

A couple with grey hair, a man and a woman, are walking along a sandy beach at sunset. The man is wearing a dark patterned jacket and the woman is wearing a grey jacket. They are looking out at the ocean. The sky is a mix of orange and blue.

Understanding the Limits of Roth Conversions: A Tailored Approach to Retirement Planning

By Partners Wealth Management

If you're looking to maximize your retirement savings, exploring Roth IRAs is a smart move. While converting to a Roth IRA has become an increasingly popular retirement strategy, it's important to make sure that it is the right fit for you.

Potential Benefits of Roth Conversions

A Roth IRA conversion allows individuals to transfer funds from a traditional IRA or 401(k) into a Roth IRA. While traditional IRAs offer tax-deferred growth, withdrawals in retirement are subject to taxation. In contrast, converting to a Roth IRA means paying taxes upfront, but it provides the advantage of tax-free earnings and withdrawals in the future.

While we can't predict future tax policies with certainty, we do know taxes are currently at historic lows, and the Tax Cuts and Jobs Act is scheduled to sunset in 2026. With the U.S. national debt exceeding \$35 trillion, many experts anticipate future tax increases. Converting to a Roth IRA allows individuals to lock in today's lower rates and safeguard their retirement savings from potential tax hikes.

Additionally, Roth IRAs offer more flexibility than traditional IRAs, as they are not subject to required minimum distributions (RMDs). This flexibility enables continued tax-free growth of your investments, making Roth IRAs an appealing option for long-term retirement planning.

How Roth IRA Conversions Can Mitigate Costs in High-Income Retirement

The Income-Related Monthly Adjustment Amount (IRMAA) is an additional fee applied to Medicare Part B and Part D premiums for enrollees whose income exceeds certain thresholds. This surcharge is determined based on income reported two years before enrolling in Medicare.

IRMAA charges increase as income rises, meaning diligent savers and high earners may face higher Medicare costs, even though their benefits are the same as those of individuals with lower incomes. Without a sound strategy, required minimum distributions (RMDs) from

traditional IRA accounts in retirement can push retirees into higher IRMAA tiers, further increasing costs.

For those under age 63, a Roth IRA conversion offers a simpler strategy to minimize future IRMAA-related expenses since it avoids affecting Medicare premiums. However, for individuals aged 63 or older, the decision becomes more complex. A financial advisor can help evaluate whether paying higher taxes now and potentially inflating income (and IRMAA surcharges) temporarily is preferable to deferring the issue, especially when future Medicare premiums are likely to increase.

Beyond IRMAA, rising Medicare costs and the potential for lower income thresholds for IRMAA brackets underscore the importance of planning for lower income levels in retirement. Additionally, higher Medicare premiums directly reduce Social Security benefits, as Medicare costs are deducted from monthly Social Security payments. This reduction highlights the need to proactively manage income in retirement to preserve Social Security benefits while minimizing taxes and healthcare expenses.

Factors to Consider Before Pursuing a Roth IRA Conversion

While Roth IRA conversions offer many benefits, they also require careful consideration. Before deciding if a conversion is the right choice, it's essential to evaluate several key factors:

1. Tax Implications

Converting a traditional IRA to a Roth IRA means the converted amount will be taxed as current income. It's crucial to ensure that the individual can cover this tax payment without tapping into their retirement savings, as doing so could undermine their long-term financial goals.

2. Complexity of the Process

Roth conversions are not as simple as transferring funds between accounts. The process involves navigating potential complications such as Social Security taxes, Medicare premiums, capital gains, and the five-year rule. Mistakes in these areas can be costly and, in many cases, irreversible. Engaging a financial advisor can help minimize risks and ensure the conversion is executed correctly.

3. Future Tax Bracket Projections

The anticipated tax bracket during retirement is a critical factor. If an individual expects to be in a lower tax bracket later, paying taxes now through a conversion may not be advantageous. However, if they foresee higher income and tax rates in the future, converting to a Roth IRA could provide significant long-term tax benefits.

Personalizing your Roth Conversion Strategy

Given the intricacies of a Roth IRA conversion, personalized advice is essential. Working with financial professionals who understand your unique financial circumstances can help you

navigate the process effectively and reduce the risk of costly errors.

Rather than converting a large sum all at once, professionals often recommend spreading conversions over several years. This approach helps manage tax liability and keeps you in a more favorable tax bracket, minimizing the immediate tax burden.

Financial advisors can also leverage advanced planning tools to help you project future income, tax rates, and investment growth. These insights provide a clearer understanding of how a Roth conversion fits into your long-term financial objectives.

Additionally, Roth IRAs offer unique benefits for estate planning. Unlike traditional IRAs, Roth IRAs allow beneficiaries to inherit funds tax-free, enabling you to leave a more substantial financial legacy.

While a Roth IRA conversion can be a powerful strategy for tax-free growth, avoiding higher future tax rates, and enhancing retirement flexibility, it's not a decision to make lightly. Consult with financial and tax professionals to develop a personalized plan tailored to your goals and circumstances.