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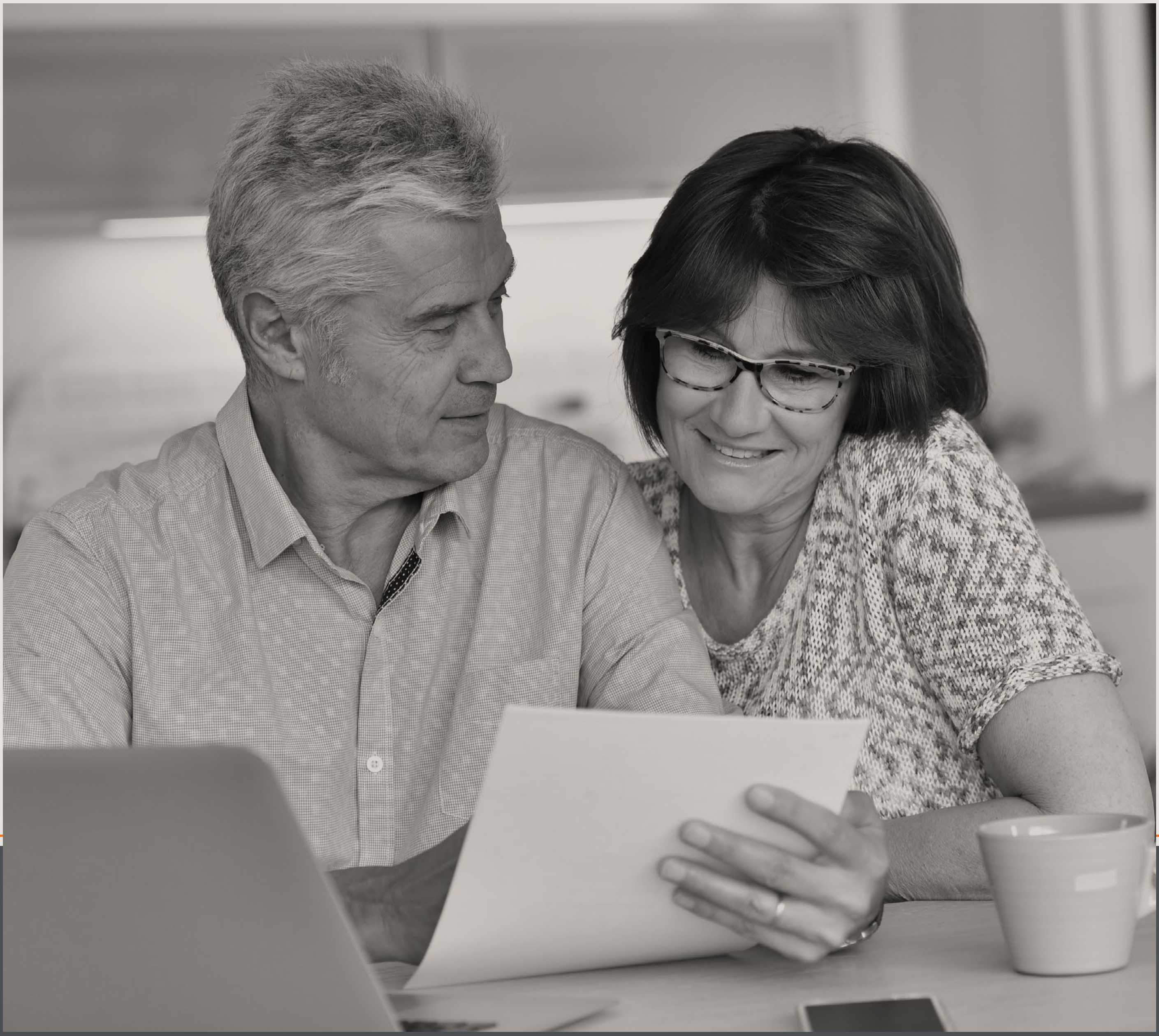

# Is a Roth Conversion Right for You?

With continued market volatility and inflation still at a high, more and more people are concerned with how their finances will be affected long-term and, more specifically, how this will affect their retirement. One strategy that some investors are employing is converting their traditional individual retirement account (IRA) to a Roth IRA. There are multiple benefits of a Roth conversion, but ultimately, you, your financial advisor, and your CPA should discuss whether the strategy is right for you and your financial goals.

