can have one person do all the work and both of you sit down together each week to go over the work.

Main items when you're newly married, you've got to pay off your debts first, that's priority number one. Then you move on to starting an emergency fund in case something bad happens, and creating your long term savings plans for retirement or the house down payment, whatever big goals you're working towards. Debt comes first, though. You have one focus and you have one priority. It's going to simplify your life. You don't want to try and do 6 different things. You want to simplify your life even more, you get one combined checking account, one combined savings account. Take you 60 minutes at the bank to do that.

Don't have separate accounts or we're going to have this account for paying bills, and this account over here for doing something else, and I'm going to have my credit debit card, you're going to have your debit card ... No. You want to make things complex then you go that route. You want to simplify your life and make things easy, combine accounts, keep it simple. Pick a time each week we're going to meet, even if you're just passing each other in the hallway, in the house, apartment, saying, "Budget looks great this week, we're on track. We haven't overspent, all the bills are paid." That can be a meeting that gets more common later on. Initially, you'll be sitting down more and having greater in depth discussions.

Couple side notes, since you're newly married, you want to make sure each other is added as your beneficiary in your retirement accounts, if you have any. Make sure you look into that. This is a fun time in your life. It is. Everyone says marriage is hard. Well, marriage is fun, there's just a lot of challenges. There's always going to be challenges. Like life itself, the journey is what you make of it. Keep in mind, even though you're in debt, you have some debts to pay off, it's new, you don't know where to begin. Hey, that's okay. This is just money. It's a handy tool, but in the grand scheme of things it doesn't matter a whole lot.

Doesn't define your character, it doesn't define your relationship. In a couple years, 5 years, whatever from now you're going to look back and say, "Man, we had some tough times but we wouldn't be who are today if we didn't have those challenges to learn and grow from." I was happy living in a 1,000 square foot rental home with the squirrels in the attic and the bugs running around ... maybe not the bugs. I'm also happy in my beautiful custom home today. My home, my stuff, my bank account, they don't define me. If you remember that you guys will be forever happier. Thanks, Sammi, for the question.

What's going on over in the Facebook community, which you can join at ScottAlanTurner.com/community

Kristin says,

Kristin: "My husband got 58 hours of back pay that had been owed to him and I received a monetary reward at work. We also got two sets of Chipotle coupons in the mail."

Scott A. T.: That's a win, congratulations. I have to apologize, a few weeks ago, I don't know what I was thinking, I decided to read a poem. I'm going to take a moment to redeem myself with ... this is actually a poem, but I kind of like this one: Llama llama red pajama, gets two kisses from his momma, snuggles pillow soft and deep, baby llama goes to sleep. There we go, that's more up my alley. Llama llama red pajama. One of the great literary works of our time. It's a book I read couple, three times a week to the kids. Those are the words.

That's it for this episode. I'm your host Scott Alan Turner, rockstar Katie is my producer. All the links mentioned in my show are available in the show notes on ScottAlanTurner.com. Thanks again, Rich Bean, for the bumper music. If you have a question you'd like answered by me, visit goaskscott.com. Thank you so much for listening, I appreciate you.