



Roth Conversions

After OBBBA

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Outline

- OBBBA
- Roth Conversion Critical Concepts
- Estate Planning Motivated Roth Conversions – In Response to the SECURE Act
- Core Roth Conversion Concepts



OBBBA

Rates – Made Permanent

- All TCJA rates & bracket thresholds are generally made permanent by the OBBBA



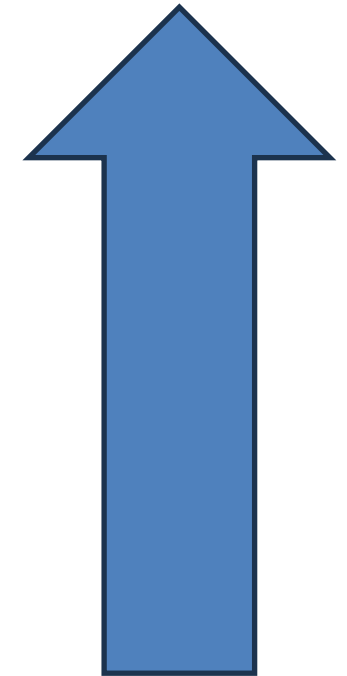
OBBBA § 70101

Standard Deduction

Made Permanent & Expanded

- TCJA standard deduction increase permanent
- Slight additional permanent increase as well
- **Effective in 2025**

	2025 TCJA	2025 OBBBA	2026 OBBBA
Single	15,000	15,750	16,100
HoH	22,500	23,625	24,150
MFJ	30,000	31,500	32,200
MFS	15,000	15,750	16,100



OBBBA § 70102

Senior Personal Exemption

- For years **2025**, 2026, 2027, & 2028 seniors are entitled to an additional \$6,000 exemption.
- Limitations
 - Available to taxpayers who have attained age 65 before the close of the tax year
 - The \$6,000 deduction is reduced by 6% of the amount modified AGI exceeds \$75,000, with full-phaseout at \$175,000 (\$150,000 - \$250,000 MFJ)
 - AGI is modified, increased, for income excluded under Sections 911, 931, & 941 (foreign income basically)

199A

Made Permanent & Other Modifications

- The bill makes the 20% QBI deduction permanent
- The bill increases the phase-out range of the SSTB / Wage & Capital limitations from \$50,000 currently to \$75,000
 - For those married filing jointly the phase-out range is increased from \$100,000 to \$150,000
 - The increased phase-out range applies 2026+
- The bill also includes a minimum deduction of \$400 for taxpayers with at least \$1,000 of QBI from one or more active trades or businesses in which the taxpayer materially participates; this will be available 2026+

State & Local Tax Deduction *Modifications*

- The bill increases the deduction cap as follows:

2025	\$40,000
2026	\$40,400
2027	\$40,804
2028	\$41,212
2029+	\$10,000

- The bill also provides the deduction cap is reduced by 30% of modified AGI over \$500,000;
 - The deduction is not reduced below \$10,000 (i.e., a \$100,000 phase-out range)
 - The income-based limitation applies 2025+

SALT Deduction

- Roth conversions are often subject to both state and federal income taxes.
- Since the TCJA, state income taxes have largely been non-deductible.
- However, the new OBBBA \$40,000 SALT deduction reduces the effective state and federal combined tax rate.
- A planner may consider limiting Roth conversions in such a way to avoid exceeding the \$40,000 SALT limitation.
- Similar to the senior deduction, planners should isolate this benefit and whether the benefit increases the efficacy of a Roth conversion.

SALT Phaseout

- Example: Randy and Sarah have MAGI of \$500,000 and itemized deductions of \$75,000 including a tentative SALT deduction of \$40,000. They execute a Roth conversion of \$100,000 and increase their MAGI to \$600,000. Like magic, their SALT deduction is reduced to the statutory floor of \$10,000
- In simple terms, their gross income increase by \$100,000 but their taxable income increased by \$130,000. If their marginal rate was 35%, their effective rate on the increase from \$500,000 to \$600,000 of income is 45.5% ($35\% * 130\%$). This hidden 10.5% tax rate increase will almost certainly eliminate most if not all the benefits of this Roth conversion. However, while a larger conversation may be impacted, it may continue to be efficacious. Long term projections will be required to determine the merit of any conversion that triggers a SALT phaseout

PEASE Limitation

Modification

- The TCJA suspended the overall limitation on itemized deductions (the PEASE limitation)
- The bill re-introduces and modifies the limitation (effective 2026+)
 - The new formula is as follows:

$$\text{Reduction} = \frac{2}{37} \times \text{the lessor of } \left\{ \begin{array}{l} \text{Total Itemized Deductions} \\ \text{Total taxable income, plus} \\ \text{itemized deductions, subject to} \\ \text{the 37\% bracket} \end{array} \right.$$

