



## Tackling the Tax Train with the Roth Conversion Strategy



### Tackling the Tax Train – Roth Conversions

#### Welcome

- » Our audience today
- » Q&A – the ProFeds Support Team standing by
- » Handouts – available for download
- » Recorded – how to get the replay
- » Stay until the end!

### Tackling the Tax Train – Roth Conversions

#### Your ProFeds Presenter



#### Chris Kowalik

- » ProFeds Founder
- » Developer of the FedImpact Retirement Workshop
- » Host of the FedImpact Podcast



#### Support Team

- » Standing by for your questions

### Tackling the Tax Train – Roth Conversions

## Tackling the Tax Train

### Exploring the Roth conversion strategy to drastically reduce your tax obligation in retirement

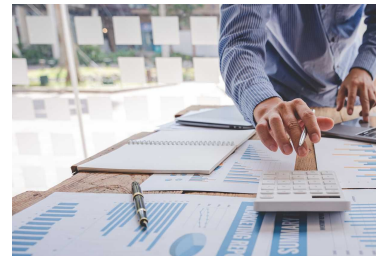
## Agenda

- » **ISSUE:** Taxes have been deferred for many years, but will be payable in retirement
- » **EFFECT:** Higher taxable income in retirement affects other benefits like Medicare
- » **CONCEPT:** Create a strategy to begin to make your TSP account tax-free in retirement
- » **COMPLEXITY:** What to watch out for to ensure you implement this strategy correctly

## What this webinar will NOT cover

## The Intention of This Webinar

- » This is not tax advice – this is tax awareness
- » We ARE NOT suggesting that a Roth conversion strategy is appropriate for you
- » We ARE suggesting that having a meaningful conversation about what control you can have over your tax situation puts you in an advantageous position
- » This is not an exhaustive reference of the Roth conversion strategy, so seek professional advice for your unique situation



## The Tax Situation Room

### The Great Tax Prediction

- » Do you think tax brackets will change in/out of your favor in the future?
- » Will your tax obligation be higher/lower in the future?
- » How do your tax choices look in the future?



### How Tax Brackets Work

- » We currently have 7 tax brackets:
  - 10%, 12%, 22%, 24%, 32%, 35%, 37%
- » Each bracket has 4 different filing statuses:
  - single,
  - married filing jointly,
  - married filing separately, and
  - head of household



*These brackets will change when the “Tax Cuts and Jobs Act” sunsets on December 31, 2025.*

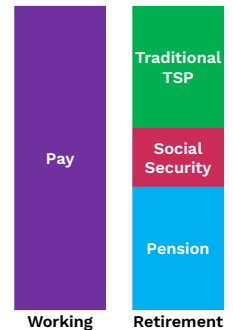
*This will cause more income to be taxed at a higher rate than it is today.*

### How Tax Brackets Work for 2024 (due in 2025)

Rate	Single	Married Filing Jointly	Married Filing Separately	Head of Household
<b>10%</b>	\$0 – \$11,600	\$0 – \$23,200	\$0 – \$11,600	\$0 – \$16,550
<b>12%</b>	\$11,601 – \$47,150	\$23,201 – \$94,300	\$11,601 – \$47,150	\$16,551 – \$63,100
<b>22%</b>	\$47,151 – \$100,525	\$94,301 – \$201,050	\$47,151 – \$100,525	\$63,101 – \$100,500
<b>24%</b>	\$100,526 – \$191,950	\$201,051 – \$383,900	\$100,526 – \$191,950	\$100,501 – \$191,950
<b>32%</b>	\$191,951 – \$243,725	\$383,901 – \$487,450	\$191,951 – \$243,725	\$191,951 – \$243,700
<b>35%</b>	\$243,726 – \$609,350	\$487,451 – \$731,200	\$243,726 – \$365,600	\$243,701 – \$609,350
<b>37%</b>	\$609,350+	\$731,200	\$365,600+	\$609,350+

### Tax Obligations

- » Most people think they will be in a lower tax bracket when they retire (so they think they’ll owe less taxes in retirement)
- » The reality is that if you intend to maintain your standard of living, (but all of the assets you have to pull from are taxable), you will likely be in the same bracket!



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**How Can You Actually Be in a Lower Tax Bracket?**

- » There are only two reasons you end up in a lower tax bracket in retirement:
  - You have less money (so you pay less tax), or
  - You have taken steps NOW to give yourself access to money that is NOT TAXED when you receive it LATER
    - This takes a concerted effort to build a strategy
    - Why your CPA might be the wrong person to ask

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**Some tax-advantaged vehicles available**

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**Individual Retirement Arrangement (IRA) Options**

