

Roth IRA Conversions: Pay Taxes Later Except for the Roth

AAII – Houston Chapter
June 18, 2022

James Lange, CPA/Attorney

Spend Time on Issues You Can Control

- So much time and effort goes into predicting the market and other things you can't control
- Better to spend your time on issues you can control

Spend Time on Issues You Can Control

- A series of “strategically planned” Roth IRA conversions is potentially the most important action you can take to protect yourself and your family from massive taxation on your IRAs and retirement plans

Major Theme of this Presentation

- **Someone, someday is going to pay income taxes on the eventual distribution of your traditional IRAs and retirement plans, unless you leave them to charity**

Major Theme

- **With looming higher tax rates and the SECURE Act, your IRA and retirement plans will be decimated both while you are alive and after you are gone unless you are proactive**

Major Theme

- Transfer taxable assets to tax-free assets
- Critical for income tax planning and estate planning

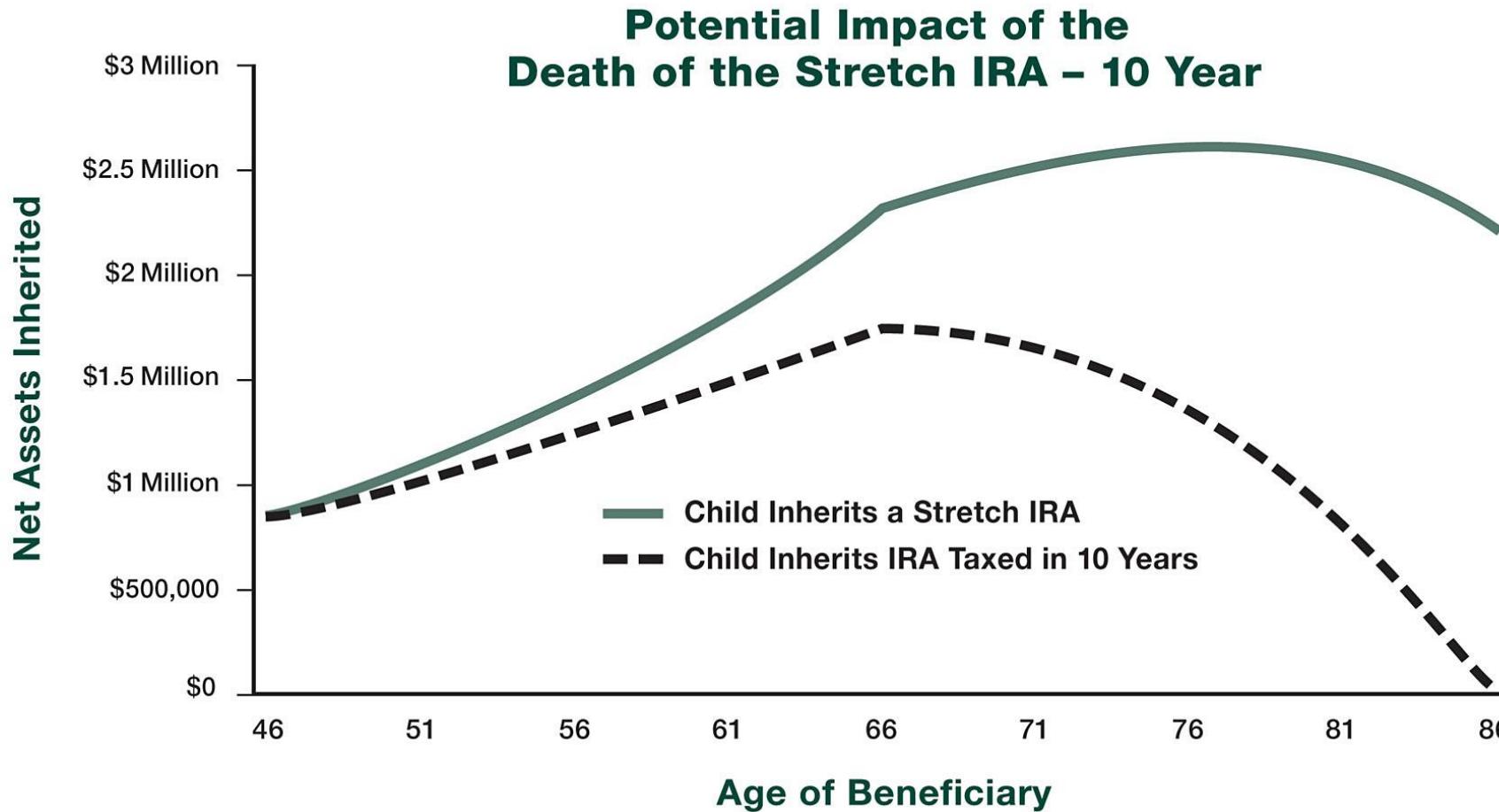
Major Theme

- **Roth IRA conversions**
- **Backdoor Roth IRA strategies**
- **Other strategies to transfer assets from the taxable world to the tax-free world**

The SECURE Act

- **Subject to exception, inherited retirement plans, and IRAs must be distributed to heirs within ten years of the death**

