TIME FOR A STRATEGIC ROTH CONVERSION?

Recent market volatility stemming from the coronavirus pandemic has sent markets cratering. For the long-term investor, a ray of sunshine may exist. Investors who had been contemplating a Roth IRA conversion may be able to move ahead at a significantly lower tax cost.

Why Now?

The short answer is the tax cost is likely significantly less than a few months ago. Many people will have lower income in 2020 due to economic disruption possibly lowering their marginal tax brackets. The Dow Jones Industrial Average closed at 29,551 as recently as February 12 and 18,592 on March 23 – a 37% decline in just less than six weeks. Investors are rightly spooked by the unprecedented volatility. While no one knows where the bottom will be or when volatility will lessen, opportunity may exist. Many long-term retirement assets are off significantly from their market highs, which allows the overall cost of a taxable conversion to be significantly less than it was a few weeks ago. By converting when the market is depressed, a larger portion of the account can be converted for the same tax cost. As the market recovers over time, there will be more tax-free gains to capture.

Some general rules regarding a Roth conversion:

- It is likely a taxable event, and an investor will need to have the funds available—preferably outside the IRA—to pay the taxes when they come due.
- The conversion is irrevocable, meaning if asset values continue to drop, the investor cannot recharacterize and reconvert; this prohibition was enacted with the Tax Cuts and Jobs Act of 2017 (TCJA).
- Investors can choose to convert only a portion of their accounts should they want to.

An additional tax consideration for beneficiaries is in effect because of the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which mandates post-death distributions to take place over 10 years to designated beneficiaries. As a result, a Roth IRA may be a far more efficient asset to inherit compared to a traditional IRA, as it allows children of inherited IRA owners to grow the inherited Roth IRA tax-free for 10 years past the date of the death of the IRA owner. Consideration should be given to the tax situation of the IRA owner versus the beneficiary.

If now is the time to move forward with a conversion, make sure the following items are covered. If a client needs IRA money or the cash used to pay the taxes immediately for daily living expenses, converting may not be right. It is best to pay the conversion tax from non-IRA funds. Mind the tax rate: if income is lower, that may favor a conversion by arbitraging current rates versus future rates. Ultimately, this is a long-term decision based on several factors, which primarily include best guesses on tax rates, ability to pay taxes, and asset values.

Additional Information and Links

Converting an IRA Annuity to a Roth IRA

Fair Market Value

Client Brochure

Opportunity to Fund Retirement with a Roth IRA

Calculator

Should I convert to a Roth IRA Reference

If you have any questions regarding Roth conversions, please contact the Retirement Strategies Group at (800) 722-2333, ext. 3939, or email RSG@PacificLife.com.
PacificLife.com