

How to Beat the Retirement Tax Bomb

Your Guide to Roth Conversions

None of us likes to think about taxes. Consequently, planning for them isn't exactly on our to-do list, either.

Steer your thoughts, then, to something more pleasant – like the beach vacation you and your spouse dream of taking in retirement. You're relaxing on the oceanfront and sipping a cold drink when a tall, bearded fellow slams down his lounge chair and kicks up sand. Without warning, Uncle Sam is your third wheel.

You didn't ask for that visual, but unfortunately, you could be handing the IRS a bigger pile of money than you ever expected.

Consider these two facts:

- America is in a historically low tax environment.
- The federal government recently issued about \$3 trillion in coronavirus aid.¹

Now, ask yourself this: Do you think taxes will be going up or down in the future?

Taxes will probably increase, don't you think?

So, what does that have to do with your Individual Retirement Accounts? A couple of definitions are in order:

Traditional IRA: Allows you to put pre-tax dollars in. Those dollars can grow tax-deferred – meaning you pay no taxes – until you start taking withdrawals at age 59 ½ or beyond.

Roth IRA: Funded with already-taxed dollars. Those contributions are not tax deductible, but because you've already paid your taxes up front, and as long as they have been there for at least five years and you are 59 ½, you don't have to pay them later when you take out distributions in retirement. There are some restrictions to withdrawals from Roth IRAs; they must be taken after age 59 ½, and after a five-year holding period. Withdrawals that do not follow those conditions may incur a 10% early withdrawal penalty.

Put yourself in a farmer's work boots for a moment. Would you rather pay tax on the seed you put in the ground? Or, would you rather pay tax on the harvest that results from that seed?

The seed, right? A Roth IRA is that seed, paid for with taxes up front. Taxes on a traditional IRA are paid later, on the harvest, with the potential to bite into a bumper crop.

Fortunately, this future tax obligation can be reduced with something called a **Roth IRA conversion**. This process is simply a transfer of all or some of your retirement assets from a traditional IRA into a Roth IRA, by paying the taxes due at the time of conversion and then allowing all future growth and distributions to continue on tax-free.

Roth conversions have **always** been something to consider, but **right now?**

They may be even more attractive for many of you. Recent losses in the market may have compressed your accounts, decreasing the tax burden on a Roth conversion.

Please remember that converting a traditional IRA to a Roth IRA is a taxable event. Increased taxable income from the Roth IRA conversion may have several consequences, including (but not limited to) a need for additional tax withholding or estimated tax payments, the loss of certain tax deductions and credits, and higher taxes on Social Security benefits and higher Medicare premiums. Be sure to consult with a qualified tax advisor before making any decisions regarding your IRA.

It is generally preferable that you have funds to pay the taxes due upon conversion from funds outside of your IRA. If you elect to take a distribution from your IRA to pay the conversion taxes, please keep mind the potential consequences, such as an assessment of product surrender charges or additional IRS penalties for premature distributions.

SO, WHAT IS THE NO. 1 MOVE YOU CAN MAKE TODAY?

Schedule a Roth Conversion Review!

- These sessions take little time, and we will explore THREE THINGS:
- Could a Roth conversion be right for you?
- Estimated taxes assessed with a conversion.
- Potential future costs.

¹Kelsey Snell. NPR. May 15, 2020. "Here's How Much Congress Has Approved For Coronavirus Relief So Far And What It's For." https://www.npr.org/2020/05/15/854774681/congress-has-approved-3-trillion-for-coronavirus-relief-so-far-heres-a-breakdown?utm_source=twitter.com&utm_medium=social&utm_term=npnews&utm_campaign=politics. Accessed June 16, 2020.

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