SECURE Act: Potential Impact to Child



The SECURE Act Exceptions

- Spousal beneficiary
- Disabled or chronically ill beneficiary
- Children under age 21
- Less than ten years younger

Tax Cuts and Jobs Act of 2017

- **Sunset provisions**
 - **Income taxes revert to 2017 rates in 2026 (plus inflation)**
 - **Estate tax exclusions also reverts to 2017 exclusion (plus inflation)**

Compare Tax Rates for 2017 and 2022

2017 Married Filing Jointly

\$ 0 – 18,650	10%
18,651 – 75,900	15%
75,901 – 153,100	25%
153,101 – 233,350	28%
233,351 – 416,700	33%
416,701 – 470,700	35%
470,701 and above	39.6%

2022 Married Filing Jointly

\$ 0 – 20,550	10%
20,551 – 83,550	12%
83,551 – 178,150	22%
178,151 – 340,100	24%
340,101 – 431,900	32%
431,901 – 647,850	35%
647,851 and above	37%

- Make Roth conversions at 24% now
- Otherwise, you might pay 28% or 33% on RMDs later

Roth IRA Conversions

- **Roth conversions made sense:**
 - With steady tax rates
 - Before SECURE Act

Roth IRA Conversions

- Now, makes even more sense for even more retirement plan owners
 - Including those who are still working
 - Including those who are retired and already taking Required Minimum Distributions (RMDs) and Social Security

Fire and Belief Put to the Test

- My wife, a software engineer with a Masters degree from CMU, needed proof
- We developed our own Excel spreadsheet

Fire and Belief Put to the Test

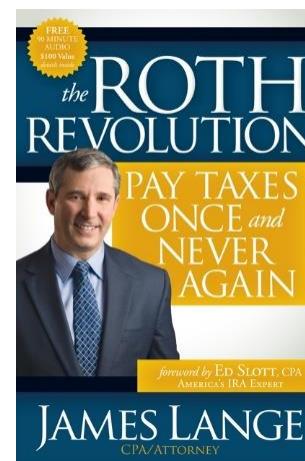
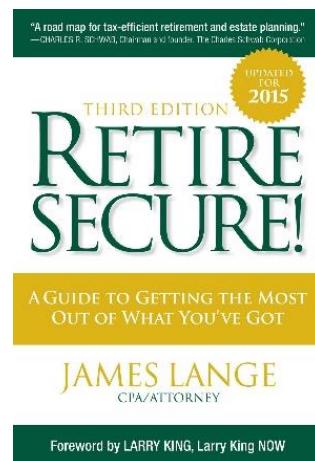
- Converted \$249,000 (everything) in 1998
- Our family will be over \$1 million better off
- Additional lesson

Spread the Word About Roth IRA Conversions

- Now I had to “prove it to the world”
- First peer-reviewed article on Roth IRA conversions with the AICPA’s journal, *The Tax Adviser*
- Won article of the year in 1998

Roth IRA Story

- Spoke all over the country
- Wrote three editions of *Retire Secure!*
- Wrote dedicated Roth conversion book, *The Roth Revolution*



Roth IRA Story

- Was featured in cover story in *Forbes* magazine
- Roth IRA article on [Forbes.com](https://www.forbes.com/sites/forbes/2012/01/10/roth-ira-175000-hits/) had 175,000 hits in the first two days

Radio Show: Roth Support

- I had the top IRA experts in the country on my radio show:
 - Ed Slott
 - Bob Keebler
 - Natalie Choate
 - Many more
- All of them are Roth IRA conversion advocates

We Started “Running the Numbers”

- Applied same methodology from peer-reviewed article to actual clients’ situations to optimize conversion
- Kept improving process and results for clients

Today's Roth Conversion Software

- Software is more manual than you likely imagine
- More like interpolation

Essence of Roth IRA Conversions

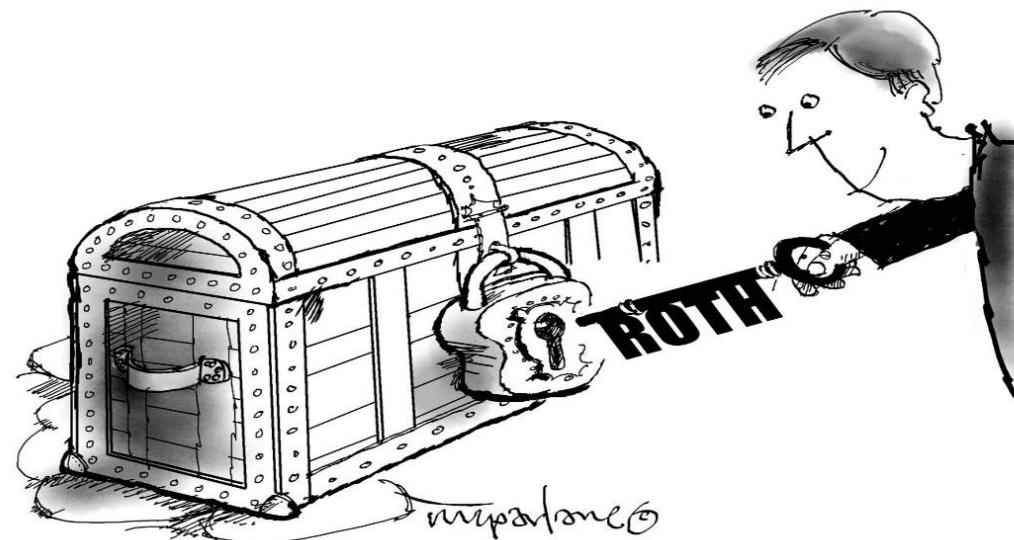
- Transfers a tax-deferred traditional IRA to a tax-free Roth IRA
- Tax is paid on the conversion amount
- Resulting Roth IRA grows income tax-free

