SPOTLIGHT

A WEALTH MANAGEMENT PUBLICATION OF FERGUSON WELLMAN, OCTAVIA GROUP AND WEST BEARING

ROTH IRA CONVERSIONS

Introduction to Roth IRAs

Roth IRAs are after-tax retirement accounts. While contributions are not tax-deductible, balances grow tax-free, and original owners are not subject to required minimum distributions (RMDs). Additionally, withdrawals are income tax-free provided they are withdrawn after age 59 ½ and meet other requirements or qualify for exceptions. Roth IRAs have been available since 1997, and individuals can convert their traditional IRAs to Roth IRAs by paying income tax on the balance of pre-tax funds that are converted. Individuals who exceed certain levels of income cannot contribute to Roth IRAs. However, the income limit for converting traditional IRAs to Roth IRAs was eliminated in 2010, which introduced another planning strategy forconsideration by high-income earners.

Roth Conversion Considerations

There are several items to consider and assumptions to be made, thus no perfect formula exists for deciding if a Roth conversion is appropriate for you. It will be important to consider the following factors and discuss the pros and cons with your tax and legal advisors. Ferguson Wellman and West Bearing have tools to support the analysis, but the assumptions will drive the outcome, and your strategy should be determined in consultation with your entire team of professional advisors.

Tax Planning: Converting your pre-tax retirement funds into a Roth account will trigger income tax now but allow you and your beneficiaries to withdraw the funds free of income tax in the future. It may be beneficial in retirement to have assets with different tax treatments to allow for tax and income diversification.

Higher Taxable Income: Converting to Roth may result in a higher taxable income, possibly increasing tax brackets, Medicare premiums and taxation of Social Security.

Estate Taxes: For those who will be subject to federal or state estate tax, Roth conversions before death will reduce estate taxes by virtue of the income tax being paid during life, reducing the value of the estate assets at death (on which estate tax is calculated).

Valuation: Converting when values are relatively low will trigger less taxation and may be a smart move if you are not using funds from the IRA to pay the taxes.

Beneficiary 10-year Rule: With the SECURE Act limiting most non-spousal inherited IRA distribution periods to 10 years, Roth IRAs are becoming even more attractive for transferring wealth. While beneficiaries must still withdraw Roth IRA balances within 10 years, the distributions will be tax-free.

Electing to convert small portions of your IRA to a Roth IRA over many years may be a useful strategy for creating your own "stretch" IRA. The primary goal of this strategy is to limit the taxable income to a beneficiary in any given year.

Backdoor Roth IRA Contributions: For those who participate in employer-sponsored retirement plans and also contribute to after-tax IRAs, it will likely be advantageous to immediately convert these funds to a Roth IRA if you do not have any pre-tax IRA funds.

Income Tax Rates: Several of the considerations listed above are driven by the goal of reducing the income tax rate that will apply to distributions. Income tax rates will be affected by three important factors:

- Size of the distribution
- Current versus future income tax rates of owner and/or future beneficiaries
- Possible changes in federal and state income tax rates

