



ZION FINANCIAL

ROTH CONVERSION CASE STUDIES

Illustrative Examples of Strategic Roth Retirement Planning



ZION FINANCIAL RESEARCH
**ROTH CONVERSION
CASE STUDY**

CASE STUDY 1

The Pre-RMD Planning Window

Client Profile

John and Lisa Carter

Ages 63 and 61

Recently retired

John had a career of 35 years in sales in companies. Lisa was part-time in healthcare administration.

They had passed their lives of service in what they were instructed to do, which they believed was the right thing to do:

Contribute to their 401(k).

Optimize tax-deferred wealth.

Let the account grow.

They had a large nest sum by the time they retired.

The better part of it was tax-deferred, however.

Financial Snapshot

When we met, their retirement image was as follows.

Traditional IRA: \$1,620,000

Brokerage account: \$260,000

Savings: \$110,000

Home: paid off

The age of social security is 70.

Their present level of taxable income in retirement was incredibly low.

Roughly \$42,000 per year.

They had been placed temporarily in a far lower tax bracket than when they were working.

An important thing, however, was at hand.

The Problem

Retirees are required to make Required Minimum Distributions at age 73 through the IRS.

John and Lisa's IRA was estimated to grow to approximately: based on a conservative 5 percent annual growth rate.

\$2.3 million by age 73.

That would establish an initial Required Minimum Distribution amounting to:

\$86,000 per year.

However, it did not end there.

RMDs increase every year.

At their early 80s, their estimated Required Minimum Distributions surpassed:

\$120,000 annually.

Now combine that with:

Social Security income

Investment income

Further withdrawals in the event of necessity.

They will have a higher taxable income in retirement than projected:

\$180,000 per year.

That would cause several consequences.

An augmentation in the marginal tax rates.

Taxation is beneficial to social security.

Medicare IRMAA premium increase charges.

Their retirement tax bill was going to increase significantly later in life.

The Planning Insight

The period between the retirement years and the minimum distribution years is usually the most neglected tax planning window.

John and Lisa had an abnormally low taxable income between 63 and 73 years.

That created an opportunity.

Instead of having to make huge withdrawals of their RMDs in the future, they may consider contributing small amounts of their IRA to a Roth account as long as their tax bracket remains relatively low.

It was not the avoidance of taxes.

The aim was on how they were going to pay taxes.

The Strategy

Our phased Roth conversion plan was a model of seven years.

Generally, John and Lisa were withdrawing about 140,000 a year out of their Traditional IRA to a Roth IRA.

This was aimed at filling targeted tax brackets and not shooting them into the higher tax brackets unnecessarily.

They could spread conversions across several years and, as such:

Decrease their Traditional IRA in the future.

Grow Roth tax-free investments.

Reduce future anticipated Minimum Distributions.

Projected Outcome Comparison

Without planning:

IRA balance 73: about 2.3M.

First RMD: roughly \$86k

Estimated taxable income in late retirement: \$180k and above.

In the case of strategic Roth conversions:

The conventional IRA balance of 73 was cut down to about 1.2M.

First RMD reduced to about \$45k

Roth IRA account increased to around 900k.

It is not only the difference in taxes.

It is flexibility.

The Roth accounts are not subject to any required minimum distributions during the lifetime of the original owner.

This allows people who retire to have a much greater choice as to their taxable income in later retirement.

Why This Matters

The reaction that John provided during the planning meeting is normal.

Tax bill could increase after retirement, something I could never imagine.

Most of them miss decades, focusing on asset acquisition.

Some of them are preoccupied with the future taxation of the assets.

By identifying the window of time during which they need to have their retirement savings repositioned before the onset of Required Minimum Distributions, John and Lisa could reposition part of their retirement savings in a manner that may result in better tax efficiency during the remainder of their lives.

Perfect. I will provide three more Roth conversion case studies, which are:

Dense with numbers

Based on realistic scenarios of planning.

Arranged in precisely the same way, credibility.

Typed in such a way that you can easily append testimonial quotes in the future.

These will be more advisor-grade planning samples than marketing fluff.