Required Minimum Distributions for Roth IRA Conversions

- No RMD for IRA owner
- No RMD for surviving spouse
- After SECURE Act, distribution in ten years for non-spousal heirs, but tax-free distributions

The SECRET

- The key to unlocking the Roth IRA treasure chest



The Key to Unlocking the Secret

Roth Conversions—Day 1

Roth IRA Value after Conversion	\$100,000	
Traditional IRA	\$100,000	
Other Non-IRA Funds*	<u>24,000</u>	<u>-0-</u>
Total Dollars	<u>\$124,000</u>	<u>\$100,000</u>

***Please note \$24,000 reduction in taxable estate for estate or inheritance tax purposes**

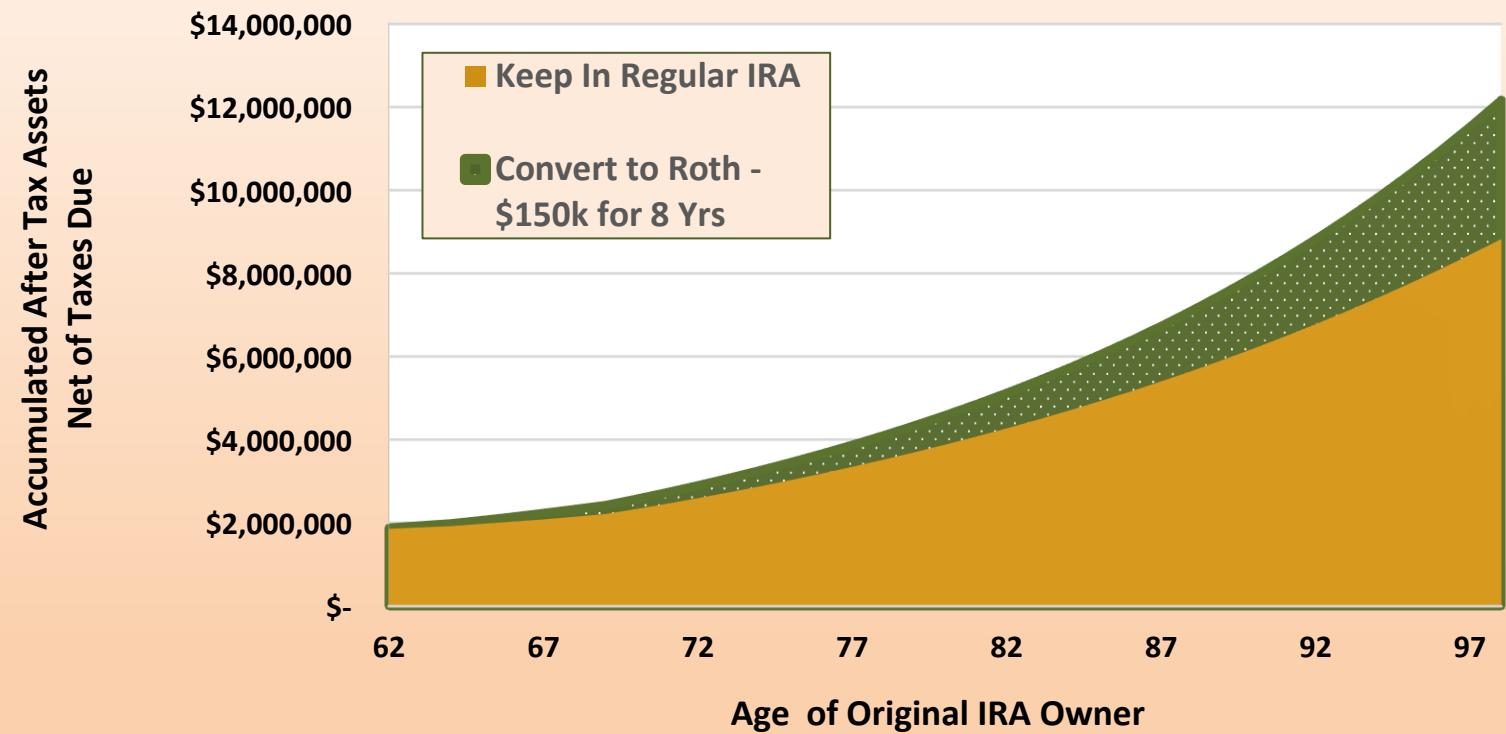
Power of a Series of Conversions

- We compared doing a series of conversions between retirement and age 72 vs. doing nothing
- The difference was life changing



