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Now Might Be a Good Time for a Roth Conversion

A cost-benefit analysis could help determine whether it would be beneficial to pay taxes on some of your IRA assets now rather than later.

One silver lining in the current bear market is that this could be a good time to convert assets from a traditional IRA to a Roth IRA. Converted assets are subject to federal income tax in the year of conversion, which might be a substantial tax bill. However, if assets in your traditional IRA have lost value, you will pay taxes on a lower asset base when you convert. If all conditions are met, the Roth account will incur no further income tax liability for you or your designated beneficiaries, no matter how much growth the account experiences.

Tax Trade-Off

The logic behind deferring taxes on retirement savings is that you may be in a lower tax bracket when you retire, so a current tax deduction might be more appealing than tax-free income in retirement. However, lower rates set by the Tax Cuts and Jobs Act (set to expire after 2025) may have changed that calculation for you. A cost-benefit analysis could help determine whether it would be beneficial to pay taxes on some of your IRA assets now rather than later. One strategy is to "fill your tax bracket," meaning you would convert an asset value that would keep you in the same tax bracket. This requires projecting your income for 2022.

Lower Values, More Shares

As long as your traditional and Roth IRAs are with the same provider, you can typically transfer shares from one account to the other. Thus, when share prices are lower, you could theoretically convert more shares for each taxable dollar and would have more shares in your Roth account to pursue tax-free growth. Of course, there is also a risk that the converted assets will go down in value. You may have the option to take taxes directly out of your converted assets, but this is generally not wise.

Two Time Tests

Roth accounts are subject to two different five-year holding requirements: one related to withdrawals of earnings and the other related to conversions. For a tax-free and penalty-free withdrawal of earnings, including earnings on converted amounts, a Roth account must meet a five-year holding period beginning January 1 of the year your first Roth account was opened, and the withdrawal must take place after age 59½ or meet an IRS exception. If you have had a Roth IRA for some time, this may not be an issue, but it could come into play if you open your first Roth IRA for the conversion.

Assets converted to a Roth IRA can be withdrawn free of ordinary income tax at any time, because you paid taxes at the time of the conversion. However, a 10% penalty may apply if you withdraw the assets before the end of a different five-year period, which begins January 1 of the year of each conversion, unless you are age 59½ or another exception applies.

More Favorable RMD Rules

Unlike a traditional IRA, Roth IRAs are not subject to required minimum distribution (RMD) rules during the lifetime of the original owner. Spouse beneficiaries who treat a Roth IRA as their own are also not subject to RMDs during their lifetimes. Other beneficiaries inheriting a Roth IRA are subject to the RMD rules. In any case, Roth distributions would be tax-free. The longer your investments can pursue growth, the more advantageous it may be for you and your beneficiaries to have tax-free income.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

What is a Roth IRA?

Roth IRAs are tax-favored financial vehicles that enable investors to save money for retirement. They differ from traditional IRAs in that taxpayers cannot deduct contributions made to a Roth. However, qualified Roth IRA distributions in retirement are free of federal income tax and aren't included in a taxpayer's gross income. That can be advantageous, especially if the account owner is in a higher tax bracket in retirement or taxes are higher in the future.

A Roth IRA is subject to the same contribution limits as a traditional IRA. The maximum combined annual contribution an individual can make to traditional and Roth IRAs is $6,000 in 2022, unchanged from 2021. Special "catch-up" contributions enable those nearing retirement (age 50 and older) to save at an accelerated rate by contributing $1,000 more than the regular annual limits.

Another way in which Roth IRAs can be advantageous is that investors don't have to begin taking mandatory distributions due to age, as they do with traditional IRAs; however, beneficiaries of Roth IRAs must take mandatory distributions.

Roth IRA withdrawals can be made at any time and for any reason. Withdrawals of your own contributions are tax-free and not subject to the 10% federal income tax penalty for early withdrawals. In order to make a qualified income tax-free distribution of earnings, the account must meet the five-year holding requirement and the account owner must be either (a) age 59½ or older, (b) disabled, (c) deceased (and assets pass to beneficiaries) or (d) purchasing a first home ($10,000 lifetime limit). Otherwise, withdrawals of earnings are subject to ordinary income tax and the 10% federal income tax penalty. [Certain additional exceptions apply to the 10% penalty tax, including withdrawals for unreimbursed medical expenses in excess of 7.5% of adjusted gross income, higher-education expenses, substantially equal periodic payments, the birth or adoption of a child (up to $5,000), and qualified reservist distributions].

Keep in mind that even though qualified Roth IRA distributions are free of federal income tax, they may be subject to state and/or local income taxes. Eligibility to make annual contributions to a Roth IRA phases out for taxpayers with higher incomes.

If you're looking for a retirement savings vehicle with some distinct tax advantages, the Roth IRA could be appropriate for you.

