Roth IRA Conversion

Looking to convert your traditional IRA to a Roth IRA? Here are a few points to keep in mind.

If you're like many investors who have their retirement savings in conventional tax-deferred accounts such as traditional IRAs and 401(k) plans, you may not be utilizing all of the effective retirement savings vehicles at your disposal. While these arrangements enable you to postpone paying taxes on your contributions and investment returns, they don't shield you from paying taxes at a future date.

A Roth IRA, however, can insulate your earnings from taxes at a time when you may need tax shelter the most — in retirement.*

Quick tips

To reduce the tax cost of a Roth IRA conversion, you can convert just a portion of your retirement assets. Ask your tax advisor if a partial conversion makes sense for you.

Depending on your company's retirement plan, you may be able to convert assets in an employer-sponsored retirement plan to a Roth IRA. Talk to the company's benefits officer or your advisor for more information.

The Roth advantage

There are a number of reasons to think about converting some or all of your retirement savings to a Roth IRA:

Tax-free treatment for eligible withdrawals

While amounts withdrawn from tax-deferred accounts are generally subject to income tax at the time of withdrawal (and perhaps a penalty if under age 59½ when you withdraw them), your withdrawals from a Roth — including account earnings — will be tax-deferred. What's more, earnings can be withdrawn tax-free and penalty-free if you've owned the account for at least five years and meet one of these conditions: 1) age 59½ or older; 2) death; 3) disability; 4) first-time home purchase ($10,000 lifetime limit).[1]

Protection from future tax hikes

Provided you are eligible for a tax-free withdrawal, your Roth IRA assets are shielded from taxes at whatever the current tax rate might be. Even if income tax rates go up at some point down the road, you can continue to take eligible withdrawals on a tax-free basis from your Roth IRA.

Taxation upon conversion

You have to pay income taxes on the money you convert to a Roth IRA, but you can withdraw the amount you've converted without tax consequences at any time. (Note that you may potentially be subject to early withdrawal penalties if you are under age 59½ and withdraw converted amounts within five years of conversion). Similarly, regular Roth contributions are not tax-deductible and can therefore be withdrawn tax-free from the account at any time.[1]

Tax planning

Tax professionals sometimes recommend allocating some assets to tax-free Roth IRAs and some to tax-deferred accounts such as traditional IRAs. By giving you both tax-free and taxable sources of retirement income, this approach can help you strategically plan your withdrawals for tax purposes.

* Because Roth IRA contributions are not tax-deductible, they can be withdrawn from the Roth IRA tax-free and penalty-free at any time.

* Withdrawals are also permitted for home purchases by account holders who have not owned a home in the prior two years ($10,000 lifetime limit).

Not FDIC-Insured. Not Bank-Guaranteed. May Lose Value.

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Legacy planning

You have to start taking required minimum distributions from most tax-deferred accounts when you reach age 70½. Roth IRAs aren't governed by this rule, allowing you to preserve the assets and eventually pass them to your beneficiaries tax-free — a potentially attractive option if you're looking to maximize your legacy.

Extended funding

Starting at age 70½, you can no longer contribute to a traditional IRA, but you can contribute to a Roth at any age — provided you have earned income and are eligible to make contributions.[2] In effect, you may be able to keep building your nest egg well into your senior years.

To convert or not to convert?

Each investor's goals and needs are unique, and a Roth IRA conversion is not for everyone. To make the right decision for your situation, it's important to seek guidance from your financial and tax advisors. They can help you weigh the tax implications of converting to a Roth against the potential long-term benefits.

Generally speaking, a Roth conversion may be a good option if one or more of these statements apply to you:

- You expect your income tax bracket in retirement to be the same as or higher than it is now;
- You likely won't need to withdraw from the Roth IRA for at least five years following the conversion; of course, if you are in a high tax bracket now, conversion may not be right for you;
- You want more flexibility with regard to when and how you make retirement withdrawals;
- You have made non-deductible (after-tax) contributions to your tax-deferred retirement accounts;
- You plan to leave all or most of your retirement assets to your beneficiaries upon your death;
- You can pay the income tax on the conversion from non-IRA resources.

Talk to your advisor to find out more

A Roth IRA can be a powerful retirement planning tool. You owe it to yourself — and your financial future — to find out if a Roth conversion can play a role in your retirement strategy. Take the first step and talk to your financial or tax advisor today.

Learn more

For more information, please contact your financial advisor.

This information is general in nature and not intended to constitute legal or tax advice. Please consult your legal or tax advisor for more detailed information on legal or tax issues and advice on your specific situation. There are fees, expenses, taxes and penalties associated with IRAs.

[1] Distributions from a traditional IRA (excluding any non-deductible contributions) will generally be subject to taxation at then-current federal and state income tax rates. Distributions made prior to age 59½ may also be subject to an additional 10% early withdrawal penalty tax, unless an exception applies. Amounts converted from a traditional IRA to a Roth IRA are taxable (excluding any non-deductible contributions) and can therefore subsequently be withdrawn from the Roth IRA tax-free at any time, but these amounts may be subject to the 10% early withdrawal penalty tax if the taxpayer is under age 59½ and withdraws the funds within the five-year period following the conversion. Distributions of accumulated Roth IRA earnings are tax-free and penalty-free if the taxpayer has owned a Roth IRA for at least five years and meets one of the following criteria: 1) attainment of age 59½; 2) death; 3) disability; or 4) first-time home purchase ($10,000 lifetime limit). Consult a tax advisor for further details.

[2] Investors who are eligible to convert assets to a Roth IRA may or may not be eligible to make regular Roth IRA contributions. Allowable annual contributions to a Roth IRA are phased out based on taxpayer filing status and modified adjusted gross income (MAGI), as follows for 2019: single with MAGI under $122,000 — full contribution allowed ($6,000 if under age 50, $7,000 if 50 or older); single with MAGI of $122,000–$136,999 — partial contribution allowed; single with MAGI of $137,000 or more — ineligible to contribute; married filing jointly with MAGI under $193,000 — full contribution allowed; married filing jointly with MAGI of $193,000–$202,999 — partial contribution allowed; married filing jointly with MAGI of $203,000 or more — ineligible to contribute.

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