Roth Conversions

IRA Basics: (Simply Stated)

• A taxpayer who makes a deductible contribution to a **traditional IRA** gets a tax deduction for the money contributed, the money grows tax-free, and is fully taxable when distributed. When the taxpayer turns $59^{1/2,}$ the money can be withdrawn penalty-free. When the taxpayer turns 73, mandatory distributions are triggered, and upon death the remainder is taxed to the heirs.

• A taxpayer who contributes to a **Roth IRA** gets no deduction for the contribution, the money grows tax-free, and there is no tax or penalty on a withdrawal after $59^{1/2}$. When the taxpayer turns 73, no mandatory distributions are triggered, and upon death the money in the Roth transfers tax-free.

Putting money in a Roth can remove it from taxation forever.

How To Convert:

• Before 2010, only a taxpayer with income under $100,000 could convert a regular IRA to a Roth by paying tax on the amount converted.

• Beginning in 2010, any taxpayer regardless of income can convert to a Roth by paying tax on the amount converted.

Why Convert?

• Qualified Roth distributions are tax-free and not mandatory.
• Qualified Inherited Roth distributions are tax free.
• A tax-free Roth distribution after retirement can keep a taxpayer in a lower tax bracket and possibly reduce the taxation of Social Security.

Reasons Not to Convert?

If you are in a high tax bracket your Roth conversion will cost you more (Roth conversions are taxable income). If you anticipate a lower income in future year(s) you may want to wait. For example, perhaps you will retire early before collecting Social Security. This might be the perfect time to convert. That said, the future is uncertain and tax laws change over time.

Who should consider converting?

• Young people (money has time to grow)
• People who anticipate being in a higher tax bracket in the future
• People who can afford to pay the tax
• People concerned about the mandatory distributions of traditional IRAs
• Those that want to provide a tax-free inheritance to their heirs
• Those who were phased-out of Roth contributions in the past due to high income

Rules:

• Converted money must remain in the Roth at least 5 years if you are under 591/2
• You can directly convert a company 401(k) to a Roth as long as you are not still working for the company.
• A SEP or a Simple IRA can also be converted, but a Simple requires 2 years of participation before conversion.
• Roth conversions cannot be undone (prior to 2018 you could recharacterize them to a traditional IRA but that was eliminated by the Tax Cuts & Jobs Act).