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JIM: Welcome, everybody. We’re doing the program a little bit differently today, as I will be my own guest, and I’m going to be speaking about a subject that I’m very passionate about that I think is not talked about a lot, and I also believe, when it is talked about, there’s a lot of myths and misconceptions about what the right thing is to do. This is an area that you absolutely should not go this alone or try to figure it out on your own. You also shouldn’t go to the lunchroom to get advice because it really doesn’t matter what your coworkers are doing, what your neighbor’s doing. You really have to look at it on an individual basis and make your own decisions based on your goals and plans and how you plan on spending money in retirement.

What is the topic? You might ask. It’s whether to convert or not convert; the old Roth conversion. A couple things you want to make sure of, first of all – is – find out if you can convert and what you can convert. For those of you that have a job and have a 401(k) or 403(b) or other employer-sponsored program, sometimes, there’s limitations on what you can do there. You do have to be careful, and you do have to make sure what your options are. Just because you can convert doesn’t mean you necessarily should. The thing that you should be looking for is that – you want to not only look at what your current situation is but also anticipate your future situation, and I would sit down with your financial professional, your tax professional. Look at your circumstances, and make an informed decision as to what to convert or not to convert.

Another thing I tell people is it isn’t all or nothing. We can do a little bit at a time. We might convert some years and not others. It’s always something that is planned on a year-to-year basis. Some important factors to make sure that you’re aware of. Number one is, know how the tax brackets work. You know it’s kind of like a staircase. The first few dollars you make is part of your standard deduction. The next few dollars you make is in the next bracket, which starts at 10%. Then it goes to 12, then 22, then 24. You’ve got to know where you fall in the bracket. For example, you could be in a 12% bracket, but the next $100 might be in the 22% bracket. Every dollar afterward is at that bracket.

There’s a lot of misconceptions when you get your tax return back. A lot of them have a report that talks about the effective tax rate of 13.2% or 11.8%. All that’s doing is saying what your average taxes are on the overall dollars of earnings that you have, so you have a blend of 0%, 10%, 12%, 22% that comes up with that number, but each additional dollar that you have as taxable earnings will be at whatever that highest step is. If you decide to do a conversion, even though your effective rate might be 11.5%, but you’re in the 22% bracket, every dollar you convert will be at 22%. Avoid the surprises when trying to do this yourself and do a careful analysis to see what makes sense. It also makes sense when considering how much to contribute to your 401(k). I see a lot of people that are right on that borderline of 12% and 22% and will probably be in maybe that 12% bracket in retirement. Well, it definitely makes sense to do a deduction at the 22%, but maybe we’re doing a Roth when we get our tax bracket down to 12.

This may all sound pretty confusing, but that’s why you want to sit down with your financial professional and your tax professional to determine not only where you’re putting the money in but when it makes sense to convert.

Those are some basic things. Then some other things you want to do is you want to make sure that you understand some of the tax traps in the future. If you’re married, filing jointly, how many of you know how the brackets will change if one of you passes away? Well, for the vast majority of people, if we live to life expectancy, we will be in the drawdown years, not the earning-and-saving years, and if we’re drawing money out of the IRAs — and by the time we’re 72, we have to start drawing money — then we want to anticipate what those tax rates will be. If one of us dies, the brackets get cut in half, and the deductions get cut in half. What happens, for the sake of discussion if – you know, I’m a married couple, and we’re living on $6000 or $7000 a month, we’re in the 12% bracket. If that same taxable income happens when one of us passes away, well, I could very easily be in now the 22% bracket.

When you’re looking at Roth conversions, if you’re in a 12% bracket today, and if you did conversions and you can do some of that 12 now, knowing that you might be in a higher bracket in the future, that certainly would be worth considering doing. In addition to that, what are tax brackets going to be in the future? Now, I know, as I’m recording this, there’s a lot of talk about creating a new tax law, but right now, on the books, we have a tax law that is going to change in 2026. The 12% bracket is where most working class Americans are paying the most taxes – is in that bracket, and basically, if you’re making under roughly 110,000-120,000 of gross income, you’re in the 12% bracket. Once you start getting over that, that’s when you hit the next bracket, 22%.

