GIBSON CAPITAL

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The Roth IRA Conversion Playbook

A Retiree's Guide To Lower Taxes & Smarter Withdrawals

The Roth IRA Conversion Playbook: A Retiree's Guide to Lower Taxes & Smarter Withdrawals

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Roth IRA Conversion Playbook

In retirement, one of the biggest challenges you'll face is managing your income in a way that minimizes taxes and preserves your hard-earned savings. If you've relied on Traditional IRAs or 401(k)s to grow your wealth, you know that every dollar you withdraw is taxed—and once you turn 73 (or 75 if you were born in 1960 or after), Required Minimum Distributions (RMDs) can force you to take income you may not need, potentially pushing you into higher tax brackets.

A Roth IRA conversion offers a powerful solution for retirees looking to gain greater control over their income and taxes. By converting funds from a Traditional IRA to a Roth IRA, you can benefit from tax-free growth, reduce or eliminate future RMDs, and leave more to your loved ones. While a Roth conversion requires paying taxes upfront, it can deliver significant long-term benefits—especially if you act strategically and convert gradually over time.

This playbook is designed to help you explore how a Roth conversion can work for you. Inside, you'll find:

- Clear explanations of the benefits and considerations of Roth conversions.
- Real-life case studies of retirees who have successfully used Roth conversions to reduce taxes and secure their financial future.
- A step-by-step guide to implementing a smart and tax-efficient conversion strategy.

By making informed decisions now, you can reduce your tax burden, gain flexibility in how you manage your income, and leave a lasting, tax-free legacy for your heirs. Let's explore how a Roth conversion can help you make the most of your retirement.

Why Roth IRA Conversions Matter for Retirees

What Is a Roth IRA Conversion and Why Should You Care?

A Roth IRA conversion allows you to move funds from a Traditional IRA to a Roth IRA. While taxes are paid upfront, the benefits of tax-free growth and withdrawals make it a valuable strategy for retirees. Additionally, future investment growth is tax free.

Why It Matters for You:

- **Avoid Higher Taxes Later:** Tax rates are low now but set to rise after 2025.
- **Control RMDs (Required Minimum Distributions):** Traditional IRAs force you to take taxable RMDs at age 73. Roth IRAs have no RMDs, offering complete control.
- **Leave a Tax-Free Legacy:** Roth IRA assets can be passed to heirs tax-free, maximizing your family's inheritance.

Top 3 Retirement Concerns Roth Conversions Can Solve

1. Will Taxes Eat Away at My Retirement Savings?

- Pay taxes now while rates are lower to secure tax-free withdrawals later.
- Example: Converting $100,000 today at 22% saves money if future rates rise to 28%.

2. Will I Outlive My Money?

- Reducing RMDs and creating a source of tax-free income gives you more control and predictable cash flow.

3. How Can I Leave More for My Heirs?

- Roth IRA assets pass to beneficiaries tax-free, unlike Traditional IRA assets that are taxable upon inheritance.

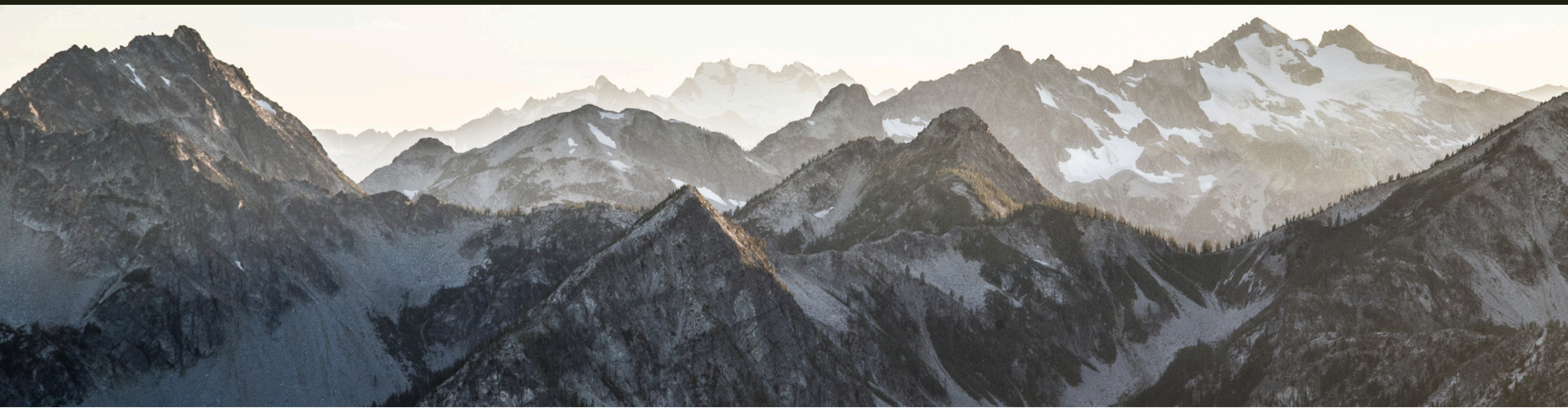
Case Study 1: Bob & Lisa

Bob and Lisa have spent their working lives saving diligently, building significant wealth, including a fully paid-off home. Recently retired, they're ready to embrace this new chapter by traveling the world and creating lasting memories—all while ensuring they leave a meaningful legacy for their two successful adult children.

