Tax Notes

# Roth IRA Conversions in the Current Tax and Market Environment

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While it might seem counterintuitive to accelerate income into any tax year, a combination of President Trump's temporary individual tax cuts and the stock market's seesaw movement creates an opportunity to revisit Roth IRA conversions. Here's one such action plan and the underlying reasoning.

The amount converted from a traditional IRA to a Roth IRA would be taxed at the FMV at the time of conversion as ordinary income at the appropriate ordinary income tax rate. Post conversion, the funds in the Roth IRA would grow ***tax free*** (versus tax deferred as it does within traditional IRAs); therefore, no further tax would be due on the principal or on the growth of the Roth, creating a tax-free annuity for the next generation. This powerful tool should be considered as taxpayers and their advisors search for tax planning ideas within the Tax Cuts and Jobs Act (TCJA).

### Roth IRA Basics

Contributions to traditional IRAs provide taxpayers with an upfront tax deduction and grow tax-deferred. Under current law, an individual must commence required minimum distributions after age 70½, and the income is taxed at ordinary income tax rates in the year of distribution. With a Roth IRA, contributions are made with after-tax dollars, so there is no deduction available at the time of contribution and the funds grow tax free, generating tax-free income for you and your heirs.

### Tax Advantages of Roth IRAs

Some advantages of Roth IRAs are:

- Unlike traditional IRA withdrawals, qualified Roth IRA withdrawals are generally federal and state income tax free.
- Unlike a traditional IRA, Roth IRAs are currently exempt from required minimum distribution rules, so distributions need not begin at 70½. This aspect of the Roth makes it a great asset to leave to one's heirs, to the extent the owner of the IRA does not need the funds for their retirement. One important item to note is that this could change if the SECURE Act is passed in its current form. [See *Bipartisan Retirement Planning Changes Are on the Horizon*.] Under the SECURE Act – in almost all instances – an inherited IRA would have to be fully distributed within 10 years of the original owner's death, closing a loophole that allowed some beneficiaries to stretch out the amount of time they had to draw down on the account over a much longer period.
- After reaching age 70½, an individual can still make annual Roth IRA contributions — assuming income limitations are met (for 2019, the phase-out range for individuals filing jointly is $193,000 to $203,000). Traditional IRAs, however, do not permit contributions after age 70½.

- Taxpayers may circumvent the income limits by first contributing to a non-deductible IRA, which has no income limits, and then converting the non-deductible IRA to a Roth.

### The Roth Conversion

The Roth conversion is treated as a taxable distribution from your traditional IRA as the funds are being contributed into the new Roth account. In doing so, a conversion could push an individual into a higher tax bracket. For this reason, we suggest partial conversions over multiple years, thereby making optimal use of the lower tax brackets while spreading out the payment of tax.

Another way to reduce the tax cost of converting is to consider increased charitable contributions in the year of conversion.

### The Bottom Line

It is important to note that under the TCJA, today's federal income tax rates might be the lowest we will see for a long time. While the TCJA rate cuts and bracket increases are scheduled to last through 2025, they could end sooner as it is likely that rates will increase in future years especially if there is a change in the U.S. presidency. Consider acting now.

### Contact Us

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