Converting Funds from a Traditional IRA to a Roth IRA: Factors to Consider

Questions	Factors to consider
Do you qualify to convert funds from a traditional IRA to a Roth IRA?	• Guessing incorrectly may have serious consequences; the conversion of funds from a traditional IRA to a Roth IRA is considered a taxable distribution, subject to federal income tax and a possible penalty. • The fact that you qualify to convert funds from a traditional IRA to a Roth IRA doesn't necessarily mean you should; consider the following factors before making a decision.
Will you pay the tax that results from converting funds with outside (non-IRA) funds?	• Converting traditional IRA funds to a Roth IRA will result in federal income tax due on those funds (to the extent that those funds consist of investment earnings and tax-deductible contributions). • Paying the tax due with IRA funds reduces the amount that grows tax free in the Roth IRA. • IRA funds used to pay the tax may be subject to additional income tax and possibly a penalty. • Paying the tax due with non-IRA funds allows more dollars to be funneled into the tax-free Roth IRA.
Do you expect to be in the same or in a lower or higher income tax bracket when you eventually take IRA distributions?	• If your tax bracket remains the same and you pay the tax that results from converting funds with IRA dollars, the conversion may have no tax consequence. • If you'll be in a lower tax bracket when you take IRA distributions, paying tax now on converted funds at your present (higher) rate may not be very appealing. • If you'll be in a higher tax bracket when you take distributions, you can convert funds to a Roth IRA now and pay tax at your present (lower) tax rate, and distributions will be tax free later (assuming you qualify for tax-free withdrawals--see below).
Can you leave your funds in your Roth IRA for at least 5 years?	• If you withdraw funds after 5 years from the time you establish **any** Roth IRA you may qualify for tax-free and penalty-free withdrawals if you meet one of several other conditions (a qualified withdrawal). • If you convert a traditional IRA to a Roth IRA, and then make a nonqualified withdrawal within 5 years of the conversion, the earnings you withdraw will be subject to income tax, and your entire withdrawal may be subject to a 10% penalty unless an exception applies (age 59½, etc.).
Can you leave your funds in your Roth IRA for at least 10 years?	• This time frame becomes more important when you're paying the tax that results from converting funds with IRA funds. • Generally, converting funds to a Roth IRA makes sense if you plan to leave the funds in the Roth IRA for 10 years or more. • If you plan to take distributions from the Roth IRA within the next 10 years, make sure converting funds is in your best interest.
Can you live comfortably in retirement without taking IRA distributions?	• You can keep contributing to the Roth IRA after age 72, as long as you have sufficient earned income. • Unlike a traditional IRA, you aren't required to take annual minimum distributions from a Roth IRA after age 72 or at any time during your life. • Assuming 5 years have elapsed from the time you established **any** Roth IRA, your beneficiary receives Roth IRA funds free from federal income tax (but not necessarily from federal estate tax) when you die.

Does your traditional IRA consist of any nondeductible (after-tax) contributions?	• You've already paid federal income tax on any nondeductible contributions to your traditional IRA, so these dollars are not subject to federal income tax when you convert funds to a Roth IRA. • After you convert funds, future investment earnings on your Roth IRA will accrue tax free.
When you die, will federal estate tax be due?	• When you die, the value of your IRA (traditional or Roth) will be included in your taxable estate to determine if federal estate tax is due. • When you convert funds from a traditional IRA to a Roth IRA, you pay federal income tax on your IRA funds now rather than later. • The money you use to pay the tax now effectively removes those dollars from your taxable estate, potentially reducing your federal estate tax liability after your death.
Will you apply for financial aid in the next few years?	• When you convert funds from a traditional IRA to a Roth IRA, you pay federal income tax on your IRA funds now rather than later. • The money you use to pay the tax now effectively removes those dollars from the assets to be considered in determining your child's eligibility for financial aid.
Are you currently receiving Social Security benefits?	• The portion of your Social Security benefits that is taxable in any year depends on your income and tax filing status for that year. • Excluding any nondeductible contributions, funds that you convert to a Roth IRA are treated as taxable income to you for that year. • If more of your Social Security benefits will be taxed as a result of converting funds to a Roth IRA, factor in the additional tax cost to you. • Balance this cost against the fact that distributions from Roth IRAs, in addition to being tax free, are not currently counted in determining the taxable portion of your Social Security benefits.
Does your state follow the federal income tax treatment of Roth IRAs?	• If your state does not follow the federal income tax treatment of Roth IRAs, you must factor in the way that your state tax treatment will affect your situation.
Does your state provide Roth IRAs with protection from creditors equal to that provided to traditional IRAs?	• Up to $1,362,800 (and in some cases more) of your total IRA assets, Roth and traditional, are protected under federal law in the event you declare bankruptcy. State law may provide additional creditor protection, but the protection given to funds in Roth IRAs may be less than that given to funds in traditional IRAs. • If you have a significant percentage of your assets in IRAs and you are at risk of being sued by creditors, you should consider your state's degree of creditor protection for each type of IRA.

