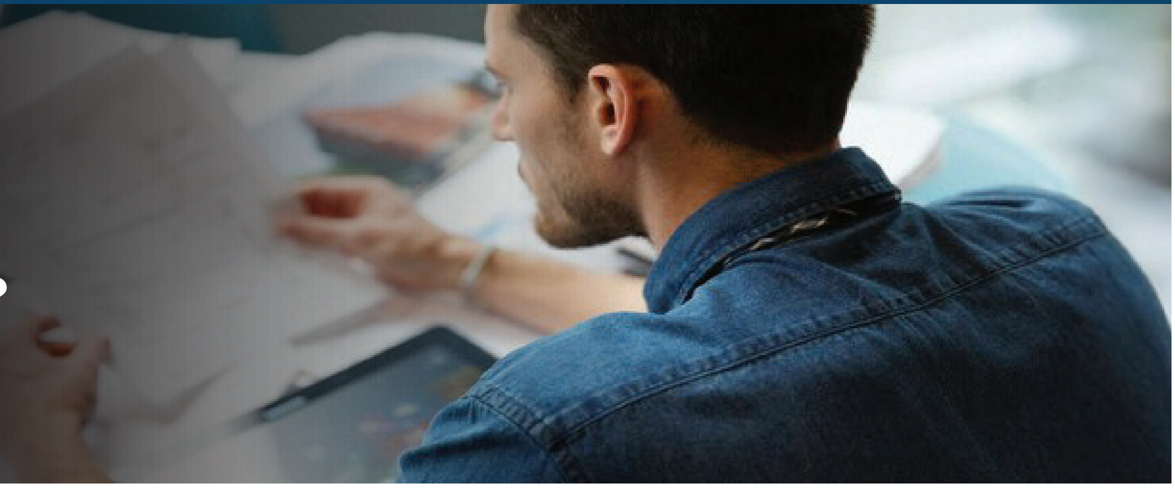
SHOULD YOU CONSIDER A ROTH IRA CONVERSION?



Depending upon your individual circumstances, a Roth IRA conversion could be a valuable retirement planning tool. Below, we provide an overview and describe some of the potential benefits.

ROTH IRA CONVERSION: AN OVERVIEW

The process of a Roth IRA conversion is typically straightforward: The account holder opens a Roth IRA (if one does not already exist) with assets that are either transferred directly into the account or are distributed to the account owner. If the latter, the account owner must subsequently fund the Roth IRA within 60 days[1].

Typically for those age 59½ and younger, IRA assets that are converted to a Roth IRA are not subject to a 10% early withdrawal penalty. However, there is a five-year rule that imposes a waiting period on withdrawals from assets converted to a Roth IRA. As a result, distributions made before the five-year mark are assessed a 10% early withdrawal penalty[2]. In addition, Roth IRA conversions are now irreversible, meaning once they are completed, they cannot be undone.

WHO SHOULD CONSIDER CONVERTING TO A ROTH IRA?

While there are many factors to consider, a Roth IRA conversion may make sense if you:

- Have sufficient taxable assets to pay the conversion taxes.
- Do not need the funds in the IRA in the near term.
- Expect to be in a higher tax bracket in retirement, particularly once required minimum distributions (RMDs) begin.
- Do not expect to need all the RMDs from the IRA to cover future cash flows.
- Can make full or partial conversions between retirement and when RMDs begin at age 72.
- Have a federally taxable estate or a state taxable estate (or both) and paying the conversion taxes may help to reduce the size of your estate.

[1] Indirect rollovers should only be used if necessary.

[2] https://www.irs.gov/publications/p590b#en_US_2021_publink100089553

HOW MUCH SHOULD YOU CONVERT AND WHEN?

If you have decided to implement a Roth IRA conversion strategy, you will want to consider the amount to convert as well as the timing. If your IRA assets constitute a relatively small percentage of your investment portfolio, you may decide to convert the full amount. Conversely, if your IRA accounts make up a large percentage of your portfolio, then it is highly unlikely you would want to convert the full amount.

POTENTIAL BENEFITS OF A ROTH IRA CONVERSION

Does not mandate RMDs

The IRS does not mandate distributions from Roth IRAs by either the account owner or the spousal beneficiary. For those who do not depend on these distributions to cover their cash flows, it can be beneficial to allow the funds to grow tax-exempt within the Roth IRA for a longer period.

Allows assets to grow tax-exempt

When the requirements are properly met, the funds within a Roth IRA grow tax-exempt, and distributions from the Roth IRA are also exempt from income tax. This applies for the lifetime of the IRA owner as well as for the lifetime of his/her spousal beneficiary. The tax-exempt status of the Roth IRA is also extended to non-spouse beneficiaries. However, as is also the case with traditional IRAs, non-spouse beneficiaries (who do not meet certain exceptions) must fully distribute the inherited Roth IRA within 10 years of inheriting the account[3].

While a traditional IRA provides for tax-deferred growth, which can be a meaningful benefit, the forced withdrawals necessitate reinvestment into taxable accounts which are less tax efficient. The dual benefit of tax-exempt growth and no distribution requirement makes the Roth IRA very compelling for some investors.

Can help to reduce estate size

IRA account holders with a federally taxable or state taxable estate might be looking for ways to reduce the size of their estate. Paying the taxes on a Roth IRA conversion can help to reduce the size of one's estate, while also relieving the next generation of the tax liability associated with inheriting a traditional IRA.

Accelerates income strategically

For many individuals, there is a period between retirement and the onset of RMDs at age 72 during which their marginal tax bracket is lower than usual. This period can present an opportunity to convert funds to a Roth IRA and spread the conversions over several years. While it may seem counterintuitive, it can often make sense to accelerate income during this time to fill in the lower tax brackets. The idea is to pay a lower tax rate today on a distribution that would have been made later at a higher rate. One way to accomplish this may be to take early distributions from IRAs and/or 401(k)s. However, assuming expenses are covered from other sources, such as Social Security, pension payments, or other investment accounts, this window of time can offer an opportunity to implement gradual Roth IRA conversions. Your accountant can help you calculate the amount of conversion that might make sense in any given year to fill up a designated tax bracket.

Considers federal marginal tax brackets

In addition to considering your personal tax bracket, both current and future, it is important to consider tax brackets as a whole. While it is impossible to predict the trajectory of federal marginal brackets, current tax

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[3] https://www.irs.gov/publications/p590b#en_US_2021_publink100090130

rates are at relative historic lows. There are some who believe that future increases to federal tax brackets are inevitable. If tax brackets do trend higher in the future, it would have been advantageous to convert to a Roth IRA during a period of relatively low tax rates.

Implications of Income in Respect of a Decedent (IRD)

IRD is income that the decedent (a person who has died) earned while alive that had not yet been taxed. If the decedent had a federally taxable estate, then the IRA may be subject to double taxation. Fortunately, under Section 691(c), a tax deduction is available to the IRA beneficiaries to compensate for this potential double taxation. However, the beneficiaries and their accountants need to be aware that they are entitled to this deduction and must remember to claim it. In contrast, if IRS rules are followed, a Roth IRA is not considered to be an IRD asset, thereby negating the need to take the Section 691(c) deduction.

First Manhattan – Stay in the Know

We are available to answer your questions on this topic and help in any other way, including by coordinating with your accountant and your trust and estate attorney, who can help you determine if a Roth IRA conversion is right for you.