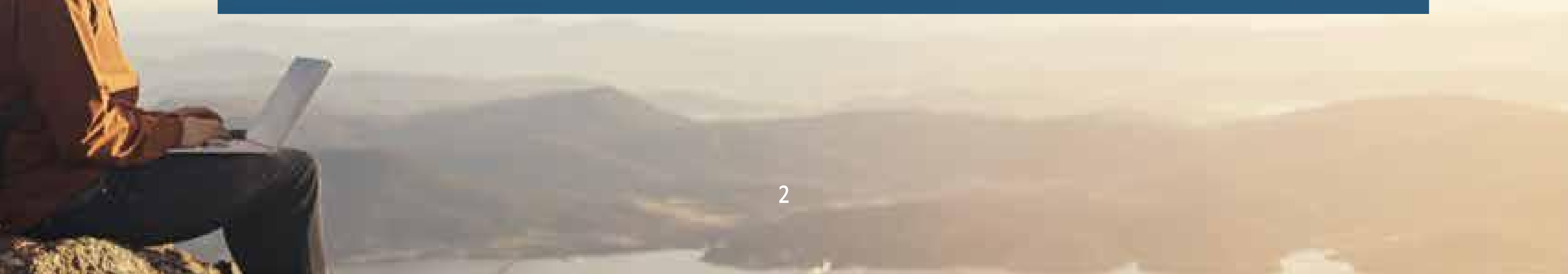
ROTH IRA CONVERSION

Pension Retirement Planning Series

Choosing between a traditional IRA and a Roth IRA is a personal choice that depends upon multiple considerations including age, income, and financial goals.

Traditional vs. Roth IRAs

Traditional IRA		Roth IRA
Tax-deferred growth Tax-deductible contributions	**Tax Benefits**	Tax-free growth Tax-free withdrawals
None (income required)	**Age Limits**	None (income required)
Some limits on tax-deductible contributions	**Income Limits**	Limited based on income
Taxable 10% penalty if under age 59½	**Withdrawals**	Contributions: Tax-free if held for more than 5 years Earnings: 10% penalty if under age 59½
Yes: 72[1]	**Required Minimum Distributions**	No (original owner)



Roth IRA Benefits

Tax-Free Distributions

By converting a traditional IRA to a Roth IRA, taxes on the account will stop. As part of the conversion process, your client will pay all of the taxes on the amount in the traditional IRA and there will be no more taxes on the account. The Roth IRA will grow tax-free and all future withdrawals will be TAX-FREE!

Favorable Tax Treatment for Heirs

Not only does a Roth IRA provide tax-free growth and tax-free income to the owner, but beneficiaries of Roth IRAs also do not owe income tax on withdrawals and therefore can stretch out distributions for many years making the Roth IRA a great wealth-transfer option.

Remove the Minimum Distribution Requirement

A Roth IRA conversion of a traditional IRA will also result in no required minimum distributions during the account holder's life. If the account holder does not need the money, they will not be required to take a distribution in any given year and the required minimum distribution will not increase each year. This translates to more growth opportunity for the account.

No Income Limits

Significant changes to IRA laws in recent years now allow everyone, regardless of income level, to convert traditional IRAs into Roth IRAs. This creates the opportunity for individuals to stop the tax accumulation on their IRAs.

Additional Benefits

If the need arises to have access to your Roth IRA money early, Roth contributions can be withdrawn penalty-free and tax-free at any time, even before age 59 ½. In addition, during the first five years after your first contribution into a Roth IRA, you can withdraw up to $10,000 penalty-free to pay for qualified first-time home buyer expenses.

Who should convert?

- **Individuals who are not currently dependent on the IRA account balance and who has the funds to pay the income taxes that will be due on the conversion.**

- **Someone who expects to be in the same or a higher tax bracket in retirement.**

- **Individuals with only after-tax IRAs and therefore who would not pay significant tax upon conversion.** An individual who has an IRA(s) with significant after-tax funds and does not have IRAs with significant pre-tax funds should consider a Roth conversion. Depending upon the amount of growth that has taken place, a conversion may not generate significant taxable income and will result in tax-free distributions in the future with no Required Minimum Distributions.

- **Individuals who choose to separate and convert a small portion of their IRAs each year.**

- **Younger individuals who have a qualified plan or IRA from a prior employer.** These individuals have many years until retirement and, if they can afford to pay the taxes out of personal funds, they can capitalize on years of tax-free growth followed by tax-free distributions in retirement.

- **High net worth individuals who may lose a large percentage of the value of a traditional IRA to estate and income taxes.** Many High Net Worth individuals could see up to 70% of their traditional IRAs lost to income and estate taxes at their deaths. If these individuals have the means of paying the tax, they can convert to a Roth IRA and will not have to take Required Minimum Distributions at age 72.[1] They can allow the account to grow and pass the account to beneficiaries who will be able to take out tax-free distributions over their lifetime.

Who should not convert?

- **Individuals who are near retirement and will need access to the money in their current IRA.**
- **Individuals who will be in a lower tax bracket in retirement.**
- **Individuals who do not have the funds to pay the taxes due on conversion.**

Frequently Asked Questions

Q: What taxes will be due upon conversion?

A: Within a traditional IRA, there may be money from pre-tax contributions and in some cases after-tax contributions. In order to convert a traditional IRA to a Roth IRA, taxes must be paid on any pre-tax money and on any growth in the account. A traditional IRA can be converted in portions over several years to spread out the tax bill.

Q: Can I Convert a Qualified Plan Directly to a Roth IRA?