If you participate in a 401(k), 403(b), or 457(b) plan at work, you may be able to make Roth contributions to the plan. (Check with your plan administrator -- plans aren't required to offer this option.) Qualified distributions of Roth contributions and related earnings are income tax free (and penalty free) at the federal level. This may be a factor in your decision of whether to convert funds from a traditional IRA to a Roth IRA. However, be sure to discuss your situation with a tax professional before making any decisions.

Converting or Rolling Over Traditional IRAs to Roth IRAs

What is it?

In general, you can transfer all or a portion of your traditional IRA funds to a Roth IRA. This can be accomplished in one of two ways: You can convert your traditional IRA to a Roth IRA, or you can roll over funds from your traditional IRA to a Roth IRA.

In the case of a conversion, you notify the trustee or custodian of your traditional IRA that you wish to convert your traditional IRA to a Roth IRA. The account is then renamed as a Roth IRA, and your funds never actually leave the account. In the case of a rollover, you actually transfer the funds from your traditional IRA to a Roth IRA. The income tax consequences of the two methods are identical.

However, the fact that you *can* convert or roll over funds from your traditional IRA to a Roth IRA doesn't necessarily mean that you *should* . There are a number of factors that you need to consider.

Caution: *If you've inherited a traditional IRA (or SEP/SIMPLE IRA) from someone other than your spouse, you cannot convert that traditional IRA to a Roth IRA.*

When can it be used?

You have a traditional IRA

It probably goes without saying, but you can't convert or roll over funds from a traditional IRA to a Roth IRA unless you already have a traditional IRA.

Tip: *In addition to traditional IRAs, SEP-IRAs, SAR-SEP IRAs, and SIMPLE IRAs (those that have existed for at least two years) are eligible to be converted to a Roth IRA. The rules that apply to conversions from traditional IRAs, as discussed in this article, also apply to SEP, SAR-SEP, and SIMPLE conversions.*

Rollovers must follow IRA rollover rules

As mentioned, one of the two ways to transfer funds from a traditional IRA to a Roth IRA is to withdraw the funds from your traditional IRA, and then roll those funds over into a Roth IRA in your name. If you choose this method to transfer funds, you must comply with federal rules governing IRA rollovers. For example, if you roll over funds from a traditional IRA to a Roth IRA, the funds must be deposited in the Roth IRA within 60 days after you receive the distribution from the traditional IRA. If you do not meet the 60-day deadline, you may be subject to tax consequences and a penalty. There is no limit on the number of rollovers from traditional IRAs to Roth IRAs that you can do in a year.

Tip: *The 60-day deadline can be waived in certain circumstances. You may be eligible for an automatic waiver if you sent your rollover assets to a financial institution within the 60-day period, but the financial institution makes an error and fails to complete your rollover before the deadline. However, to be eligible to use this automatic waiver, your rollover must be completed within one year from the beginning of the 60-day period. The IRS also has the discretion to grant a waiver of the 60-day deadline "where failure to do so would be against equity or good conscience," such as a casualty, disaster, or other event beyond your reasonable control. However, you'll need to request a private letter ruling from the IRS, an expensive proposition — the filing fee alone is currently $10,000. There is also a third way to seek a waiver of the 60-day requirement: self-certification. Under the new procedure, if you've missed the 60-day rollover deadline, you can simply send a letter to the IRA trustee/custodian certifying that you missed the 60-day deadline due to one of 11 specified reasons. To qualify, you must generally make your rollover contribution to the employer plan or IRA within 30 days after you're no longer prevented from doing so. Also, there is no IRS fee. The downside of self-certification is that if you're subsequently audited, the IRS can still review whether your contribution met the requirements for a waiver. For this reason, some taxpayers may still prefer the certainty of a private letter ruling from the IRS.*

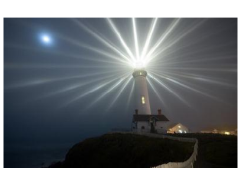
Strengths

Qualified distributions from Roth IRAs are tax free

A withdrawal from a Roth IRA (including both contributions and investment earnings) is completely tax free (and penalty free) if made at least five years after you first establish any Roth IRA, and if one of the following applies:

- You have reached age 59½ at the time of the withdrawal
- The withdrawal was made due to qualifying disability
- The withdrawal was made to pay for first-time homebuyer expenses ($10,000 lifetime limit)
- The withdrawal is made by your beneficiary or estate after your death

Tip: *The five-year holding period begins on January 1 of the tax year for which you make your first contribution to any Roth IRA.*



Each taxpayer has only one five-year holding period for this purpose.

If these conditions aren't met, your distribution is "nonqualified" and only the portion of a Roth IRA withdrawal that represents investment earnings will be subject to federal income tax (and a potential 10% early distribution penalty unless an exception applies). The portion of a Roth IRA withdrawal that represents your contributions (including amounts converted to or rolled over from a traditional IRA) is never taxable, since those dollars were already taxed. Roth IRA withdrawals are treated as coming from your nontaxable contributions first and from investment earnings last.

