The Roth Conversion Guide

> A Roth conversion moves money from pre-tax to tax-free by paying the tax now. Whether that is smart comes down to your tax rate today against your rate later.

A Roth conversion is a deliberate choice to pay tax on retirement money now, in exchange for never paying tax on it again. It is one of the few moves where volunteering to be taxed can be the smart play, and the reason is all about timing.

How the tax is figured

When you convert, the amount you move from a traditional IRA to a Roth is added to your ordinary income for that year and taxed at your marginal rate. There is no penalty, just income tax on the converted sum.

For example, converting 50,000 dollars while in a 24 percent bracket costs about 12,000 dollars in tax. If you pay that 12,000 from a separate account rather than from the conversion itself, the full 50,000 lands in the Roth and grows tax-free from there. The Roth Conversion Calculator shows the exact cost for your income.

When a conversion makes sense

The logic mirrors the traditional versus Roth choice. A conversion wins when your tax rate today is lower than the rate you expect later. Convert while your rate is low, lock in that rate, and skip a higher rate in the future.

The best moments are usually low-income years. Early retirement before Social Security and required distributions begin, a gap between jobs, or a year with unusually low earnings all open a window to convert at a low rate. Fill up the lower brackets, then stop before the conversion spills into a higher one.

The traps to avoid

The first trap is bracket creep. A large conversion can push part of itself into a higher bracket, so converting a bit each year over several years often costs less than one big conversion. The second is paying the tax from the converted funds, which shrinks the amount that gets to grow tax-free and can trigger a penalty if you are under 59 and a half.

The third is the five-year rule. Converted amounts generally must sit for five years before the converted principal can be withdrawn penalty-free, and a conversion can also raise income-linked costs like Medicare premiums. None of these kill the strategy, but each is a reason to plan the size and timing carefully.

Key takeaway. Convert when your tax rate is low relative to the future, pay the tax from outside the account, and spread large conversions across years to stay out of higher brackets.

Assumptions

- The converted amount is added to your ordinary income for the year and taxed at your rate.
- You pay the conversion tax from outside funds, not from the money being converted, so the full amount keeps growing tax-free.
- Your current and future tax rates are estimates. Tax law can change.

Sources

- IRS, Roth IRAs and conversions
- IRS, topic on IRA conversions to Roth