LESSON · TAX & WITHDRAWALS

Roth Conversions: Paying Tax Now to (Maybe) Avoid It Later

A Roth conversion moves money from a Traditional account to a Roth, and you pay the tax bill today. Done at the right time it can lower your lifetime tax bill and future RMDs. Done at the wrong time, it can wreck your ACA subsidy for a year. Here's how to think it through, bracket by bracket.

Read time: 9 minutes **Level:** Intermediate **Includes:** Knowledge check

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A Roth conversion moves money from a Traditional IRA or 401(k) into a Roth account. You pay ordinary income tax on the converted amount in the year you do it — and in exchange, that money (and all its future growth) can come out completely tax-free later, once it's met the applicable holding period and age requirements. Done at the right time, a conversion can lower your lifetime tax bill and shrink future RMDs. Done at the wrong time, it can quietly wreck an ACA subsidy or push you into a bracket you didn't mean to be in.

The classic "conversion window"

The years between when you stop earning a paycheck and when Social Security and RMDs begin are often the lowest-income years of a person's adult life — which makes them the best window to convert. Converting deliberately in those years lets you fill up the lower tax brackets on purpose, paying tax at rates you might not see again once Social Security and RMDs are both layered on top of each other.

Worked example: converting into a bracket

Say your ordinary income this year — before any conversion — leaves about $30,000 of room left in the 22% federal bracket before you'd spill into the next one up. A common strategy is to convert exactly that $30,000, no more: you pay tax on the conversion entirely at 22%, and stop before any of it is taxed at the higher rate above. Converting $60,000 instead might mean the second half is taxed at a noticeably higher rate — which can still be worth it, but it's a different, deliberate decision rather than an accident of not checking the bracket first.

The math only works if you pay the tax from outside the IRA

If you withhold taxes directly from the converted amount, you lose growth on whatever was withheld — and if you're under 59½, that withheld portion can also trigger the 10% early-withdrawal penalty, on top of defeating the purpose of the conversion. The clean version of this strategy pays the tax bill from a taxable brokerage account or cash on hand, so the full converted amount keeps growing tax-free inside the Roth.

The 5-year rule has two different clocks

This is one of the more confusing parts of Roth conversions, because there are genuinely two separate 5-year rules that get conflated:

- **The account's overall 5-year rule** determines whether earnings can come out tax-free at all — it starts on January 1 of the first year you funded any Roth IRA, and only needs to be satisfied once, ever.
- **Each conversion's own 5-year clock** determines whether the converted principal (not earnings) can come out before 59½ without a 10% penalty. Every conversion starts its own separate clock — so someone doing conversions in five different years has five different clocks running, oldest to newest.

In practice, this mostly matters for people converting before 59½ who might need to access the converted funds early. Once you're past 59½, both clocks stop mattering for penalty purposes, as long as the account's overall 5-year rule has been met.

The pro-rata rule — a trap for anyone with after-tax IRA money

If you've ever made a non-deductible (after-tax) contribution to a Traditional IRA, the IRS doesn't let you cherry-pick which dollars convert. All of your Traditional IRA balances, across every account, are treated as one combined pool for tax purposes — so a conversion pulls out a proportional mix of pre-tax and after-tax money, not just the after-tax portion you might have been hoping to convert tax-free. This is the single most common way a "backdoor Roth" strategy goes wrong: someone assumes only their new after-tax contribution converts tax-free, without realizing an old rollover IRA sitting untouched for years is quietly part of the same pro-rata calculation.

What a big conversion can quietly break

Because the converted amount counts as income in the year of the conversion, it raises your MAGI for that year — which can shrink or eliminate an ACA subsidy if you're on marketplace coverage (see the ACA lesson), or, two years later, trigger an IRMAA surcharge on Medicare premiums if you've reached that age. A conversion that's too large in a single year can also push you into a materially higher bracket than the one you're trying to avoid down the road, which defeats the purpose. The right conversion size in any given year is usually "as much as fits in your target bracket, without spilling into ACA or IRMAA thresholds," not "as much as possible."

State taxes can change the math too

Federal tax treatment of a conversion is consistent nationwide, but state tax treatment isn't — some states don't tax retirement account withdrawals the same way they tax ordinary income, and a few don't tax them at all. If you're planning a move to a different state in retirement, the state you're a resident of in the year you convert is the one that taxes the conversion, which can make timing relative to a move a real, calculable difference.

How this fits the rest of your plan

Conversions interact with almost everything else in this lesson series: they reduce the balance that future RMDs will be calculated from, they raise MAGI in the year they happen (which touches ACA subsidies and IRMAA), and they only pay off with enough time horizon left for tax-free growth to matter. That's why this is usually a multi-year decision made in coordination with your broader plan, not a single lump-sum choice.

Before you convert:

- [ ] Project the MAGI impact for the year — tax bracket, ACA subsidy, and future IRMAA
- [ ] Confirm you have cash outside the IRA to pay the resulting tax bill
- [ ] Check whether the pro-rata rule applies if you have any after-tax dollars in a Traditional IRA
- [ ] Have a realistic time horizon — conversions need years to pay off through tax-free growth
- [ ] Coordinate the amount with any RMD reduction you're trying to achieve
- [ ] If relocating in retirement, consider how state tax treatment interacts with your conversion timing

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KNOWLEDGE CHECK

Test what you just learned

Answer four quick questions to test what you just learned.

1. When you complete a Roth conversion, who pays the tax, and when?

> A. No one — conversions are always tax-free
> B. You do, in the year of the conversion, as ordinary income
> C. The receiving Roth account pays the tax automatically

2. What's typically the best window to do sizable Roth conversions?

> A. Any year is equally good
> B. The lower-income years between retirement and when Social Security and RMDs begin
> C. Only before age 30

3. What does the pro-rata rule mean for someone converting who also has after-tax contributions in a Traditional IRA?

> A. Only the after-tax dollars convert, tax-free
> B. All Traditional IRA balances are treated as one pool, so the conversion is a proportional mix of pre-tax and after-tax money
> C. The pro-rata rule only applies to 401(k)s, not IRAs

4. Why can a large conversion in a single year hurt an early retiree on ACA coverage?

> A. It can't — conversions don't affect ACA subsidies
> B. It raises MAGI for that year, which can shrink or eliminate an ACA subsidy
> C. Roth conversions are not legal before age 59½

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