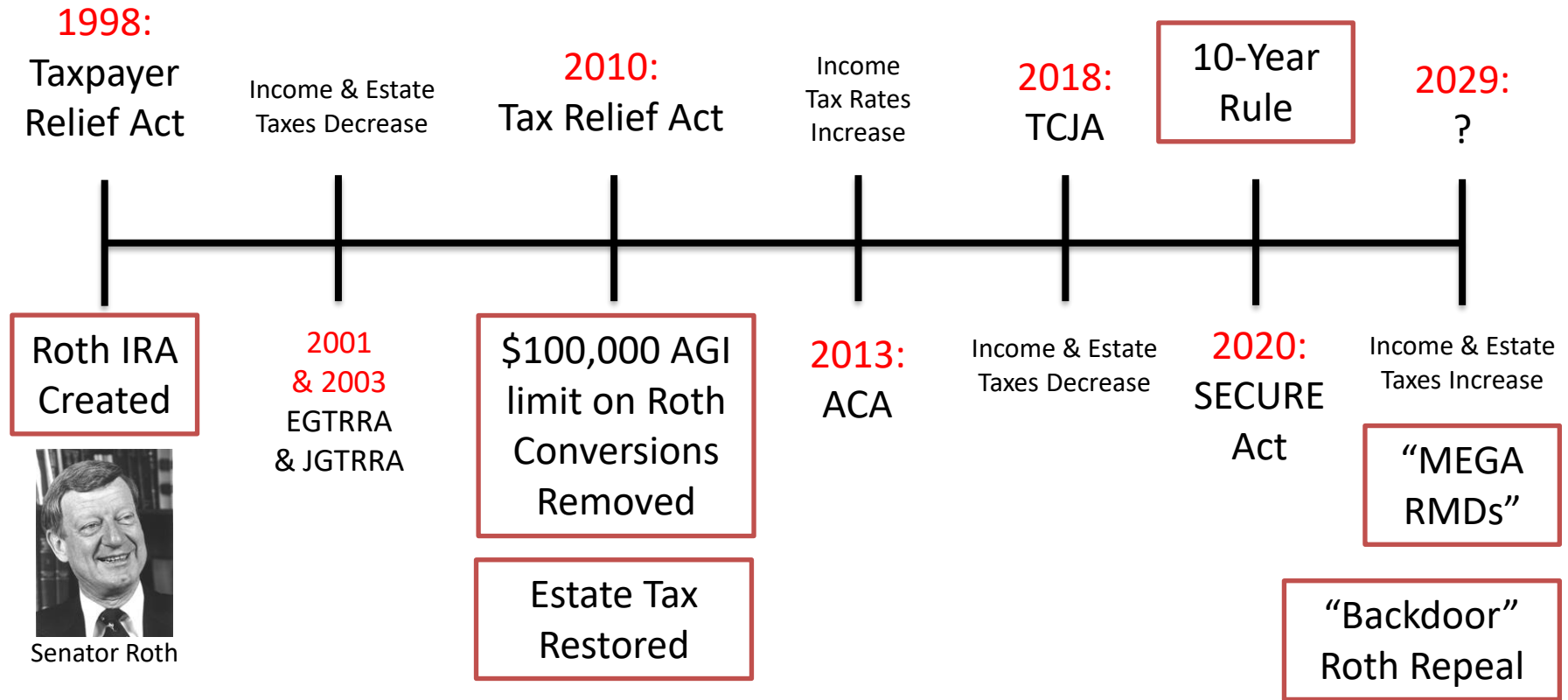
OBBBA § 70111

0.5% Floor for Itemized Charitable Deductions

- The adds a new limitation – contributions must exceed 0.5% of the taxpayer's contribution base to be deductible
- The bill also permanently increases the cash contribution to 60% (recall, it was 50% before the TCJA)
- Effective to taxable years beginning after 12/31/25

Roth Conversion Critical Concepts

ROTH IRA TIMELINE



Senator Roth

Raising Revenue via IRA Reform

- Base broadening changes to raise revenue may impact IRAs; Potential options include:
 - Limiting accruals in retirement accounts
 - Limitations have been proposed in many prior budgets, which is a common pattern before eventual enactment
 - In 2015, the Obama administration proposed a limit of about \$3,400,000
 - During the Biden administration, a limit of \$10,000,000 was proposed
 - Repeal backdoor and mega-backdoor Roth Conversions
 - “Rothification” of contributions for high-earners
 - NUA exclusion repeal

Post-Mortem Distributions

Stretch Out IRAs

“Inherited” IRA

- An IRA is treated as “inherited” if the individual for whose benefit the IRA is maintained acquired the IRA on account of the death of the original owner.
- Under Pre-Secure law, the IRA assets could be distributed based upon the life expectancy of the beneficiary.
- The SECURE Act generally, requires all IRAs, Roth IRAs, and Qualified Plans to be distributed within 10 years of death (applies to deaths which occur 2020+)

Stretch Out IRAs

“Inherited” IRA

- Two Strategies
 - Spousal Rollover
 - “Inherited” IRA
- Advantages
 - Rollover delays RMD until spouse’s own RBD
 - “Inherited” IRA provisions allow distributions to occur over many years after the death of the IRA owner