	Traditional IRA	Roth IRA
<b>Contribution limits</b> (Trad & Roth combined)	For 2024: \$7,000/yr (under age 50) or \$8,000/yr (age 50+)	
<b>Income limits</b>	No income limits	\$161,000 (single) \$240,000 (married filing joint)
<b>Tax on the way IN...</b>	<b>Not taxed now</b> (you contribute with money you have NOT paid tax on)	<b>Taxable now</b> (you contribute with money you HAVE paid tax on)
<b>Tax on the way OUT...</b>	<b>Taxed later</b> (all principal & earnings are taxes as ordinary income)	<b>Tax-Free later</b> (all principal & earnings are paid to you tax-free)
<b>Restrictions</b> (see IRS.gov for exceptions)	Generally, you must be age 59½ for penalty-free withdrawals	Generally, you must be age 59½ for penalty-free withdrawals & satisfy the 5-yr holding period

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**Thrift Savings Plan (TSP) Options**

	Traditional TSP	Roth TSP
<b>Contribution limits</b> (Trad & Roth combined)	For 2024: \$23,000/yr (under age 50) or \$30,500/yr (age 50+)	
<b>Income limits</b>	No income limits	
<b>Tax on the way IN...</b>	<b>Not taxed now</b> (you contribute with money you have NOT paid tax on)	<b>Taxable now</b> (you contribute with money you HAVE paid tax on)
<b>Tax on the way OUT...</b>	<b>Taxed later</b> (all principal & earnings are taxes as ordinary income)	<b>Tax-Free later</b> (all principal & earnings are paid to you tax-free)
<b>Restrictions</b> (see special rules on next slide)	Generally, you must be age 59½ for penalty-free withdrawals	Generally, you must be age 59½ for penalty-free withdrawals & satisfy the 5-yr holding period

### Penalty-Free Access to TSP

- » Federal employees RETIRING/SEPARATING from federal service may access TSP funds without penalty if they meet these rules:
  - Regular employees:
    - retire/separate in the calendar year they turn age 55 (or older)
  - Special category employees (LEO, ATC, FF):
    - retire/separate in the calendar year they turn age 50 (or older), OR
    - retire/separate at any age (w/ at least 25 yrs of covered service)

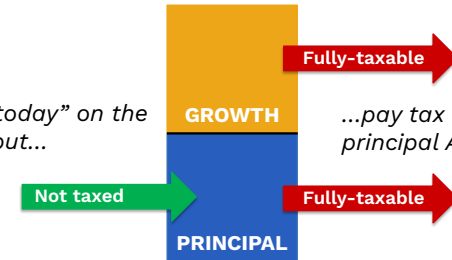
### Tax-Advantaged Options in TSP (TRADITIONAL)

When \$\$\$ goes in

When \$\$\$ comes out

Save tax “today” on the principal, but...

...pay tax “later” on the principal AND growth!



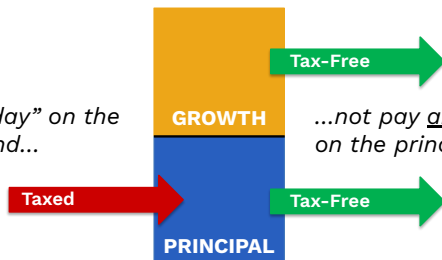
### Tax-Advantaged Options in TSP (ROTH)

When \$\$\$ goes in

When \$\$\$ comes out

Pay tax “today” on the principal, and...

...not pay any income tax on the principal OR growth!



### Tax Diversification

» Concept:

- Have different buckets of money to choose from that are taxed differently in retirement
- Choose when and how to take money from each bucket based on tax environment
  - When taxes are low, take \$\$\$ from taxable account (Trad)
  - When taxes are high, take \$\$\$ from tax-free account (Roth)



*Investors use strategies like ‘tax diversification’ to control taxes. The more tax-diversified their portfolio is, the more flexibility they have to control their tax burden each year.*

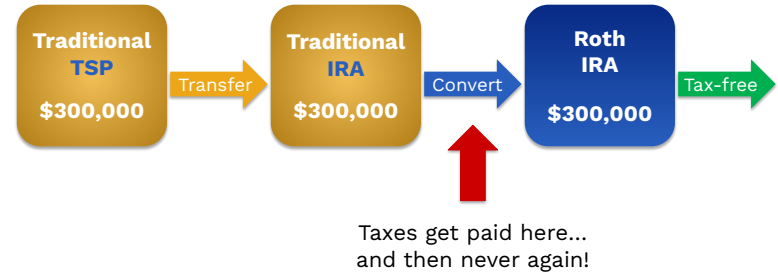
## Our Case Study Today



Linda

Her big question:  
***“How can I make some of my \$300k Traditional TSP be tax-free in retirement?”***

## The General Concept of a Roth Conversion



## FAQs on Roth Conversions

**Q:** ***Can I do a Roth conversion inside the TSP to turn my Traditional money into Roth?***

**A:** No – the TSP does not allow this strategy to happen inside the account. The only way to do this is to move the money to a private Traditional IRA and then do the Roth conversion.

It's also worth noting that once the money is in a Roth IRA, you are NOT allowed to move it back into the TSP.

