

Why Physicians Should Consider Roth IRA Conversions

As you embark upon your medical career as a resident or new attending physician, preparing for financial independence is a top priority. Making the appropriate financial decisions now can set the stage for a professionally and financially confident future. Among these decisions, investing in retirement accounts and executing a Roth IRA conversion strategy may be appropriate for retirement income planning. This article discusses why residents and new attending physicians may want to consider a Roth IRA conversion.



UNDERSTANDING ROTH IRAs¹

First, it is helpful to understand the features of a Roth IRA. A Roth Individual Retirement Account (IRA) enables you to invest after-tax dollars and grow your investment and accumulation tax-free, which means there are no taxes on qualified withdrawals made in retirement. Roth IRAs differ from traditional IRAs and 401(k)s where contributions may be tax-deductible for the year of the contribution. In addition, traditional IRA and traditional 401(k) withdrawals during retirement are taxed as ordinary income.

Moreover, the Roth IRA does not impose required minimum distributions (RMDs) during the owner's lifetime—a feature that Traditional IRAs or 401(k)s do not offer. This feature allows more time for tax-free growth and provides additional flexibility in retirement distribution planning.

WHAT TO KNOW ABOUT ROTH IRA CONVERSIONS²

A Roth IRA conversion refers to converting assets from a traditional IRA or 401(k) to a Roth IRA. This process results in paying taxes on the converted funds now at your current income tax rate rather than later when you retire.

The idea of paying taxes now may seem unattractive to those in high-income professions such as physicians. However, due to their lower salaries, resident physicians typically fall into lower income tax brackets than their physician co-workers. Experienced physicians can also benefit from converting to a Roth IRA because they will pay lower taxes now than in the future as their income increases.

The taxable income generated by the conversion could push one into a higher tax bracket. Therefore, strategic planning and execution of the conversion are crucial to avoid landing in a significantly higher tax bracket. Physicians should work with financial and tax professionals to fully understand the tax liability of a Roth IRA conversion.

HOW TO DETERMINE IF A ROTH IRA CONVERSION IS APPROPRIATE FOR YOU

Recognize your tax bracket

Understanding the difference between your current tax bracket and the one you anticipate being in during retirement is important. If you expect to be in a higher tax bracket during your retirement years, a Roth IRA may be worth considering since it may allow you to reduce those future higher taxes. Conversely, a traditional IRA may serve you better if you anticipate being in a lower tax bracket in retirement.

Understand the conversion's tax implications

Be mindful of the fact that converting from a traditional IRA to a Roth IRA means you will owe taxes since the funds are treated as income by the IRS in the year of the conversion. A Roth IRA conversion can lead to a hefty tax bill, especially if the conversion pushes you into a higher tax bracket. Planning and performing partial conversions over several years may be appropriate to help lessen the tax burden. In addition, each conversion has a five-year waiting period before withdrawal, ensuring steady tax-free retirement income after five years.

Consider your retirement timeline

Another key consideration is how far away you are from retirement. If retirement is over a decade away, you may benefit from executing a Roth IRA conversion now. The longer your investments have to grow in a Roth account, the more beneficial it is because your earnings and withdrawals are tax-free.

Evaluate your estate planning goals

A Roth IRA can also be an appropriate strategy for estate planning. Assets in a Roth IRA can continue to grow tax-free over your lifetime, making it attractive if you intend to leave a portion of your retirement assets to heirs. Unlike traditional IRAs, Roth IRAs are not subject to RMDs, allowing the assets to grow undisturbed for beneficiaries.

Engage financial and tax professionals

Given the complexity of tax laws and the sizeable impact they can have on your financial stability, it's always advisable to seek the guidance of financial and tax professionals who specialize in serving medical professionals. The taxable income generated by the conversion could push you into a higher tax bracket. Therefore, strategic planning and execution of the conversion are crucial.

These professionals can offer personalized strategies considering your financial situation, career trajectory, and long-term goal planning. The prospect of growing your retirement savings tax-free should be considered as part of your overall financial strategy as you progress in your medical career.

In conclusion, a Roth IRA conversion can be an appropriate strategy for physicians seeking an independent financial future. However, it is not a one-size-fits-all strategy. It necessitates a meticulous evaluation of your financial situation, present tax bracket, anticipated tax bracket in retirement, retirement timeline, retirement savings, and estate planning goals.

NEED ASSISTANCE?

If you have any questions, please don't hesitate to contact me!



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ILPL Financial does not offer tax advice.

¹A Roth IRA offers tax deferral on any earnings in the account. Qualified withdrawals of earnings from the account are tax-free. Withdrawals of earnings prior to age 59 ½ or prior to the account being opened for 5 years, whichever is later, may result in a 10% IRS penalty tax. Limitations and restrictions may apply.

²Traditional IRA account owners have considerations to make before performing a Roth IRA conversion. These primarily include income tax consequences on the converted amount in the year of conversion, withdrawal limitations from a Roth IRA, and income limitations for future contributions to a Roth IRA. In addition, if you are required to take a required minimum distribution (RMD) in the year you convert, you must do so before converting to a Roth IRA.

Sources:

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