

# Roth Conversion Guide

## Strategic Decisions for Managing Retirement Taxes

### What Is a Roth Conversion?

A Roth conversion moves money from a pre-tax retirement account (traditional IRA, 401(k), or similar) into a Roth IRA. The amount you convert becomes taxable income in the year you convert it, but once in the Roth account, it grows tax-free and future withdrawals are tax-free as well.

Unlike Roth IRA contributions, which have income limits and annual caps, Roth conversions have no income restrictions and no limit on how much you can convert. This makes conversions a powerful planning tool, especially for people in their 50s and 60s who are thinking strategically about retirement taxes.

The key question is not whether Roth conversions are good or bad in general, but whether they make sense for your specific situation. The answer depends on your income, tax bracket, timeline, and how the conversion fits into your broader retirement plan.

### When Roth Conversions Work Well (And When They Don't)

Roth conversions are not universally beneficial. They work well in specific situations and poorly in others. Understanding the difference is critical to making a good decision.

Good Fit for Roth Conversions	Poor Fit for Roth Conversions
<b>Low-Income Years</b> You're in a temporarily low tax bracket (early retirement, between jobs, business down year)	<b>High-Income Years</b> You're still working full-time or have high income from other sources
<b>Future RMD Concerns</b> Large pre-tax balances that will create substantial Required Minimum Distributions starting at age 75	<b>Small Pre-Tax Balances</b> Modest IRA/401(k) balances where future RMDs won't be a problem
<b>Long Time Horizon</b> You're 10+ years from needing the money, allowing tax-free growth to compound	<b>Short Time Horizon</b> You need the converted funds within a few years
<b>Cash to Pay Taxes</b> Sufficient cash reserves to pay conversion taxes without touching the converted amount	<b>No Cash Reserves</b> Would need to withhold taxes from the conversion itself (especially problematic if under age 59½)

<b>Estate Planning Goals</b> Want to leave tax-free assets to heirs who will be in high tax brackets	<b>Plan to Spend It All</b> Intend to use all retirement assets during your lifetime
<b>Below Income Thresholds</b> Conversion won't push you over Medicare IRMAA thresholds or affect ACA subsidies	<b>Near Key Thresholds</b> Conversion would trigger higher Medicare premiums or eliminate health insurance subsidies
<b>Balanced Tax Diversification</b> Currently heavy in pre-tax accounts, want flexibility with both pre-tax and Roth assets	<b>Already Diversified</b> Already have substantial Roth assets and good tax diversification

**Important:** Most people's situations include factors from both columns. The goal is to understand which factors dominate in your specific case.

## Real-World Scenarios

Looking at specific examples helps illustrate when conversions work well and when they don't.

### Scenario 1: Early Retirement Window (Good Fit)

**Tom, age 62, recently retired from the Pipe Trades. His situation:**

- \$600,000 in traditional IRA
- Plans to delay Social Security until 67
- Pension of \$3,000/month starting now
- Married, filing jointly
- \$75,000 in cash savings

**The Opportunity:** For the next five years (until Social Security starts), Tom's taxable income is just his pension (\$36,000/year). This puts him well into the 12% federal tax bracket with room to spare before hitting 22%.

**The Strategy:** Convert enough each year to fill up the 12% bracket (approximately \$95,000 for married filing jointly in 2025). This means converting roughly \$60,000 per year, paying about \$7,200 in federal taxes from cash savings.

**The Benefit:** Over five years, Tom converts \$300,000 at low rates. When RMDs start at 75, his IRA balance is much smaller, keeping him in lower brackets and reducing taxes on Social Security benefits.

### Scenario 2: High-Income Working Years (Poor Fit)

**Sarah, age 58, still working full-time. Her situation:**

- \$450,000 in traditional IRA
- Salary of \$95,000

- Spouse earns \$65,000
- Combined income: \$160,000, solidly in the 22% bracket

**The Problem:** Any Roth conversion would be taxed at 22% federal (plus state taxes). If Sarah converts \$50,000, she'd pay \$11,000+ in federal taxes alone.

**Better Approach:** Wait until retirement when income drops. If Sarah retires at 62 with just a pension, she could convert at 12% instead of 22%, potentially saving thousands in taxes on the same conversion amount.

### Scenario 3: Medicare Premium Spike (Poor Fit)

**Mike and Linda, both 64, considering a large conversion:**

- Combined income of \$195,000 (just under the first IRMAA threshold)
- Want to convert \$100,000 from Mike's IRA
- Both will be on Medicare next year

**The Problem:** A \$100,000 conversion pushes their income to \$295,000, triggering higher Medicare Part B and D premiums (IRMAA surcharges) two years later. The surcharge could be \$3,000+ per person annually for multiple years.

**Better Approach:** Either convert smaller amounts to stay under IRMAA thresholds, or time the conversion for a year when the premium impact is less significant.

## How Much Should You Convert?

If you've determined that Roth conversions make sense for your situation, the next question is how much to convert. There's no universal answer, but there are strategic approaches.

### Strategy 1: Fill Up Your Tax Bracket

The most common approach is converting enough to reach the top of your current tax bracket without spilling into the next higher bracket.