Caution: *If you convert or roll over funds from a traditional IRA to a Roth IRA, special penalty provisions may apply if you subsequently withdraw funds from the Roth IRA within five years of the conversion (and prior to age 59½). See "Tax considerations," below.*

Roth IRAs are not subject to the lifetime required minimum distribution (RMD) rules

Federal law requires you to take annual minimum withdrawals (required minimum distributions, or RMDs) from your traditional IRAs beginning no later than April 1 of the year following the year in which you reach age 72. These withdrawals are calculated to dispose of all of the money in the traditional IRA over a given period of time. Because Roth IRAs are not subject to the lifetime RMD rules, you are not required to make any withdrawals from your Roth IRAs during your life. This can be a significant advantage in terms of your estate planning and may be a good reason to consider converting funds.

Converting or rolling over funds may reduce your taxable estate and your countable assets for federal financial aid purposes

If you use non-IRA funds to pay the conversion tax that results from converting or rolling over funds from a traditional IRA to a Roth IRA, the funds that you use to pay the tax are removed from your taxable estate, potentially reducing your future estate tax liability. Also, the funds that you use to pay the tax are no longer part of your countable assets for purposes of determining your children's eligibility for federal financial aid. In contrast, if you use IRA funds to pay the conversion tax, there generally is no effect on financial aid eligibility, because the federal aid formula does not count retirement accounts when determining aid eligibility.

Qualified distributions from Roth IRAs are not included when determining the taxable portion of Social Security benefits

Converting or rolling over your funds from a traditional IRA to a Roth IRA could be beneficial when it comes time to begin receiving your Social Security benefits. The portion of your Social Security benefits that is taxable (if any) depends on your MAGI and federal income tax filing status in a given year. Under current law, qualified distributions from Roth IRAs are not included when determining the taxable portion of an individual's Social Security benefits.

A conversion can be used to overcome the income limit on annual Roth IRA contributions

Annual Roth contributions may be limited, or eliminated, depending on your income and filing status. If your ability to make annual Roth contributions is restricted because of these limits, and you want to make annual Roth contributions, a conversion may be the answer. You can simply make your annual contribution first to a traditional IRA, and then convert that traditional IRA to a Roth IRA. (You can make nondeductible contributions to a traditional IRA if you have taxable compensation.) There are no limits to the number of Roth conversions you can make. (Note: you'll need to aggregate all traditional IRAs and SEP/SIMPLE IRAs you own — other than IRAs you've inherited — when you calculate the taxable portion of your conversion.) This is often called a "back door" Roth IRA.

Tradeoffs

You have to pay tax now on the funds that you convert or roll over

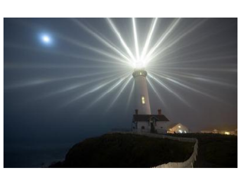
When you convert or roll over funds from a traditional IRA to a Roth IRA, the funds that you transfer are subject to federal income tax (to the extent that those funds represent investment earnings and tax-deductible contributions made to the traditional IRA). Even if it makes overall financial sense to convert funds from a traditional IRA to a Roth IRA, paying tax on your IRA funds now may not be desirable.

Using IRA funds to pay conversion tax has significant drawbacks

If using other IRA dollars is the only way that you can pay the conversion tax that results from converting or rolling over funds from a traditional IRA to a Roth IRA, the benefits of converting or rolling over funds are substantially reduced. Using IRA dollars to pay the tax reduces the amount of funds in your IRAs, potentially jeopardizing your retirement goals. In addition, the IRA funds used to pay the tax may themselves be subject to federal income tax and a premature distribution tax. If possible, paying the conversion tax with non-IRA funds is generally more advisable.

Special penalty provisions may apply to withdrawals from Roth IRAs that contain funds converted from traditional IRAs

If you're under age 59½ and take a nonqualified distribution from a Roth IRA, the 10% premature distribution tax generally applies only to that portion of the distribution that represents investment earnings. However, if you convert or roll over funds from a traditional IRA to a Roth IRA and then take a premature distribution from that Roth IRA within five years, the 10% premature distribution tax will apply to the entire amount of the distribution (to the extent that the distribution consists of funds that were taxed at the time of conversion).



Tip: *The five-year holding period begins on January 1 of the tax year in which you converted or rolled over the funds from the traditional IRA to the Roth IRA. When applying this special rule, a separate five-year holding period applies each time you convert or roll over funds from a traditional IRA to a Roth IRA.*

Taxable income resulting from conversion can increase taxable portion of Social Security benefits being received

If you're currently receiving Social Security benefits or soon will be, consider the possible tax consequences of converting or rolling over funds from a traditional IRA to a Roth IRA. When you convert or roll over funds, those funds are generally considered taxable income to you for the year in which you transfer them. Remember that the portion of your Social Security benefits that is taxable (if any) depends on your income and tax filing status for the year. This means that converting funds to a Roth IRA may increase the taxable portion of your Social Security benefits for that year.