Both Still Available
After the Secure Act

The SECURE Act

Mathematical Considerations

RMDs after Death

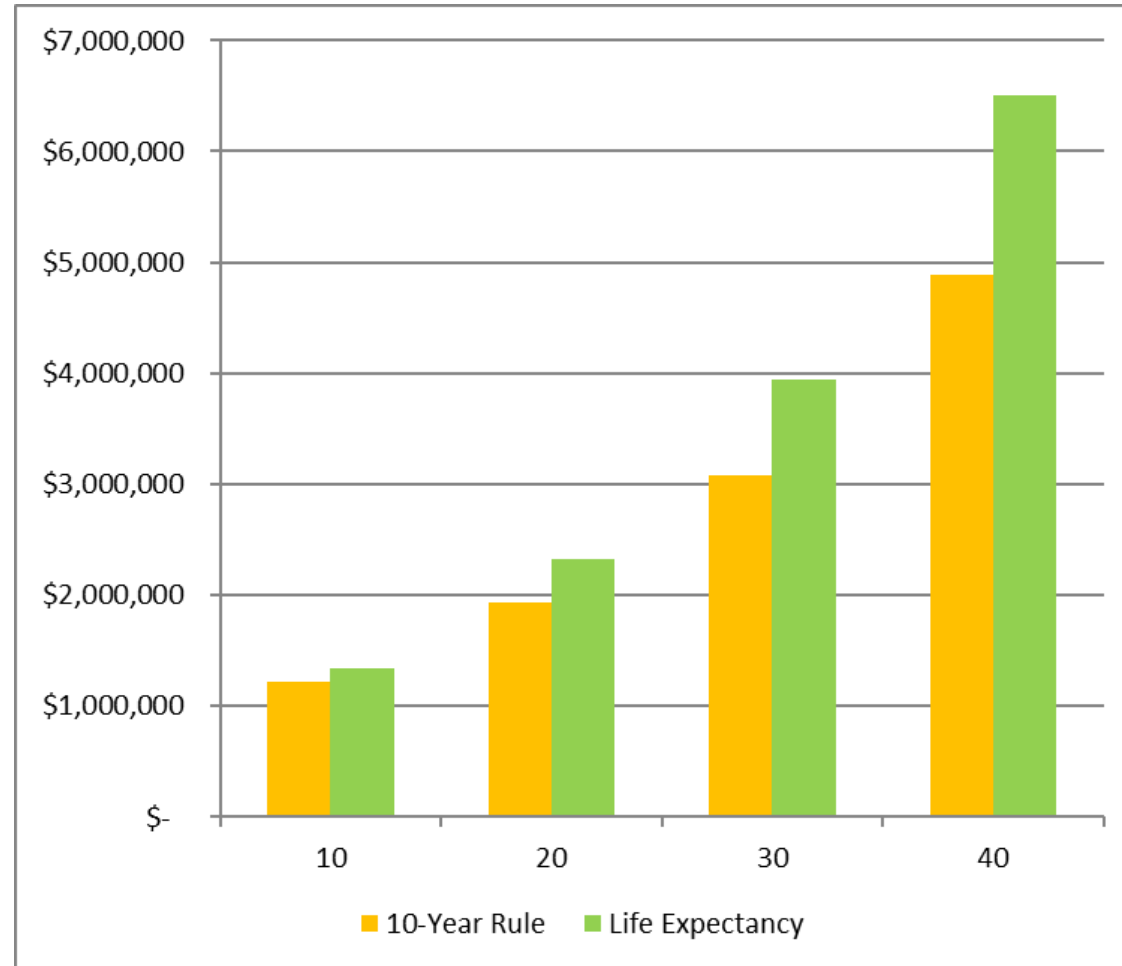
Example

Ten-Year vs. Life Expectancy

Age of (Oldest Trust) Beneficiary	40
IRA Balance	\$ 1,000,000
Pre-Tax Growth Rate	6.00%
After-Tax Growth Rate	4.75%
Average Income Tax Rate - Life Expectancy Rule	24.00%
Average Income Tax Rate - Ten Year Rule	28.00%
Distributions Occur at Beginning or End of Period?	End
Lump-Sum Distribution or Amortize Payments?	Amortize

RMDs after Death

Example



RMDs after Death

Exceptions from the 10-year Rule for certain beneficiaries
("eligible designated beneficiary")

- Surviving Spouse
- The employee's **Children** under the age of majority (*not grandchildren or any other children*)
- Disabled
- Chronically ill
- Individual not more than ten years younger than employee



§§ 401(a)(2)(E)(ii)