A: Yes, a direct conversion from a 401(k), 403(b), 457, or other employer qualified plan can be converted to a Roth IRA. However, this can only be done if you could make the longer two-step conversion from a qualified plan to a traditional IRA and then to a Roth IRA. Additionally, it normally can only be done if you have separated from service from the Employer holding the 401(k) or other qualified plan.

Q: Do I have to convert the entire traditional IRA to a Roth IRA?

A: No, individuals can separate out and convert an amount each year from their IRAs and do not need to convert all of their traditional IRAs. The individual will need to determine how much they want to convert and then do a trustee to trustee transfer to a separate IRA which could then be converted to a Roth IRA. Doing this over a number of years raises the amount of money beneficiaries can receive income tax-free because traditional IRA funds are not used to pay the tax upon conversion. If someone intends to use traditional IRA funds to pay the tax, they need to ensure they are over 59½ in order to avoid paying a penalty tax in addition to income tax.

Q: How are Distributions Treated After Conversion to a Roth IRA?

A: After conversion there is a period of time, known as the five-year rule, where the transferred assets cannot be withdrawn without penalty. To avoid penalties for distributions after a conversion (subject to certain exceptions such as disability or medical expenses), owners must hold the transferred assets in the Roth IRA for five years or until they reach age 59½, (whichever comes first) in order to make penalty-free withdrawals of the converted principal amounts. In the event of multiple conversions, a separate five-year rule is applied to each transfer of assets to a Roth IRA and begins in the year the conversion is made, even if the Roth IRA had already been in effect for five years. Five years must pass to withdraw earnings from the Roth IRA conversion without penalty, even if you have attained age 59½.

Q: What are the Tax Implications?

A: Individuals who will soon need the money from their retirement accounts should think twice about paying 35–40% of the funds in taxes in order to convert to a Roth IRA. Growth on the taxes paid now would result in more money being available later in the traditional IRA than in a Roth IRA. The Roth IRA is for individuals who do not require the money to live on and want to maximize what they pass on to children, grandchildren, or other beneficiaries.

Frequently Asked Questions

Q: How can I estimate how much tax will be due on the conversion?

A: Care must be taken when determining the after-tax basis of the conversion. The reason is that all IRAs owned by an individual, not just the one being converted, are taken into account when computing the tax basis.

Therefore, if an individual owns IRAs that contain after-tax contributions as well as an IRA rollover from a qualified plan made up of pre-tax contributions, both IRAs must be used in computing the tax basis for the conversion, even if only the after-tax IRA is being converted to the Roth IRA.

Example:

Jill tells her agent that she wants to convert her traditional after-tax IRA with a $5,000 balance ($4,000 of after-tax contributions + $1,000 of growth for a total of $5,000).

Jill's agent asks if she has any other IRAs and Jill mentions that she also has a pre-tax IRA Rollover with a value of $45,000. Because the IRS counts all traditional IRAs as one, Jill's agent tells her that the tax basis calculation will be based on the total balance of her traditional IRAs, $50,000.

To find her tax basis:

- The after-tax portion of the after-tax IRA is divided by the total balance of all of Jill's traditional IRAs.
  $4,000 (after-tax IRA) / $50,000 (Total balance of all traditional IRAs) = 8% basis
- Now that the basis percentage has been determined, the total amount of the IRA that will be converted is multiplied by the 8% basis percentage.
  $5,000 x 8% = $400

If Jill's agent had only been aware of the $5,000 IRA, her basis calculation would have been:

- **$4,000 (after-tax IRA) / $5,000 (total balance of all IRAs) = 80% Basis**
- $5,000 (total to be converted) x 80% = $4,000

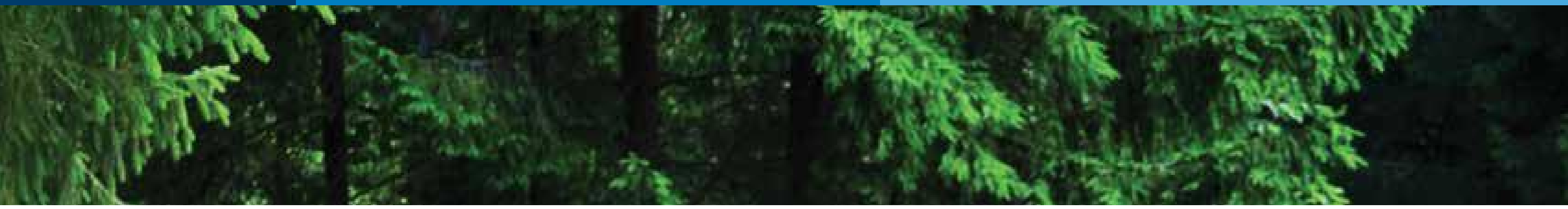
Therefore because all traditional IRAs are considered as part of the calculation, Jill's tax basis is $400 rather than the $4,000 it would have been if Jill did not include the $45,000 Rollover IRA.

This is why it is very important to include all traditional IRAs in the basis calculation!

Interested?

Talk to your financial and tax advisors if you desire to stop the tax accumulation of your IRA and ask for help in determining the impact of a Roth IRA conversion on your specific personal situation. This includes calculating the tax cost on such a conversion and then determining if you have the funds to pay the taxes.

Considering all the options is important in deciding if a Roth IRA conversion and its impact to stop taxes on a retirement plan works best for the individual.



1) If you turned 70½ after December 31, 2019 the deadline for taking your first RMD from your traditional IRA is now April 1 of the year after the year you turn 72. If you turned 70 ½ prior to January 1, 2020 this rule change does not apply to you, and you must continue taking RMDs.

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