Risk of future change in the law

One of the main reasons to consider converting or rolling over funds from a traditional IRA to a Roth IRA is that qualified distributions from Roth IRAs are completely tax free. Under current law, this is the federal tax treatment given to Roth IRAs. Some experts, however, are skeptical that this will always remain the case, given the uncertain status of Social Security and the projected lost federal revenue attributable to Roth IRAs.

States may differ in their treatment of Roth IRAs

Although most states follow the federal tax treatment of Roth IRAs, you should check with a tax professional regarding the tax treatment of Roth IRAs in your particular state.

Creditor protection

Federal law provides protection for up to $1,512,350 of your aggregate Roth and traditional IRA assets if you declare bankruptcy (Note: This amount is scheduled for adjustment in April 2025). (SEP IRAs, SIMPLE IRAs, and amounts rolled over to the IRA from an employer qualified plan or 403(b) plan, plus any earnings on the rollover, aren't subject to this dollar cap and are fully protected if you declare bankruptcy.) The laws of your particular state may provide additional bankruptcy protection, and may provide protection from the claims of your creditors in cases outside of bankruptcy. (Inherited IRAs may be afforded less protection from creditors under federal and state law — seek professional guidance.)

How to do it

Calculate the tax that will result from converting or rolling over funds from your traditional IRAs to Roth IRAs

All or a portion of the funds that you convert or roll over from your traditional IRA to a Roth IRA will be subject to federal income tax in the year that you shift the funds. Consult a tax professional for an accurate calculation of the income tax liability that will result. This will help you decide if converting funds makes sense for you.

Decide where the dollars will come from to pay the resulting tax

Decide if you will use IRA funds or non-IRA funds to pay the conversion tax that will result from converting or rolling over funds, and make sure that you understand the tax consequences of either choice. For example, if you plan to sell stock to pay the tax, realize that your sale of stock will have tax consequences of its own. If you plan to use IRA funds to pay the tax, be aware that this may trigger additional income tax liability (and possibly a penalty). Again, consult a tax professional.

Decide whether to convert or roll over

If you have decided to transfer funds from your traditional IRA to a Roth IRA, your next step is to decide whether to convert your traditional IRA to a Roth IRA, or to roll over your traditional IRA funds to a Roth IRA. The income tax consequences are the same either way, so the question is: Do you want your IRA to stay at the same institution with the same custodian/trustee, or would you prefer to move your IRA dollars to another institution and have a different custodian/trustee?

If converting, contact the custodian of your traditional IRA

The custodian/trustee of your traditional IRA will provide you the paperwork you need to convert your traditional IRA to a Roth IRA with that same institution.

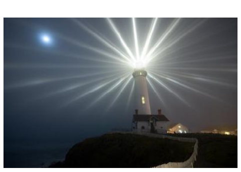
If rolling over, establish a Roth IRA and roll over your traditional IRA

First, you need to establish a Roth IRA in your name, if you don't already have one. Once you have a Roth IRA, you can have the funds in your traditional IRA transferred directly to your Roth IRA. The custodian of your Roth IRA can give you the paperwork that you need to do this. If you prefer, you can instead contact the custodian of your traditional IRA, have the funds in your traditional IRA distributed to you, and then roll those funds over into your Roth IRA within 60 days of the distribution.

Tax considerations

You include funds that are converted or rolled over from a traditional IRA to a Roth IRA in income

When you convert or roll over funds from a traditional IRA to a Roth IRA, those funds are subject to federal income tax in the year



that you transfer them (to the extent that the funds consist of deductible contributions and investment earnings). If you have made only deductible contributions to your traditional IRAs, then the entire amount of any funds that you convert or roll over to a Roth IRA will be taxable.

If, however, you have ever made nondeductible (after-tax) contributions to your traditional IRAs, then those contribution amounts will not be taxable when converted or rolled over to a Roth IRA (since they have already been taxed). In effect, the income tax consequences of converting funds are the same as those that apply when you make a withdrawal from a traditional IRA. Each distribution you convert or roll over to a Roth IRA will contain a pro-rata amount of pre-tax and after-tax dollars.

Caution: *You need to aggregate all traditional IRAs and SEP/SIMPLE IRAs you own (other than IRAs you've inherited) when you calculate the taxable portion of your conversion.*

The IRS has provided the following formulas to determine the pre-tax and after-tax portions of each conversion:

After-tax amount = (after-tax amounts in all IRAs/Value of all IRAs) x amount distributed

Pre-tax amount = amount distributed - after-tax amount

Caution: *You must make these calculations as of year-end (December 31 of the year of the distribution) and not on the date of the distribution.*

Application of the 10% premature distribution tax

The 10% premature distribution tax does not apply at the time that you convert or roll over funds from a traditional IRA to a Roth IRA, even if you convert the funds before reaching age 59½. However, if you convert or roll over funds from a traditional IRA to a Roth IRA and withdraw any portion of those funds from the Roth IRA within five years (and prior to age 59½), the withdrawal will be subject to the 10% premature distribution tax (to the extent those funds were taxed at the time of the conversion).

