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Retirement Watch  
SPOTLIGHT SERIES

# IRA Conversions: Myths, Facts, and More You Need to Know



Bob Carlson  
Editor, *Retirement Watch*  
800-552-1152

[www.RetirementWatch.com](http://www.RetirementWatch.com)



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# Happy 25<sup>th</sup> Birthday, Roth IRA

- **Taxpayer Relief Act of 1997**
- **Opposite of traditional IRAs**
- **Pay taxes now, no taxes later**
- **Initially \$100,000 income limit on conversions**
- **Slow uptake on conversions**



# Basics of IRA Conversions

- **Anyone can convert**
- **No annual, lifetime or dollar limit**
- **Conversion is a rollover**
- **Converted amount is gross income**
- **Taxed as ordinary income**
- **Tax-free after five years**
- **Withdraw principal first**



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# Peak Year of Conversions?

- **Higher tax rates likely**
- **Baby Boomer population bulge**
- **Peak IRA values**
- **Congress starts to encourage**
- **IRA owners know more**



# Examine the Tax Differences

- **Difference in income tax rates is key**
- **Don't forget Stealth Taxes and RMDs**
  - **Both current and future matter**
- **Empty an IRA early?**
- **Future taxes aren't only factor**



# Other Factors That Matter

- **How will conversion tax be paid?**
- **How long can the Roth compound?**
- **What is the estimated rate of return?**
- **State income tax treatment?**
- **Don't forget the future Stealth Taxes**



# Estate Planning Conversions

- **IRA primarily for next generation or two**
- **Beneficiary pays taxes on traditional IRA**
- **Conversion tax = tax-free gift**
- **Taxes paid aren't in gifts or in estate**
- **Heirs must distribute within 10 years**



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# How to Decide

- **Should you convert?**
- **When?**
- **How much?**
- **How to decide?**





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## Retirement Watch IRA CONVERSION CALCULATOR

FACTS AND ASSUMPTIONS:									
CURRENT YEAR						2022			
IRA OWNER'S AGE						68			
AMOUNT TO CONVERT THIS YEAR						\$100,000			
PRE-TAX, PRE-RETIREMENT INVESTMENT RETURN						8.00%			
PRE-TAX, POST-RETIREMENT INVESTMENT RETURN						6.00%			
EFFECTIVE TAX RATE YEAR OF CONVERSION						28.75%			
EFFECTIVE PRE-RETIREMENT TAX RATE						28.75%			
EFFECTIVE POST-RETIREMENT TAX RATE						28.75%			
EFFECTIVE PRE-RETIREMENT TAX RATE, TAXABLE SIDE ACCOUNT						19.25%			
EFFECTIVE POST-RETIREMENT TAX RATE, TAXABLE SIDE ACCOUNT						19.25%			
AGE WITHDRAWALS BEGIN/ RETIREMENT AGE						70			
FIRST YEAR WITHDRAWAL RATE						4.0%			
ANNUAL WITHDRAWAL INCREASE/INFLATION RATE						3.0%			

TAXES ON CONVERSION	\$28,750								
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## PRE-DISTRIBUTION RESULTS

			PRE-TAX VALUE AT RETIREMENT			
			TRADITIONAL		ROTH	
			IRA		IRA	
IRA			\$123,638		\$123,638	
TAXABLE SIDE ACCOUNT			\$34,163		N/A	
TOTAL			\$157,802		\$123,638	
TOTAL CONVERSION ADVANTAGE*					\$52,911	
*Based on "Results in Retirement."						



# When a Conversion is Better

- **Serial conversion/bracket management**
- **Reduce gross income**
- **Lower adjusted gross income**
- **Monitor your situation**
- **Monitor the markets**



# **No Changing Your Mind**

- **Recharacterization used to be allowed**
- **Repealed in Tax Cuts and Jobs Act**
- **No 60-day or other grace period**
- **Surprise income is the big risk**
- **Two prime times to convert:**
  - **Near end of year**
  - **After market decline**



# When Not to Convert

- **Will incur the Stealth Taxes**
- **Assets highly-valued, risky**
- **Not enough cash to pay the taxes**
- **Expect lower future tax rate**
- **Opposed to paying taxes early**



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# Key Conversion Points

- **No income or wealth limit**
- **No limit on conversion amount**
- **Inherited IRAs can't be converted**
- **No 10% early distribution penalty**
- **Potential penalty if taxes paid from IRA**



# Key Conversion Points

- **Partial conversions allowed**
- **Serial conversions allowed**
- **Must be distributed by December 31**
- **RMDs come first**
- **Know the five-year rules**
- **Contributions distributed first, then conversions, then earnings**