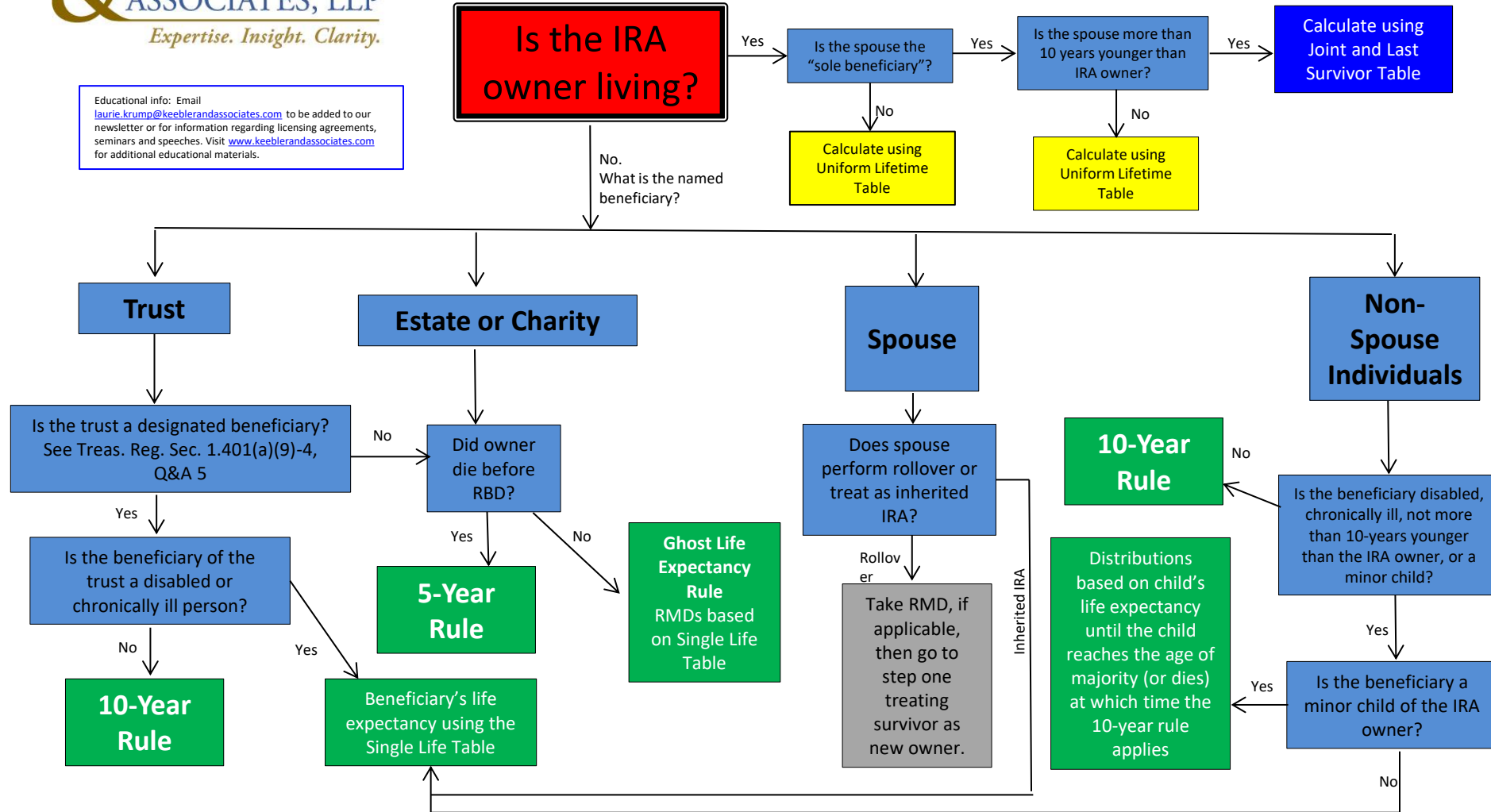
Secure Act Beneficiary RMD Summary

Tax Terminology	Designated Non-Eligible Beneficiary	Surviving Spouse	Eligible Minor Child	Person Less Than 10 Years Younger	Disabled or Chronically Ill Person
Outright Beneficiary	10-Year Rule	Life Expectancy Rule	Life Expectancy Rule (Until Majority then 10-Year Rule)	Life Expectancy Rule	Life Expectancy Rule
Conduit Trust	10-Year Rule	Life Expectancy Rule	Life Expectancy Rule (Until Majority then 10-Year Rule)	Life Expectancy Rule	Life Expectancy Rule
