CPA Advantage 5 | Roth IRA Conversions | Transcript

Andy Bertke & Ryan Lauer

Ryan Lauer:

On the tax side, one thing that we see quite a bit for folks a lot of times we're dealing with in our 60s doing some math on this, is Roth conversions. Now it is not always a slam dunk to do a Roth conversion. Andy, just high level, what is a Roth conversion?

Andy Bertke:

The Roth conversion is when you have a regular IRA and you want to convert it into a Roth IRA. Try to enjoy all the benefits of a Roth, i.e. Not paying tax when you take that money out.

Ryan Lauer:

So basically you're choosing on your tax return to say, "Hey, if I want to convert 50,000 from a traditional or regular IRA into a Roth, you're choosing to pay that tax now, not at a future date." When it comes to those, what are the fact patterns that you see where it can make sense? Or again, is it just not easy across the board?

Andy Bertke:

Well, right off the bat, it's a very difficult decision because you're doing what you and I do as tax CPAs, self-inflicting tax. Always a big hurdle to get over. A numerous amount of things that you have to assume in order to make this work. What we use as CPAs when we have the tax hat on is there's a sweet spot. And that sweet spot is generally if that individual who wants to convert is in about the 24% tax bracket. But there again are a myriad of factors that play into that.

Ryan Lauer:

For sure. I was recently actually just dealing with somebody who I wanted to bring this idea up to them because their income was really, really low. But it would actually cause him to potentially lose his VA medical benefits, and we definitely didn't want to blow that. So it's always very, very fact specific.

I do think this is something that you hear people talk about all the time, but you have to have a very clean fact pattern. Also, it really works best if you can pay the tax with dollars outside of the IRA. And what I mean by that is, if you're trying to convert $50,000, you want to convert $50,000. Not, "I want to convert 50,000, but I really need to take 60,000 out to be able to pay that 10,000 in tax." So again, very fact specific if it makes sense.

Andy Bertke:

Yes, it can. And the problem is, is that when, as you said, had to take the tax money out of your regular IRA and convert it, you're paying tax on that. And that gets into a point where of no return, right? Having to take more and more money out to pay for the tax.

Ryan Lauer:

For sure. I mean, I think the situations where, again, you have to understand all the fact patterns. But if you're in a really low tax bracket, or if a lot of the dollars are ultimately going to go to your children and they're in a really high tax bracket, those could be a couple situations where it really makes sense to consider this.

Andy Bertke:

I think Ryan, when we were working on the client yesterday, we pulled three different conversion tape models off the internet. Same facts we put in and we got three different answers. Answers from, "Yeah, it makes sense," to, "No, that's a really bad idea." The problem in that was what? All the assumptions that that software is using. So you have to be very careful if you're going to go out on the internet, plug some numbers into a conversion model and expect to get the right answer. You're probably not going to get the right answer.

Ryan Lauer:

Yeah. Again, it's not simple. For folks that are at least 65 I believe right now, ultimately they can get a social security deduction on their tax return. Well, that gets tripped and gets knocked down if your income is so high. Well, you could be doing a Roth conversion that might bump somebody into that higher income number. Make them lose the ability to get that social security deduction, or even tax more of their social security benefits than they already are.

Andy Bertke:

Right. This is not a decision you take lightly, and there is a holistic approach to making that decision. Because as you pointed out, there are other factors outside of just making that conversion. It affects a lot of different deductions and items on your tax return as your adjusted gross income goes up.

Ryan Lauer:

Yeah. I think maybe simply putting it. Making sure you're working with the tax CPA to run those numbers to really understand if that fact pattern makes sense. Or just what's going to result by doing a Roth conversion.

Andy Bertke:

Agreed.