CASE STUDY 2

The High-Balance IRA Retiree

Client Profile

Michael Anderson

Age 68

Recently retired executive

Michael had spent more than 40 years in the technology sector and made most of his fortune in employer retirement plans.

Once his 401(k) was rolled into a Traditional IRA on retirement, taxes became his main concern.

He had done well saving.

Never had he really planned, how those savings would be afterward taxed.

Financial Snapshot

Traditional IRA: \$3,200,000

Brokerage account: \$420,000

Savings: \$180,000

Home: paid off

Michael would not take Social Security until he was 70.

His present retirement taxable income was in the nature of:

\$55,000 per year.

However, that was a provisional figure.

The Problem

The IRA balance of over three million dollars would mean high required minimums distributions.

Based on existing IRS tables of life expectancy and low growth projections:

The estimated value of Michael IRA at age 73 was:

\$3.9 million.

That would give a first Required Minimum Distribution of the approximate:

\$147,000.

In his early 80s the projected annual Warren Buffett needed Minimum Distribution would be more than:

\$210,000 per year.

This would force Michael solidly into brackets with increased taxation.

Also, an increased taxable income may cause:

Medicare IRMAA surcharges

Taxing the Social Security more.

Less flexibility of taxation in the retirement.

However, the biggest problem was the tax exposure in the long run.

Unplanned, much of the retirement money of Michael would be stuck indefinitely in future tax increase.

The Planning Insight

Most retirees assume that since they will no longer be employed, they will automatically be in reduced tax bracket.

In the case of IRA holders with high balance, the reverse may happen. Even when the Required Minimum Distributions are large later in retirement, it is possible to see that they actually generate more taxable income than those in working years.

The most important planning opportunity is the time in between retirement and Required Minimum Distributions.

In the case of Michael, it was around five years of that window.

The Strategy

We simulated a systematic Roth conversion policy at the age of between 68 and 72.

Rather than letting the RMDs cause him to withdraw, Michael transformed strategic amounts of his IRA as he managed his tax bracket.

During a total of more than five years he had converted:

\$1,000,000 of his Traditional IRA to Roth IRA.

Each conversion was to be tailored to cover certain tax brackets and not to excessively incur high marginal rates on him.

The use of his brokerage account to pay taxes instead of drawing further retirement benefits was also a characteristic of this scenario.

Projected Outcome Comparison

Without Roth conversions:

Projected IRA balance at 73: \$3.9M

First RMD: approximately \$147k

Foreseen lifetime taxable withdrawals: large and growing.

Under Roth conversion strategy:

Traditional IRA was down to about \$2.6M.

Roth IRA balance in the range of about 1.2M.

First RMD reduced to roughly:

\$98,000

His Roth account would now be able to grow tax free without future required minimum distribution.

Why This Matters

The high-net-worth retirees tend to be concentrated on the growth of the portfolio.

However, when growing within tax-deferred accounts, one may enter a tax problem in the future without proper planning.

Throughout his time in the lower-earning years, Michael enhanced the tax efficiency of his retirement plan by transferring a part of his retirement savings to Roth assets.

CASE STUDY 3

The Widow's Legacy Strategy

Client Profile

Susan Thompson

Age 72

Susan's husband died three years ago.

He had been their main financial planner in the family, and he had the majority of their retirement savings residing in tax-deferred accounts.

Another issue that Susan was concerned with was basic.

She desired to make her finances easier and leave the two children with a tax-saving inheritance.

Financial Snapshot

Traditional IRA: \$1,450,000

Savings: \$150,000

Brokerage account: \$210,000

Income: Social Security, \$34,000 a year.

Susan was a comfortable client who did not need any substantial supplementary income.

But, Required Minimum Distributions have already started.

The Problem

The current tax policies have such a provision that surviving spouses ultimately switch to single taxpayer brackets.

There is rapid compression of single tax brackets.

It would imply that widows and widowers will be able to move to higher tax brackets much faster.

Susan will have an estimated Required Minimum Distribution:
\$54,000.