Designated Beneficiary Trust	10-Year Rule	10-Year Rule	10-Year Rule	10-Year Rule	Life Expectancy Rule
Non-Designated Beneficiary Trust	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule
	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule

TRADITIONAL IRA RMD FLOWCHART

For Deaths After Effective Date of SECURE Act

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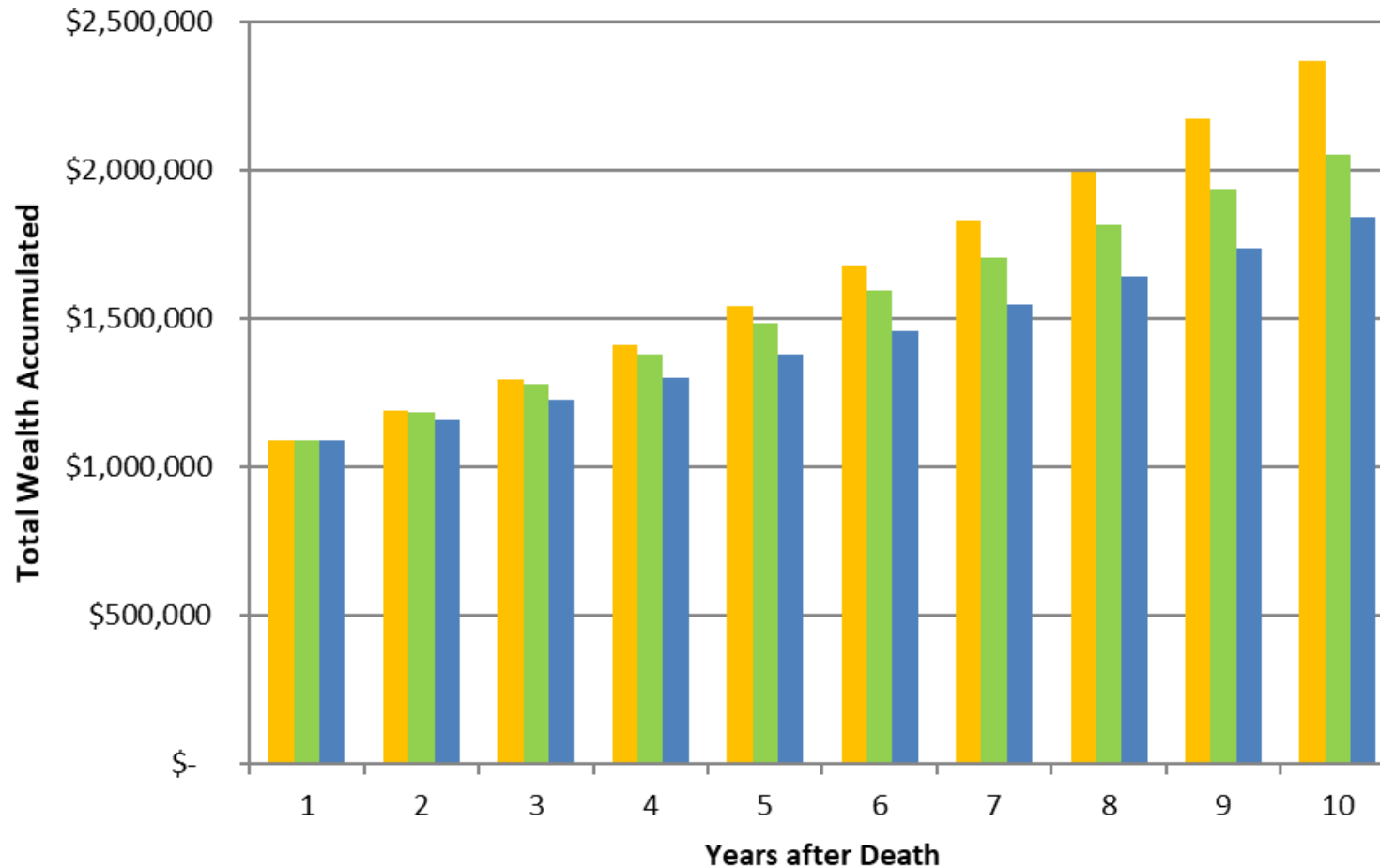
Trusts for Disabled and Chronically Ill Beneficiaries

