White Lighthouse
Investment Management

# 2020 – The Year of the Roth Conversion

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Many advisors and tax planners are touting 2020 as 'The Year of the Roth Conversion'. In most cases, this is excellent advice. Federal tax brackets are at historically low levels; the Federal tax rate was as high as 94% in 1944. However, this advice may not be in your best interest, for example, if you are a US citizen living abroad or are in a higher federal tax bracket.

**What is a Roth IRA?**

Roth IRA's are funded with after-tax dollars, and qualified withdrawals are tax-free. You won't receive a tax deduction now, but the money grows and is withdrawn tax-free at retirement. This is ideal if you are in a lower tax bracket (12$ - 24%) and expect your income and tax bracket to increase in the future.

**What is a Roth IRA conversion?**

A Roth conversion is the process of moving funds from a Traditional IRA to a Roth IRA. Since a Traditional IRA holds pre-taxed income and a Roth IRA holds income that has already been taxed, the conversion generally triggers an ordinary tax event.

*If you live abroad, you will most certainly be subject to automatic 10% withholding. If you were to convert a $10,000 Traditional IRA to a Roth IRA, you would need to "top-up" the account with an additional $1,000 to cover the withholding. When you file your return, your final ordinary income rate will be determined and could be between 0%-37% (2020).

**Reasons to consider a Roth Conversion in 2020**

- Job Loss / Salary or bonus reduction
- Relocation back to the US planned in the next 1-5 years
- Retirement income gap period

Any of the above factors may put you in a lower tax bracket. Accelerating income with a Roth conversion in the lower Federal tax rates of 12%, 22% or 24%, will mean potential tax savings at retirement.

**Advantages of a Roth IRA**

- Early withdrawal rules are much more flexible with a Roth
- Fewer restrictions for retirees – there is no required minimum distribution

**Disadvantages of a Roth IRA**

- Potentially included in foreign wealth tax assessment on an annual basis
- Your foreign country of residence may treat the ROTH IRA as a regular investment account

If you live abroad, a Traditional IRA may be more advantageous to you – check out this article on how you can lower your tax bill without increasing your wealth tax in Switzerland.