ENDOWMENT WEALTH MANAGEMENT®
Fee-Only Fiduciary Advisors

EWM Personal Finance
Tips & Solutions

Utilize Systematic Roth IRA Conversions as Part of Your Tax Planning!

Consider Tax Management When Planning for Retirement!

Many investors may overlook maximizing their marginal tax brackets annually, potentially missing out on tax savings and affecting their long-term financial outcomes. Proactive tax management should be an annual discussion with your fee-only fiduciary advisor to help identify strategies that may reduce your tax liability.

How a Roth IRA Can Help You!

All contributions to a Roth IRA are funded with after-tax dollars, which means qualified Roth IRA withdrawals may be free from federal income tax if applicable IRS requirements are satisfied. Investors must follow these 2 rules in order to avoid paying the 10% early withdrawal penalty and any taxes on the funds in their Roth IRA.

1. The 5-Year Rule:

Contributions: Regular Roth IRA contributions can generally be withdrawn tax- and penalty-free at any time.

Earnings: Earnings are generally tax-free when the distribution is qualified, which typically requires satisfying the Roth IRA 5-year rule and a qualifying event such as reaching age 59½.

Conversions: Each Roth conversion generally has its own 5-year period for purposes of the 10% early-distribution penalty on converted amounts, subject to applicable exceptions.

2. The withdrawal must take place after age 59 ½, except for other qualifying exceptions.

Unlike a Traditional IRA, there are no required minimum distributions (RMDs) for Roth IRAs. This allows for greater flexibility in deciding when to withdraw/convert pre-tax funds.

There are no income limits on Roth IRA conversions. This allows investors of any income level to take advantage of this tax-mitigation technique. Depending on an investor's circumstances, Roth conversions may be one of several tax-planning strategies worth evaluating.

Considerations When Evaluating Roth Conversion Timing

Strategic Roth conversions may help manage the timing of taxable income by converting amounts in years when an investor is in a lower marginal tax bracket. Whether a conversion reduces lifetime taxes depends on future tax rates, investment performance, income needs, and individual circumstances.

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Details to Note:

10-year rule: Many non-spouse beneficiaries must fully distribute an inherited IRA or Roth IRA by the end of the 10th year following the owner's death, subject to applicable exceptions and distribution requirements. Consult with a financial professional before making any decision.

Be mindful of Roth conversions near Medicare enrollment or while receiving Social Security. Higher income from a conversion may increase future Medicare premiums and may also increase the portion of Social Security benefits subject to income tax.

Using funds outside the IRA to pay conversion taxes may allow more assets to remain invested in the Roth IRA, subject to the investor's liquidity and tax circumstances.

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Roth IRA conversions generally create taxable income in the year of conversion and may increase your current tax liability. The potential benefits and drawbacks of a Roth conversion depend on numerous factors, including current and future tax rates, income levels, investment objectives, time horizon, Medicare premium considerations, Social Security taxation, state tax consequences, and estate-planning goals. Because future tax laws and tax rates are unknown, a Roth conversion may not be beneficial for all investors and could result in higher lifetime taxes in certain circumstances. The information presented is for educational and illustrative purposes only and should not be construed as individualized tax, legal, or investment advice. Before implementing a Roth conversion strategy, investors should consult with their tax professional, attorney, financial advisor, or other qualified professionals regarding their specific situation.

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