Tip: *Remember that withdrawals from Roth IRAs are treated as coming from contributions first and investment earnings second. Contributions are considered to consist first of regular contributions (i.e., contributions other than rollover contributions), and then of amounts converted or rolled over from a traditional IRA (on a first in, first out basis).*

Tip: *All of your Roth IRAs (other than Roth IRAs you've inherited) are aggregated for this purpose.*

Example(s): *John is age 40. John contributed $3,000 to his Roth IRA in 2019. In 2020, John converted $10,000 from his traditional IRA to his Roth IRA, and included this $10,000 in his 2020 gross income. He made no further contributions to his Roth IRA. In 2022, his Roth IRA has grown to $14,000, of which John withdraws $4,000. None of the exceptions to the 10% premature distribution tax apply to John. John's $4,000 withdrawal is considered to consist first of his $3,000 regular contribution made in 2019. John owes no premature distribution tax on this $3,000. The remaining $1,000 of John's $4,000 withdrawal is considered to consist of funds he converted from his traditional IRA, and is subject to the 10% premature distribution tax.*

You can't convert or roll over RMDs into a Roth IRA

After age 72, you are required to begin taking annual minimum withdrawals from your traditional IRAs (RMDs). You cannot roll over or convert these RMD amounts to a Roth IRA.

Questions & Answers

Should you convert or roll over funds from your traditional IRA to a Roth IRA?

Before you even begin to think about converting or rolling over funds from a traditional IRA to a Roth IRA, be sure that you understand what the Roth IRA is and how it works. If the Roth IRA seems like an appropriate retirement savings vehicle, be sure to consider the income tax consequences of converting funds, and how you will pay the resulting tax. Think about the following scenarios and factors before you act.

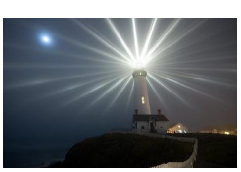
Scenario 1: You'll pay the resulting "conversion" tax with non-IRA funds, you have 10 years or more before you will be taking distributions from the Roth IRA, and you will be in the same or a higher tax bracket when you start taking those distributions. Converting funds probably makes overall sense.

Scenario 2: You'll pay the conversion tax with IRA funds, you need to take substantial distributions from the Roth IRA within a few years (5 years or less), and you will be under age 59½, or in a lower tax bracket when you begin taking distributions. You probably shouldn't convert funds to a Roth IRA.

Can you convert or roll over only a portion of the funds in your traditional IRAs to Roth IRAs?

Yes, you can convert or roll over whatever amount you want from your traditional IRAs to a Roth IRA. All or a portion of the funds that you convert or roll over to the Roth IRA will be subject to federal income tax. If you have ever made nondeductible (after-tax) contributions to your traditional IRAs, you have to calculate what portion of the funds that you convert represents nondeductible contributions. Because those amounts were already taxed, they will not be taxed again when converted to a Roth IRA.

How do you calculate the portion of your conversion that represents nondeductible contributions?



If you have made only deductible contributions to your traditional IRAs, the full amount that you convert or roll over from your traditional IRAs to a Roth IRA will be subject to federal income tax, since no portion of the funds represents nondeductible contributions. If you have ever made nondeductible contributions to your traditional IRAs, you calculate and report the taxable and nontaxable portions of the funds that you convert or roll over using IRS Form 8606. Basically, you calculate the ratio of all of your nondeductible contributions to the total balance of all of your traditional IRAs, including simplified employee pension plan (SEP) IRAs and savings incentive match plan for employees (SIMPLE) IRAs. That ratio is then applied to any withdrawal that you make from any of your traditional IRAs, including a conversion or rollover to a Roth IRA. So, if 50% of the total balance of all of your traditional IRAs represents nondeductible contributions, half of the funds that you convert to a Roth IRA would be taxable, and half would not.

Can you convert or roll over funds from your traditional IRAs to a Roth IRA if you're already receiving RMDs from your traditional IRAs?

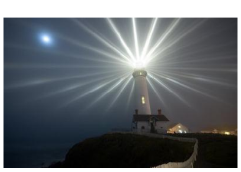
The fact that you're receiving RMDs from your traditional IRAs doesn't by itself disqualify you from converting funds to a Roth IRA. You cannot, however, convert or roll over an RMD itself into a Roth IRA.

When you withdraw funds from a Roth IRA, in what order are the funds considered withdrawn?

Withdrawals from Roth IRAs are considered made in the following order:

- Regular Roth IRA contributions (i.e., contributions other than rollover or conversion contributions).
- Rollover or conversion contributions, in the order made (i.e., first in, first out). If any rollover or conversion included nondeductible contributions, the withdrawal is considered made first from funds that were subject to federal income tax at the time of the rollover or conversion.
- Any investment earnings.