I would imagine a lot of people listening to this program are probably paying most of their taxes in that 12% bracket. How many of you know that that bracket is going to go 15%? It’s scheduled to go there in 2026. Well, if you think about that as a percentage, 15% is 25% more. All the money that falls in that bracket, you’re going to be paying 25% more tax. Does it make sense to do some conversions if we know the future rate’s going to be higher? Now, none of us have a crystal ball. Congress changes all the time. They change their minds. We have tax cuts, tax increases, but in my opinion, when I look at the national debt and our appetite for spending more than we bring in, some day we’re going to have to pay the piper. I believe there’s a better than average chance that tax rates will be higher in the future, and they need to tax more people. We can’t rely on the rich to fund all of our spending. There’s not enough of them to go around, so the thing is, you want to understand how your brackets are, what your brackets might be in the future.

Now, another thing you want to be aware of is the traps of taxes on social security and additional Medicare premiums in the form of IRMAA. How this comes into play – if you make too much taxable income, you will pay taxes on your social security. They’ve never adjusted this for inflation, so when this law became the law of the land – social security used to always be tax-free. Well, now they’re taxing social security if you make over 25,000 as a single individual, 32,000 as a couple of modified adjusted gross income. Now, I’m not going to get into what that all means, but let’s face it, back in 1980, if you were making that kind of money, your social security was free, tax-free. Even back then, if you made $30,000 of income in 1986, you were living pretty good in retirement, where today – with gas prices what they are, food prices, healthcare costs – they’re all substantially more than it was in the mid-80s, and so a lot more people are being affected by taxes on social security because that’s never been adjusted for inflation.

However, they did make one adjustment, and that was in 1991. They added a new bracket where, if you made over 34,000 as an individual or 44,000 as a couple, then 85% of your social security was subject to taxation. Now, that doesn’t mean they taxed 85% or taxed 50%. That just means that amount of the social security is subject to whatever your tax bracket is. Now, if you’re doing conversions and you’re already drawing social security or you’re on Medicare, those are things to consider, because you may end up having to pay higher premiums for Medicare because you made too much money, or you need to pay taxes on your social security because you made too much money. Those are all considerations. However, if you’re doing a Roth conversion, and let’s say you trigger those things. You’ve got to figure that out in a calculation because, now, if we’ve got all our IRAs converted, we no longer have required minimum distributions, going forward, so it could be that the money that we’re being forced to take out of retirement accounts are triggering those taxes. If we get it all done at once – okay, we might have to pay that once, but now, going forward, when we draw money out of a Roth IRA, we don’t have any income taxes. It does not affect IRMAA. It does not affect taxes on social security, so those are some pretty big considerations when considering to do a Roth. Now, we’re going to talk about a couple other things when we return. I’m going to take a short break, so please stay tuned.

Welcome back as we continue to discuss whether to convert or not to convert our IRAs into Roth or other retirement accounts into Roth, and before the break, we were talking about some of the trapdoors and understanding tax brackets. Let’s talk about a couple other things you want to consider. One is – that I see missed a lot, even still today, even though it’s been on the books for a number of years – is tax-free charitable contributions from a traditional IRA. Here’s one of the reasons you would not want to convert. Let’s say you have 80,000-90,000 in your IRA, and you’re giving $3000 to church every year or your other favorite charity. Well, if you’re over age 70-1/2 – okay, so not the 72, but at 70-1/2, you can look at the government table and see what RMDs would be for that age. That is the percentage of what’s in your IRAs that you can give to charity with no tax. Now, normally, when you give to charity, you have to itemize, and with the high standard deduction today, most people in the middle class are not able to itemize because they do not have enough deductions to do that. Now, if you are able to itemize, charitable contributions are deductible, and you should talk to your tax professional to understand the limits and how that all works, depending on what you’re giving and all that kind of stuff. When it comes to an IRA, you’re able to give the RMDs completely tax-free. Well, if you only have, let’s say, $80,000 or $90,000 in your IRA – you’re giving $3000 to your favorite charity every single year, and you plan on continuing to do that. Well, if we would convert that IRA, you would create a tax for yourself right now, potentially. However, if the amount we want to give to charity is the same or greater than what the RMD is, well, then, we could just give that money to charity. It comes out tax-free, so there wouldn’t be a reason to do a conversion if that was something we were doing. That’s why you’ve got to really sit down and do an analysis of what your goals are.

