



## **Roth Conversions: When They Make Sense for High-Income Investors—and When They May Not [Ep. 1]**

### *Transcript*

**Note:** The transcript of this podcast was generated using an automated transcription tool for informational purposes only and may not reflect the exact wording or content discussed in the episode.

And they can invest whatever they want in that Roth IRA. We can invest as fiduciaries. At what age do we have to do required minimum distributions? How does that work in an IRA? How does that work in a Roth? Wait till the 10th year. Let it get all of those gains. Let it continue to grow tax exempt. And now the savings and taxes for you are \$1, but for your kids it could be more than doubled. (Upbeat Music)

Awesome, you ready? I'm ready. Let's do it. So today we're going to talk about Roth conversions. One of my favorite topics. I love it. So talk to me. Why would someone want to do a Roth conversion? What is a Roth conversion?

Well, first I'm a huge believer in Roth conversions, but it doesn't make sense for everybody. So, what is a Roth conversion? It's where you take assets that are in a traditional IRA, a qualified account that is tax deferred money, and you convert it over into a Roth IRA, which Roth IRAs are tax exempt. Okay. But when you convert it at the time of conversion, on that year when you convert it, you're going to pay taxes on it. And it's going to be taxed at your ordinary income tax rate, which plays a huge factor when we're calculating Roth conversions. So, there's people sometimes that ask, hey, I thought I was, I'm not allowed to make a contribution into a Roth because I make too much money. So, how's this different converting money into a Roth? Great. So, the government has a limitation on if you make too much money, then they're going to limit how much you can put into a Roth IRA in any given year, a contribution limit. However, when it comes to a Roth conversion, there is no income limitation. Warren Buffet himself could do a million-dollar conversion over into a Roth. He'd have to pay taxes, right? You're going to have to pay taxes on that million dollars or whatever your tax bracket is. And in his case, it's probably

37%. But the next question people would ask is, does it make sense? And you have to do the math. That's where financial planning comes into play because a lot of things are going to play a part into the factors of it. What are a few things that you want to look at if I'm trying to just from eyeball it, does it make sense to do a Roth conversion on myself? What are a couple of things I should be aware of? Your current age. Okay. Your current income. You know, long-term. What are the long-term goals? Because when you convert a Roth IRA, the converted amount has to be held in that Roth IRA without being touched for a minimum of five years. But since you're paying taxes on it, you want it to grow enough to make up for those taxes. And then you can get the benefit after that growth. So, there's a good break-even age and you want to do it. But then after that point, it grows tax exempt. Okay, so let's think of an example. Let's say I'm a 60-year-old guy who wants to retire in five years. Does it make sense? And I have \$2 million in an IRA. Does it make sense for me to do a Roth conversion? It depends. I want to give you some follow-up questions so I can better answer it. And so, let's say, is this 60-year-old person, they're still working five years till retirement, right? Yeah, let's say they're still working, yes. What's their income?

\$100,000. \$100,000, and they're married? They're married, yes. Okay, and how old's their spouse? Let's say they're the same age, 60 years old. Any kids? Yes, three children, all adults over the age of 21. Okay, perfect.

So, \$100,000, 60 years old. Okay, what is the main purpose of the assets, all the assets, it doesn't have to be in the part we're converting to Roth. Just, they just want to pay less taxes, that's it. They want to make as much money as possible and pay less taxes. Have they been saving well throughout their working career? Sure. Okay, so I know it's a lot of questions, but all of these things matter. You can't just give a blanket answer to anyone. So, in this case, I never want to say always or never, but in this case, I would say there's a high probability that a Roth conversion for this couple is going to make sense. Walk us through that, why? Well, a couple of things, and they're at a tricky age too, but it's a convenient age, right? They're 60 years old. At 65, Medicare kicks in. And not that we're talking about Medicare today, but just a brief little blurb on it. Medicare, you pay a certain amount of Medicare out of your social security when you turn 65. And that amount is determined by the income that you make each year. Well, IRS has a funny thing that they do a two-year look back, right? So, when you're 63, they start looking at your income on what they're going to charge you at 65.

And then depending on that income level, you may have to pay something called IRMA. IRMA. Hurricane IRMA. Hurricane IRMA. It's going to feel like that if you don't know what IRMA is before you turn 65. Because IRMA is technically a fee or penalty on your Medicare where it doubles and sometimes even triples depending on the income you make. Well, how does all of this tie into Roth conversions? Well, Roth conversions are considered ordinary income. So, depending on how much you convert, you could unknowingly jump yourself into an income level to where you get hit by IRMA for two years, every year for two years after your last conversion. Sounds confusing, I know.

