

The IRA Digest

Retirement Account Strategies and Tips

January – February

2022

5 Key Factors for Determining if a Roth IRA Conversion is Right for You

By: [Denise Appleby, MJ, CISP, CRC, CRPS, CRSP, APA](#)

Converting your traditional IRA to your Roth IRA is usually recommended if doing so reduces the amount of income tax that you would owe on your retirement savings. One way to know the potential result is to perform a Roth IRA suitability assessment.



Generally, the goal of converting amounts from a traditional IRA to a Roth IRA is to minimize the amount of income tax that would be owed on the amount. But that is not the outcome in all cases. The question then becomes whether a Roth conversion would reduce your income tax. The answer lies in a Roth IRA suitability assessment, which takes many factors into consideration. Here, we focus on five of those factors.

How Roth IRAs Are Taxed

Retirement planning experts often consider Roth IRAs a key component of a tax-diversified retirement savings portfolio because it adds a tax-free element. When combined with accounts that would be taxable when distributed or subject to capital gains when liquidated, the tax-free feature provides flexibility to choose the type of account from which to take distributions.

Distributions from amounts attributed to your Roth IRA conversion and regular contribution amounts are tax-free because you would have already paid any income tax due when the amounts were added to your Roth IRA. Distributions of earnings on your Roth IRA assets are tax-free when the requirements for qualified distributions are met. An example of a qualified distribution from your Roth IRA is one that is made when you are at least age 59 ½ and have funded a Roth IRA for at least five years. *Additional restrictions apply to nonqualified distributions.*

5 Key Factors for A Roth IRA Suitability Assessment

A Roth IRA suitability assessment is a comprehensive analysis that compares how much income tax you would owe if you keep your assets in a traditional IRA vs how much income tax you would owe if you convert the amount to a Roth IRA. In some cases, the assessment is extended to include your beneficiaries. The following are five of the key factors that are included in a Roth IRA suitability assessment.

1. **Your current income tax rate vs. your projected income tax rate at the time you plan to take distributions:** Generally, if your current tax rate would be lower than when you plan to take distributions, it is

considered more tax-efficient to convert your traditional IRA to your Roth IRA now as the conversion would result in the amount being taxed at your current (and lower) tax rate. If your tax rate is projected to be lower during your distribution years, converting now might cause you to pay more income tax on that amount. The challenge is determining your future tax rate, and while it might not be possible to do so, reasonable assumptions can be made.

Mitigation strategy: Instead of converting the entire balance of your traditional IRA in one year, you could convert small amounts over several years. This could help keep you in a lower tax bracket and reduce the amount of income tax you would owe on the converted amounts.

2. **The tax treatment of earnings:** Growth on investments in your traditional IRA are taxable at your ordinary tax rate when you take distributions of those amounts.

For Roth IRAs, growth on your investments would be tax-free for Roth IRA distributions that are qualified.

Converting amounts to your Roth IRA helps to ensure that earnings would be tax-free when distributed to you and/or your beneficiaries.

3. **The source of the funds used to pay any income tax due:** You would owe income tax on any pre-tax amount that you convert to your Roth IRA. At issue is whether you have the funds available outside of your retirement accounts to pay the income tax. If you do not, you would need to cover the taxes with a distribution from your retirement account. The distribution used to pay the income tax would be treated as ordinary income, could be subject to a 10% early distribution penalty if you are under age 59 ½ at the time of the distribution, and could negatively impact the results of your Roth suitability assessment.
4. **There are no mandatory distributions for Roth IRA owners:** You must start taking required minimum distributions (RMDs) from your traditional IRA for the year you reach age 72 and continue for every year after that. Roth IRA owners are not subject to RMDs, allowing those amounts to continue to benefit from tax-deferred growth longer.
5. **Who/What is your beneficiary?** If your beneficiary is a charity that will not owe income tax on IRAs it inherits, it usually makes better tax sense to leave your traditional IRA to that charity. On the other hand, if your children, spouse, or other tax-paying individuals will inherit your IRA, consideration should be given to whether it is more tax savvy for you to pay the income tax that would be owed on the amount and leave them a tax-free Roth IRA, or leave them your traditional IRA and have them pay any income tax due.

Let Us Help You Decide

One of the steps towards maximum tax efficiency for your retirement accounts is working with an advisor who is proficient in both the accumulation and distribution phases of your retirement savings. These high-level explanations are just the start. Further, they do not address all the factors included in a Roth IRA suitability assessment. We can help you to create your Roth IRA profile and thereby help you to make an educated choice between keeping your savings in a traditional IRA and converting all or a portion of it to a Roth IRA.

Important Disclosure

This article was prepared by Appleby Retirement Consulting, Inc., and provided solely for informational purposes, and should not be regarded as a complete analysis of the subjects discussed, or construed as personalized legal or tax

advice. Before making any decisions with legal or tax ramifications, you should consult, as appropriate, with an attorney or accountant. The information is subject to change without prior notice.