Rochester Wealth Strategies

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Should You Consider a Roth Conversion?

By Bradley Sorenson

Many of you who are fortunate enough to save for retirement have opened a Traditional IRA to benefit from tax-deferred growth. Consequentially, you may have stumbled across the following questions: How does a Traditional IRA differ from a Roth IRA? Should I consider converting my Traditional IRA to a Roth IRA? What opportunities could this provide me? How could this impact me from a tax perspective?

The main factors unique to a Roth IRA is that contributions occur on an after-tax basis and the earnings eventually come out tax-free. Whereas Traditional IRA contributions are usually deductible, and the earnings are taxed upon withdrawal. The catch with a Roth IRA, is that they are *technically* not available to high-income earners; in the year 2021 this equates to a MAGI of $140,000 for single filers, and $208,000 for married filing jointly. I say *technically* because there is a legal tax loophole around this, often referred to as the "Backdoor Roth" strategy. This is where an investor makes a non-deductible contribution to their Traditional IRA and immediately transfers (converts) the funds to a Roth IRA. Among other considerations, you must account for all your Traditional IRA accounts and determine if any taxes will apply.

Those of you who already have a Traditional IRA, the question remains; should you convert to a Roth? This decision is dependent on a variety of factors, including time horizon, taxes, and beneficiaries.

You should consider your age and how long until you will need to utilize the funds. Unlike a Traditional IRA, a Roth IRA does not require the original owner to take RMDs (Required Minimum Distributions). This alone allows more time for the funds to grow.

What is your tax bracket, both now and in retirement? Keep in mind that when you make a conversion, you may be subject to income tax on all the funds being converted. This could potentially cause you to fall into a higher tax bracket, incur a surtax, and/or may increase your future Medicare premiums. More often than not, it is appropriate to convert your IRA over multiple years rather than all at once.

If your focus is legacy planning, a conversion may allow your beneficiaries to receive money with no tax consequences. It is worth considering your tax bracket relative to theirs. For example, if you believe your heirs will be in a much higher tax bracket than you are, then it could be worth converting and paying the taxes in your lower bracket. The same may also apply if you feel tax rates will rise. We already know that most of the current tax provisions are scheduled to expire in 2025, which could mean an automatic tax hike in 2026.

The decision to make a Roth Conversion is hardly ever black and white. In future articles, we will discuss other options such as an "In-Plan Roth Conversion" and a "Mega Backdoor Roth."

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