STRATEGIC ROTH CONVERSIONS

Strategic Roth Conversions: Maximing Your Retirement Legacy

For many diligent savers, retirement is not only about freedom and fulfillment—it's also about protecting and preserving what you've built. Yet, even the most disciplined planners often overlook a silent threat to their retirement and legacy: future taxes on retirement accounts.

Recent changes from the SECURE Act and SECURE 2.0 have amplified the importance of proactive tax planning. Non-spousal beneficiaries—most often adult children—are now required to withdraw inherited IRA assets within ten years. This accelerated distribution can push heirs into higher tax brackets during their peak earning years, creating a potential "tax tsunami."

A Roth conversion can help you get ahead of this problem—turning what could be a tax burden into a wealth transfer opportunity.

The RMD Tax Challenge

Traditional IRAs and 401(k)s grow tax-deferred, but withdrawals are fully taxable. Starting at age 73 and at age 75 for those born after 1960, Required Minimum Distributions (RMDs) must begin—often forcing retirees into higher tax brackets, even if they don't need the income.

Many retirees discover too late that these required distributions can increase their marginal tax rate, trigger taxation of Social Security and Medicare benefits, and create significant tax obligations for heirs under the 10-year withdrawal rule.

The Strategic Advantage of Roth Conversions

A Roth conversion means voluntarily paying taxes now—often at today's historically low rates—to avoid larger future taxes. Key advantages include:

- Tax-Free Growth and Withdrawals
- No RMDs for Original Owners
- Estate Efficiency
- Flexibility and Control
- Protection Against Rising Taxes
- Mitigation of the "Widow's Penalty" (which can greatly impact a survivors tax burden)

Your "Tax Valley" Opportunity

Many retirees face a "tax valley"—a window between retirement and the start of RMDs or full Social Security benefits—when taxable income is relatively low. This is an ideal time to perform partial Roth conversions to fill up lower tax brackets before RMDs begin.

Next Steps: Personalizing Your Roth Strategy

Every conversion should be customized. The ideal approach depends on income, account balances, and legacy goals. A personalized analysis can help you model potential lifetime tax savings, identify optimal conversion timing, and coordinate with your CPA or estate planner.

At Isthmus Partners, we believe in proactive, strategic planning. The Roth conversion opportunity is time-sensitive—tax laws and rates can change. Acting now could enhance your after-tax wealth and the legacy you leave for the next generation.

Let's explore how a strategic Roth conversion can work for you.

608.729.0949
ISTHMUSPARTNERSLLC.COM

Case Study: Bill & Mary

Bill and Mary, both age 67, recently retired. Their current financial snapshot looks like this:

- **Net Worth**: $6.5 million
- **Retirement Accounts** (IRA/401(k)): $3.13 million
- **Annual Spending**: $100,000 (met through Social Security and non-qualified investments)

They expect to live comfortably from Social Security and investment income without touching their IRAs until RMDs begin at 73.

The Projected RMD Tax Tsunami

By age 73, their retirement accounts are projected to be nearly $4 million. Their first RMD will be over $150,000—doubling their federal tax bracket from 12% to 24%.

The Solution: Roth Conversions

The core strategy is to pay some of this future tax burden now - while they are still in a lower tax bracket - through a Roth IRA conversion. This lessens the eventual tax impact for both their life and their heirs. They implemented a strategic Roth conversion plan, gradually converting portions of their IRA while in a lower tax bracket. Let's take a look at the powerful difference Roth conversions make for Bill and Mary (projected values at the end of their plan) in the table below.

The Impact of Shifting Assets

The most vital aspect of these numbers is the substantial shift of assets from taxable and qualified accounts into Roth.

- Heirs Benefit: While some qualified assets will likely still pass to the next generation subject to the 10-year RMD rule and associated taxes, the over $6.5 million in Roth assets, though still subject to the 10-year distribution period for heirs, will be distributed completely free of tax.
- Increased Net Worth: The conversion strategy results in an overall increase in total asset value of $737,137. This gain is due to the tax-free growth and distribution of the Roth funds.
- Current Tax Relief: By proactively paying taxes upfront on converted amounts, Bill and Mary significantly reduce their qualified assets, which, in turn, lowers their future RMDs and the resulting tax burden during their own lifetimes.

Key Takeaway

Bill and Mary mitigated future RMD-driven tax burdens for themselves and their beneficiaries, leaving a larger, more tax-efficient legacy. This strategy also provides greater flexibility in managing retirement income, as Roth distributions are typically tax-free.

CASE STUDY: RESULTS OF THEIR STRATEGY OVER TIME/END OF PLAN

Asset Category	With Roth Conversions	Without Conversions	Impact
Taxable Assets	$1,220,486	$4,891,687	−$3.67M
Roth Assets	$6,560,307	$0	+$6.56M (Tax-Free)
Tax-Deferred*	$2,959,208	$2,959,208	$0
Qualified (IRA)	$2,175,387	$4,327,356	−$2.15M
Total Net Worth	$12,915,388	$12,178,251	+$737,137

**Tax-Deferred: Assets held in the cash value life insurance*

CASE STUDY: ANALYSIS ASSUMPTIONS

Taxable Assets: With Roth conversions, the taxable assets are used to pay taxes and are significantly reduced from $4,891,687 to $1,220,486. This means that a smaller portion of their total assets will be subject to taxation, leading to potential tax savings both during their lifetimes and for their heirs.

Roth Assets: The Roth assets increase from $0 to $6,560,307 with the conversion strategy. This is crucial because Roth IRA distributions, including those inherited by beneficiaries, are typically tax-free, providing a tax-efficient way to pass on wealth to the next generation as well as adding flexibility to one's own retirement income planning.

Tax-Deferred: The amount of assets held in the cash value life insurance appreciates over time and is worth $2,959,208 in either scenario at the end of the plan.

Qualified Assets: The IRA assets decrease from $4,327,356 to $2,175,387. However, by converting a portion of these assets to Roth, Bill and Mary can potentially reduce the size of their traditional IRA accounts subject to RMDs, thereby lowering their future tax liabilities.

Total Asset Values: Overall, the total asset value with Roth conversion strategies increases to $12,915,388 compared to $12,178,251 without the strategies. This indicates that by implementing Roth conversions, Bill and Mary can potentially increase their net worth and pass on more assets to their heirs.