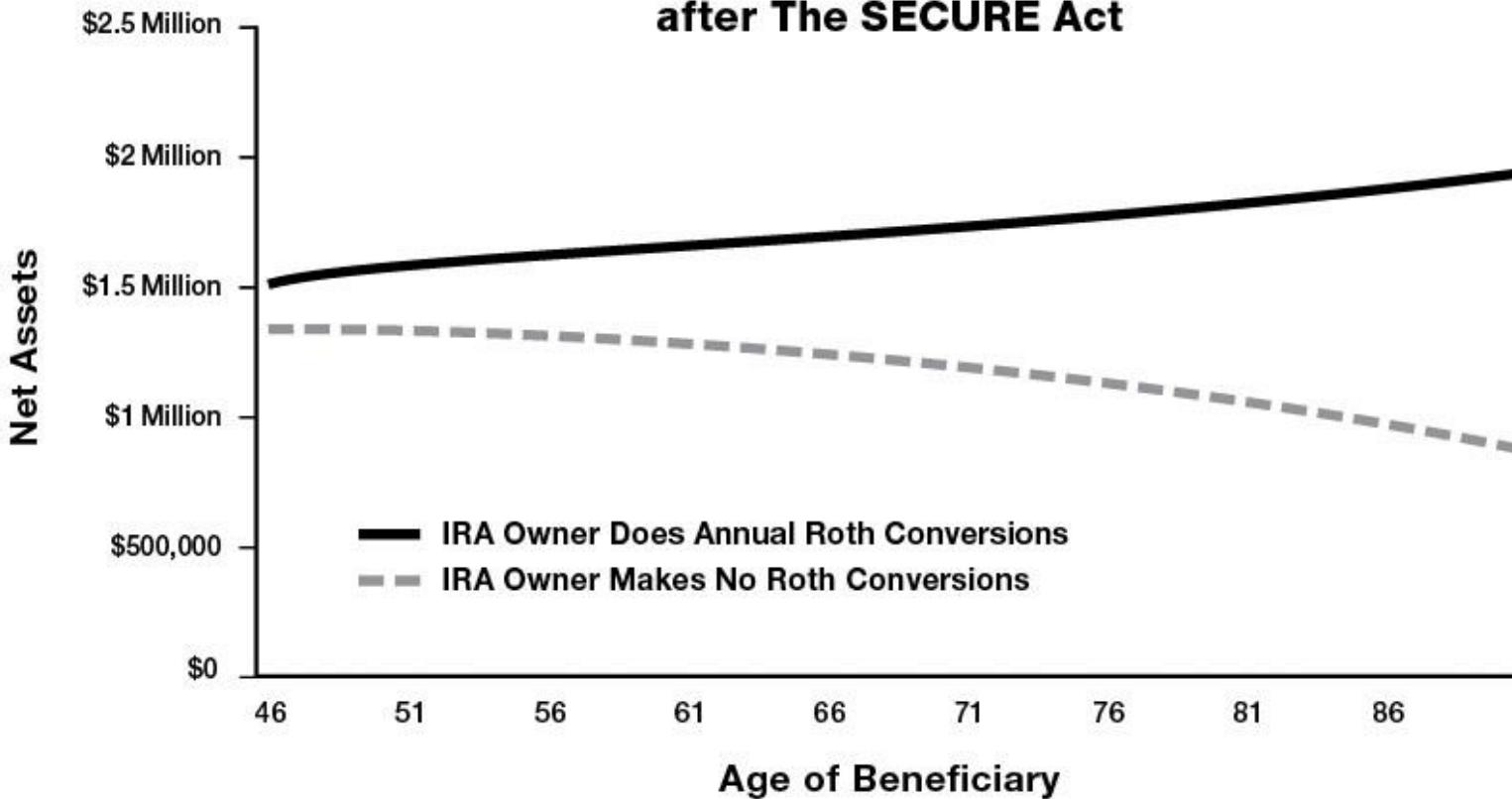
Should You Convert?

\$1,114,883 Advantage at Age 85



GRAPH 6.2

Child Inherits Roth IRA vs. Traditional IRA after The SECURE Act



Classic Time to Make a Conversion

- **Ideally, you convert when your tax rates is low**
- **Usually, best time is after retirement and before RMD**
- **SECURE Act changed RMD to age 72 allowing many IRA owners additional low-income years to convert**

SECURE Act 2.0

- This would be a welcome change that will give IRA and retirement plan owners born in 1951 or later additional time before they must begin taking their RMDs

SECURE Act 2.0

Proposed Changes to RMD

- Turning age 72 after 12/31/22 (born in 1951 to 1956), RMDs begin at age 73
- Turning age 73 after 12/31/29 (born in 1957 to 1958), RMDs begin at age 74
- Turning age 74 after 12/31/32 (born in 1959 or later), RMDs begin at age 75

Roth Conversion Considerations

- Do you have after-tax dollars to pay for the conversion?
- Are you headed for higher income with higher tax rates, RMDs, and Social Security?
- The year after the first spouse dies, tax rates go from married filing jointly to single which are much higher rates

What If You Don't Have Money To Pay Tax On Conversion?