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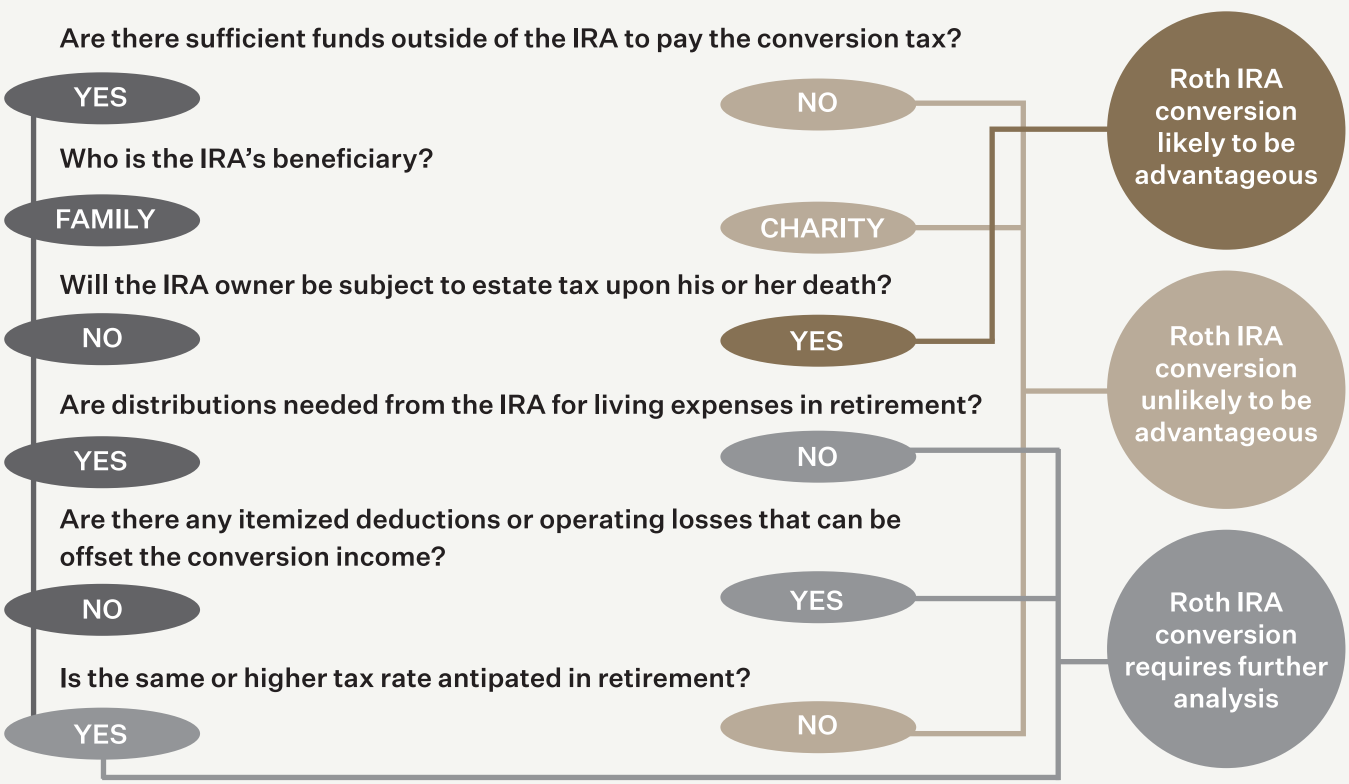
Portfolio Rates of Return: Using realistic assumptions is important in any analysis used to make financial decisions. Roth conversions will appear more advantageous when using higher portfolio rates of return in analysis, due to taxes being assessed on a smaller relative number.

Length of Time: All other things being equal; conversions are most beneficial when the funds remain invested in the Roth IRA for extended periods of time.

Source of Funds to Pay Taxes on Conversion: It is rarely advantageous to convert to a Roth IRA if you need to withdraw funds from the IRA to pay the taxes. Withdrawals to pay the taxes on conversion will be subject to taxation and possible penalties.

Charitable Intent: Naming a charity as beneficiary of a traditional IRA is not only impactful, but also tax-wise as the charity will not be subject to any income or estate taxes. If there are legacy charitable intentions, it may not make sense to convert the entire traditional IRA to a Roth IRA.

Five-year Period: Wait five years after conversion before withdrawing funds, or you will likely owe tax on the earnings and a 10% penalty. Each conversion carries its own five-year window that starts on January 1 of the year in which the conversion occurred.



*In 2026, the federal estate tax rate is 40% on assets over $15 million per person. The Oregon estate tax rate is 10-to-16% on assets over $1 million, and Washington has a 10-to-35% tax on assets over $3 million per person. Idaho and California do not currently have a state-level estate tax, but residents are still subject to federal estate taxes. Both federal and state-level estate taxes are subject to change and could result in negative outcomes.