While they prefer to remain in their home state of California, they're mindful of its high income taxes and want to understand how staying there might impact their cash flow and long-term financial goals. With $2 million in Traditional IRA assets and $1 million in a taxable brokerage account, Bob and Lisa feel confident in their resources but are concerned about the potential impact of inflation and future tax increases on their financial security.

Bob & Lisa's Situation:

- $2 million in traditional IRA
- $900k in taxable brokerage with a $450k cost-basis
- $100k in cash
- Own home free and clear
- Live in high income tax state of California



Bob & Lisa's Options:

- No Roth conversions: pay an estimated $2.67 million in taxes over a 30 year retirement
- Fixed Roth conversions of $100k annually: pay an estimated $1.44 million in taxes over a 30 year retirement (a savings of $1.22 million). Pass on an additional $694k to heirs.
- Roth Conversions to the top of the 22% / bottom of the 24% bracket (based on current tax laws): pay an estimated $1.29 million in taxes over a 30 year retirement (a savings of $1.37 million). Pass on an additional $1.04 million to heirs.

Case Study 2: Tim & Jennifer

Tim and Jennifer, both 60, are at an exciting yet critical stage of life. With $1.5 million in traditional retirement accounts and $1 million in taxable brokerage assets, they've done an excellent job of saving for the future. However, like many retirees, they're concerned about whether their nest egg will last. They dream of traveling and living in different cities over the next 10 to 15 years, taking advantage of their good health and newfound freedom. Adding complexity to their planning, Jennifer anticipates a significant inheritance but isn't sure when—or even if—it will materialize.

Tim & Jennifer's Situation:

- $1.5 million in traditional IRA
- $1 million in taxable brokerage without any gains or losses
- A $1.5 million inheritance in 10 years
- Live in high income tax state of California
- 5 More Years of planned work until retirement

Tim & Jennifer's Options:

- No Roth Conversions: cumulative estimated taxes over next 35 years $3.48 million
- Roth Conversions to top of 12% Bracket: Estimated tax over retirement of $2.76 million and an additional $400k in assets at age 95
- Roth Conversions to top of 22% Bracket: Estimated taxes over retirement of $1.70 million and an additional $400k in assets at age 95

5 Steps to a Smart Roth Conversion

Step 1: Understand the Tax Impact

- Roth conversions trigger ordinary income taxes on converted amounts.
- If your IRA includes both deductible and nondeductible contributions, the Pro-Rata Rule applies. Your custodian will report this on Form 1099-R.

Step 2: Time It Right

- Low-Income Years: Convert before Social Security or RMDs start.
- Market Downturns: Convert during portfolio declines to reduce the taxable amount.
- Future Tax Rates: Historically, we are in a low tax rate environment. Since taxes are probably only going up from here, it may be the best time to convert.

Step 3: Convert in Phases

- Spread out conversions over multiple years to control tax exposure.
- Use strategies like converting up to the top of a bracket (e.g., 24%) to minimize tax spikes.
- Gradual conversions allow you to balance taxes and cash reserves.

Step 4: Pay the Taxes on your Conversion

- Use cash savings or after-tax funds to pay conversion taxes
- If you are above age 59 ½, you may also withhold part of your IRA conversion to cover some or all of the taxes.

Step 5: Work With a Professional

- A financial advisor can help:
    - Identify tax-efficient conversion amounts.
    - Coordinate the process with your IRA custodian (trustee-to-trustee transfers are preferred).
    - Avoid costly mistakes like triggering IRMAA (Medicare surcharges).

Bonus: Estate Planning Benefits

- Roth IRAs grow tax-free with no RMDs, making them ideal for wealth transfer.
- Heirs receive Roth funds tax-free, avoiding the burden of Traditional IRA taxes.

A Roth IRA conversion can be a powerful strategy to reduce taxes, increase financial flexibility, and secure a more confident retirement. By converting Traditional IRA assets into a Roth IRA, you gain the benefits of:

- Tax-Free Growth and Withdrawals: Eliminate the uncertainty of future taxes and enjoy knowing your savings can be accessed tax-free.
- Freedom From RMDs: Stop forced withdrawals from your retirement accounts and maintain control over how and when you use your money.
- Legacy Planning Advantages: Leave a tax-free inheritance to your loved ones, ensuring they benefit fully from your hard work and careful planning.

Throughout this guide, you've seen how retirees like Bob & Lisa and Tim & Jennifer used Roth conversions to reduce their long-term tax burden and build a stronger financial future. Whether through full conversions, staggered conversions, or "converting the gap" to stay within a tax bracket, each approach demonstrates that small, strategic decisions can have a profound impact over time.

While Roth conversions require paying taxes upfront, the long-term benefits often far outweigh the costs. The key is to carefully plan your conversions—considering your income, tax brackets, and goals—and execute them in a way that aligns with your broader retirement strategy.

With this distinct strategy, you can:

- Protect your savings from rising taxes.
- Simplify your income planning in retirement.
- Maximize what you leave behind for future generations.

Retirement should be about enjoying the life you've worked so hard to build, not worrying about taxes or forced withdrawals. With the right strategy, a Roth IRA conversion can give you the peace of mind and financial confidence to fully embrace your retirement years. Reach out to us below with any further questions!