



Roth IRA | Traditional IRA

IRAs: To Convert or Not To Convert?

Is it nobler to suffer the slings and arrows of your traditional IRA?
It depends on your circumstances.

TRADITIONAL IRAs VS. ROTH IRAs

There are three main distinctions between a traditional IRA and a Roth IRA: *eligibility*, *contributions* and *withdrawal requirements*.

Eligibility. With both types of IRAs, the owner must have earned income (or have a spouse with earned income) to be eligible to contribute. With a Roth IRA, there is also a total income threshold you must remain under to be eligible to contribute. Conversely, there are no such limits with a traditional IRA – someone at any income level can contribute. (Note: If your income makes you ineligible to open a Roth IRA, you still have the option of opening a traditional IRA and then converting it to a Roth – more on that below.)

Tax Treatment. Contributions to a Roth IRA won't provide any immediate tax benefit, as contributions are never tax deductible. However, if the owner meets some basic requirements, all withdrawals from a Roth IRA can be tax-free. Contrast that to a Traditional IRA, where

contributions can be tax deductible (for those who meet specific income requirements), and withdrawals from the account are typically fully taxable.

Withdrawal Requirements. Both accounts generally allow for withdrawals of any amount once you reach age 59½, although as said above the tax treatment of withdrawals from the two accounts can be very different. Once the owner reaches age 72, Traditional IRAs are subject to the Required Minimum Distribution rules, forcing money out of the account and triggering a tax cost. There are no RMD rules related to Roth IRAs, so owners (and even their surviving spouse) can leave the money to grow tax-free as long as they want.

In some cases, income restrictions will prevent individuals from contributing to a Roth IRA or deducting a Traditional IRA contribution, but for everyone else they'll have a choice to make: Forgo an immediate tax benefit in order to have tax-free income later in life by using ►

IRAs: To Convert or Not To Convert? *continued*

the Roth IRA, or take an immediate tax deduction with the traditional IRA now knowing that future withdrawals will be taxable. In many cases, this comes down to the taxpayer's current tax situation compared to where they'll be in the future. See TABLE 1 for a more complete snapshot of the differences between the two accounts.

CONVERTING A TRADITIONAL IRA TO A ROTH IRA

For those who aren't eligible to contribute to a Roth IRA, there is still a way to take advantage of the tax-free growth those accounts offer. The Roth conversion technique allows a taxpayer to withdraw funds from a Traditional IRA in a taxable distribution, but then roll those funds into a Roth IRA, where all future growth can be tax-free. There are no income thresholds to be eligible for a conversion, but there are plenty of factors to consider before doing so.

One of the most common reasons to convert your traditional IRA to a Roth is if you determine your tax bracket in retirement will be higher than your current tax rate – say, if you've accumulated significant savings in your retirement accounts or achieve your top earnings later in your career. Other reasons to consider a Roth conversion include:

TABLE 1

Features	Traditional IRA	Roth IRA
Tax Benefits		
This year or in the future?	This year, generally	In the future
Contributions grow...	Tax-deferred	Tax-free
Contribution Rules		
Funding source	Pre- or after-tax dollars	After-tax dollars only
Maximum annual contribution (for 2022)	\$6,000	\$6,000
Over-age-50 catch-up contribution	\$1,000	\$1,000
Eligibility	Anyone with earned income (or a spouse who as earned income)	Anyone with earned income below a certain threshold, based on tax status
Age restrictions?	No	No
Withdrawals		
Penalty-free?	Yes, after age 59½	Yes, after five years and age 59½
Taxability	Yes, taxed as ordinary income	No, as long as you meet specific requirements
Required minimum distribution	Yes, starting at 72	No

Table 1. Snapshot: Traditional IRA vs. ROTH IRA. All data are for 2022.

Editor's Note: This article was originally published December 2020 and was updated August 2022 with more current information.

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Additional flexibility in retirement. Because Roth IRAs allow you to withdraw funds without increasing your tax burden and have no RMD obligations, they are less restrictive and can give you additional financial choices – including the option of staying invested in the stock market for a longer period of time. They might also provide some tax planning benefits if your other retirement assets are taxed when withdrawn.

Avoiding the IRMAA. If you are enrolled in Medicare Part B or D and your modified adjusted gross income is above a certain threshold, you pay a surcharge on top of your monthly premium. That Income-Related Monthly Adjustment Amount could cost thousands of dollars per year, but a Roth conversion can help avoid that extra cost. While withdrawals from a traditional IRA are part of your MAGI, potentially triggering an IRMAA surcharge, withdrawals from a Roth IRA are not.

A lower tax burden for your heirs. If you leave a traditional IRA to an heir, they only have 10 years to deplete it in most cases, meaning larger annual distributions that could move them to a higher tax bracket. By converting to a Roth, your heir would still have to deplete it in 10 years, but those distributions would be tax-free. Think of paying the tax on a Roth conversion as a gift to your heirs!

That said, converting a traditional IRA to a Roth IRA might not be right for everyone in every situation. For example, if you're nearing retirement and using your traditional IRA distributions to pay for living expenses, you might not have time to recoup what you would pay in additional taxes with a conversion. A Roth conversion might also not be necessary if you're using a Qualified Charitable Distribution to meet your traditional IRA's RMD requirements. The appropriateness of a Roth conversion, much like the decision to open a traditional or Roth IRA, will depend on your specific financial circumstances and goals.

Finally, there are two important factors to keep in mind if you decide to make the conversion: (1) you must pay income taxes on any pre-tax funds you convert in the year of the conversion, and (2) you can't change your mind once you convert.

Please reach out if you or anyone you know would benefit from discussing this topic further.