- Sometimes it makes some sense to pay for the conversion with the proceeds of cashing in a retirement plan or IRA
- Mathematically, it usually works out better to get a home equity loan and use those funds to live and pay taxes on a Roth IRA conversion

Home Equity Loan to Pay Taxes on the Roth IRA Conversion

- This strategy often passes the math test
- It may not pass the stomach test
- Forbes.com published my article titled *Let Your House Pay for Your Roth IRA Conversion*

Roth Conversion Considerations

- Impact on Medicare premiums must be considered, but not in itself determinative

Other Taxable to Tax-Free Strategies

- Cash in a portion of the IRA
- Pay income taxes on the withdrawal
- You now have after-tax dollars left

Taxable to Tax-Free

- Take after-tax dollars you have left after cashing in a part of your IRA and gift to heirs

Taxable to Tax-Free

- **Sample gifts that will grow tax-free outside of your estate**
 - **529 plans to educate grandchildren**
 - **Life insurance**
 - **They use money for their own Roth IRA, Roth 401(k), or Roth conversion**
 - **They use money for their own Health Savings Account**

Taxable to Tax-Free

- These strategies are like a Roth IRA conversion
- They transfer money from the taxable world to the tax-free world

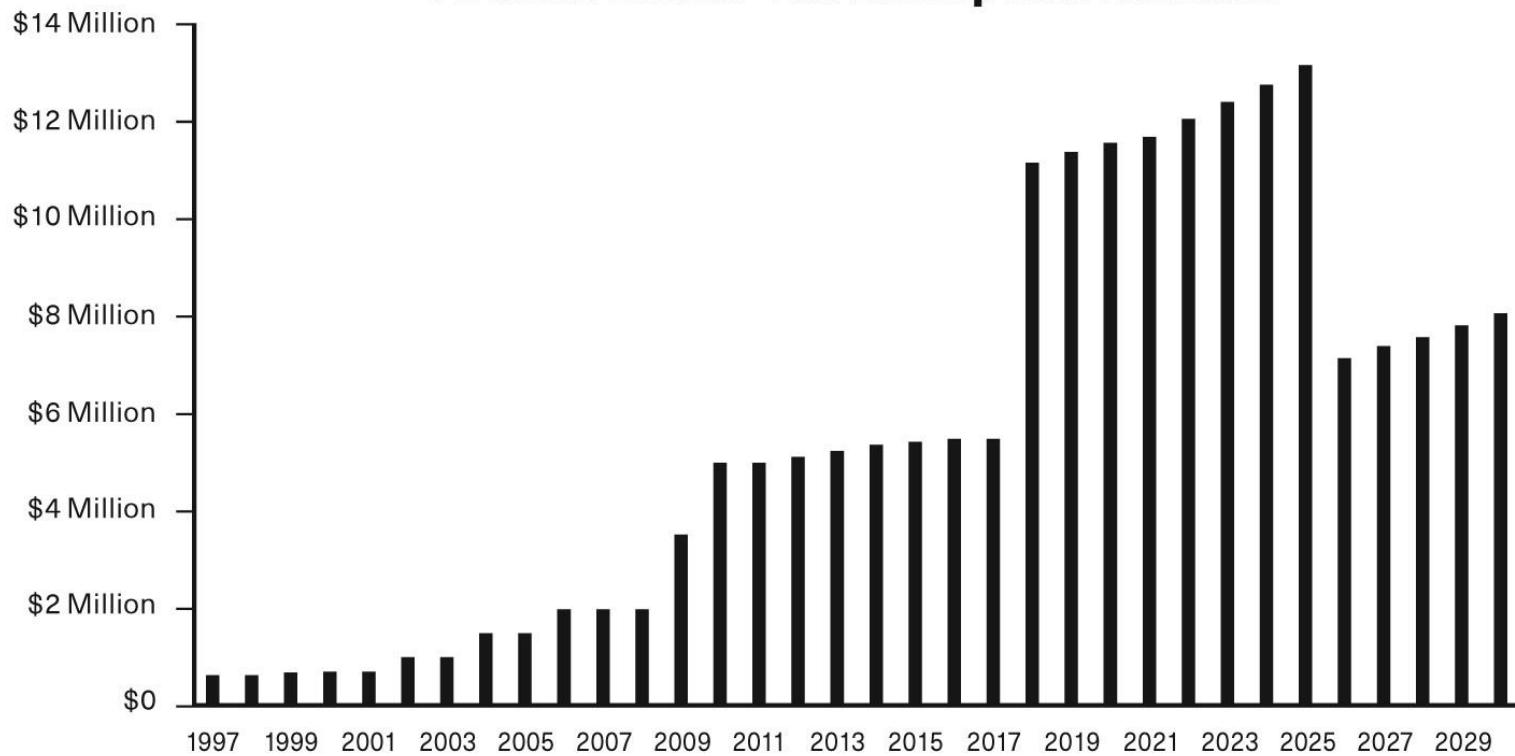
Taxable to Tax-Free

- Additional advantage is the tax-free growth gained with these strategies will fall outside of your estate