Adding to the Social Security pay and investment income, her taxable income would most probably be more than:

\$95,000 per year.

In the case of one filer, this would put her in higher marginal tax rates in the long run.

Furthermore, the IRA would be passed to her children later.

According to the existing legislation, inherited IRAs should be removed in the next 10 years on average.

This may propel her children to even greater tax brackets as they are able to inherit the account.

The Planning Insight

The assets that are transferred in legacy planning are usually the value.

But it is equally important to consider the tax structure of such assets.

Conventional IRAs would be passed over as taxable income to heirs.

Roth IRAs bequeath to beneficiaries without tax.

In the case of Susan, this provided her with a chance to restructure part of her retirement resources so as to benefit her children.

The Strategy

We considered a five-year Roth conversion strategy, which transferred a share of her Traditional IRA to Roth accounts over a period of time.

Since Susan did not have any serious income demands on the IRA, she was able to transfer moderate sums annually when managing her tax bracket.

During the period of over four years, she changed about:

\$320,000 into Roth assets.

The intention of this strategy was to:

Minimize Future Required Minimum Distributions.

Enhance tax efficiency for heirs.

Get more tax flexibility in a later retirement.

Projected Outcome Comparison

Without Roth conversions:

Administrators may have an heir with more than 1.3M in a Traditional IRA.

With the 10-year rule, they would be pushed into higher tax brackets because of the withdrawals.

Partially Roth converted:

Some of the inheritance would be pumped up to Roth accounts.

The assets may be passed on to heirs free of income tax.

Why This Matters

To most retirees, legacy planning is not about the amount of money inherited.

It is concerning the weight that inheritance bears in the form of tax.

By turning a part of her IRA into a Roth during her lifetime, Susan had created a more tax-efficient bequest to her children.

CASE STUDY 4

The Business Owner Retirement Window

Client Profile

David Martinez

Age 60

David is a successful owner of a construction business that has been operating for more than 25 years.

In his prime income years, he was contributing aggressively to tax-deferred retirement accounts.

Once he started planning the sale of the business, he started thinking in the long term about retirement planning.

Financial Snapshot

Traditional IRA: \$980,000

SEP IRA: \$540,000

Brokerage account: \$300,000

Intended sale of the business in 2 years.

Following the sale, David estimated that his taxable income would be reduced to a large extent.

The Problem

A substantial alteration in income is witnessed by many business owners during periods of retirement.

Years of high income during ownership are normally succeeded by years of low income after the business has been sold.

David was retiring in 10 or so years to come, and this would imply that his taxable income would be considerably lower.

Most of his retirement funds were, however, in tax-deferred products.

Such accounts would continue to grow without planning until the Required Minimum Distributions.

The Planning Insight

Uniqueness in tax planning usually arises as a result of retirement transitions.

In the case of David, the time that had just elapsed after the sale of his business would have been a window of opportunity for a tax bracket.

Instead of not making Roth conversions until the Required Minimum Distributions started, we reviewed the possibility of partial Roth conversions in these lower-income years to make it more efficient in the long term.

The Strategy

We simulated a five-year conversion program that will start at the end of the year after the business sale.

David used his retirement accounts to convert some of the funds annually and remain in the targeted tax brackets.

During a period of more than five years, he translated about:

\$600,000 into Roth assets.

The payment of taxes was made out of his brokerage account instead of taking extra retirement funds.

Comparison Projection of outcomes.

Without Roth conversions:

The number of conventional retirement plans was estimated to be over 2 million when they were 73 years old.

Initial Requirement Minimum Distribution estimated:

\$75,000 annually.

With Roth conversions:

Traditional retirement accounts declined drastically.

A significant part of David's retirement portfolio was now represented by Roth assets.

This had increased tax diversification and heightened flexibility later in retirement.

Why This Matters

Strategic planning usually has brief periods of time because of major life changes.

The fact that the lower-income developed an opportunity by having the ability to capitalize on it many years after David sold his business helped him to reposition part of his retirement savings in a manner that would enhance tax efficiency in the long term.

These, together with the original one, have four good Roth conversion cases.