- Life Expectancy Treatment is Available with an “Eligible Designated Beneficiary Trust”
- Need to Draft an Accumulation Trust
- **Roth IRAs may work better due to:**
 - **The difference in the individual and trust tax rates**
 - **The ability to pay the income tax on conversion out of nonqualified funds**
- Two trusts may be advisable if the client has both a traditional IRA and a Roth IRA – this avoids “trapping” the taxable IRA income

The “Roth Reprieve”

- **Consider the following example:**
 - Connie dies and leaves her \$3,000,000 Roth IRA to her three children equally
 - Each child has a different understanding of the rules, but is responsible and good investor
 - Derek distributes the IRA immediately and reinvests the money in a brokerage account
 - Daniel computes a 10-year level amortization schedule and makes annual transfers from the inherited IRA to his brokerage account
 - David waits the full 10-years to transfer the funds in the IRA to his brokerage account
 - Assume a 6% after-tax return and a 9% before tax return

The Roth Reprive



■ 10-Year Rule - Full Deferral

■ Ten Year Rule - Amortized Distributions

■ Immediate Distribution at Death

ROTH CONVERSIONS

Core Strategic Planning



ROTH CONVERSIONS

Best practice is to use Roth Conversions to spread taxable income over many years and lower brackets



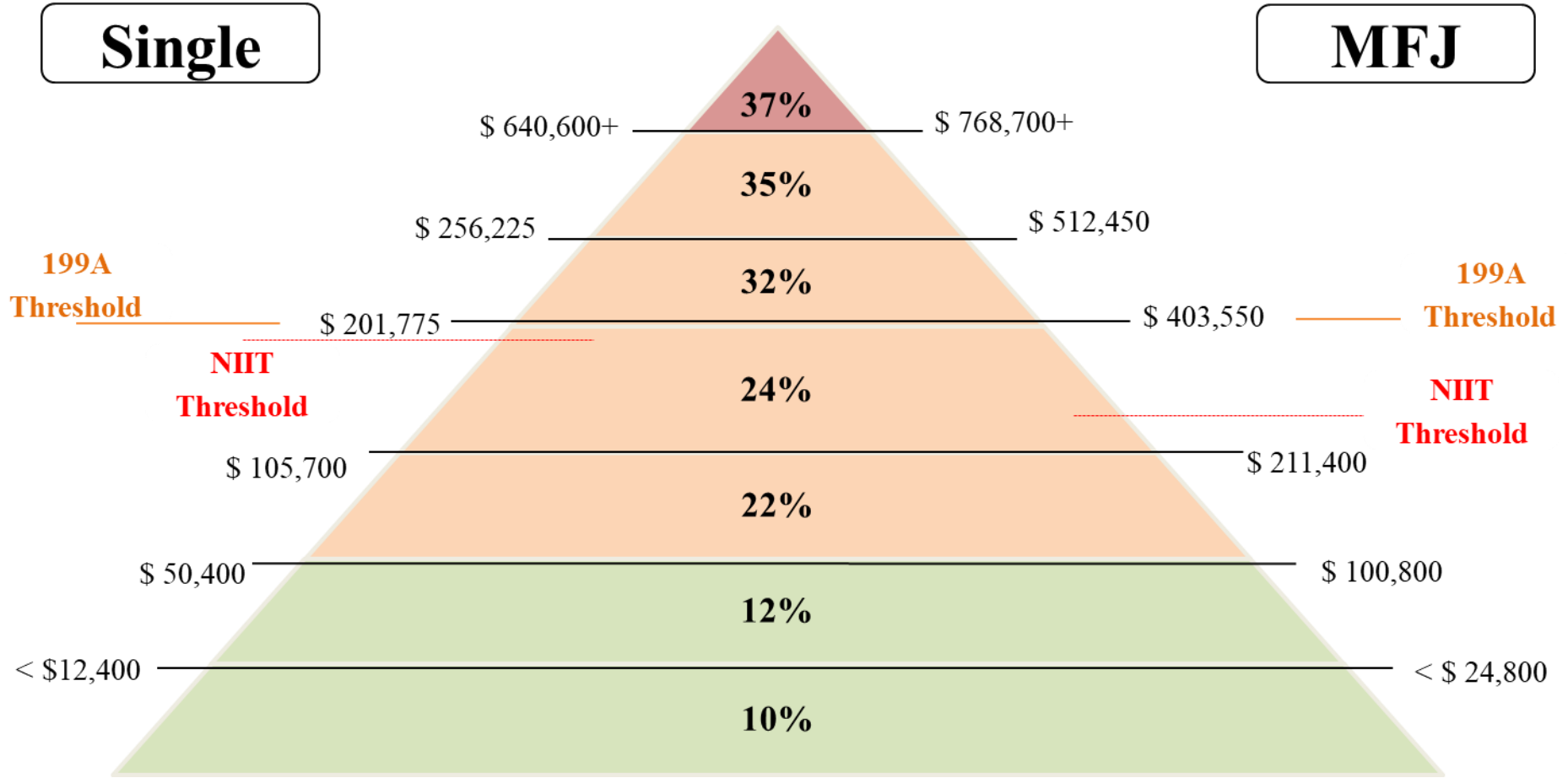
Roth Conversions

Reasons to Convert

1. The taxpayer has special favorable tax attributes, which reduce the effective tax rate of the conversion: Charitable deductions, net operating losses, tax credits, etc.
2. Conversion may avoid higher marginal rates applying to surviving spouses.
3. Conversion may allow Taxpayers greater control over their retirement income stream to avoid phaseouts.
4. No RMDs for Roth IRAs provide a considerable advantage for retirees with excessive cashflow.
5. Favorable post-mortem treatment for Roths following the SECURE Act's 10-Year Rule.
6. Paying the conversion tax from non-IRA funds effectively, mathematically, results in shift of assets to a tax-free environment.
7. Paying the income tax, before the estate tax, provides a superior mathematic result; especially if a state estate tax applies.
8. Generation Skipping Transfer (GST) allocations do not consider the built-in tax liability of a traditional IRA – Roth Accounts are more efficient.

Taxation of Roth IRA Conversions

2026 Tax Brackets



Non-Deductible Contributions: Basis

- When a traditional IRA has non-deductible contributions, a portion of the conversion to a Roth IRA will be non-taxable “basis” to the IRA owner
- In determining the non-taxable portion of a Roth IRA conversion, all traditional IRAs and IRA distributions during the year (including outstanding rollovers) must be combined for apportioning “basis”
 - See IRS Form 8606

Non-Deductible Contributions: Basis

Current year non-deductible IRA contributions	\$ 1,000
Prior year non-deductible IRA contributions	6,000
Total non-deductible IRA contributions	<u>\$ 7,000</u>
FMV of all IRAs	\$ 580,000
Outstanding rollovers	20,000
Distributions	-
Roth IRA conversions	100,000
Total value of IRAs, distributions and Roth IRA conversions	<u>\$ 700,000</u>
"Basis apportionment" factor	<u>0.0100</u>
Gross Roth IRA conversion	\$ 100,000
Non-taxable portion	(1,000)
Taxable Roth IRA conversion	<u>\$ 99,000</u>

Roth Conversions

Frustrating Traps for the Unwary Professional & Client

- Consider the impact of Roth Conversion income on:
 - The taxation of Social Security benefits
 - Medicare part B premiums
 - ACA health insurance premium credit



Mathematics of Roth IRA Conversions

Mathematics of Roth IRA Conversions

- In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:
 - The annual growth rates are the same
 - The tax rate in the conversion year is the same as the tax rate during the withdrawal years (i.e. $A \times B \times C = D$; $A \times C \times B = D$)

Mathematics of Roth IRA Conversions

	Traditional IRA	Roth IRA	Life Insurance
Current Account Balance	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Less: Income Taxes @ 40%	-	(400,000)	(400,000)
Net Balance	\$ 1,000,000	\$ 600,000	\$ 600,000
Growth Until Death	300.00%	300.00%	300.00%
Account Balance @ Death	\$ 3,000,000	\$ 1,800,000	\$ 1,800,000
Less: Income Taxes @ 40%	(1,200,000)	-	-
Net Account Balance to Family	\$ 1,800,000	\$ 1,800,000	\$ 1,800,000

