WHY 2024 MIGHT BE THE YEAR TO CONSIDER CONVERTING TO A ROTH IRA

With multiple stimulus packages passed in the last 3 years and a new government administration in office, many are asking the question, "Will taxes go up in the near future?" Many believe the answer is a resounding YES. That's why 2024 might be the best time year to consider a Roth conversion. Let's break down the reasons why a Roth might be a good option in this current environment, the differences between a traditional and Roth IRA, and a few considerations before converting to a Roth.

1. HISTORICALLY LOWER TAX RATES

Beginning in 1918, top Federal income tax rates ranged from 23% up to 94%. In fact, for 50 years (1932 -1986) the top federal income tax rates has been at 50% or higher.[1] So while today's top tax rate of 37% may seem steep, it's one of the lower rates Americans have experienced. World War I, The Great Depression, and World War II spiked tax rates significantly, and three subsequent acts (Revenue Act of 1964, Economic Recover Tay Act of 1981, and the Tax Reform Act of 1986) helped bring those tax rates back down to what we see today.[2]

What does this mean? Simply put: tax rates could be on the rise in the near future.

2. AVOIDING REQUIRED MINIMUM DISTRIBUTIONS

With the passing of the Setting Every Community Up for Retirement Enhancement (SECURE) Act, Required Minimum Distributions (RMDs) for tax-deferred accounts have changed. The SECURE Act changed the RMD age from 70½ to 73. For those who want to continue to stave off RMDs for a more favorable tax environment, a Roth conversion might be a good fit for you. You'll still pay taxes when converting funds from a traditional IRA to a Roth, but if you believe taxes will be higher the year you turn 73 and onward, now might be a good time to move your funds into a Roth IRA. Roths don't have required minimum distributions, since the taxes have already been paid.

Just remember, if you convert a traditional IRA into a Roth IRA, you can't withdraw contributions penalty-free for five years after the conversion.[3]

3. LOOKING FOR TAX-FREE GROWTH

While nothing is truly "tax-free," because you pay taxes on what you put into the Roth (rather than when you take distributions from it) you can still maximize on growth without the fear of a large tax bite later down the road. This also allows you to continue growing your money tax-free without RMD time limits. With a traditional IRA, you must begin taking RMDs at 73, but you have the opportunity to contribute based on your modified adjusted gross income or "AGI" to a Roth for as long as you want, regardless of age.[4] This could be a good strategy if you had losses in a traditional IRA that you'd like to turn into tax-free growth potential.

4. YOU'RE IN A LOWER TAX BRACKET

If you've lost your job, been furloughed, or are thinking about retiring early, a Roth conversion could make sense to lock in a lower tax rate. You could pay the lower rate, but still have tax-free growth potential in your Roth account.

5. YOU MAY NOT ALWAYS HAVE THE OPTION

In late 2021, Congressional Democrats drafted the Build Back Better (BBB) bill, which would have "tamped down on Roth conversions."[5] "An additional rule had aimed to prevent Roth conversions of any kind made by anyone making more than $400,000, or any couple making more than $450,000, by 2032."[5] While this bill didn't pass in January 2022, expect future bills that could eliminate backdoor Roth conversions.

DIFFERENCES BETWEEN TRADITIONAL VS. ROTH IRAS[5]

ROTH	TRADITIONAL
After-tax contributions	Pre-tax contributions
Tax-free growth	Tax-deferred growth
Max contribution limits (2024): up to $7,000 ($8,000 for age 50+) depending on your modified AGI[6]	Tax-deductible*
Generally, penalty & tax-free after 5 years and age 59½	Max contribution limits (2024): $7,000 ($8,000 for age 50+)[7]
No mandatory distributions	Mandatory distributions after age 73

*Subject to income limitations for participants in employer-sponsored plans

HOW TO CONVERT TO A ROTH ACCOUNT[8]

1. **Meet with your tax and financial professional(s) to see if a Roth conversion is best suited for your unique needs.**

2. **Currently have a traditional IRA or create a traditional IRA.**

3. **Pay taxes on your IRA contributions and gains.** Because Roth IRAs only allow for post-tax dollars, you'll need to pay tax before converting from a traditional IRA to a Roth.

4. **Create a Roth IRA and convert all or a portion of your account.** According to the IRS, you can do this in one of the following ways:

   a. Rollover: You receive a distribution from a traditional IRA and contribute it to a Roth IRA within 60 days after the distribution (the distribution check is payable to you)

   b. Trustee-to-Trustee Transfer: You tell the financial institution holding your traditional IRA assets to transfer an amount directly to the trustee of your Roth IRA at a different financial institution (the distributing trustee may achieve this by issuing you a check payable to the new trustee)

   c. Same Trustee Transfer: If your traditional and Roth IRAs are maintained at the same financial institution, you can tell the trustee to transfer an amount from your traditional IRA to your Roth IRA.

*A conversion to a Roth IRA results in taxation of any untaxed amounts in the traditional IRA. The conversion is reported on Form 8606, Nondeductible IRAs. See Publication 590-A, Contributions to Individual Retirement Arrangements (IRAs), for more information.

WHEN A ROTH MIGHT NOT BE A GOOD CHOICE

While Roth IRAs can be a great option for some retirees, there are a few reasons why a Roth conversion might not be a great fit. For instance, if:

1. **You need access to your funds in the next five years.** After converting to a Roth IRA, the account holder (aged 59½ or older) generally doesn't have access to the earnings for five years without incurring tax penalties.[3]

2. **You don't want to pay an upfront tax bill.** By converting your account, you are essentially "pre-paying" the taxes at the current tax rate rather than at an unknown tax rate in the future. However, if you convert enough, it could push you into an even higher tax bracket.

Before making a decision, sit down with your tax and financial professionals and have them look at your unique situation to see if it makes sense for you.

[1] https://www.investopedia.com/articles/tax/10/history-taxes.asp

[2] https://www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates

[3] www.thebalancemoney.com/roth-ira-conversions-3193209

[4] www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distributions

[5] www.forbes.com/advisor/retirement/congress-to-end-backdoor-roth-conversions/#:~:text=Starting%20in%202022%2C%20the%20bill,IRA%20to%20a%20Roth%20IRA

[6] https://www.irs.gov/newsroom/401k-limit-increases-to-23000-for-2024-ira-limit-rises-to-7000

[7] https://www.irs.gov/newsroom/401k-limit-increases-to-23000-for-2024-ira-limit-rises-to-7000

[8] www.investopedia.com/roth-ira-conversion-rules-4770480#:~:text=The%20IRS%20describes%20three%20ways%20to%20go%20about,Roth%20account%20at%20another%20financial%20institution%20More%20items