But in this case, it may make sense for us to do more of a Roth conversion at 60, 61, and 62. So you don't have to do it lump sum, you can stage it. That was my next point, great, great lead. Some people may decide to do a Roth conversion all in one lump for many reasons that we could talk about. But most people will do it gradually over time after we do the math. And I always say it's important to do the math. And what's interesting about that is, you know, we've been building financial plans for 15 years now and not all financial planning software is created

equal. Only a handful of financial plans that I've ever come across have an analysis or a program in it that does the math for you bringing the future into the present for Roth conversions. So, you can show a person, not just tell them, see ink on paper, what could you save if you did a Roth conversion throughout your life expectancy or even the benefit of what it does for your heirs. Okay, I would say nine out of the last ten potential clients we've met with, we asked them about Roth conversions and nine out of ten didn't do it or were recommended not to do it by their advisor. Why do you think that is?

One of these answers is going to be speculation. But what I would tell you is knowledge is power, and you've got to do the math. Yesterday, yesterday I was talking to a potential client, and he said the former advisors they've talked to said don't do it. Now there could be, maybe they have their own reasons for it. But while we were doing the math, it made sense for them to do it. So my only, again, speculation. Why do you think? Right, it's a fine line is many advisors don't want to talk about Roth conversions for one of two reasons. One, they just don't want to run the numbers and they don't want to do the math. Two, financial advisors or wealth managers get paid on the amount of assets they manage, they hold. Well, every time a client does a Roth conversion, as we said earlier, they have to pay taxes on it. Where do they get the money to pay the taxes that year? You tell me. Probably from their accounts that the financial advisor is managing. You know, last year, you know this because we did it together. Last year at GDS we sent around \$15 million back to our clients specifically for taxes on Roth conversions that we helped promote. Because as a fee only fiduciary, it's not about what's best for our pocket. It's about what's best for the client. And we would rather give up that asset or give up that 15 million because it's better for them than try to hold it and not do what's best for our clients. Okay, thank you for sharing that. Absolutely. What about, talk to me a little bit about RMDs. So on those that aren't familiar, RMDs are required minimum distributions. At what age do we have to do required minimum distributions? How does that work in an IRA? How does that work in a Roth? What are some things we need to be aware of?

RMDs require minimum distributions. Normally the age you have to do them depends on when you were born, but normally it's between 73 and 75. So let's start with what is a required minimum distribution and why do they exist? Well, I'm going to quote a famous philosopher, Glen Smith. Sounds smart. One of his famous quotes when we talk about RMDs, required minimum distributions is, "The government looks at your traditional IRA." And let's say you don't need the funds. You're living off of a pension. You're living off of social security. And you've got a nice chunk of money in a traditional IRA, so not a Roth. And you get to 73, 74, 75, whatever age you're going to do, required minimum distributions. The government, even though you don't need the money, is going to force you to start taking those distributions out at a percentage rate every year. And to quote Mr. Glen Smith over here, they do that because it's the government's way of saying, "You've held on to your money long enough. Now you've got to start paying some taxes on it." And you're also going to pay taxes on whatever tax bracket you're in. Well, you don't need the funds. You're living off of this other income, and now you're being forced to pay taxes on it. Not fun. The other thing is if you pass away, how it gets passed to your heirs is extremely important because your heirs in a traditional IRA are going to be forced to take out required minimum distributions over a 10-year timeframe. So in that scenario I gave you, I'm a 60-year-old couple, I and my wife pass away, and we have three children. Let's say by the end of that, two million's grown to six million. They each inherit two million on their own. How are they going to take money out, each of them?

They are going to be forced to take out that money over a 10-year timeframe. They can take it-- This is for a traditional and a Roth? This is, yes. For a traditional and a Roth, they're going to be forced to take it out. But in the traditional specifically, they can take it, or traditional and a Roth specifically, they can take it out all in the first year, take it out a little at a time, wait till the 10th year. Well, when do people mainly inherit money? Normally. It's usually in their highest income earning years. Your parents are retired, they pass away. You're in the middle of life, you're earning well. So now they're being forced to take out money at their highest tax bracket probably ever.