All Roth IRAs you maintain (other than Roth IRAs you've inherited) are aggregated (i.e., treated as a single Roth IRA) for purposes of classifying withdrawals.



401(k) In-Plan Roth Conversions

A 401(k) in-plan Roth conversion (also called an "in-plan Roth rollover") allows you to transfer the non-Roth portion of your 401(k) account into a designated Roth account within the same plan. The amount you convert is subject to federal income tax in the year of the conversion (except for any nontaxable basis you have in the amount transferred), but qualified distributions from the Roth account in the future are entirely income tax-free. The 10% early distribution penalty doesn't apply to amounts you convert (but that tax may be reclaimed by the IRS if you take a nonqualified distribution from your Roth account within five years of the conversion).

What part of my account can I convert?

Assuming your 401(k) allows in-plan conversions (plans aren't required to), you can convert any vested part of your 401(k) plan account into a designated Roth account regardless of whether you're otherwise eligible for a plan distribution.

Keep in mind that if you're entitled to an eligible rollover distribution, you can always roll those dollars into a Roth IRA instead of using an in-plan conversion.

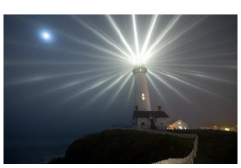
What else do I need to know?

If you have the choice of an in-plan conversion or a rollover to a Roth IRA, which should you choose? There are a number of factors to consider:

- In general, the investments available in an employer 401(k) plan are fairly limited, while virtually any type of investment is available in an IRA (on the other hand, your 401(k) plan may offer investments that you can't replicate in an IRA, or that aren't available at similar cost).
- An IRA may give you more flexibility with distributions. Your distribution options in a 401(k) plan depend on the terms of that particular plan, and your options may be limited.
- Finally, 401(k) plans typically enjoy more protection from creditors under federal law than do IRAs (consult a professional if creditor protection is important to you).

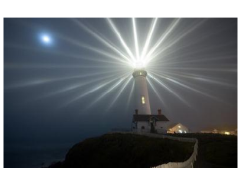
Caution: *When evaluating whether to initiate a rollover from an employer plan to an IRA, always be sure to (1) ask about possible surrender charges that may be imposed by your employer plan, or new surrender charges that your IRA may impose, (2) compare investment fees and expenses charged by your IRA (and investment funds) with those charged by your employer plan (if any), and (3) understand any accumulated rights or guarantees that you may be giving up by transferring funds out of your employer plan.*

Whether a Roth conversion makes sense financially depends on a number of factors, including your current and anticipated future tax rates, the availability of funds with which to pay the current tax bill, and when you plan to begin receiving distributions from the plan. Also, you should consider that the additional income from a conversion may impact tax credits, deductions, and phaseouts;



marginal tax rates; alternative minimum tax liability; and eligibility for college financial aid.

This information is not intended as tax, legal, investment, or retirement advice or recommendations.



The Health of Social Security: Some Good News and Some Bad News

With approximately 94% of American workers covered by Social Security and 65 million people currently receiving benefits, keeping Social Security healthy is a major concern.[1] Social Security isn't in danger of going broke — it's financed primarily through payroll taxes — but its financial health is declining, and benefits may eventually be reduced unless Congress acts.

Each year, the Trustees of the Social Security Trust Funds release a detailed report to Congress that assesses the financial health and outlook of this program. The most recent report, released on June 2, 2022, shows that the effects of the pandemic were not as significant as projected in last year's report — a bit of good news this year.

Overall, the news is mixed for Social Security

The Social Security program consists of two programs, each with its own financial account (trust fund) that holds the payroll taxes that are collected to pay Social Security benefits. Retired workers, their families, and survivors of workers receive monthly benefits under the Old-Age and Survivors Insurance (OASI) program; disabled workers and their families receive monthly benefits under the Disability Insurance (DI) program. Other income (reimbursements from the General Fund of the U.S. Treasury and income tax revenue from benefit taxation) is also deposited in these accounts.

Money that's not needed in the current year to pay benefits and administrative costs is invested (by law) in special government-guaranteed Treasury bonds that earn interest. Over time, the Social Security Trust Funds have built up reserves that can be used to cover benefit obligations if payroll tax income is insufficient to pay full benefits, and these reserves are now being drawn down. Due to the aging population and other demographic factors, contributions from workers are no longer enough to fund current benefits.

In the latest report, the Trustees estimate that Social Security will have funds to pay full retirement and survivor benefits until 2034, one year later than in last year's report. At that point, reserves will be used up, and payroll tax revenue alone would be enough to pay only 77% of scheduled OASI benefits, declining to 72% through 2096, the end of the 75-year, long-range projection period.

The Disability Insurance Trust Fund is projected to be much healthier over the long term than last year's report predicted. The Trustees now estimate that it will be able to pay full benefits through the end of 2096. Last year's report projected that it would be able to pay scheduled benefits only until 2057. Applications for disability benefits have been declining substantially since 2010, and the number of workers receiving disability benefits has been falling since 2014, a trend that continues to affect the long-term outlook.

