

Planning for Roth Conversions

Weighing Today's Cost and Tomorrow's Benefit

Anthony Juliano, CFP®



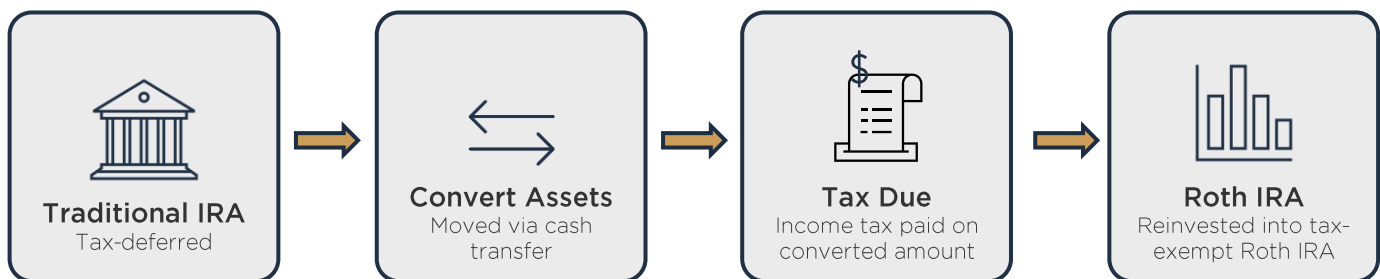
Summary

Roth conversions have become one of the darlings of financial planning discussions. The underlying thesis is generally sound: pay taxes at a lower rate on tax-deferred assets today in exchange for tax-free growth and withdrawals in the future. But with their growing popularity has come a tendency to oversimplify the strategy. Roth conversions are not one-size-fits-all, and whether a conversion ultimately creates value depends heavily on an individual's tax situation and broader financial plan.



The key is determining whether paying tax today is likely to improve an investor's long-term retirement and wealth transfer goals. More specifically, will future tax savings exceed taxes paid today?

Roth Conversions at a Glance



A Roth conversion is a transaction in which an investor converts tax-deferred retirement assets, most commonly from a Traditional IRA, into a Roth IRA. The taxable portion of the conversion is generally included in income for that year, while the converted assets can thereafter grow in the Roth IRA and potentially be withdrawn tax-free if applicable requirements are met.

The impact of a Roth conversion can extend well beyond moving into a higher marginal tax bracket. Because a conversion generally increases adjusted gross income (AGI), it may also affect other taxes, premiums, deductions, credits, and income-based thresholds. These ripple effects can materially change the conversion's true cost.

Beyond the Tax Bracket

Higher AGI may affect:

- ▲ Medicare premium surcharges
- ▲ Net investment income tax
- ▲ Deductions and credits
- ▲ Other income-based thresholds

Understanding the Roth Conversion Opportunity

Every Roth conversion starts a race to breakeven. Reducing a future tax liability sounds attractive on the surface, but deeper analysis is needed to understand how changes in income interact with other planning variables. Paying tax earlier only creates value if the future tax savings eventually exceed the tax paid today. Depending on the investor's age, tax rate, life expectancy, and future withdrawals, that breakeven point may occur many years later—or potentially after the investor's lifetime.

Every Roth conversion starts a race to breakeven

In a perfect world, the conversion will both reduce future RMDs (Required Minimum Distributions) and provide a higher after-tax inheritance – but this is not a perfect world. Investors should understand that conversions may end up only benefiting their heirs and should decide if they are comfortable effectively pre-paying the tax for them today.

When Conversions Work

Conversions tend to be most attractive when an investor can recognize income at a lower effective cost today relative to the expected tax cost in the future. Several circumstances can create more favorable opportunities.



Low Income Years

Temporary reductions in income can create opportunities to convert at lower rates.

Common Examples: early retirement, sabbatical years, career transitions, business losses



Large Expected RMDs

Large expected RMDs can push retirees into higher tax brackets and reduce flexibility.

Common Examples: Large IRA balances, strong portfolio growth, income not needed from IRA



Legacy Planning

Converting today may increase the after-tax value ultimately received by beneficiaries.

Common Examples: High income beneficiaries, concentration of large IRA assets



Tax Law Changes

Changes in tax law may favor conversions when today's tax rates are lower than those expected in future years—even if income remains unchanged.

Important: Tax changes can be harder to forecast than investor-specific circumstances.



Market Declines

Temporary market declines alone are not a reason to convert, but they can amplify the impact of the opportunities above. Converting during a down market can allow more assets to be converted for the same tax cost.



When Conversions Can Hurt



Roth conversions can create unintended tax consequences even when staying in the same ordinary income tax bracket. Additional income may trigger other taxes, premiums, phaseouts, or lost benefits that increase the conversion's true cost.

Long-term Capital Gains & Qualified Dividends

A Roth conversion can cause capital gains or qualified dividends that would otherwise be taxed at 0% to become taxable at 15%, increasing the effective cost of the conversion.

Medicare IRMAA Premiums

Medicare premiums are partially based on income (MAGI) from two years earlier. A large conversion can increase future Medicare Part B and Part D premiums without changing your tax bracket.

Marketplace Premiums

For pre-Medicare retirees using Marketplace insurance, exceeding 400% of the annual poverty level can cause a repayment of pre-paid premium credits.

Cash-flow Constraints

Conversions are generally most effective when taxes can be paid using non-retirement assets. Using IRA assets to pay the tax can significantly reduce the net benefit.

How to Evaluate a Conversion

A Roth conversion is not just a current-year tax decision, but a long-term strategy. A thoughtful evaluation should compare the full cost today, the time required to reach breakeven, and the potential benefits tomorrow.

Cost Today

Estimate the immediate tax impact



1

- Use your tax return to project income
- Estimate tax due on converted amount
- Consider impact on AGI, deductions, credits and other thresholds.

Benefit Tomorrow

Model the potential long-term benefits



2

- Project future RMDs, retirement income, and future tax brackets
- Evaluate potential inheritance outcomes
- Integrate key variables like investment growth and life expectancy

Breakeven

Compare costs and benefits



3

- Determine how long before future tax savings outweigh the taxes paid
- Depending on age and circumstances, the breakeven point may occur many years later – or not at all



Coordinated Approach



Because Roth conversions can affect multiple areas of the tax equation, coordination between your financial advisor and tax professional is important. An advisor can model long-term retirement and estate implications, while a CPA can confirm the current-year tax impact prior to execution.

Our Perspective

Roth conversions can be a valuable tax-planning strategy, but they require a comprehensive cost-benefit analysis. Investors should compare the cost today with how, when, and to whom potential benefits may be received in the future. In some cases, thoughtful planning may ultimately lead to the decision not to convert at all. These decisions are best made within the context of a financial plan and with tools that can model how changes in income, tax rates, and future distributions may affect the outcome.

Trillium Perspectives are meant to provide practical context around the complex planning decisions investors face. By looking at tax, investment, retirement, and estate-planning decisions together, we aim to help clients make more informed decisions and coordinate those strategies with their other professional advisors when appropriate.

Have a question? Let's discuss



Suken Jogani

Founder - Managing Director



Theodore (TJ) Zak, CFP®, AIF®

Founder - Managing Director



Anthony Juliano, CFP®

Founder - Wealth Advisor



3711 Kennett Pike, Suite 205
Wilmington, DE 19807

www.trilliumwealthde.com



(302) 626-0112