And for money they may not even need. So, they could take it out, but the thing is if they don't need it, they're forced to take it out. They're forced to take it out. That's exactly right. Now, let's pivot back to the Roth IRA. Roth IRA, same rules apply. You have to take it out over a 10-year timeframe whether it's the first year over time or at the 10th year. So, same rules apply. But when we're talking to clients and we realize what they've inherited, if it's just a traditional IRA, they may go, when do I take it out? In some cases, it may make sense, especially if they're already at a high tax bracket, to take it all out in the first year. I'm not saying that makes sense for everybody, but why? Well, it's going to be invested. It's going to continue to grow. So that 2 million in your example, continues to grow, you're paying, let's say 37% tax rates on it. Well, now you can either pay 37% on the 2 million upfront or take it a little bit of time, but that 2 million is going to grow, maybe 3, maybe 4 million. So, you're gonna pay 37% on a higher dollar amount at a longer period of time, right? Yep, makes sense. So, you may want to rip that band-aid off and take it on the first year. What about the Roth? Remember, the reason we do Roth's is because they grow tax exempt. It's one of the only vehicles we have to shelter us from taxes in the future. So, in the sense of your kids inheriting money, if it's in a Roth, they can take it over one year or each year over 10 years. But I would say in some cases, if you can, wait till the 10th year, let it get all of those gains. Let it continue to grow tax exempt. And now the savings in taxes for you is \$1, but for your kids could be more than double. What else? Anything else? What I'm hearing you say is do the math on Roth conversions, see what makes the most sense. Most of the time it makes sense, not always, that sometimes potentially advisors maybe not recommending a Roth conversion because it's not in their best interest, although it would be in the clients.

What's the last thing you'd like to tell somebody if they're considering a Roth conversion?

What are the last couple thoughts that you wanna recap that with? The biggest thing I can tell anybody, and we already said it, is do the math. And if somebody tells you no, that it doesn't make sense, I would always say, at least let me see ink on paper. And if they don't show you that, get a second opinion, we're happy to do it. Sounds good to me. Thanks, Robert. Oh, my pleasure. I appreciate it.

Okay, so we got a couple questions that came in, Robert. First one is, can I use the money in my kids 529 plan if none of them go to college or have kids? Yes, actually, it's a great question. Whoever sent that in.

About, let's call it two years ago, something came out in SEC 2.0, which allowed individuals that had 529 funds, because one of the biggest things about 529s for anybody who doesn't know their college savings accounts that you wanna use them for your kids' college. But sometimes there's leftover money, or maybe the kid just doesn't go to college, as the question suggested. What can you do? Well, before, many years ago, when you take it out, you're hit a penalty. Not just taxes on the growth, but a 10% penalty on the dollar amount that was put in,

because the whole purpose of that is to be used, the tax advantage to be used for education. But two years ago, when SEC 2.0 came out, they said that if all assets aren't used, you can do up to \$5,000 per year for a total of, let's call it seven years, for a total of \$35,000. So, they're going to allow \$35,000 of a 529 to be moved over into a Roth IRA for your child. But the kid has to have earned income, they still have to have earned income, and they can only go up to the limit of the Roth contributions each year, which currently in 2025 is \$7,000 for anyone under 50. Okay, and they can invest whatever they want in that Roth IRA? We can invest as fiduciaries into our models and help grow the money. But if that person had an account at, you know, Fidelity, Schwab, whatever, they can invest in whatever they want in that Roth IRA. They can, yes sir. Okay.

GDS Wealth Management ("GDS") is an SEC-registered investment adviser. Registration as an investment adviser does not imply a certain level of skill or training. GDS does not provide tax or legal advice. You should contact your tax advisor, accountant, and/or attorney before making any decisions with tax and/or legal implications. This webinar contains general information that is not suitable for everyone and was prepared for informational purposes only. The examples provided are hypothetical and intended to illustrate general principles. The information presented does not take into account your specific financial situation and is not a substitute for individualized advice from a qualified professional. This webinar does not endorse any specific investment products, 401(k) plan providers, 529 plans, or financial institutions. The content is based on assumptions, theories, and principles that may not fully reflect an individual's situation. Opinions and views reflect the judgment of the authors as of the publication date and are subject to change without notice. Past performance of any investment strategy or retirement plan features is not indicative of future results. Investments and retirement plan contributions may fluctuate, and there are risks associated with all retirement plan investments, including 401(k) plans and 529 plans. This webinar does not guarantee any specific financial outcome or return from participation in any retirement plan. Any discussion of taxes or tax advantages is based on current laws, which are subject to change. Listeners should verify the latest rules and limits for the current tax year. For additional information about GDS, including its services and fees, material risks and firm's disclosures, please visit <https://www.gdswealth.com/disclosures>.