**Example:** If you're married filing jointly with \$50,000 in taxable income, the 12% bracket extends to approximately \$95,000 (2025 estimate). You could convert about \$45,000 while staying in the 12% bracket.

This strategy works well during low-income years (early retirement, gap years between jobs, years with business losses).

### Strategy 2: Stay Below Key Thresholds

Sometimes the right amount is determined by important income thresholds rather than tax brackets:

- **Medicare IRMAA thresholds:** For 2025, surcharges begin at \$206,000 (married) and \$103,000 (single)
- **ACA subsidy cliff:** If you're under 65 and using marketplace insurance, income thresholds matter significantly
- **Social Security taxation:** Higher income can cause more of your Social Security to be taxed

### Strategy 3: Multi-Year Planning

Rather than one large conversion, spreading conversions over multiple years often makes more sense:

- Keeps you in lower brackets each year
- Provides flexibility to adjust based on changing circumstances
- Reduces risk of a single bad conversion decision
- Allows you to respond to tax law changes

**Example:** Instead of converting \$200,000 in one year at 22-24%, convert \$40,000 per year for five years at 12%. Total tax savings could be \$20,000 or more.

The ideal conversion window is often the years between retirement and when Social Security starts, or between Social Security starting and RMDs beginning at age 75.

### How to Pay the Taxes: Pure vs. Net Conversions

Once you've decided to convert, you need to decide how to pay the resulting taxes. This choice has significant long-term implications.

#### Pure Conversion (Pay Taxes from Outside Sources)

With a pure conversion, you pay the taxes from cash savings or other non-retirement accounts. The entire converted amount moves to the Roth IRA.

**Example:** Convert \$50,000. Pay \$6,000 in taxes from checking account. Full \$50,000 goes into Roth IRA.

##### Advantages:

- Maximizes the amount growing tax-free
- Over time, this can result in significantly more wealth
- More efficient tax treatment (you're effectively moving more money into tax-advantaged space)

##### Requirements:

- Sufficient cash reserves or taxable investment accounts
- Willingness to reduce liquid savings to fund the tax bill

#### Net Conversion (Withhold Taxes from Conversion)

With a net conversion, taxes are withheld from the amount being converted. Only the remaining balance goes into the Roth IRA.

**Example:** Convert \$50,000. Withhold \$6,000 for taxes. Only \$44,000 goes into Roth IRA.

##### Advantages:

- Simpler process
- Doesn't require cash reserves

- Can still be beneficial despite being less efficient

#### **Disadvantages:**

- Less money compounds tax-free
- **If you're under 59½:** The withheld amount may be subject to a 10% early withdrawal penalty unless you qualify for an exception
- Reduces the immediate impact of the conversion

**Important for people under 59½:** If you withhold taxes from a conversion before age 59½, that withheld amount is treated as a distribution and typically subject to a 10% penalty. This makes pure conversions significantly more attractive for people in their 50s.

## **Building a Multi-Year Conversion Strategy**

The most effective conversion strategies usually unfold over several years, not in a single tax year.

### **The Ideal Conversion Window**

For most people, there are two prime windows for Roth conversions:

#### **Window 1: Early Retirement to Social Security**

If you retire at 62 but delay Social Security until 67 or 70, you have a golden window. During these years, your income is just your pension (and possibly some part-time work or other income). This often creates your lowest-income years in decades.

**Example:** Retire at 62 with \$40,000 pension. Delay Social Security until 70. Convert \$50,000/year during ages 62-69, staying in low brackets. By age 70, you've moved \$400,000 to Roth at favorable rates.

#### **Window 2: Social Security to RMDs**

Even after Social Security starts, you have time before RMDs begin at age 75. If your combined income from pension and Social Security is moderate, you may still have room to convert strategically.

**Example:** At 70, Social Security starts at \$30,000/year, pension at \$40,000/year. Total: \$70,000. You could still convert \$25,000 annually without jumping brackets, gradually reducing future RMDs.

### **Annual Review and Adjustment**

A multi-year strategy requires annual evaluation:

- Review your income for the year
- Calculate how much room you have in your current bracket
- Check if any thresholds (Medicare, ACA) are relevant
- Decide on that year's conversion amount
- Execute the conversion before December 31

This flexible approach lets you adapt to changes in income, tax laws, and personal circumstances while steadily building your Roth balance.

## Integration with Other Retirement Decisions

Roth conversions don't happen in isolation. They interact with nearly every other retirement planning decision you make.

### Social Security Timing

When you claim Social Security directly affects your conversion strategy:

- **Early claiming (62-65):** Adds taxable income sooner, reducing conversion room
- **Delayed claiming (67-70):** Creates larger conversion window in your 60s when income is lower
- **Strategic coordination:** Sometimes delaying Social Security specifically to enable more conversions makes sense

### Pension Decisions

Your pension election affects conversion capacity:

- **Higher pension payment:** More taxable income, less room for conversions
- **Lower pension payment:** More conversion room but may need IRA distributions for living expenses (which works against conversion goals)
- The balance matters: you need enough guaranteed income to live on while keeping taxable income low enough to convert efficiently

### Required Minimum Distributions

Roth conversions before RMDs begin can significantly reduce your future required distributions:

**Example:** \$600,000 IRA at age 75 requires roughly \$25,000 minimum distribution. Convert \$300,000 between ages 62-74, and your RMD drops to about \$12,500, keeping you in lower brackets.

