2023

ROTH CONVERSION

BAACKE
INSURANCE & FINANCIAL SERVICES

Looking for tax-free retirement income? A Roth conversion strategy can be used to pay taxes now and avoid tax bills later when your income may be lower or taxes may be higher.

TRADITIONAL IRA vs. ROTH IRA

There are a few key differences between a traditional IRA and a Roth. The biggest is how they're taxed.

With a traditional IRA, you may be able to deduct your contributions each year from your taxes. However, all distributions from the IRA are taxed as income.

With a Roth IRA, there are no upfront deductions for contributions, but your distributions are tax-free, assuming you are age 59 1/2 or older and the account has been open five years.

	Traditional IRA	Roth IRA
Deductible Contributions	Contributions may be tax-deductible, depending on income	Contributions are not tax-deductible
Tax Treatment of Distributions	All distributions are taxable as income	Distributions after age 59 1/2 and after account has been open 5 years are non-taxable
Required Minimum Distributions	Taxable RMDs start at age 72	Distributions are never required
Tax Treatment of Death Benefit	At death, beneficiary payouts are taxed as income	At death, beneficiary payouts are not taxed

IRA Contributions

One area where the traditional IRA and Roth IRA are the same is with regard to contributions. In 2023, the contribution limits for both IRAs are the same:

Annual Contribution Limit	$6,500
Catch-Up (Over 50)	$1,000

https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits#:~:text=More%20In%20Retirement%20Plans&text=For%202023%2C%20the%20total%20contributions,taxable%20compensation%20for%20the%20year

A key difference is whether or not you can contribute. Not everyone can contribute to a Roth IRA. If your income is too high, you may only be able to make a partial contribution or no contribution at all:

Single Income	Married Income	Max Contribution	Over 50 Contribution
< $138,000	< $218,000	$6,500	$7,000
$138,000 - $153,000	$218,000 - $228,000	$600 - $5,400	$700 - $6,300
$153,000+	$228,000+	$0	$0

https://tax.thomsonreuters.com/news/2023-contribution-limits-401k-increases-to-22500-ira-to-6500/

How does a Roth Conversion work?

1. ***Fund a traditional IRA.*** The first step is to actually have a traditional IRA to convert. It may be a traditional IRA that you've been funding for years. Or perhaps you are rolling an old 401(k) into a traditional IRA before converting to a Roth.

2. ***Open the Roth IRA.*** Before you can transfer your traditional IRA assets, you have to have an open Roth IRA to direct the money.

3. ***Pay taxes on the converted assets.*** Remember, ALL distributions from a traditional IRA are taxed as income - not capital gains. That includes distributions for Roth conversions.

4. ***Transfer the traditional IRA assets to the Roth IRA.*** Your financial professional or IRA custodian can help you complete the paperwork so that the assets are automatically transferred, avoiding any penalty.

5. ***Wait at least five years to achieve tax-free distributions.*** For Roth IRA distributions to be tax-free, you must be at least 59 1/2 and the account must be open at least five years. Plan ahead and make sure you wait the correct amount of time. Otherwise you'll lose the Roth IRA tax benefits.

TIP:
If possible, pay the conversion tax with assets outside the IRA. If you use IRA funds to pay the taxes, you reduce the amount that funds the new Roth IRA. That reduces the benefit of tax-deferred growth and tax-free distributions in the future. If you use other assets to pay the taxes, you can maximize the amount going into your Roth IRA.

When is a Roth Conversion right for you?

- You want tax-free income in retirement or a tax-free benefit for your heirs.
- If you can't make contributions to a Roth because of your income. You could make contributions to a traditional IRA and immediately convert it.
- If you believe your tax rate will be higher in the future than it is today.
- You'll have current-year deductions, credits, or capital losses that will offset the taxes from the conversion.
- You want to avoid RMDs at age 72.

When is a Roth Conversion *not* right for you?

- You will have low income in retirement. If this is the case, it may not be worth it to pay taxes now to avoid taxes in the future.
- You don't have the money to pay the taxes. Remember, the conversion tax is due in the year you complete the conversion. If you can't afford to pay the taxes, a Roth conversion may not be the best choice.
- You may need the money soon. You must wait at least five years to take distributions in order to qualify for tax-free Roth distributions. If you may need distributions sooner than that, it may not be worth it to convert.

What's next?

Think a Roth conversion might be right for you? The first step is to consult with a financial professional who can help you analyze how a Roth may fit into your whole financial picture.

Let's talk about it. Reach out today to start the conversation.

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