Should You Do a Roth Conversion?

What is a Roth Conversion?

A Roth conversion involves moving money from a traditional retirement account (like a 401(k) or IRA) to a Roth IRA. When you do this, you'll pay taxes on the amount you convert. However, once the money is in the Roth IRA, it grows tax-free, and qualified withdrawals in retirement are also tax-free.
Roth conversions are especially beneficial if:

- You expect to be in a higher tax bracket in retirement.
- You want to minimize the required minimum distributions (RMDs) from traditional accounts.

Why Consider a Roth IRA?

A Roth IRA offers several advantages:

- **Tax-Free Growth:** Your investments grow tax-free, which can be a big benefit if taxes increase in the future.

- **High-Growth Potential:** Ideal for investing in assets like stocks that may generate significant returns.
- **Tax-Free Withdrawals:** If you meet certain conditions (e.g., age 59½, account held for 5+ years, first-time home purchase), you can withdraw money without paying taxes.
- **No RMDs:** You're not required to withdraw money during your lifetime.
- **Tax-Free Inheritance:** Your heirs can inherit the account tax-free.

How do Tax Rates Affect Roth Conversions?

If tax rates are expected to rise, converting funds sooner can save you money. By converting before a tax hike, you lock in today's lower rate instead of paying more later.

What to Consider Before Converting

- **Your Current and Future Income:**
  - If your income is steady and you expect tax rates to rise, converting sooner could save you money.
  - If your income is likely to drop in the future (e.g., after retiring or changing jobs), waiting to convert at a lower tax rate might be smarter.

- **Tax Brackets:**
  - Avoid converting so much that you jump into a higher tax bracket. Instead, consider converting just enough to stay within your current bracket.
  - If you expect to be in a much lower tax bracket in the future, waiting might be a better choice.

- **How Much to Convert:**
  - Converting a large amount all at once could push you into a higher tax bracket.
  - Spreading smaller conversions over several years (a "laddered" strategy) might reduce your overall tax bill.

- **Medicare and Healthcare Costs:**
  - Converting increases your taxable income for the year, which might raise your Medicare premiums (IRMAA surcharges). Smaller, spread-out conversions could help you avoid this.

- **State Taxes:**
  - Some states handle Roth conversions differently than the IRS.
    - **States without income tax:** No taxes on conversions.
    - **Special rules:** For example, Iowa allows retirees over 55 to exclude some retirement income from taxes.
  - Be careful—a slight income increase in some states could push you into a higher tax bracket.

Key Takeaway

Converting now might be a great opportunity to take advantage of lower tax rates. However, timing depends on your income, health, retirement plans, and where you live.

Next Steps

Use our Roth IRA conversion calculator to weigh the pros and cons of converting.

Try the Roth Conversion Calculator

Consult a financial advisor or tax professional. They can help you:

- Avoid jumping into a higher tax bracket.
- Minimize Medicare surcharges.
- Understand your state’s tax rules.

This way, you can make the most of a Roth conversion without unexpected surprises.

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