YOUR GUIDE TO ROTH IRAs

CONVERSIONS AND ADVANCED TAX PLANNING

Harlow
WEALTH MANAGEMENT

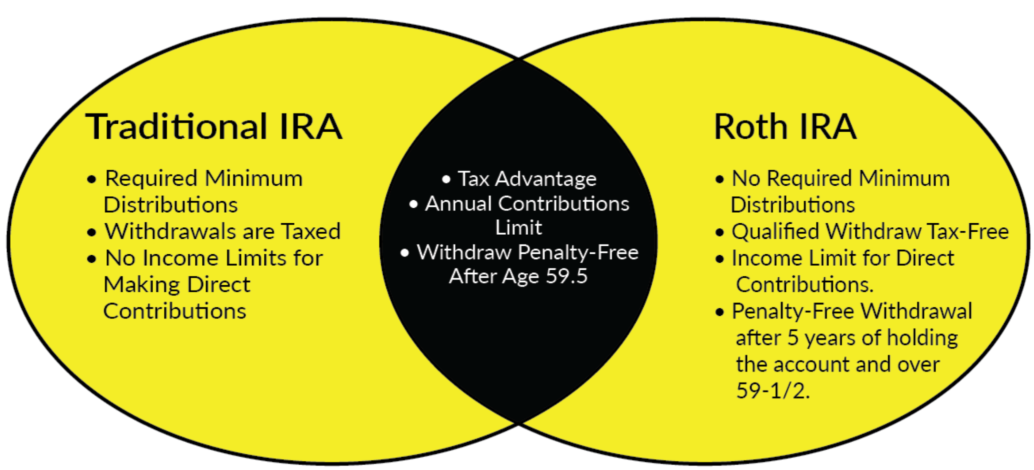
WHAT IS A ROTH IRA?

An IRA, which stands for Individual Retirement Account, is an investment account you own that typically holds stocks, bonds, mutual funds, ETFs, and more. It is structured and regulated with limitations, penalties, and tax advantages for using the account to grow a fund that you use to provide you income in retirement. The Roth IRA is a tax-advantaged retirement account, but some of its tax advantages are structured differently than the Traditional IRA.

- As with the Traditional IRA, you need to be at least 59 ½ to withdraw money without penalty. You'll also need the account to have been open for 5 years to avoid owing the 10% penalty fee.[1]

The Roth IRA Compared to A Traditional IRA

- The key difference is that Roth IRA contributions are made after-tax, as opposed to pre-tax, for that year so distributions are tax-free after the age of 59½.
- Basically, your contributions are taxed when you put them in, but your withdrawals are not subject to taxes.
- There are no Required Minimum Distributions (RMDs) for Roth IRAs.
- You can hold your Roth IRA for as long as you'd like regardless of your age, giving you more control over your retirement plan and income strategy.giving you more control over your retirement plan and income strategy.



[2]

1 https://www.investopedia.com/roth-ira-withdrawal-rules-4769951#:~:text=2-,Roth%20IRA%20Five%2DYear%20Rule,the%20five%2Dyear%20rule)
2 https://www.investopedia.com/roth-ira-required-minimum-distribution-rmd-4770561#:~:text=Unlike%20traditional%20IRAs%2C%20there%20are,is%20an%20exception%20for%20spouses

WHY ROTH IRAs?

Rather than waiting to pay the unknown tax rates of the future, as with a Traditional IRA, you could pay taxes at today's rates by contributing to a Roth IRA. In short, if taxes are "on sale," do you want to take advantage? If so, knowing how a Roth IRA works is your next step.

Today's retirees are the first generation to largely rely on their savings for income in retirement rather than a pension. Some may worry about running out of money, especially when they consider high healthcare costs, the potential for market loss, and the fact that lifespans have increased.

While it's important to consider these factors, it's also important to consider taxes.

Right now, we may be enjoying relatively low tax rates: In 1944, the highest income tax rate was 94%, and in 1978 the maximum capital gains tax rate was almost 40%.[3] We could see higher income taxes and capital gains taxes, as well as new taxes in the future.

3 https://taxfoundation.org/federal-capital-gains-tax-collections-1954-2009/

WHAT IF YOU DON'T QUALIFY TO CONTRIBUTE TO A ROTH IRA?

Roth IRA Income and Contribution Limits:

The Traditional IRA and Roth IRA contribution limit for 2022 is $6,000 for workers under age 50 and $7,000 for workers aged 50 and older.[4]

Roth IRA Income Limits

If your income is over a certain amount, you aren't eligible to contribute directly to a Roth IRA: Your Modified Adjusted Gross Income (MAGI) must be under $140,000 for the tax year 2021 and under $144,000 for the tax year 2022 to contribute to a Roth IRA, and if you're married and file jointly, your MAGI must be under $208,000 for the tax year 2021 and $214,000 for the tax year 2022. Note that you cannot contribute the full amount if you make under $10,000.[5]

Roth IRAs for Couples

Since you can only contribute earned income to a Roth IRA, married people who aren't working for income may think they can't contribute to a Roth IRA or a Traditional IRA. But a working spouse may be able to contribute to on behalf of their non-working spouse if they file taxes jointly.