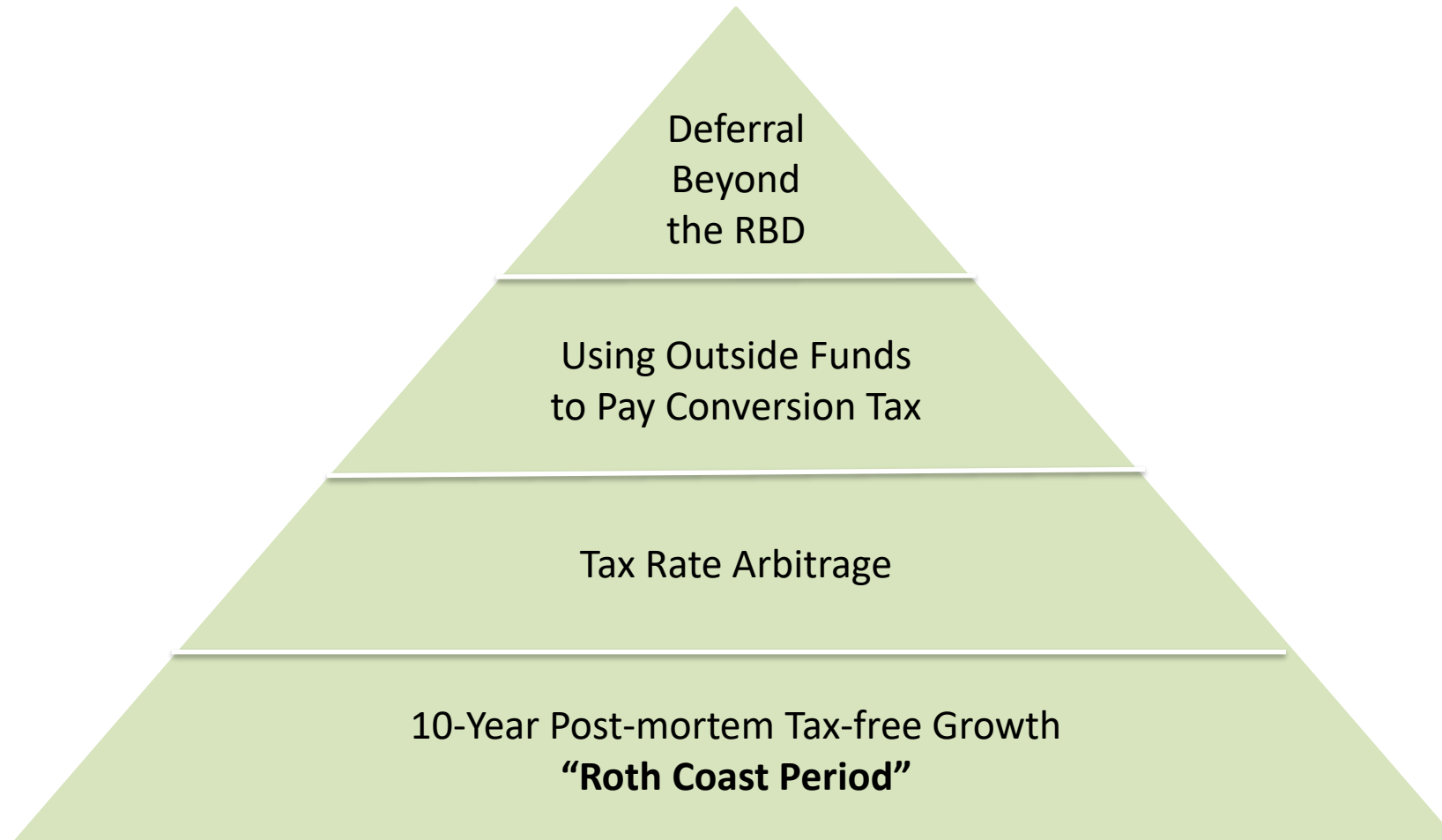
Mathematics of Roth IRA Conversions

- Tactical considerations
 - Unused charitable contribution carryovers
 - Current year ordinary losses
 - Net Operating Loss (NOL) carryovers from prior years
 - Alternative Minimum Tax (AMT)
 - Credit carryovers
 - Dollar-cost averaging to reduce the risk that the amount converted will decrease in value

Mathematics of Roth IRA Conversions

- Critical decision factors
 - Tax rate differential (year of conversion vs. withdrawal years)
 - Use of “outside funds” to pay the income tax liability
 - Need for IRA funds to meet annual living expenses
 - No RMDs
 - Time horizon
 - Tax-free post-mortem distributions
 - Ten Year “Roth Reprieve” period
 - Estate tax considerations