Estate Tax Savings

- Keep in mind the sunset provisions bring the exclusion amount from \$12.06 million to \$5 million plus inflation in 2026
- Many fear will revert to \$3.5 million
- Latest I heard was \$5 million plus inflation

Federal Estate Tax Exemption Amount



Backdoor Roth IRAs

- Before year-end, we heard backdoor Roths would be eliminated
- We also heard they may be eliminated retroactive to Jan. 1, 2022
- Maybe, but the longer there is no legislation, the tougher it is going to be to eliminate backdoor Roths retroactively

Backdoor Roth Contributions

- Assume working and income exceeds \$144,000 for MJF in 2022
- Make a \$7,000 nondeductible IRA (each if over 50)
- Assume no other IRAs
- Convert \$14,000 of nondeductible IRA to Roth

Backdoor Roth Contributions

- In effect, you got around the income limitations for a Roth contribution
- Must not have any IRAs or you will run into pro-
ration rule

Mega Backdoor Roth If Plan Allows

- Assume plan allows maximum contributions to 401(k) or 403(b)
- \$67,500—limit total retirement plan contribution for 2022
- \$27,000—either Roth or traditional retirement contribution by retirement plan owner

Mega Backdoor Roth If Plan Allows

- \$10,500—employer contribution (always traditional)
- \$30,000—remaining amount allowed for retirement plan contribution (after-tax dollars)

Retirement Plan Owner Funds Excess \$30,000

- Retirement plan owner writes a check or through payroll deduction into the plan for \$30,000
- That is a nondeductible contribution
- Plan owner then converts that \$30,000 inside the plan to a Roth 401(k) or Roth 403(b)
- In effect, converted \$30,000 of after-tax dollars to \$30,000 Roth

Other Technique to Convert After-Tax Dollars in IRA to Roth Explained in *The Roth Revolution*

- Establish a one person 401(k) assuming you have earned income
- Transfer the pre-tax dollars from your IRA to the 401(k)
- Left with after-tax dollars in IRA

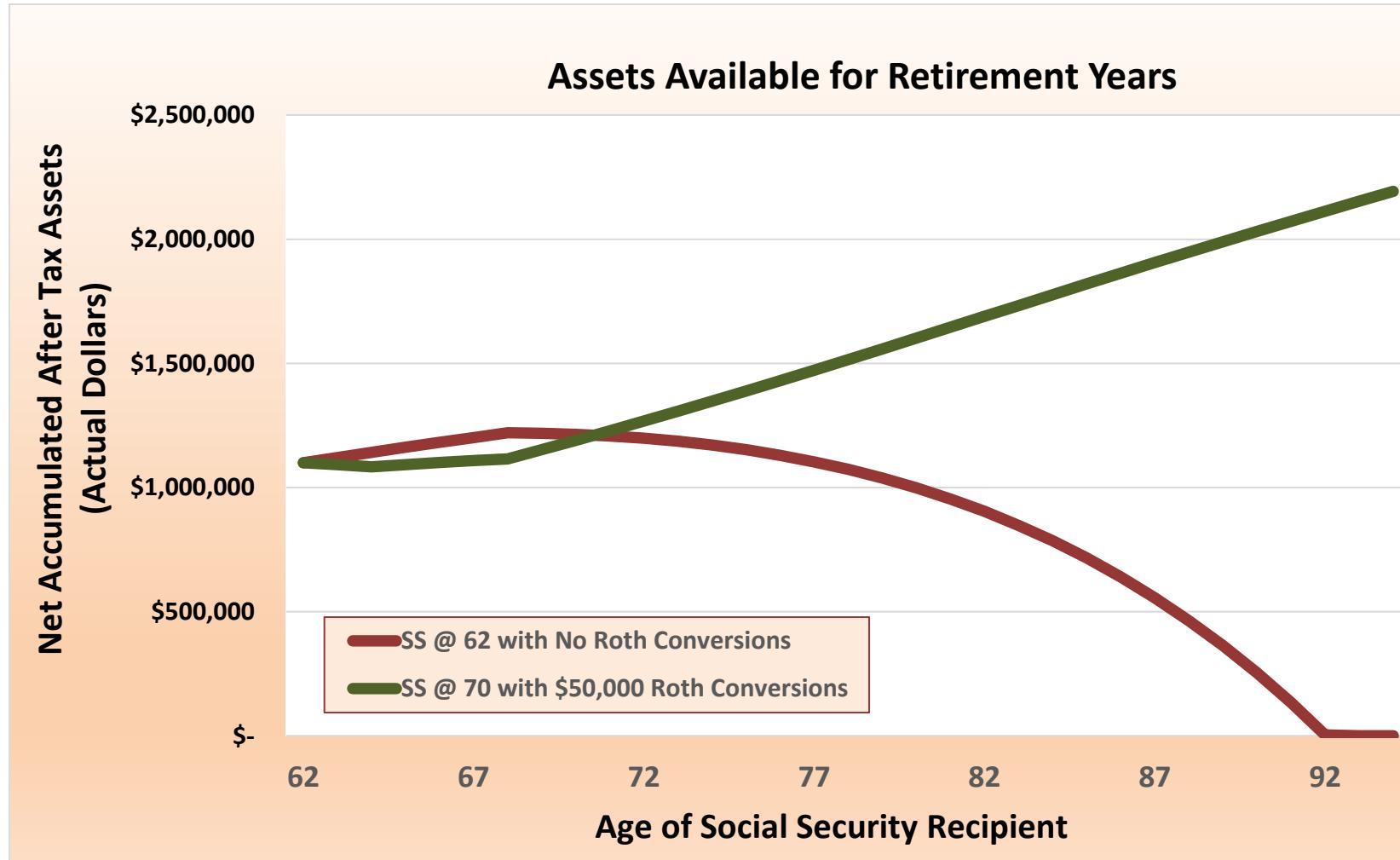
Other Technique to Convert After-Tax Dollars in IRA to Roth Explained in *The Roth Revolution*

