

WHY YOU MIGHT CONSIDER A ROTH CONVERSION

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With the trend toward changing jobs every few years now, chances are you've already changed workplaces more often than your parents or grandparents did during their entire lifetime. And the odds are pretty good you left a 401(k) or other retirement plan behind when you switched employers, thinking you would "deal with it later."

The problem is most Americans don't deal with it until they have to — they tend to delay transferring their funds and find themselves juggling a number of different workplace retirement accounts during their working years. Because there's no instant portability or universality when it comes to transferring 401(k) and other retirement plans, they're left with the headaches of keeping tabs on multiple accounts in a number of locations, often spread across the country.

If this sounds all too familiar, it may be time to consider consolidating your multiple accounts into a Roth IRA (Individual Retirement Account).

Let's take a closer look at some of the key considerations that might influence your decision.

WHY CONVERT YOUR ACCOUNTS TO A ROTH IRA?

If you haven't considered including a Roth IRA in your retirement planning process, perhaps now is an opportune time to do so. The recent tax law changes and volatile market conditions may make a Roth IRA even more attractive for your retirement planning.* With the lure of tax-free distributions, Roth IRAs have become increasingly popular retirement savings vehicles.

You can convert your eligible retirement assets to a Roth IRA regardless of your income level or marital status. While Roth IRAs can be attractive retirement planning tools under the right circumstances, there are important considerations you should take into account before converting to ensure it's the right move for you. Creating a tax-free source of income is tempting, but first it's important to talk with your tax professional and advisor regarding your personal financial situation.

CONSIDERATIONS BEFORE CONVERSION

Do you have funds available to pay the conversion tax? When you convert eligible assets to a Roth IRA, you pay taxes on the accumulated earnings and contributions that you took tax deductions on in previous years. Taxes created by the Roth conversion should be paid with after-tax assets, if possible. Using the IRA or other pre-tax assets to foot the tax bill will only increase your taxable income and reduce the amount of money ultimately funding

IRAS PLAY AN INCREASINGLY IMPORTANT ROLE IN SAVING FOR RETIREMENT¹

With \$9.7 trillion in assets at the end of the second quarter of 2019, individual retirement accounts (IRAs) represented 33 percent of U.S. total retirement market assets, compared with 23 percent two decades ago.

In mid-2019, 36.1 million U.S. households owned traditional IRAs (the oldest and most common type of IRA). Roth IRAs, which were first available in 1998, are the second most frequently owned type of IRA, held by 24.9 million U.S. households.

the Roth IRA. This is because the distribution for the tax payment, is itself subject to taxes. The larger the conversion and the higher your tax bracket, the greater the need for access to cash to pay the tax bill.

How much time do you have before you take distributions? The more time you have before distributions, the more favorable a conversion. Because Roth IRAs grow tax-deferred and the growth is never taxed when withdrawn, the power of compounding tax-free may outweigh the immediate cost of paying tax up front. Roth IRAs are not subject to minimum distribution rules until they are passed to a non-spouse beneficiary, so withdrawals can be completely discretionary during retirement.

What's your tax liability? Similar or higher future income tax rates can favor a conversion. Ideally, you would want to know the tax you would pay when making a future distribution had you not converted, versus what you will pay in the year of conversion. That's impossible to know because the tax you pay in the future will depend not only on tax rates but also on your entire financial picture in retirement—your sources of income and deductions. If you're in your prime earning years today and you truly expect your tax rate to go down dramatically in retirement, consider holding off on a conversion until you hit those low tax years. When the time comes, work with your advisor on how much could be converted while keeping you in a relatively low income tax bracket.

Is the majority of your retirement savings in tax-deferred accounts? The decline of the traditional pension plan has shifted the retirement savings burden from employer to employee. As a result, many employees are accumulating the bulk of their retirement stash in tax-deferred retirement plans. A Roth conversion with at least a portion of those assets may offer you more flexibility down the road to meet lifestyle and estate planning objectives without triggering income taxes with every withdrawal. You're in essence diversifying the tax attributes of your retirement resources.

Do you want to leave your IRA as an inheritance? With the passage of the SECURE Act, children and other non-spouse beneficiaries generally no longer have the option of stretching the distributions from an IRA or Roth IRA over their lifetime, they must now distribute the assets within 10 years. Because the distributions must be made over a much shorter period of time, this can translate to higher taxes owed by the beneficiary. When the tax on the converted Roth amount is paid, you have made a tax-free gift of future growth. The value is driven by how the account is allowed to grow both in your hands and in the hands of your heirs.

COMPLETING THE CONVERSION

If you determine a conversion is right for you, the process is relatively simple. You start by notifying your existing traditional IRA trustee or custodian that you want to convert all, or part of your traditional IRA to a Roth IRA, and the financial institution will provide you with the necessary paperwork. You can also open a new Roth IRA at a different financial institution and then have the funds in your traditional IRA transferred directly to your new Roth IRA. The trustee or custodian of your new Roth IRA can provide you the necessary paperwork.

IS A ROTH IRA CONVERSION RIGHT FOR YOU?

Determining whether a Roth conversion is right for you depends on many factors, including your current and projected future income tax rates, the length of time you can leave the funds in the Roth IRA without taking withdrawals, and how you'll pay the income taxes due at the time of conversion.

Contact Commerce Trust Company today—we can help you evaluate your personal financial situation, explore your options, and determine if a conversion should be part of your retirement and estate planning strategies.

* Consult your tax advisor

¹ Source: Holden, Sarah, and Daniel Schrass. 2019. “The Role of IRAs in US Households’ Savings for Retirement, 2019.” ICI Research Perspective 25, no. 10 (December). Available at www.ici.org/pdf/per25-10_data.pdf.

² Source: Internal Revenue Service, “IRA FAQs—Rollovers and Roth Conversions” and Publication 590-A, <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-iras-rollovers-and-roth-conversions>. Page last reviewed or updated: 12-January-2021.

The opinions and other information in the commentary are provided as of March 30, 2021. This summary is intended to provide general information only, and may be of value to the reader and audience.

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Andy is a private client advisor for Commerce Trust Company. He serves as a consultant and relationship manager providing clients with personalized objective advice and oversight across all of our services, including trust administration, financial advisory services, private banking, and investment management. Andy facilitates all aspects of relationship management for the client team, including administering complex trusts, maintaining client communication, and coordinating with internal and external partners to deliver a superior client experience. He joined Commerce in 2016 with ten years of industry experience. Andy received his bachelor of science degree in finance/economics and MBA with a concentration in finance from Rockhurst University. He has achieved the designations of Certified Trust and Financial Advisor and CERTIFIED FINANCIAL PLANNER™. Andy is a member of St. Ambrose Catholic Church and the Crusaders Club at St. Ambrose.



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