Lower RMDs also mean less of your Social Security gets taxed, creating a compound benefit.

### State Tax Considerations

For Minnesota residents, state income tax adds approximately 5-10% to conversion costs depending on your bracket. This doesn't usually change the conversion decision, but it affects the math.

**Planning consideration:** If you're considering moving to a no-income-tax state in retirement, timing conversions around that move could save thousands in state taxes.

### Common Roth Conversion Mistakes

- **Converting during high-income years** just because you can, without considering whether you should wait for lower-income years

- **Doing one massive conversion** instead of spreading it over multiple years at lower rates
- **Forgetting about Medicare IRMAA thresholds** and inadvertently triggering premium surcharges
- **Withholding taxes from the conversion** when under age 59½, creating unnecessary penalties
- **Not having a multi-year plan** and making ad-hoc decisions year by year
- **Converting without considering the 5-year rule** for penalty-free withdrawals of converted amounts before age 59½
- **Making conversions in isolation** without coordinating with Social Security, pension, and other income decisions
- **Assuming conversion is always beneficial** without running actual projections comparing conversion vs. no conversion scenarios

## Evaluating Whether Conversions Make Sense for You

### Start with These Questions

- What's your current tax bracket, and what do you expect it to be in retirement?
- How large are your pre-tax retirement account balances?
- When do you plan to retire, claim Social Security, and start taking distributions?
- Do you have cash reserves to pay conversion taxes without withdrawing from retirement accounts?
- How long until you need the money you're considering converting?
- Are there estate planning considerations (leaving assets to heirs in high tax brackets)?

### When Professional Guidance Helps

Roth conversion planning benefits from professional analysis when:

- You have substantial pre-tax retirement balances and need to determine optimal conversion amounts
- You're near Medicare IRMAA thresholds or using ACA insurance
- You need to coordinate conversions with Social Security timing and pension decisions
- You want projections showing the long-term tax impact of conversion vs. no conversion
- You're building a multi-year strategy and need annual guidance on conversion amounts

An advisor who specializes in retirement tax planning can model different scenarios, show you the numbers, and help you build a conversion strategy that integrates with your complete retirement plan.

## Roth Conversion Planning Worksheet

Use this worksheet to organize information and begin thinking through whether Roth conversions fit your situation.

### Current Situation

Age: \_\_\_\_\_ Spouse age: \_\_\_\_\_

Current employment status: \_\_\_\_\_

Current tax filing status: \_\_\_\_\_

Estimated federal tax bracket: \_\_\_\_\_ State bracket: \_\_\_\_\_

### Retirement Account Balances

Traditional IRA: \$\_\_\_\_\_

401(k)/403(b): \$\_\_\_\_\_

Roth IRA: \$\_\_\_\_\_

Roth 401(k): \$\_\_\_\_\_

Total pre-tax retirement accounts: \$\_\_\_\_\_

### Income Sources

Current employment income: \$\_\_\_\_\_

Pension (current or expected): \$\_\_\_\_\_ /month

Social Security (when planning to claim): Age \_\_\_\_ Amount: \$\_\_\_\_\_ /month

Other income: \_\_\_\_\_

### Conversion Capacity

Cash/taxable investment accounts available to pay taxes: \$\_\_\_\_\_

How much room in current tax bracket before jumping to next bracket: \$\_\_\_\_\_

Years until RMDs begin: \_\_\_\_\_

### Threshold Considerations

Currently on Medicare?  Yes  No If yes, current MAGI: \$\_\_\_\_\_

Using ACA marketplace insurance?  Yes  No

Distance to next IRMAA threshold: \$\_\_\_\_\_

### Conversion Window Analysis

Expected retirement date: \_\_\_\_\_

Expected Social Security claiming age: \_\_\_\_\_

Years between retirement and Social Security: \_\_\_\_\_

Years between Social Security and RMDs: \_\_\_\_\_

### **Initial Assessment**

Based on this worksheet, do Roth conversions seem like a good fit?

- Yes, strong fit
- Maybe, need more analysis
- No, probably not beneficial
- Unsure, need professional guidance

Notes and questions:

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## Important Disclosure

This guide is provided for educational and informational purposes only. It does not constitute investment advice, tax advice, legal advice, or a recommendation to engage in any particular investment strategy.

Tax laws are complex and subject to change. The scenarios and examples presented in this guide are hypothetical and for illustrative purposes only. Your individual circumstances may differ significantly, and what works well for one person may not be appropriate for another.

Roth conversions create immediate tax liability. The long-term benefits depend on many factors including future tax rates, investment returns, time horizon, and personal circumstances. There is no guarantee that a Roth conversion will reduce your lifetime tax burden.

Before making any Roth conversion decision, consult with qualified tax and financial professionals who can analyze your specific situation, run projections based on your actual numbers, and provide personalized guidance.

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