- Proration rules are for all IRAs, not IRAs and 401(k)s
- Convert after-tax dollars in IRA to Roth IRA without having to pay the tax
- You in effect converted money that was a nondeductible IRA to a Roth IRA without having to pay the taxes – “tax-free” Roth conversion

Simple Technique at Retirement

- Assume you have after-tax dollars and pre-tax dollars in your retirement plan at work
- At retirement, direct after-tax dollars to a Roth and pre-tax dollars to an IRA
- Source: IRS Notice 2014-54
- This opportunity may end in 2022 as pending legislation may eliminate conversion of basis in retirement plans

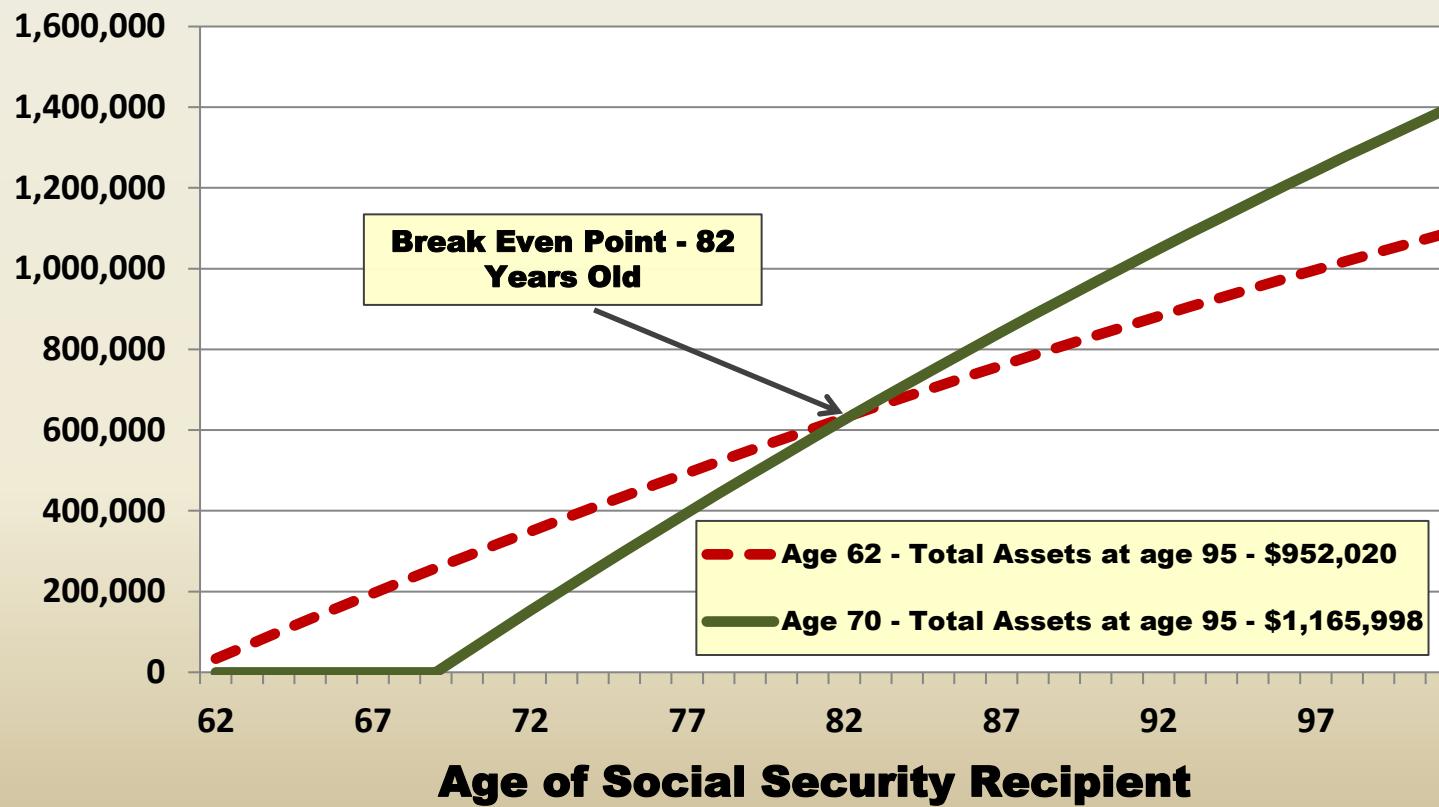
Optimizing Roth IRA Conversions & Social Security for You—Forgetting Your Heirs



