

TOO OLD TO CONVERT? THINK AGAIN

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You may have heard how converting to a Roth IRA is a great move for younger people. This is no surprise. A younger person who converts has two big factors working in her favor. She may pay taxes on a smaller IRA balance, and she has many years to accrue tax-free earnings in her Roth IRA. But what about older people? It is a mistake to write off conversion just due to age. Older individuals should not overlook the potential tax benefits of converting later in life.

Converting Your Traditional IRA

When you convert your traditional IRA to a Roth IRA, your pre-tax traditional IRA funds will be included in your income in the year of the conversion. This will increase your income for the year of the conversion. That may, in turn, impact deductions, credits, exemptions, phase-outs, the taxation of your Social Security benefits and Medicare Part B and Part D premiums; in other words, anything on your tax return impacted by an increase in your income.

That is a tax hit for sure, but keep it in perspective. Remember, the extra income is only for the year of the conversion. The trade-off is the big tax benefit down the road. If you follow the rules for qualified Roth IRA distributions, all your Roth IRA funds, including the earnings, will be tax-free when distributed to you. Not a bad deal!

Three Questions to Ask

Thinking conversion may be the right move for you? No matter how young or old you are, you should ask yourself three questions. First, when will you need the

money? Do you need your IRA money immediately for living expenses? If so converting may not be for you. Second, what is your tax rate? If you are retired and your income is lower, that may favor conversion. The third question to ask yourself is whether you have the money to pay the tax on the conversion. It is best to pay the conversion tax from non-IRA funds.

Distributions from your Roth IRA

After you convert, your converted funds can always be distributed from your Roth IRA both tax-and penalty-free if you are over age 59 1/2. However, no matter what your age, you must wait five tax years from the year of your first Roth IRA conversion or contribution to any Roth IRA for a distribution of earnings from any Roth IRA to be tax-free. The good news is that earnings are considered the last funds distributed from your Roth IRA(s) and will never be subject to the 10% early distribution penalty if you are over age 59 ½.

Another plus of converting is the fact that you are not required to take required minimum distributions (RMDs) from your Roth IRA. If you convert your traditional IRA to a Roth IRA, you must take any RMD before converting. However, you will not have to take any more RMDs during your lifetime from your Roth IRA. For those with large IRAs and large RMDs, this could be a big tax savings.

Roth IRA Estate Planning Advantages

A Roth IRA can be a great estate planning tool. You may be thinking that converting is not for you because you don't want to pay the tax. Don't forget the big picture. In the short run there will be a tax, but in the long run, your beneficiaries will get the Roth IRA completely tax-free in most cases. Plus, because RMDs are not required during your lifetime, your Roth IRA can sit there growing tax-free for your beneficiaries who will inherit more because of this extra growth.

Roth IRA distributions to your beneficiaries are generally income tax-free, in contrast to traditional IRA distributions to beneficiaries, which are generally taxable. If your beneficiary takes a distribution from the inherited Roth IRA after five tax years from the year of your first Roth IRA conversion or contribution to any Roth IRA, the distribution will be completely income tax and penalty-free.

Should You Convert?

Should every older person with a traditional IRA convert? No, of course not. Conversion is not the best course of action for everyone. However, it should not automatically be off the table for older individuals. Age is just a number. Don't let it prevent you from exploring if you could benefit from this valuable strategy. Are you a good candidate? The best way to find out is to discuss your situation with a knowledgeable financial or tax advisor.

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