Roth IRA Conversions During Retirement

Todd Flynn, CPA, CFP®
Principal, Soundmark Wealth Management

KEY TAKEAWAYS

- Many retirees are surprised to learn they remain in a high tax bracket even after leaving the workforce.
- Taking Social Security along with Required Minimum Distributions (RMDs) from retirement accounts is often what spikes a retiree's tax exposure.
- Converting traditional IRAs into Roth IRAs may save clients significant tax and money over time and enable them to leave substantially more to their heirs.

When clients move into their retirement years, we evaluate several tax planning opportunities that could positively impact their overall financial plan and investment allocation. Initially, we consider whether it makes sense to convert a client's IRA to a Roth IRA before they start taking Social Security benefits. Depending on the client's asset structure and cash flow needs, we may be able to convert significant amounts of their IRA holdings to a Roth IRA at very advantageous tax rates. Here are three of the biggest benefits to this approach:

1. **Proper management of client's tax rates before they take Social Security and Required Minimum Distributions (RMDs) from their IRA.** Taking RMDs along with Social Security benefits can increase a client's tax rate in the future. Many clients are surprised to learn they remain in such a high tax bracket after leaving the workforce. A Roth conversion prior to beginning Social Security benefits or taking RMDs may significantly lower their tax hit.

2. **Continued reduction of client's future tax rates.** Moving a portion of a client's IRA assets (that would be subject to RMDs at age 70 ½) to a Roth IRA that currently does not require the account holder to take RMDs. This again allows us to reduce a client's future tax rates and help them manage their cash flow.

3. **Creating estate and beneficiary planning opportunities.** A tax-free Roth account is a great asset for clients to leave to their beneficiaries who will receive tax-free distributions over their lifetime. Also, since there are no RMDs with a Roth, we may allocate the Roth IRA more aggressively than other client asset accounts. This maximizes account growth and the amount left to the client's future beneficiaries.

Real World Example

We have been working on this planning scenario with a couple that retired at age 60. Fortunately for our clients, they had a large taxable investment account that provided them with enough cash flow to meet their living expenses via dividends and tax-managed asset sales. While working with their CPA, we developed a tax projection that allowed them to convert at least $80,000 per year from their IRA to a Roth IRA at very low tax rates. In addition, we prepared an analysis that calculated the value of waiting until age 70 to take Social Security benefits. By doing so, they could make 10 years of Roth conversions, which significantly reduced their future RMDs and future tax bill.

NOTE: There are several issues that affect a Social Security analysis including the client's financial situation, their desire (or need) to take Social Security early, and even Medicare rates based on the client's income level. However, we often find there is an opportunity to make Roth conversions during a client's retirement.

Effective Planning Strategies

In my next article, I will discuss how charitable planning can help maximize a client's tax deductions and allow for even larger Roth IRA conversions.

Please contact us if you would like to discuss year-end tax planning strategies for your clients. ■

ABOUT THE AUTHOR:

Todd Flynn, CPA, CFP® is a Principal at Soundmark Wealth Management. Todd works closely with physicians, business owners, and other high-net-worth individuals to help them define their financial goals and implement an ongoing financial planning process.

SOUNDMARK
WEALTH MANAGEMENT