



ROTH Conversions: More attractive under new tax law



There is no investment account more loved than a ROTH IRA. The promise of tax-free growth followed by tax-free withdrawals is hard to beat. My other two favorite features of the ROTH IRA are: 1) You can withdraw your contributions, but not the growth, before age 59 ½ without penalty (unlike every other retirement account), and 2) There are no Required Minimum Distributions (RMDs) at age 70 ½, or any age for that matter, during your lifetime.

The problem is a very small portion of the nation's retirement savings is in ROTH IRAs. Most people have the majority of their retirement funds in traditional IRAs or 401(k)s. The solution is to convert some, or all, of your IRA or 401(k) to a ROTH. This simple process is called a ROTH conversion. The downside is you have to pay income tax on all the funds converted.

This begs the question...

“Does it make sense to pay taxes now so that all future growth will be tax-free, or are you better off continuing to defer taxes until the money is withdrawn?”

The biggest factor in whether you should convert your IRA to a ROTH is:

Your marginal tax bracket now vs. your future tax rate. The main advantage of converting your IRA to a ROTH IRA only comes into play if you are in a lower tax bracket at the time of the conversion than you will be in the future when the money is withdrawn.

ROTH conversions became more attractive in January 2018 because the new tax rates are lower than they've been in a long time. This is likely a temporary situation and, in fact, individual income tax rates

are scheduled to go back to their 2017 levels in 2025. Check out these charts below from [Business Insider](#) showing how most people's marginal tax rate dropped 3% in 2018 and are anticipated to remain that way for the next 6 years.

Tax brackets for single filers			
	2017		2018
10%	\$0–\$9,325	10%	\$0–\$9,525
15%	\$9,326–\$37,950	12%	\$9,526–\$38,700
25%	\$37,951–\$91,900	22%	\$38,701–\$82,500
28%	\$91,901–\$191,650	24%	\$82,501–\$157,500
33%	\$191,651–\$416,700	32%	\$157,501–\$200,000
35%	\$416,701–\$418,400	35%	\$200,001–\$500,000
39.6%	\$418,401 or more	37%	\$500,001 or more
Standard deduction:	\$6,350	Standard deduction:	\$12,000
Personal Exemption:	\$4,050	Personal Exemption:	Eliminated

Tax brackets for married taxpayers filing jointly			
	2017		2018
10%	\$0–\$18,650	10%	\$0–\$19,050
15%	\$18,651–\$75,900	12%	\$19,051–\$77,400
25%	\$75,901–\$153,100	22%	\$77,401–\$165,000
28%	\$153,101–\$233,350	24%	\$165,001–\$315,000
33%	\$233,351–\$416,700	32%	\$315,001–\$400,000
35%	\$416,701–\$470,700	35%	\$400,001–\$600,000
39.6%	\$470,701 or more	37%	\$600,000 or more
Standard deduction:	\$12,700	Standard deduction:	\$24,000
Personal Exemption:	\$8,100	Personal Exemption:	Eliminated

Factors that Make ROTH Conversions *More* Attractive:

- 1) You may have a low-income year at some point during your career (e.g., you get laid off). This would be a great time to convert some IRA funds to a ROTH since you'll be a low tax bracket.
- 2) Another reason to convert is if you plan to leave your IRA account to beneficiaries who are in a higher tax bracket.

Factors that Make ROTH Conversions Less Attractive:

- 1) A ROTH conversion may not make sense while you're working and in your peak earning years. You may be in a lower tax bracket when withdrawing funds during retirement, which would be a better time to convert.
- 2) The ROTH conversion makes a lot less sense if you will need Required Minimum distributions or other withdrawals from your IRA. It's more attractive if you can then let the converted funds grow tax-free for the rest of your life.
- 3) The ROTH conversion is less attractive if you need to take money from the IRA to pay the taxes. It is much better if you can pay the taxes with after-tax dollars that are sitting in savings account.
- 4) Lastly, definitely do not convert any IRA funds that you may leave to charity, since charities do not pay taxes on funds you donate to them.

Two more details you need to know about ROTH conversions:

- 1) There is a 5-year holding period on conversions

Once you convert an IRA to a ROTH IRA, you must wait 5 tax years before withdrawing the principle (converted amount) if you are under age 59 ½. Even if you wait 5 years, any growth on the converted amount must remain until age 59 ½ to avoid an early withdrawal penalty.

- 2) ROTH recharacterizations have been eliminated in the new tax law

Prior to 2018, you were able to convert funds to a ROTH and then "Undo" the conversion for any reason (e.g., Uh oh! I converted too much and put myself in a higher bracket) up to your tax-filing deadline. However, that opportunity was eliminated under the new tax law, so you better make sure you really want to do this, and you have the funds to pay the taxes.

Final Thought: The best time to convert a traditional IRA to a ROTH IRA is when you are in a temporarily low tax bracket. That time may be now.