HAYES ADVISORY GROUP

RETIREMENT PLANNING

Knowledge is Power

March 2024 Question Of The Month?

"I have heard a lot about the benefits of doing Roth conversions to become more tax efficient. However, someone told me it is not a good idea because of the lost opportunity cost. What does that mean specifically, and is this a reason not to do Roth conversions? Thank you." LeAnn

Hi LeAnn. Very good question! Every retirement tool and strategy has its advantages and disadvantages, as well as times where it should and should not be used; Roth conversions are no different. This is a great move for a lot of people to make, however, there are situations where you shouldn't do a Roth conversion. But there is no 'lost opportunity cost' to a Roth conversion. This is a myth and not a factor against doing a Roth conversion.

The point argued here is that using funds now to pay the tax upfront on a Roth conversion means losing the future earnings that could have been produced on those funds you paid the tax with, i.e. an opportunity cost. Again, this is simply not true. The main factor here is taxes, meaning the difference between the tax rates paid upfront, now at the time of conversion, versus the projected tax rates, either later in retirement or for beneficiaries.

It's all about the tax rates: not inflation, not earnings, and certainly not the lost opportunity cost. If the tax rates are the same both at conversion and later in retirement, the end financial result will be exactly the same, and this is true regardless of how long the funds are invested before being withdrawn in retirement.

To illustrate this point, let's take a look at an example. Let's look at a $100,000 IRA, and let's just assume a lifetime earnings rate of 200% and a tax rate of 30%. With no Roth conversion, that $100,000 would grow to $300,000, but after the 30% tax rate, the IRA would be worth $210,000. Now let's look at it with a Roth conversion. Let's go ahead and convert that $100,000 today with a tax rate of 30%. This will knock the balance down to $70,000 and with the 200% lifetime earnings, it would grow to $210,000. The result is exactly the same as if you didn't do a conversion.

So, as you can see, the decision whether or not to do a Roth conversion is all about taxes. When can you pay the least amount of tax, now by doing a conversion, or later by not doing a conversion? That is the key question you need to answer before you decide whether or not to do a Roth conversion. With taxes right now at all-times lows, it is likely that for a lot of people, tax rates could be higher in retirement, making the case for doing Roth conversions now. For more detailed information on this question and to get answers to many more retirement planning questions submitted by our readers and listeners, join me this weekend on The Retirement Money Matters Educational Radio Show Program. The show airs on Saturday morning at 6 on WIBC (93.1 FM), Sunday morning at 8 on WWKI (100.5 FM), or online at www.theretirementmoneymattersshow.com. You can also obtain this information by reaching out to us at Hayes Advisory Group at 452-PLAN (7526), 800-939-1603 or brian@hayesadvisorygroup.com.