According to the Trustees report, the combined reserves (OASDI) will be able to pay scheduled benefits until 2035, one year later than in last year's report. After that, payroll tax revenue alone should be sufficient to pay 80% of scheduled benefits, declining to 74% by 2096. OASDI projections are hypothetical, because the OASI and DI Trust Funds are separate, and generally one program's taxes and reserves cannot be used to fund the other program. However, this could be changed by Congress, and combining these trust funds in the report is a way to illustrate the financial outlook for Social Security as a whole.

All projections are based on current conditions and best estimates of likely future demographic, economic, and program-specific conditions, and the Trustees acknowledge that the course of the pandemic and future events may affect Social Security's financial status.

You can view a copy of the 2022 Trustees report at ssa.gov.

What about Medicare?

Like Social Security, Medicare faces a significant funding shortfall. Medicare's Hospital Insurance (HI) Trust Fund currently has a surplus due to higher income and lower expenditures in the short term, but is expected to be depleted in 2028, two years later than in last year's report. Once this fund is depleted, tax and premium income would be enough to pay 90% of scheduled benefits, declining to 80% in 2046, then gradually increasing to 93% by 2096.

Many options for improving the health of Social Security

The last 10 Trustees Reports have projected that the combined OASDI reserves will become depleted between 2033 and 2035. The Trustees continue to urge Congress to address the financial challenges facing these programs so that solutions will be less drastic and may be implemented gradually, lessening the impact on the public. Many options have been proposed, including the ones below. Combining some of these may help soften the impact of any one solution.

- Raising the current Social Security payroll tax rate (currently 12.4%). Half is paid by the employee and half by the employer (self-employed individuals pay the full 12.4%). An immediate and permanent payroll tax increase of 3.24 percentage points to 15.64% would be needed to cover the long-range revenue shortfall.
- Raising or eliminating the ceiling on wages subject to Social Security payroll taxes ($147,000 in 2022).
- Raising the full retirement age beyond the currently scheduled age of 67 (for anyone born in 1960 or later).
- Raising the early retirement age beyond the current age of 62
- Reducing future benefits. To address the long-term revenue shortfall, scheduled benefits would have to be immediately and permanently reduced by about 20.3% for all current and future beneficiaries, or by about 24.1% if reductions were applied only to those who initially become eligible for benefits in 2022 or later.
- Changing the benefit formula that is used to calculate benefits.
- Calculating the annual cost-of-living adjustment (COLA) for benefits differently.

A comprehensive list of potential solutions can be found at ssa.gov/OACT/solvency/provisions.

1) Social Security Administration, 2022

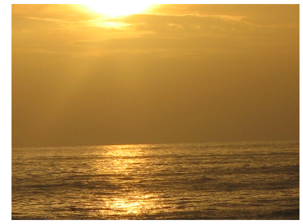
The IRS has increased the optional standard mileage rates for computing the deductible costs of operating an automobile for business, medical, and moving expense purposes for the last half of 2022.

Due to recent increases in the price of fuel, the IRS has increased the optional standard mileage rates for computing the deductible costs of operating an automobile for business, medical, and moving expense purposes for the second half of 2022. The standard mileage rate for computing the deductible costs of operating an automobile for charitable purposes is set by statute and remains unchanged.

For July 1, 2022, to December 31, 2022, the standard mileage rates are as follows:

- **Business use of auto:** 62.5 cents per mile (up from 58.5 cents for January 1, 2022, to June 30, 2022) may be deducted if an auto is used for business purposes. If you are an employee, your employer can reimburse you for your business travel expenses using the standard mileage rate. However, if you are an employee and your employer does not reimburse you for your business travel expenses, you cannot currently deduct your unreimbursed travel expenses as miscellaneous itemized deductions.
- **Charitable use of auto:** 14 cents per mile (the same as for January 1, 2022, to June 30, 2022) may be deducted if an auto is used to provide services to a charitable organization if you itemize deductions on your income tax return. Your charitable deduction may be limited to certain percentages of your adjusted gross income, depending on the type of charity.
- **Medical use of auto:** 22 cents per mile (up from 18 cents for January 1, 2022, to June 30, 2022) may be deducted if an auto is used to obtain medical care (or for other deductible medical reasons) if you itemize deductions on your income tax return. You can deduct only the part of your medical and dental expenses that exceeds 7.5% of the amount of your adjusted gross income.
- **Moving expense:** 22 cents per mile (up from 18 cents for January 1, 2022, to June 30, 2022) may be deducted if an auto is used by a member of the Armed Forces on active duty to move, pursuant to a military order, to a permanent change of station (unless such expenses are reimbursed). The deduction for moving expenses is not currently available for other taxpayers.

The IRS normally updates the standard mileage rates once a year in the fall for the next calendar year. Mid-year increases in the standard mileage rates are rare — the last time the IRS made such an increase was in 2011.



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