Is a Roth Conversion Right for You?

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Roth vs Traditional IRA

The Traditional IRA traces its origins to the Employee Retirement Income Security of Act of 1974 and was designed to offer a tax-deferred vehicle to build retirement savings, but there are, however, income limitations to the tax-deferred component. When a taxpayer's Adjusted Gross Income (AGI) exceeds pre-set thresholds, contributions to traditional IRAs do not offer tax deductions, but the earnings in the account grow tax-free until the time of withdrawal and the withdrawal of amounts contributed post-tax are not subject to income tax upon withdrawal.

The Roth IRA, established under the Taxpayer Relief Act of 1997, lacks the tax-deferred element of the traditional IRA, but, importantly, earnings inside a Roth IRA grow tax free and these earnings, along with the initial contributions, are generally non-taxable upon withdrawal. One of the primary obstacles that prevent taxpayers from making Roth IRA contributions is the relatively low AGI threshold for making a Roth IRA contribution.

The Backdoor Roth IRA

For taxpayers whose AGI exceeds the threshold for making direct Roth IRA contributions, there is a loophole available that allows a taxpayer to convert funds from a traditional IRA to a Roth IRA. If no basis exists in the traditional IRA (basis exists in a traditional IRA only if non-deductible contributions have previously been made), the full amount of the conversion is taxable at the time of conversion.

Possible Reasons to Execute a Roth Conversion

Every taxpayer's situation is different, but the following scenarios are examples of times when a Roth conversion may be appropriate:

- *You expect to be subject to a higher marginal tax rate in retirement than your current marginal tax rate*. This can be a bit nuanced as it involves not only projecting your future retirement income, but also forecasting where Congress will set income tax rates in the future.

- *You have a large tax-deferred portfolio and your future Required Minimum Distributions will place you in a higher marginal tax bracket and/or increase the taxable amount of your Social Security* *distributions in retirement.* This will require cash-flow projections that should be carefully contemplated.

- *You expect to leave an inheritance when you pass away that consists of tax-deferred balances and you believe your heirs will be in a high marginal tax bracket*. An inheritance of a tax-deferred traditional IRA will be taxable to your heirs, whereas the inheritance of a Roth IRA will generally be income tax-free.

- *You believe that your estate will be subject to federal or state Estate taxes when you pass away*. By paying the tax on a Roth conversion before you pass away, you are lowering the amount of your taxable estate by the amount of tax paid on the conversion. This can prove to be especially useful for New York residents that are near the so-called Estate Tax Cliff.

Discuss With Your Tax Advisor

Ultimately, the decision to convert all or a portion of your traditional IRA to a Roth IRA should only be made after a discussion with your tax advisor. In addition to the nuanced considerations regarding future tax rates, there is also a wide variety of risk tolerances that varies from client to client. No decision that involves accelerating the payment of income tax should be made without thoughtful analysis and thorough consideration.

If you would like to discuss whether a Roth conversion may be advantageous for you, please contact:

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About Landmark Wealth Management
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