I can also construct the fifth one, which is the most convincing case, had you the heart:

The Tax Bracket Filler Strategy.

That would land very well, as it would demonstrate to retirees how even small annual conversions can save them significant lifetime tax benefits.

The following is the fifth and last case study of Roth conversion, and is also of the same dense analysis level as the rest. This is the one that can be most common and most convincing since it demonstrates the growth of small annual conversions.

This can be copied/pasted to your case study packet.

CASE STUDY 5

The Tax Bracket Filler Strategy

Client Profile

Robert and Karen

Ages 67 and 65

Robert is a retired 38-year-old employee of a manufacturing company in the region. Karen was part-time in the education sector, and she was intending to retire completely within the following year.

They had been saving all along and were financially happy, and never thought of paying much attention to the way their retirement money would be taxed.

The retirement plan that they had was typical of a lot of disciplined savers: their wealth was concentrated in tax-deferred accounts.

Financial Snapshot

Traditional IRA: \$1,280,000

Brokerage Account: \$310,000

Savings: \$140,000

Social Security (scheduled at 67 years of age):

\$52,000 combined annual benefit

Projected retirement expenses required:

\$85,000 annually

The Problem

There was a similar assumption between Robert and Karen.

This is because they thought that after they ceased working, their taxes would naturally decrease.

But on projecting their future income by existing tax regulations, a different picture arose.

If no planning occurred:

It was estimated that their IRA would reach around 1.85 million at age 73 with a mid-long growth rate.

That would produce a first Required Minimum Distribution of approximately:

\$68,000 per year.

Their projected later retirement taxes on Social Security income, as well as portfolio withdrawals, might amount to:

\$120,000–\$135,000 annually.

Such income would drag them into greater marginal income tax brackets and may lead to further taxation of Social Security benefits.

What the couple had formed was a scenario in which their tax payment in later years of retirement may be even higher than during the early years of retirement.

The Planning Insight

The taxable income of Robert and Karen decreased temporarily when they retired.

Their estimated taxable income in their early retirement years would have been about, without income earned through employment:

\$60,000 per year.

This implied that they were not utilizing a huge share of their present tax bracket.

Rather than letting that unused tax space evaporate every year, we investigated the possibility of it being rational to fill those brackets with partial Roth conversions purposefully.

This measure has been known as bracket-filling or tax bracket management.

This is aimed at converting moderate amounts of retirement assets without moving them out of a preferred tax bracket.

The Strategy

Instead of having a single Roth conversion, Robert and Karen took it in stages.

They converted about 11,145 each year between ages 67 and 72.

Between 90,000 and 110,000 of their Traditional IRA into a Roth IRA.

The conversion amount was also to be such that their taxable income would be near the upper limit of their present marginal tax bracket without an unnecessary push towards the next tax bracket.

The conversions were subject to taxes, on which they paid using their brokerage account funds.

This enabled the total account to keep on growing within the Roth account.

Projected Outcome Comparison

Without Roth conversions:

Forecasted balance of IRA at 73: about 1.85M.

First Requirement Minimum Distribution: \$68,000.

RMDs forecasted in the early 80s: \$90,000+ per year.

Under bracket-management Roth conversions:

The conventional IRA balance of 73 was dropped to about 1.15M.

Accumulation of Roth IRA balance to some extent of about 540,000.

First Requirement: Minimum Distribution to be decreased to about:

\$42,000

The approach also resulted in a large pool of tax-free Roth funds that can be withdrawn at a later age during retirement without raising the taxable income.

Why This Matters

The fact that Roth planning does not necessarily involve a dramatic action is one of its most potent sides.

In some cases, a simpler approach, such as an intentional tax bracket, can be the best strategy.

In converting small sums annually and not falling into unfavorable tax brackets, Robert and Karen could:

Lower Minimum Distributions in the Future.

Grow tax-free retirement funds.

Enhance management of taxable income in old age.

Most significantly, they became flexible.

Instead of being coerced to create huge taxable payouts in retirement, they can now make more decisions on when and how they tap into their retirement savings.