**Q:** *I heard I make too much to do a Roth conversion – is that true?*

**A:** No – there are no income limits set on Roth conversions like there are when someone contributes directly to a Roth IRA account. Regardless how much you make, you are eligible to do a Roth conversion.

**Q:** *Is there any limit how much I can convert in a Roth conversion?*

**A:** No – there are no limits to the amount of Traditional money that can be converted to Roth money. However, remember that taxes will be owed at the time of the conversion, so that might keep you from wanting to move all of the money in one tax year. You can spread out your conversions over several tax years to convert chunks at a time.

**Q:** *Can I use some of the money in the Traditional TSP to pay the tax owed on the Roth conversion?*

**A:** Yes, but you should avoid doing this because it lowers the amount that is being converted. Plus, if you are under 59 ½, you will be subject to a 10% early withdrawal penalty on the money you keep to pay the taxes.

**Q:** *Do I have to be a certain age to do a Roth conversion?*

**A:** No – there are no age restrictions on when you are allowed to do this conversion. However, you will not have access to your TSP until you retire (or you reach age 59½ while you're still working). Be cautious about doing large conversions as you near age 65. All money you convert from Traditional to Roth will count as income to determine your Medicare Part B premium.

**Q:** *When is the deadline to do a Roth conversion (for tax purposes)?*

**A:** If you wish to do a Roth conversion, it must be done by December 31st of that tax year. Remember, any funds converted to be reported as taxable income for that year in which the conversion occurred.

**Q:** *If I do a Roth conversion, do I have to wait to withdrawal the money?*

**A:** Yes - any Traditional TSP money you convert to a Roth IRA (through a Roth conversion) starts a 5-year clock. It is important that you do not need to access that money until that time. Plus, the ideas with a Roth account is that you want the money to grow for as long as possible because the growth is tax-free.

**Q:** *What happens if I do a Roth conversion and then need the money before age 59½ or before the 5 years has passed?*

**A:** You can withdraw your principal from a Roth IRA at age age without paying taxes or penalties. However, if you withdraw your gains from a Roth IRA without meeting both the “age 59 ½ & 5-year” rules, you may owe taxes and penalties on that portion. See IRS.gov for exceptions.

**Q:** *If I am in a state that does not have income tax, are Roth conversions still a good idea?*

**A:** Maybe – it’s worth having a conversation about and look at the bigger picture. This should certainly be part of the discussion and factored into your decision. Keep in mind that you will always owe federal tax on any Traditional distributions regardless of the state in which you live!



**Q:** *If I'm in a state that doesn't tax TSP or IRA distributions, is a Roth conversion still a good idea?*

**A:** Maybe – where you live (when you plan to receive the money) is certainly an important factor to consider.

States that do NOT tax TSP at the state level:  
AK, FL, IL, IA, MS, NV, NH, PA, SD, TN, TX, WA, WY

**Q:** *If I do a Roth conversion and later change my mind, can I undo it?*

**A:** No – you are not allowed to “undo” a Roth conversion. Prior to 2018, this was allowed, but current law prohibits this now.

**Q:** *Do Roth accounts have Required Minimum Distributions (RMDs) that make me take money out once I'm 73 and older?*

**A:** No – both Roth IRAs and Roth TSPs are exempt from RMDs. You can allow this account to continue to grow tax-free for your lifetime if you wish.

Both Traditional TSP and Traditional IRAs have RMDs. This means you have to take money out (and pay taxes on it) even if you don't need it!

**Q:** *If I die with a Roth IRA, do my beneficiaries receive the money tax-free?*

**A:** Yes – this is a huge perk for Roth accounts (even your Roth TSP)! Your beneficiaries get to receive your account balance tax-free. They can also allow it to continue to grow tax-free for up to 10 years before being required to deplete the account.

**Q:** *Who can help me to assess whether a Roth conversion strategy makes sense (and if so, make it happen)?*

**A:** This can be a complicated process, so please seek professional help. Ideally, your tax professional is able to provide the necessary data so that a proper assessment can be done to determine if a Roth conversion is an advantageous move.

A licensed financial professional provides financial context, analysis and account recommendations.

#### Tackling the Tax Train – Roth Conversions

### The Biggest Challenges According to the Pros

- » Taxes are always a moving target
- » It's not IF – it's WHEN – you'll pay the taxes
- » This process is not pain free, but the goal is to take the least painful route
- » The Roth conversion process is complicated and wields a lot of consequence if done incorrectly
- » You get to choose whether you're going to be reactive or proactive in the tax world

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IN YOUR OWN RETIREMENT STORY**

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U.S. Office of Personnel Management

"The most information I have ever received and heard in my ENTIRE military and professional career."  
L.B., Department of Defense



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### Handouts and Replay



- » Handouts
  - Download
  - Emailed
- » Replay
  - Link will be emailed to all registered participants

## Next Webinar



- » Next webinar topic!
  - **TSP Withdrawal Options**  
How to get money out of the TSP in retirement
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