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Roth IRA Strategies

Depending on your financial circumstances and tax bracket, you may decide that a Roth IRA would be a better retirement savings vehicle than a Traditional IRA. There are several ways to fund a Roth IRA including direct contributions, initiating a Roth conversion or the Backdoor Roth IRA strategy. However, there are a few considerations to discuss with your tax and financial advisors before engaging in any of these options.

EVALUATING A ROTH CONVERSION

A Roth conversion allows you to convert Traditional IRA assets into Roth IRA assets. Determining the most appropriate mix of these pre-tax and post-tax assets can be complicated. It would help if you weighed the advantages and potential drawbacks before making a final decision.

POTENTIAL ADVANTAGES:

- Qualified withdrawals from a Roth IRA are tax-free. If you anticipate being in a higher tax bracket in the future, it could be financially beneficial to incur the tax liability now and receive tax-free withdrawals during retirement.
- Required Minimum Distributions (RMDs) are not required from Roth IRAs.
- Roth IRA beneficiaries receive distributions tax-free, whereas distributions from an inherited Traditional IRA would be taxable.
- Qualified distributions from a Roth IRA are not counted in determining the taxable portion of your Social Security benefits.
- You can do a partial conversion in an amount that takes you to the top of your existing income tax bracket but does not push you up into the next bracket. Your CPA can help you determine the appropriate amount annually.

POTENTIAL DRAWBACKS:

- If you do not have funds to pay the tax liability outside of the IRA, you will be depleting your retirement savings and the Roth IRA will need significant market growth to return to the value of the Traditional IRA.
- In general, distributions are considered qualified if the account owner is over age 59 ½ and the Roth IRA has been established for at least 5 years. **Note – there is a new 5-year clock for each conversion.** Distributions occur in the following order: contributions, conversions on a first-in-first-out basis and then earnings.
- Your tax bracket could be lower in retirement than it is today.

OTHER CONSIDERATIONS:

- Some states do not extend the same creditor protection to Roth IRAs as they do to Traditional IRAs.
- The SECURE Act of 2019 changed the distribution rules for inherited IRAs (Roth and Traditional) and qualified retirement plans by eliminating the stretch provision for many non-spouse beneficiaries. Under the SECURE Act, most non-spouse beneficiaries are required to distribute the entire balance of the inherited account within 10 years of the death of the account owner. In 2022, the IRS also issued proposed regulations regarding these new distribution rules which require beneficiaries to take annual RMDs in years 1 to 9 and the remaining balance in year 10, provided the owner had already passed their required beginning date for RMDs. Thus, if the account owner had begun taking RMDs then the beneficiary is required to continue taking RMDs. Keep in mind this guidance doesn't apply to beneficiaries of Roth IRAs. However, non-spouse beneficiaries may still need to distribute all the funds within the 10-year window.
- The IRS has announced that it will waive the 50% penalty for beneficiaries who didn't take 2021, 2022 and 2023 RMDs as required under the proposed regulations. This effectively eliminates RMD requirements for those years. Please note, the guidelines don't affect regular RMDs, eligible designated beneficiaries or heirs who inherited retirement accounts before 2020.

ROTH IRA CONTRIBUTIONS

If you have a Roth IRA or have established one through a Roth conversion, you might be eligible to make annual contributions. For 2024, the contribution limit is $7,000 ($8,000 for individuals age 50 or older). You must have earned income in order to contribute. If you file married filing jointly and have enough earned income, you can also make a Roth IRA contribution on behalf of your non-working spouse. These are known as spousal Roth IRA contributions. In addition, the following phase-out limits apply for 2024:

If your filing status is…	And your modified AGI is…	Then you can contribute…
Married Filing jointly or qualifying widow(er)	< $230,000	Up to the limit
	≥ $230,000 but < $240,000	A reduced amount
	≥ $240,000	Zero
Single or head of household	< $146,000	Up to the limit
	≥ $146,000 but < $161,000	A reduced amount
	≥ $161,000	Zero
Married filing separately	< $10,000	A reduced amount
	≥ $10,000	Zero

BACKDOOR ROTH IRA STRATEGY

Entering retirement with both pre-tax and post-tax funds provides you with additional financial flexibility and the ability to manage your tax bracket from year to year. Due to your income, you may not be eligible to make direct contributions to a Roth IRA. At the same time, your Traditional IRA contributions may not be eligible for an income tax deduction. Utilizing the Backdoor Roth IRA strategy could be a solution for increasing your retirement savings.

This strategy begins with non-deductible contributions made to a Traditional IRA. The Traditional IRA is then converted to a Roth IRA. Since the Traditional IRA is holding after-tax dollars, there is no tax due on the Roth conversion. One caveat to this strategy is that you cannot have any other IRA accounts. This includes Traditional, SEP and SIMPLE IRAs. There is an aggregation rule that looks at all of an individual's IRA assets and determines the percentage mix of pre-tax and post-tax contributions and applies that ratio to the Roth conversion. To take full advantage of this strategy, you will need to start with only one IRA with a zero balance. If you have additional IRA accounts, you could consider rolling them into your qualified retirement plan, if allowable.

There is a specific tax form (form 8606) that must be filed when utilizing this strategy. We recommend working with a tax professional to ensure this filing is done correctly. If it isn't, you will pay taxes twice on the Backdoor Roth IRA contribution.