It's Roth Conversion Season

A few things to consider about converting Traditional IRAs and 401(k)s to a Roth IRA

- Contributed by Justin Fundalinski -

Here at Jim Saulnier and Associates it is appropriate to say that we love Roth IRAs and we could go on and on about them. As the days shorten and the holidays approach, Roth conversion season is setting into full swing. The purpose of this article is not to dive into all benefits and nuances of a Roth IRAs, rather to describe what Roth conversions look like. With that said, it is important to review some of the benefits of a Roth before you consider conversion.

Why Roth?

The primary reason to think about a Roth is **tax-free income in retirement**. As you may already know about Roth accounts, taxes have already been paid on the contributions and any growth within the account can be received tax free if removed with a qualified distribution. This means that the "younger you" prepaid taxes for the "older you." Often we are asked if Roth accounts make sense because people feel they will be in lower tax bracket during retirement. That is, why pay a higher tax rate now when you will be in a lower tax bracket throughout retirement? While it's possible to be in a lower tax bracket in retirement it's generally not probable because of how wide tax brackets are.

Consider this, if a single filer earns $60,000 per year and is currently in the 25% marginal tax bracket they would have to reduce their income in retirement to less than $36,901 to be in 15% tax bracket. Even in a case that you know you will fall to a lower tax bracket, do you know what the tax rate will be? Tax rates can change, tax brackets can change, and a Roth IRA removes the risk of this uncertainty.

Another very important tax consideration regarding Roth IRAs is that any income received from qualified Roth distributions is not considered "countable income" when your tax preparer is calculating how much of your Social Security benefits will be taxed. This means that income drawn from your Roth will not subject your Social Security benefit to taxes.

Finally, understand that if you don't need the income from your Roth IRA there are no required minimum distribution rules forcing you to draw down your Roth after you turn 70 ½. Required minimum distribution rules apply to all other qualified retirement accounts including Traditional IRAs and 401(k)s. This means you can continue to grow your Roth assets throughout retirement and your beneficiaries will receive these assets 100% tax free.

How do I get my assets into a Roth?

You can get assets into a Roth two different ways:

First you can make annual **contributions** to a Roth account. For the 2014 and 2015 tax years you can contribute $5,500 (or $6,500 if you're age 50 or older) to your Roth IRA. You are allowed to make a contribution until the tax filing deadline for each tax year (April 15ish). It doesn't get much easier than that.

Or second, you can do a **Roth IRA conversion** by moving Traditional IRA or 401(k) funds into a Roth IRA. There is no annual limit on how much you decide to convert. However, you must make your conversion from the Traditional IRAs and 401(k)s on or before December 31^{st}. Since all this pretax retirement money and is going into a Roth account that is after-tax dollars, this conversion creates a taxable event and leads us into the meat and potatoes of this article.

Approaching a Roth IRA Conversion

As mentioned above, a distribution from your Traditional IRA or 401(k) is a taxable event. Unlike an annual contribution to a Roth or Traditional IRA, figuring out how your conversion will impact your taxes isn't so straight forward because the dollar figures are often much higher than a $5,500 and you must act on or before the December 31^{st} deadline when your tax situation may not be clear.

Keep in mind that Roth conversions are not an all or nothing option. You can convert as much or as little as you chose. However, you do not want to convert too much and face an unfordable tax burden or unnecessarily kick yourself into a higher tax bracket. You also want to avoid converting too little during the years that you actually can afford the additional tax burden.

The trick is to find out what your optimal amount is each year. There are many ways to work around the December 31^{st} deadline so that you do not have to make a blind decision. Jim Saulnier and Associates can help you navigate through the IRS's maze regarding Roth Conversions and educate you on their rules for 60 day rollovers, recharacterizations, cost basis, and more. We hope this quick overview shines some light on Roth IRA conversions. Please call us if you are interested in migrating your Traditional IRA and 401(k) assets to warmer (Roth) climates as we hunker down for the upcoming Colorado winter.