- Spousal IRAs are not joint accounts; they are two separate Roth IRAs set up in each spouse's name.
- If the working spouse also contributes to his or her own Roth IRA, their earned income must equal or exceed the total amount contributed to both IRA accounts.
- *Note that spousal IRAs are still subject to the regular income limits and contributions up to $7,000 (or $14,000 combined) if both spouses are age 50 or over and a working spouse has enough earned income to make contributions.*[6]

4 https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-iras#:~:text=The%20annual%20contribution%20limit%20for,your%20filing%20status%20and%20income
5 https://www.irs.gov/retirement-plans/plan-participant-employee/amount-of-roth-ira-contributions-that-you-can-make-for-2022
6 https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits

The Process of Converting

You have the option to convert funds from a Traditional IRA, 401(k), or similarly qualified retirement account into a Roth IRA, **no matter how much money you make.** This is sometimes referred to as a **"Backdoor Roth IRA."**[7]

- In this case, you would pay tax on the funds converted and then be able to withdraw them tax-free later.
- The money can't be withdrawn penalty-free until five years after it is converted and typically not until age 59 ½.[8]
- Note that, because you don't want to face early withdrawal penalty fees, it is ideal that the taxes due upon conversion come from funds outside of the IRA itself.
- *Consult a professional before converting part or all of your Traditional IRA or 401(k) to a Roth IRA: There could be certain times that are more optimal than others, and you may be wondering how much to convert.*

The Partial Roth Conversion

You can do a partial Roth conversion by taking your RMDs from a different type of IRA and making Qualified Charitable Donations (QCDs) to ease your tax burden for a given year.[9]

- A QCD is a donation to a verified charity organization.
- Donating your RMDs as a QCD, renders the RMD amount non-taxable, effectively reducing your income if you'd like to stay in a certain tax bracket.
- Many retirees who receive large RMDs from a non-Roth IRA, such as a Traditional IRA or SEP IRA, and who hit their Roth IRA contribution limit, might opt to make QCDs to reduce their taxes for a given year.[10]
- *Note that QCDs are available to make if the donator is over the age of 70 ½ and the dollar limit is $100,000.*
- *Note that QCDs can be made with any distribution you take from a retirement account. In other words, you can make a QCD without making it a part of a Partial Roth Conversion strategy.*

7 https://www.investopedia.com/terms/b/backdoor-roth-ira.asp#:~:text=A%20backdoor%20Roth%20IRA%20is,prescribes%20for%20regular%20Roth%20ownership
8 https://www.irs.gov/retirement-plans/designated-roth-accounts-in-plan-rollovers-to-designated-roth-accounts
9 https://www.irahelp.com/slottreport/tag/roth-conversion
10 https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distribution

A Roth conversion could be one way to plan for the tax rates of the future. There are many factors to consider:

- Your current income levels and tax situation.
- What you think your future income and tax situation will look like.
- What tax policy changes end up happening.
- Your estate plans.

Potential Estate Planning Advantages to the Roth IRA

Recently, the SECURE Act eliminated the option for most non-spouse beneficiaries, such as your offspring, to take RMDs from an inherited IRA based on their own life expectancy. Before its elimination, the ‘stretch IRA’ option allowed inherited Roth IRA beneficiaries to take RMDs over the course of their own life instead of the original owner’s, effectively “stretching” the life of the IRA.[11]

Now, most non-spouse IRA beneficiaries must deplete accounts within 10 years by taking distributions. This means that:

- You could potentially miss out on years of tax-free growth opportunity with either IRA
- You could face an increased tax burden if you are forced to withdraw more than you planned to from an inherited Traditional IRA.

A Roth IRA can be a valuable tool in an estate plan

- Distributions are generally not taxed for beneficiaries.
- The money can continue to grow tax-free while it’s in the account.[12]
- You can create an estate plan and figure out which of your loved ones should inherit which assets based on their own tax situations and how inherited assets can be taxed.

11 https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distribution
12 https://www.investopedia.com/inheriting-roth-ira-from-parent-5220471#:~:text=Anyone%20who%20inherits%20a%20Roth,withdrawals%20will%20be%20tax%20free

DON'T WAIT

YOUR ABILITY TO DO A ROTH CONVERSION MAY NOT LAST

While anyone can convert money from a Traditional IRA to a Roth IRA now, that could change. At the end of 2021, Congress came close to changing the rules so that the "backdoor Roth" was no longer allowed.[13]

Since the entire tax code is always subject to change, it's important to consult with a professional before making any big decisions that could impact your tax situation. We can help you review the dos and don'ts of Roth IRAs and create a strategy that fits you. Get in touch to find out more!

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12 https://www.investopedia.com/tipra-backdoor-roth-ira-5221902

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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.