

When to Consider Roth IRA Conversions

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Over the last few years, there's been some press on Roth IRA conversions. When these concepts are raised by the media, naturally, clients want to know if it's something to consider. Like every other tax strategy, Roth conversions are individual. They're certainly not appropriate for everyone, however, there are some individuals who benefit from this strategy.

The purpose of this article is to point you in the right direction. I've simplified the concepts to efficiently give you direction. You may read enough to determine Roth IRA conversions aren't for you. You may read enough to decide you're not sure. I'm happy to schedule a tax planning meeting if you'd like more information.

THE BASICS

Individual Retirement Accounts (IRAs) are investment accounts that offer tax advantages, encouraging you to plan for retirement. The tax advantages of traditional IRAs and Roth IRAs differ.

A **traditional IRA** is tax advantageous because contributions into them are tax deductible (up to a specific dollar amount and if you are under a specific income threshold). If you meet the requirements, you will deduct the amount you contribute from your taxable income when filing your tax return, reducing your income tax in the year you contribute. On the flip side, distributions from a traditional IRA (your original contributions as well as earnings) are taxed in the year the money is distributed/withdrawn, presumably when you are retired with lower income (and lower tax rates).

Although contributions into a **Roth IRA** are not deductible, a Roth IRA is tax advantageous because distributions from these accounts (including earnings) are tax-free.

A **Roth conversion** is a transfer (rollover) of traditional IRA funds (already in the IRA) into a Roth IRA account. Making this change has both immediate and long-term tax consequences.

Immediate: the traditional IRA funds that are rolled into the Roth account are treated as a distribution and taxed in the year of the transfer. You will pay tax on the amount of funds you convert at your current tax rate. **Long-term:** in the Roth account, the investment will grow tax-free and when the Roth funds are eventually withdrawn, the individual will pay no income tax on the distribution.

BENEFITS OF ROTH CONVERSIONS

The benefits of converting traditional IRA funds to a Roth IRA include:

- Tax-free distributions going forward
- To minimize lifetime cumulative tax, a combination of:

- Federal tax
- State income tax
- Federal estate tax (comes into play if your assets are over \$13.99 million in 2025)
- State inheritance tax (there is no federal inheritance tax)
- To reduce required minimum distributions (RMDs) – converted amounts are not subject to RMDs while the Roth IRA holder is alive
- Wealth transfer benefits – post-death distributions to beneficiaries are tax-free

IS A ROTH CONVERSION RIGHT FOR ME?

The idea of future tax-free distributions from a Roth IRA is enticing, but a conversion only makes sense if your current tax rate is **less than** your predicted future tax rate. It is presumed that the very nature of being retired means lower income, in which case, your current tax rate while working is **more than** your predicted future tax rate at retirement. ***This is certainly not always the case, but it is often the case.

A word about the US income tax system... The US income tax system is progressive, which means that higher tax rates are applied to higher levels of income (the first \$X dollars of taxable income is taxed at 10%, the next \$X dollars is taxed at 12%, etc.). When considering a Roth conversion, good care should be taken to avoid hitting a higher tax rate with the additional taxable income that will be created by the conversion.

WHEN TO CONSIDER A ROTH CONVERSION

Converting to a Roth IRA may work in your favor if you're in the following situations:

- You have outside funds to pay for the tax for converting
- You expect to be in the same or a higher tax bracket when you retire
- You have losses, deductions, or tax credits to help offset the tax impact if a conversion

THE BIG PICTURE

As your tax preparer, I analyze your tax rates and monitor many factors that impact your bottom line each year as part of the tax preparation process. To offer a more complete evaluation of your financial interests, I'm also happy to work with other professionals you've hired, such as financial advisors and attorneys. Please connect me as you see fit.