SPEAKER 1

Welcome everybody to Victory's virtual workshop where I unpack complex financial and economic topics to make them more accessible for

I'm Patrick Huey and today is March the 6th, 2024.

Today we're diving into the intriguing, I guess, world of Roth IRA conversions.

It's a decision that requires careful consideration and it can have a significant impact on your retirement, your investment strategy, and your

I'll be your guide through the decision-making process when it comes to Roth IRA conversions today, so let's jump right in.

Right On In.

Just a reminder, this week send me any questions you may have via email.

You can do that at Patrick at VictoryIndependentPlanning.com or text me at 239-567-5477.

I will not be using the chat button for this particular virtual workshop.

Now, when contemplating a Roth IRA conversion, there are four key questions that you should ask yourself.

One, will you need distributions from your retirement account to fund your retirement plan?

Two, what is the tax status you expect to be in in the future?

Three, do you have cash outside of retirement accounts to pay taxes on your conversions?

And four, will you need to make withdrawals within five years of said conversions?

All right, let's dive a little deeper into each question.

Number one, will you need distributions from your retirement account to fund your retirement plan?

Seems like a no-brainer, but this question is crucial because Roth IRAs have different distribution rules compared to traditional IRAs.

With a Roth IRA, you can withdraw contributions at any time without taxes or penalties, making it more flexible for retirement income pla

And further, if you find that you will not need the distributions from your IRA to fund your retirement income, well, congratulations.

First of all, you're a great saver.

And second, we need to make you a great planner in order to minimize your taxes.

We also need to ask another question here.

Are Your Beneficiaries People or Places?

Meaning, will you transfer the IRA funds to your kids, grandkids, or friends?

Or Are the Proceeds Going to a Charitable Institution?

If the answer is charity, then let's go ahead and rule out the Roth conversion right now.

There is very little advantage to a Roth conversion when you could instead make charitable contributions directly from your IRA during yo

and you don't have to include it in your income.

If you have questions about the QCD, let me know.

We are using it quite a bit in the world we find ourselves in today where you don't typically itemize deductions.

Speaking of itemizing deductions, question two is what is the tax status you expect in the future?

Do you or your beneficiaries who are not charities expect to be in a higher tax bracket or pay higher tax rates later in life?

If you anticipate higher taxes in the future, it makes sense to pay taxes now at lower rates by converting to a Roth IRA.

And here are five reasons you might find yourself paying more in taxes later in life.

Number one, spending more than you thought.

Some of the retirees I know are going to every new restaurant, traveling the world, and they're spending time at the lake house with the kid

Their retirement and their retirement spending may actually outpace that of their working years.

It's not often, but it is possible.

Reason number two, fewer deductions.

By retirement, our homes are paid off and our children are out of the house, hopefully.

We have limitations on property and state tax deductions and 9 out of 10 of us now claim the standard deduction and therefore don't itemize

Which incidentally means no charitable deductions either.

The third reason we might be taxed at higher rates later?

Death of a spouse.

They call this the widow penalty where the surviving spouse goes from married filing jointly to filing single.

Income Goes Down but Taxes Paid and the Average Rate of Tax Actually Go Up.

And the fourth reason is actually 34 trillion reasons.

That is the current federal debt level and it is rising with a $1.8 trillion gap between spending and tax receipts for fiscal 2023.

Something has to give and no one that I've heard recently has talked about cutting spending.

And the fifth reason, there is already an automatic tax increase on the books for December 31st, 2025.

That's the date the new brackets we've had since the Tax Cuts and Jobs Act of 2017 will automatically go away.

Yes, we might get itemized deductions back, but this is still a tax hike for most people.

I encourage everyone to plan for taxes to go up in our lifetime and not down.

I'd rather be pleasantly surprised than disappointed by a tax bill I didn't plan for.

So at this point, we will assume that you or your family plan to use the assets in your IRA for income and that taxes are going up.

A Roth Conversion is Looking Pretty Good Right Now.

But it brings up question three.

Do you have cash outside of retirement accounts to pay taxes on your conversions?

Converting to a Roth IRA triggers taxes now on the converted amount.

So having cash on hand to cover these taxes without dipping into your retirement savings is preferred.

If you have a short time horizon, you may want to skip the conversion as you won't have as long to enjoy the benefits of tax-free growth on your investments.

But if you are the average retiree who is in their mid-60s, remember you may have a time horizon of over 30 years.

And you can add an extra 10 years to this horizon for your beneficiaries who will have that long to withdraw the funds after you are gone.

And we also have to take into account how the conversion will affect things like your Medicare costs due to the income-related monthly adjustment amount, or IRMA, provisions.

Finally, we're up to question four.

Will You Need Distributions from the Roth IRA Within Five Years?

And this question relates to the five-year rule for Roth IRA distributions.

The Roth IRA five-year rule says you cannot withdraw earnings tax-free until it's been at least five years since you first contributed to a Roth IRA account.

Now keep in mind that the five-year clock begins ticking on January 1st of the year you made your first contribution to the account.

The Internal Revenue Service, the IRS, requires a waiting period of five years before withdrawing balances converted as well from a traditi

There is an exception to the penalty if you are 59 and a half or older.

But remember, we said the clock starts on January 1st of the year you do the contribution or the conversion, no matter when during the year

So if you converted in December, the aging requirement might in practice be only a bit more than four years, potentially as low as four year

And it's important to note, the five-year rule is counted separately for each conversion.

So beware of this provision and get the timing right if you decide that a Roth conversion is the best way to fire Uncle Sam as your investme

Listen, it's essential for you to assess your current financial circumstances, your future income expectations, your retirement goals and tax s

Consulting with a financial advisor and a tax planner can help you decide what's right for you.

Personally, my VIP retirement glide path system helps me to clarify the income and tax planning so that clients can make confident decisio

Thanks for joining me on this journey through the decision-making process behind Roth IRA conversions.

If you'd like a copy of the Roth conversion decision tree that goes along with this presentation, please message me or email me.

Thanks for being with me today.

Be on the lookout in the weekly briefing email for the next topic for our virtual workshop.

Thanks everybody, and I'll see you next week.