

3 ENTICING BENEFITS OF A ROTH CONVERSION FOR HIGH-INCOME EARNERS



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Many retirees are familiar with Roth individual retirement accounts (IRAs) and their advantages. But for those high-income earners who have decided against a Roth conversion, there may be some enticing benefits you have overlooked. First, it should be noted that there are generally two ways to fund a Roth IRA: either by way of a contribution or a conversion. This article focuses on a Roth IRA conversion, which usually comes from a Traditional IRA.

A Roth IRA conversion is a taxable event that creates an income tax consequence for the amount converted in the year of conversion. High-income taxpayers should know that they are not required to convert their entire Traditional IRA; rather, they can convert an amount of their choosing. If you choose to do partial Roth IRA conversions over several years, this method allows you to spread the tax consequence across as many years as possible.

The benefits of a Roth IRA conversion, if done correctly, are that there are generally no taxes on the distributions, there are no required minimum distributions (RMDs), and there is no income or age limit on whether you can do the conversion.

However, moving funds from a Traditional to a Roth IRA triggers income taxes, some of which may have been deferred for many years! For some high-income earners, that tax bill could wind up being close to 50% when accounting for federal/state/local taxes.

So, when should high-income taxpayers consider such a conversion?

If you:

...want to eliminate your RMDs and pass tax-free distributions on to your heirs

Many high-income, high net worth investors won't need to draw down on their IRAs and instead consider them as vehicles with which they will pass wealth on to their heirs. Roth IRA owners never have to take required minimum distributions. So after enjoying decades of tax-free growth, a conversion allows you to also skip out on required minimum distributions. After inheriting your Roth IRA, your heirs will have to take annual RMDs, but they generally won't have to pay any federal income tax on those withdrawals as long as the account has been open for at least five years.

...expect to be in a higher tax bracket later in life

There are high-income earners that anticipate being taxed at a higher rate when they plan to withdraw from their IRAs. Some tax bracket changes may be so significant that paying the tax on the conversion now may be more cost efficient than being taxed on withdrawals later; especially if you know you'll be in a low tax bracket in a particular calendar year. The Roth conversion can eliminate federal income tax to the participant on any future withdrawals.

...expect tax rates in general to be higher in years to come

Those high-income taxpayers who are pessimistic about the future of the internal revenue code may also choose to convert their traditional IRAs to Roth IRAs, as today's tax rates may not be as high as those of the near future. Uncertainty in this regard may encourage you to convert today.

If you need professional help with your retirement plan, call (561) 680-6625 or email pcapell@wealthenhancement.com today to schedule an initial consultation!