Now, here are some other reasons to consider a Roth conversion. Let’s say, down the road, something comes up. You want to buy a new car, and let’s say your IRAs is the money that you tap into any time you wanted to do something like that, a major purchase or a major renovation. Well, every time you take a dollar out of your retirement account, that is going on top of the other dollars that you’re already being taxed on and could very well push you in a higher bracket and could cause extra taxes on social security. It could cause extra premiums on your Medicare, whereas, had we converted everything by the time you retire – or even during retirement – now, let’s say you need 50,000 for a new car. Well, it’s not affecting my brackets. It’s not creating extra taxes on social security. It’s not creating all of these other problems because the taxes are already paid. Well, the other thing is – what if we needed to move some money? We want to gift some money to the kids. Well, one thing that keeps a lot of people from making any gifts is, if they take money out of their retirement accounts, they have this big tax burden to pay. Wouldn’t it be nice to know that the money that you have is yours, and there’s not a tax lien on it? Another consideration is, a lot of people like to save for a rainy, and those IRAs, depending on the state you live, are creditor-protected. One of the best places to keep money when you don’t need it, because if you are to get in a car accident and get sued, whatever – you’ve got to check the state laws on this, but most states have creditor protection for IRAs, including Roth IRAs. Well, if I don’t have to take money out and I don’t need the money out, the money stays in that position of being creditor-protected. In addition to that, it’s also tax-protected because I’m not going to pay any taxes on it.

Now, one of the rule changes that happened recently is that when we leave our money to a nonspousal beneficiary – that’s a fancy way of saying kids or grandkids or nieces and nephews – they don’t get to just roll it over like a spouse can. They have to take the money out in 10 years or less, so they have to get all the money out. Now, there were proposals to make it five years, in some cases making it a lump sum. The handwriting’s on the wall. They want to push this money out quicker and quicker. Well, if you’re in a traditional IRA, and let’s say you have a million dollars and one beneficiary in your retirement accounts, that means whoever your beneficiary is has to take out that full million dollars within 10 years. Now, even if they average it out, $100,000 a year per year, that’s going to probably affect them tax-wise, pretty significantly. However, if during your lifetime, you’re able to get everything converted, you get to make a decision as to convert or not to convert each and every year, where a beneficiary doesn’t have a choice. They’ve got a 10-year window. It all has to come out. If you have large amounts in your IRAs, kicking the can down the road is subjecting you to the risk of higher taxes in the future and maybe a more accelerated pulling of that money more so than makes sense than if we could just kind of plan on it.

The moral of the story is, talk to your financial professional. Talk to your tax professional. Do an analysis. Don’t make a decision one time at a snapshot in time that Roth conversions are not for you or Roth conversions are for you. If you have traditional retirement accounts, you owe it to yourself to understand the consequences of a Roth conversion and, more importantly, the consequences of kicking the can down the road and ignoring it. We are in unprecedented times. Our government is in more debt than it ever has been. Our deficit spending is higher than it’s ever been, and I think we’re being kind of – burying our heads in the sand if we don’t think tax rates will be higher in the future. Taxes probably have the biggest impact on your retirement, more so than rates of return and ups and downs in the market, in my humble opinion, because it’s always a drag on your investments. If we can figure out a plan or a strategy to minimize the impact of taxes, that just means there’s going to be more money left in your retirement for you and more money to leave your family when you’re done with it for yourself.

Consider doing a Roth conversion. Consider taking advantage of the fact that it’s even available. One other thing is, with proposed legislation, they have talked about shutting the door on Roth conversions or limited the ability for people to do Roth conversions, and there’s been proposals to reduce or eliminate the ability to contribute to Roths. Now, my hope is that Roths will be there forever, but that’s the one constant for sure that we have – is nothing’s for sure, and right now, it’s about as good as it gets. There’s not too many opportunities to shelter our money completely from taxes, and Roths are one of them. Make sure you’re sitting down and figuring that out. Set an appointment with your investment professional today and determine whether or not a Roth conversion is right for you.

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The views expressed are not necessarily the opinion of the Advisor or their broker dealer and should not be construed directly or indirectly, as an offer to buy or sell any securities mentioned herein. Individual circumstances vary. Investing is subject to risks including loss of principal invested. No strategy can assure a profit against loss. Due to volatility within the markets mentioned, opinions are subject to change without notice. Information is based on sources believed to be reliable; however, their accuracy or completeness cannot be guaranteed.

To qualify for the tax free penalty free withdrawal of earnings, a Roth IRA must be in place for at least five tax years, and the distribution must take place after age 591/2 or due to death, disability, or a first time home purchase (up to $10,000 lifetime maximum). Before taking any specific action, be sure to consult with your tax professional.