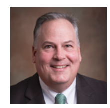
# Comparing IRAs: Could Converting to a Roth IRA Benefit You?

Moving assets to a Roth IRA can provide more income flexibility in retirement.



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### KEY INSIGHTS

- A Roth conversion could be especially beneficial if you expect to be in a higher tax bracket in retirement.
- With a Roth conversion, taxes are due on the converted amount in the year of the transaction.
- There are different ways to cover these taxes, each with its own tax implications.

There is a fairly simple financial move that can create significant advantages for many investors: converting a Traditional individual retirement account (IRA) to a Roth IRA. While it may not be the right choice for everyone, Roth conversions can provide tax diversification and help many investors increase their future financial flexibility in retirement. For retirees, having a Roth IRA can increase their after-tax income, since qualified withdrawals from the account are income tax-free.* While Roth contributions are subject to income restrictions, conversions are available to all investors.

### Why Convert?

There are a number of benefits to owning a Roth IRA. The trade-off is that moving assets from a Traditional IRA to a Roth IRA generally requires paying taxes at the time of the conversion rather than later, when you start taking withdrawals.

Deciding whether to convert assets to a Roth IRA depends largely on what you anticipate that your future income tax bracket will be. The conversion could be especially beneficial if you expect to be in a higher tax bracket in retirement—you'll pay the taxes now at your lower current rate. That said, the move may be advantageous in some cases if you think your tax rate will stay the same or decline—for example, if your beneficiaries could be in higher tax brackets.

Having tax-free Roth assets can provide you with freedom to use that money to pay for expenses in retirement, such as a new roof or a special vacation, without increasing your annual taxable income. Conversely, if you used money from your

*A qualified distribution from a Roth IRA is tax-free if taken at least 5 years after the year of your first Roth contribution AND you've reached age 59½, become totally disabled, met the requirements for a first-time homebuyer, or died. If your distribution is not qualified, any earnings from the Roth portion will be taxable in the year it is distributed.

...Roth IRAs do not have required minimum distributions (RMDs) for the original owner, which makes them a valuable retirement and estate planning tool.

Traditional IRA to pay for those expenses, those assets would be included in your taxable income and potentially could increase your marginal tax rate as well as your Medicare premiums.

Additionally, Roth IRAs do not have required minimum distributions (RMDs) for the original owner, which makes them a valuable retirement and estate planning tool. If you don't need to make withdrawals during retirement, Roth assets left to your heirs can generally continue to grow tax-deferred.

Your heirs will be required at some point to take required minimum distributions from either an Inherited Traditional IRA or an Inherited Roth IRA. As a reminder, they can always withdraw more whenever they need it. Due to the passing of the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, for accounts of IRA owners who died after December 31, 2019, non-spousal beneficiaries of retirement accounts will generally need to withdraw all of the funds within 10 years, with some exceptions. When taken from traditional accounts, these can increase a beneficiary's tax rate, which makes it appealing to inherit Roth assets instead, since their distributions are generally tax-free.

### The Cost of Conversion

Before converting, consider each of the following strategies for paying the taxes.

- Stagger the conversion. If a Roth IRA conversion would push you into a higher federal tax bracket, consider conducting partial conversions over multiple years.
- Generally speaking, it's ideal to pay taxes on the conversion from a taxable account. This method may have the smallest tax consequences.
- If you don't have enough savings in a taxable account to pay the taxes, consider taking a tax-free withdrawal from an existing Roth IRA. Note that for those under age 59½, only contributions can be taken tax-free. However, if you're age 59½ or older and have held the account for at least five years, you can take tax-free withdrawals of both contributions and earnings.
- If neither a taxable account nor an existing Roth IRA is available to pay the taxes, you can consider withdrawing from a Traditional IRA. One consequence is that this would result in additional taxes on the amount you withdraw to pay the conversion taxes. And if you tap in to the Traditional IRA when you're younger than age 59½, your withdrawal will be subject to a 10% early withdrawal penalty. These taxes and penalties could outweigh the benefit of the conversion.

Converting at least some of the assets in your Traditional IRA into a Roth IRA may provide you with considerable flexibility in retirement. As with anything, there are pros and cons to converting your money—and remember that a Roth conversion cannot be reversed. After weighing your options, you'll be positioned to make the choice that's best for your personal circumstances.

## A Comparison of IRAs

Both Traditional IRAs and Roth IRAs offer unique tax advantages.

With a Traditional IRA, you have to start taking RMDs from the account each year once you reach age 73.[1] This distribution amount generally is treated as ordinary taxable income. With a Roth IRA, there are no RMDs for the original owner, and you can make qualified withdrawals without paying taxes.

| | Traditional IRA | Roth IRA |
|---|---|---|
| **Taxes on withdrawals** | Withdrawals of pretax contributions and earnings are taxed as ordinary income. | Withdrawals of contributions are tax-free. Withdrawals of converted assets are tax-free but could be subject to early withdrawal penalties (described below). Generally, withdrawals of investment earnings are also income tax-free if:<br>▪ you've held the account for at least five years and<br>▪ you are age 59½ or older |
| **Required minimum distributions (RMDs)** | You must take your first RMD by April 1 of the year after the year you turn age 73. | None for the original owner |
| **Early withdrawal penalties** | Withdrawals of contributions and earnings prior to age 59½ may be subject to a 10% penalty (with some exceptions). | Withdrawals of earnings that are not qualified distributions may be subject to a 10% penalty (with some exceptions). Withdrawals of converted assets within the five-year period may be subject to a 10% penalty (with some exceptions). A separate five-year period applies to each conversion. |
| **Advantages** | ▪ Tax-deductible contributions (when applicable) subject to phaseout based on IRA owner's modified adjusted gross income<br>▪ Tax-deferred potential growth | ▪ Tax-deferred potential growth<br>▪ Tax-free qualified withdrawals<br>▪ No RMDs for the original owner<br>▪ Heirs can take potentially tax-free withdrawals from Inherited Roth IRAs |
| **Considerations** | ▪ Withdrawals of pretax contributions and earnings are taxed as ordinary income<br>▪ RMDs begin at age 73 | ▪ Contributions are not tax-deductible<br>▪ Contributions are subject to income limitations<br>▪ Generally, non-spousal heirs must withdraw all funds within 10 years |
| **Spousal beneficiaries** | Subject to RMD rules | No RMDs |
| **Non-spousal beneficiaries** | ▪ Subject to RMD rules<br>▪ Generally, the Inherited IRA will need to be fully distributed within 10 years | ▪ Subject to RMD rules<br>▪ Generally, the Inherited IRA will need to be fully distributed within 10 years |

[1] The RMD age will change to 75 in 2033.

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**Important Information**

An IRA should be considered a long-term investment. IRAs generally have expenses and account fees, which may impact the value of the account. Nonqualified withdrawals may be subject to taxes and penalties. Maximum contributions are subject to eligibility requirements. For more detailed information about IRAs, consult IRS Publication 590 or a tax professional regarding personal circumstances.

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