Social Security Breakeven Analysis

Benefits Reinvested at 4%

Starting Social Security Benefits as a Single Person Age 62



Larry Kotlikoff's Lesson

- **Don't think like an actuary**
- **Think like an economist**

Spousal Benefits

- Spousal benefit = 1/2 the primary worker's PIA if started at Full Retirement Age (35% if started at 62)
- Example:
 - John's PIA is \$2,000
 - Jane's PIA is \$800
 - If Jane applies at FRA, her benefit will be \$1,000 (50% of John's PIA)

Divorced-Spouse Benefits

- **Same as spousal benefits if:**
 - Marriage lasted ten years or more
 - Person receiving divorced-spouse benefit is currently unmarried or remarries after age 60

Rules for Divorced-Spouse Benefits

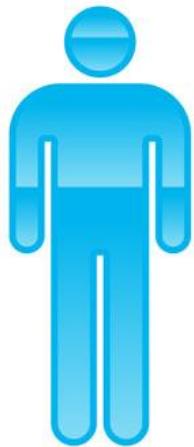
- More than one ex-spouse can receive benefits on the same worker's record
- Benefits paid to one ex-spouse do not affect those paid to the worker, the current spouse, or other ex-spouses
- The rascal supports seven ex-wives with spousal benefits

Survivor Benefits

- **If spouse dies while both are receiving benefits, widow(er) may switch to the higher benefit**

Social Security Offers Survivor Benefits

Both Spouses Living



\$2,000

\$1,200

After Husband Dies



\$2,000

Synergy Between Delaying Social Security and Roth IRA Conversions

- If you hold off on your Social Security, you will be in a lower income tax bracket for Roth IRA conversions
- These are not two independent decisions (i.e., when to take Social Security and when and how much to convert to a Roth IRA)

So Far, You Have Discovered

- **Most important tax principle for retirement plan owners**
- **Don't pay taxes now, pay taxes later**
- **SECURE Act**
- **Brief mentions of important portions of Proposed Regulations and SECURE Act 2.0**

So Far, You Have Discovered

- **Sunset provisions of The Tax Cuts and Jobs Act of 2017**
- **The Secret**
- **The peer-reviewed math on Roth IRA conversions**

So Far, You Have Discovered

- Roth conversions and Medicare premiums
- What to do if you don't have money to pay the tax on Roth conversion

So Far, You Have Discovered

- Other taxable to tax-free strategies
- The backdoor Roth
- A few Social Security concepts

Where To Go From Here

- I encourage all attendees to take advantage of the free resources which are listed in the next three slides

Bonuses

- To claim your bonuses, please go to:
<https://PayTaxesLater.com/AAII>
- Bonuses include:
 - Digital copy of my book, *Beating the New Death Tax*
 - Digital copy of the Advanced Reader Copy of *Retire Secure for Professors*

Bonuses (Continued)

- To claim your bonuses, please go to:

<https://PayTaxesLater.com/AAII>

- Bonuses include:
 - Digital copy of my dedicated Roth book, *The Roth Revolution*
 - Digital copy of my book, *The \$214,000 Mistake: How To Double Your Social Security & Maximize Your IRAs*

If You Are Interested In Working With Our Firm

- We offer a **Financial Masterplan** on a fee-for-service basis
 - You must be approved for us to offer you this service
 - The typical cost is \$15,000
- We also offer an **Assets Under Management (AUM)** model with a \$1 million dollar minimum

Non-PA Residents

- **We do not draft wills, trusts, etc. for anyone but PA residents**
- **We do review your current wills and trusts and make recommendations**
- **We only review documents for out-of-state residents if you become an AUM client or a Financial Masterplan client**

Your Next Step: A Retire Secure Consultation

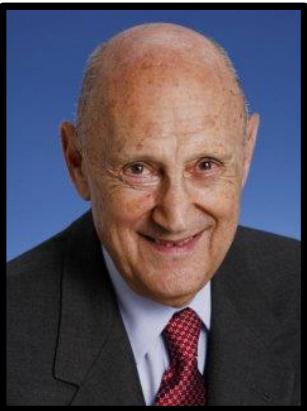
- One-hour Zoom consultation with me for AUM or for a Financial Masterplan
- To see if you qualify, please go to:

<https://PayTaxesLater.com/AAII>

Action Steps

- Go to <https://PayTaxesLater.com/AAII> to see if you qualify for a free Retire Secure consultation with me for AUM or Financial Masterplan

Excerpts from FOREWORD, *Retire Secure for Professors*



by Burton Malkiel, Author, *A Random Walk Down Wall Street*,
and Professor Emeritus of Economics, Princeton University

“I have not seen a better discussion of the advantages and potential pitfalls of converting your IRA into a Roth.”

