CONSIDER THE IMPORTANCE

A Closer Look at Roth Conversions

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As we have discussed, the SECURE Act had a significant impact on clients' retirement accounts and strategies. For clients whose retirement accounts feature heavily in their overall estate and legacy planning, this impact is only heightened. For many advisors, the natural response to the SECURE Act is to suggest Roth conversions for clients with sizeable Traditional IRAs. Let's take a look at this approach and determine any potential pitfalls.

SECURE CONVERSIONS

In light of the SECURE Act, Traditional IRAs have lost a significant amount of appeal from a legacy-planning perspective. Clients used to be able to factor in the stretch capabilities as a means of transferring wealth with the knowledge that inherited IRAs could continue to grow while non-spousal beneficiaries[*] took required minimum distributions over their lifetimes. Now, not only does the ten-year distribution requirement limit the opportunity for continued growth, but it also burdens a non-spousal beneficiary with increased taxation as they are forced to take larger distributions.

As a means of combating this, many advisors are suggesting that clients execute Roth conversions so that the transfer to non-spousal beneficiaries will be income tax-free. Of course, this strategy is not without its price, as a client will have to pay taxes on the conversion and therefore consume additional funds that otherwise could contribute to their legacy. For high-net-worth clients, it should also be noted that while a Roth IRA may pass free of income tax, the overall balance is still includable in calculating a taxable estate. Despite this, for some clients the Roth conversion strategy remains a viable option for dealing with the tax implications of the SECURE Act.

IN PRACTICE

However, while a Roth conversion may adequately address tax issues, it could still fall short from an estate and legacy planning perspective. Like Traditional IRAs, Roths are still subject to the ten-year

[*] For the purposes of this article, we will be focusing solely on non-spousal beneficiaries that do not meet the criteria to be an Eligible Designated Beneficiary (EDB).

distribution requirement. So for clients with spendthrift, creditor, or special-needs concerns for their beneficiaries, a Roth conversion does little to help them in that arena, and Trusts that are named as a beneficiary of IRA accounts are still subject to the same SECURE distribution rules.

From a pure wealth transfer standpoint, the growth of assets in a Roth must also outpace the tax cost of the conversion in order to be financially worthwhile. And finally, recent proposals in Washington have mentioned changes to conversion rules, leading some to wonder what future legislation might hold for Roth conversions entirely.

WHERE DO WE GO FROM HERE?

To be clear, this is not an indictment of Roth conversions; for many clients a conversion will make sense and help them better achieve their goals despite the SECURE Act. It is important, however, to remember that Roth conversions are not a one-size-fits-all strategy, especially for clients with particular estate and legacy objectives or concerns. As planning professionals have had time to digest the new regulations, alternative strategies have emerged to address various client profiles.

For example, charitable clients may want to explore implementing a Charitable Remainder Trust (CRT) as beneficiary of their retirement assets to both provide for beneficiaries and accomplish their charitable goals, all while receiving a charitable deduction toward their estate. For clients wanting to maximize their wealth transfer to subsequent generations, an IRA Maximization strategy employing life insurance may provide a more favorable financial outcome than a Roth conversion, with the added possibility of addressing legacy concerns through the use of an Irrevocable Life Insurance Trust (ILIT). As is always the case, having impactful conversations with clients and, consequently, the right professionals is paramount.

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