## WHAT IS A ROTH CONVERSION?

In its simplest form, a Roth conversion is when you move funds from your existing traditional IRA into a Roth IRA. In some cases, this can get around the fact that you may not be eligible to contribute to a Roth IRA.

In 2023, if you're married and filing jointly and earn more than $228,000* a year, you can't contribute to a Roth IRA. For single individuals and head of household filers, the cutoff is $153,000.[1]* That's when converting from a traditional IRA to a Roth IRA comes into play.

Contributions to a Roth IRA are made after-tax, so when you're converting your retirement assets from a traditional IRA to a Roth IRA, you'll have to pay income tax on the money that you converted in the year of the conversion. Unlike a withdrawal from your traditional IRA prior to age 59 1/2, there is no 10% early withdrawal penalty on any amount you convert into a Roth IRA.

## IMPORTANT THINGS TO CONSIDER BEFORE CONVERTING

### TAX CONSIDERATIONS

- The tax you pay on a Roth conversion will be determined by your tax bracket at the time of the conversion and how much money you convert. The amount is taxed as ordinary income.
- To mitigate the tax burden, you can spread your conversion out over a few years, so you can control the amount of tax you pay each year you do the conversion.
- Know where you're going to get the money to pay the income tax on the conversion. Cash on hand is the best option, as you won't need to take money out of an IRA or sell appreciated assets, both of which could undermine the benefits of the conversion.

### PERMANENT RESIDENCE CONSIDERATIONS

- Where you will live during retirement matters:
  - If you live in a high-tax state but plan on moving to a state that does not have income tax as you near retirement, you may want to hold off on converting until you make the move.
  - If you're planning on moving to a state with a higher state income tax rate, you may want to consider converting some of your eligible assets prior to the move.

## TIMING CONSIDERATIONS

- If you retire before you have to start taking RMDs, you may have an opportunity to take advantage of converting while in a lower tax bracket. If you are within two years of filing for Medicare and Social Security, this would not be a good idea, as a conversion could increase your Medicare premiums and the taxes you pay on your Social Security benefits.
- If you do convert, you must wait five years to take tax-free withdrawals, even if you're over 59 1/2. The five-year period starts at the beginning of the calendar year that you did the conversion.

## ESTATE CONSIDERATIONS

- A Roth conversion can be beneficial for estate planning. A traditional IRA inherited by the next generation will have its income taxed as withdrawals are made over the course of the IRA's 10-year withdrawal period. Withdrawals from a Roth IRA are tax-free unless the Roth account is less than 5-years-old at the time of the withdrawals, at which time the earnings may be subject to income tax.[2] The account must still be emptied by year 10.

### CONVERSION BENEFITS

- Contributions and earnings in a Roth IRA grow tax-free. Once you pay taxes on the funds going into your Roth IRA, you don't pay any additional taxes on those funds.
- Roth IRA withdrawals in the future, when you are retired, come out tax-free, so a Roth conversion might help you get into a lower tax bracket in the future
- Roth IRAs are not subject to RMDs, so you won't have to take RMDs on your account when you reach 73 years old.* If you don't need the funds, you can continue to let it grow tax-free and ultimately pass it on to your heirs one day.

### CONVERSION DRAWBACKS

- You pay tax on the conversion when you do it, which could be a substantial amount.
- You may not benefit from the conversion if your tax rate is lower in the future.
- You must be 59 1/2 and keep the funds in your Roth IRA for five years before taking tax-free withdrawals. There is a 10% penalty for early withdrawals, and you may owe income tax in addition to the early withdrawal penalty.

A Roth IRA conversion can be a very powerful tool when it comes to your retirement. Weighing the pros and cons and discussing this with a financial advisor can be extremely helpful for your long-term financial success. Feel free to give us a call to discuss whether a Roth IRA conversion is the right solution for you.

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[1] https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2023

[2] https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-beneficiary

* These numbers are subject to change, and you need to consult with your tax advisor.