

Think you can't own a Roth IRA? Think again.

Many people are well aware of two key advantages of a Roth IRA: the ability to withdraw money tax-free — which appeals to anyone who wants to minimize their tax bite in retirement — and the ability for wealthier taxpayers to maximize assets and minimize taxes for their heirs. Unfortunately, high earners often assume they are ineligible for a Roth IRA. This is not necessarily true. Even though you might not be eligible to contribute directly to a Roth IRA, you might be able to convert a traditional pre-tax IRA into a Roth IRA.

One such strategy is accomplished by first making non-deductible contributions to a traditional IRA (up to \$7,000/year in 2024, or higher if you qualify for catch-up provisions). Non-deductible contributions create “after-tax” basis in the pre-tax IRA. Later, one might consider converting this to a Roth IRA, and this conversion is likely to be partially tax free due to the after-tax basis in the account.

Now for the caveats:

- If you have an existing IRA, you should consult with your Mesirow wealth advisor and your accountant to determine if a Roth conversion is appropriate.
- If you have multiple IRA accounts, they are treated as one IRA for tax purposes. Therefore, the conversion would be considered a partial conversion of all IRA assets, not just the newly contributed funds. This would cause the conversion to be partially taxable (pro-rata).

Tax time is a great time to have the conversation with your wealth advisor

For many of our clients, tax time is the perfect time to discuss whether converting their traditional IRA to a Roth makes sense based on their unique circumstances. We can discuss eligibility requirements, the pros and cons of a conversion and the potential benefits of a Roth IRA for intergenerational wealth transfer.

Commonly asked questions about Roth IRAs

What is the difference between a Roth IRA and a traditional IRA?

Roth IRAs are similar to traditional IRAs except that Roth contributions are “after-tax,” which means you pay taxes on your contribution upfront. Consequently, withdrawals from Roth IRAs are tax-free, meaning that your investment earnings and growth are never taxed. Traditional IRA contributions are not taxed upfront, but are instead taxed when you take a distribution from the account. Depending on your situation, a Roth may create significant value for you and your heirs despite the fact that you don't benefit from an initial tax-deduction.

Who can contribute to a Traditional IRA?

Everyone can contribute to a traditional IRA as long as they have earned income or qualify for a spousal IRA. However, only taxpayers who meet certain requirements may take a deduction for their contribution. Individuals that don't meet the requirement are still eligible to make non-deductible contributions to a traditional IRA.

Who can contribute to a Roth IRA?

Only taxpayers with income below certain levels may contribute to a Roth IRA. In 2024, individuals with income less than \$161,000 and married couples filing jointly with income of \$240,000 or less are eligible.¹

How much can you contribute to a Roth IRA?

The contribution limits are the same as a traditional IRA. You can contribute \$7,000 per year plus \$1,000 if you are over the age of 50 (“Catch-Up Deferrals”).

What is the deadline to contribute to a Roth IRA?

You have until April 15, 2024 to make a contribution for the 2023 tax year.²

What are the advantages of a Roth IRA?

There are many advantages.

- When money is distributed from a Roth it is entirely tax-free, including the earnings.
- There are no annual required distributions from a Roth (there are for a traditional IRA).
- A Roth IRA is a tax-efficient way to transfer wealth to beneficiaries upon the account owner's death. A spouse inheriting their partner's Roth is not required to take mandatory distributions, while non-spouse beneficiaries must take distributions based upon their own actuarial life expectancy. In either case, all distributions are withdrawn tax free.

Can you have both a Roth and traditional IRA?

Yes, you can have both. It is important to keep in mind though that the contribution limit of \$7,000 is applied aggregately, not \$7,000 for each account.

What are the rules for Roth IRA distributions?

There are two primary requirements for distributions to avoid taxes and penalties:

1. Roth owners must be at least 59½.
2. The distribution must occur five years after the establishment of a Roth account.

What is a Roth 401(k)?

Roth 401(k)s are relatively new, and often provide additional retirement savings flexibility. They function similarly to a traditional 401(k) except the employee contributions are taxed up-front, just like a Roth IRA. However, anyone can contribute to a Roth 401(k) if available, as there are no income limitations. It is important to note that if you contribute to a Roth 401(k) any contribution your employer makes will be part of the traditional 401(k), not the Roth 401(k). Your employer is responsible for segregating these two accounts. When you leave that employer, the Roth 401(k) portion will roll over to a Roth IRA and the traditional 401(k) portion will roll over to traditional IRA. Your Mesirow Wealth Advisor can help explain this to you in more detail.

As always, please reach out to us if we can assist with your understanding of whether a Roth might make sense for you when viewed as part of your overall long-term financial plan.

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1. <https://www.mesirow.com/sites/default/files/PDFs/Wealth/2024-Contribution-Limits.pdf>

Additional source: <https://www.investopedia.com/terms/r/rothira.asp>

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