Krosnowski & Scott LLC
Investment & Retirement Planning Specialists

**Roth Conversion/RMD Planning**

When does it make the most sense to convert assets from an IRA into a Roth account?

There are no tax benefits when assets are contributed into a Roth account. The tax benefits of a Roth account are tax deferred accumulation and tax free withdrawals. Two situations that are ideal for investors to be involved with a Roth account are being in a low tax bracket when you are making contributions and being in a high tax bracket when you are receiving distributions. To qualify for the tax-free and penalty free withdrawal of earnings, a Roth IRA must have been in place for at least five years and the distribution must take place after age 59 ½ or due to death, disability or a first time home purchase. Roth IRA distributions may be subject to state laws.

Let's take a look at a hypothetical situation where an investor who retired at age 60, has a traditional IRA balance of over $500,000 and is considering converting assets into a Roth account. The investor may be well served to consider making annual IRA/Roth conversions, by converting an amount of assets that does not cause him or her to be taxed in a higher tax bracket. This strategy would enable the investor to reduce their IRA balance and reduce their exposure to income taxes when they reach age 70 ½ by reducing the amount of their RMD (required minimum distribution). We refer to this strategy as "brush fires now to reduce forest fires later." At age 70 ½, IRA investors are required to begin to receive RMDs from their traditional IRAs.

Example: An IRA investor who has gross income of $60,000 would be in the 15% joint federal income tax bracket. The IRA investor and their beneficiary spouse are both age 60. Since the 15% tax bracket limit for 2015 is $74,900, the investor could convert $14,900 from his or her IRA into a Roth account. Converting this amount of assets would enable the investor to avoid having income taxed at the next higher tax bracket (25%). For illustrative purposes, let's assume 15% federal and 5% state income tax. The annual tax bill for the Roth conversion would be $3,180. The drawback of this strategy is that the investor would be required to pay income tax on the balance during the year of the conversion and the balance paid in taxes would no longer be able to accumulate tax deferred in an IRA. The benefit of this strategy is that it would enable the investor to reduce their IRA balance which would lower their tax exposure on their RMDs when they reach age 70 ½. Assuming a 6% rate of return, if an investor converted $14,900 annually for ten years, this might reduce their IRA balance and increase their Roth account balance by around $208,000. An IRA investor with a $558,395 balance who receives a six percent return would have a balance of around $1,000,000 after ten years. This hypothetical example is used for illustrative purposes only, and simple compounding performance which is not indicative of any particular investment. Rates of return will vary over time, particularly for long-term investments. Investments offering the potential for higher rates of return also involve a higher degree of risk.

When the investor reaches age 70 ½, he or she would be required to receive a RMD of around $36,496 if their IRA balance was $1,000,000. Had they made Roth conversions as described above, their RMD would be around $28,898 at age 70 ½ based on a balance of $791,800. Investors are not required to receive RMDs from Roth accounts.

In 2015, for joint filers, taxable income (income minus deductions) from $74,901 to $151,200 and $151,201 to $230,450 is taxed at the 25% and 28% rates respectively.

| ACCOUNT | IRA without CONVERSION | | IRA with ROTH CONVERSION | | Roth |
|---|---|---|---|---|---|
| AGE | IRA Balance* | RMD | IRA Balance** | RMD | Balance |
| 70 | $ 1,000,000 | $36,496 | $ 791,800 | $ 28,898 | $208,000 |
| 71 | $ 1,021,314 | $38,540 | $ 808,676 | $ 30,516 | $220,480 |
| 72 | $ 1,041,740 | $40,692 | $ 824,850 | $ 32,221 | $233,708 |
| 73 | $ 1,061,111 | $42,960 | $ 840,187 | $ 34,016 | $247,731 |
| 74 | $ 1,079,240 | $45,346 | $ 854,541 | $ 35,905 | $262,595 |
| 75 | $ 1,095,928 | $47,857 | $ 867,754 | $ 37,893 | $278,350 |
| 76 | $ 1,110,955 | $50,498 | $ 879,653 | $ 39,984 | $295,000 |
| 77 | $ 1,124,084 | $53,023 | $ 890,049 | $ 41,983 | $312,755 |
| 78 | $ 1,135,325 | $55,927 | $ 898,950 | $ 44,283 | $331,520 |
| 79 | $ 1,144,162 | $58,675 | $ 905,947 | $ 46,459 | $351,411 |
| *Assuming (Balance plus 6% annual return) less annual RMD | | | | | |
| **In our calculations the greater IRA balances were over $1 Million the less financial benefit the Roth Conversion provided. | | | | | |

This strategy not only may serve to reduce your tax exposure, the longer that time goes by it may also enable you to accumulate a significant Roth account balance for you or your beneficiaries to enjoy.

We hope that you have found this essay to be of use in your retirement planning efforts. Please feel free to contact us if you have any questions or if you would be like to review retirement and investment planning strategies with us.

Sincerely,

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