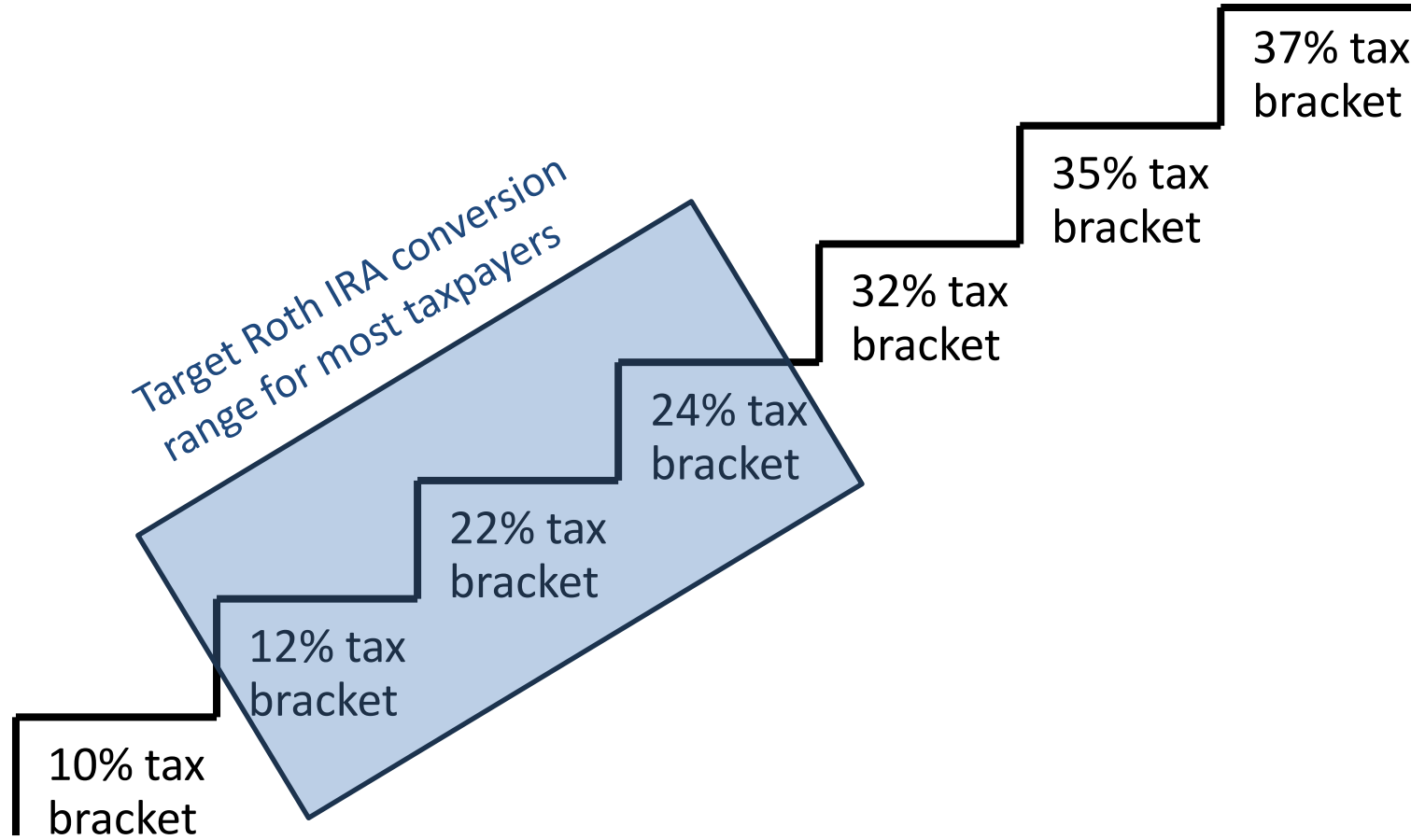
Mathematics of Roth IRA Conversions



Mathematics of Roth IRA Conversions

- The key to successful Roth IRA conversions is usually to avoid large jumps in brackets (e.g. converting at a 32% when distributions will likely be subject to a 24% rate will often be ineffective)
- Although brackets are the primary consideration, there are others: capital gains, AMT, NIIT, 199A, etc.
- Timing conversions is critical

Mathematics of Roth IRA Conversions

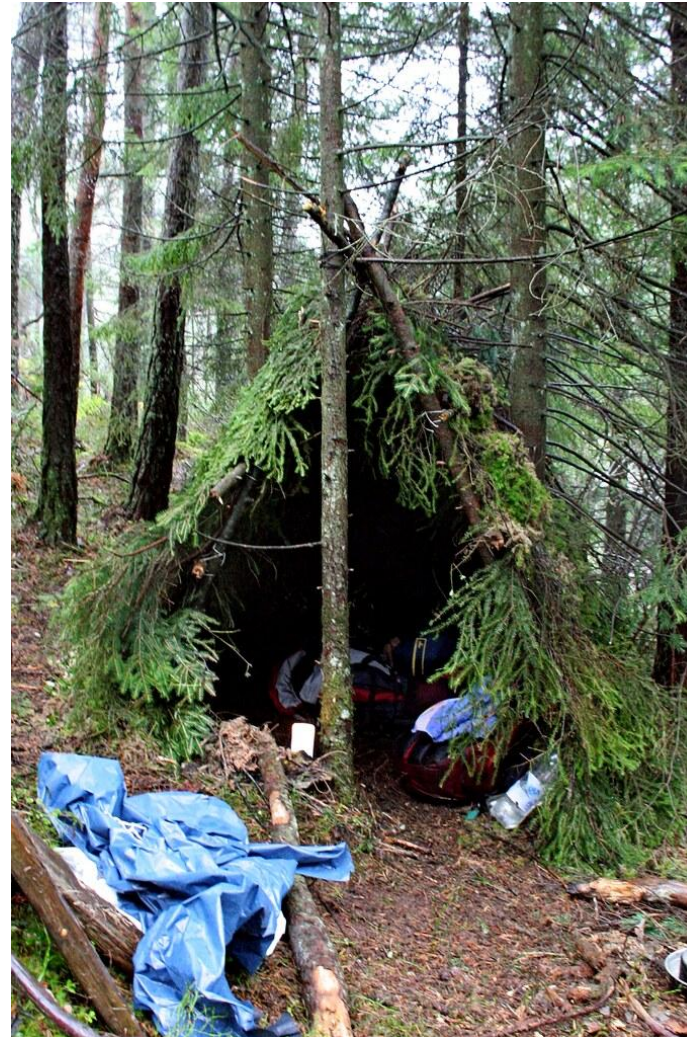


Generating Losses

Generating Losses

Ideas to Shelter Income:

- Active trade or business
- Real estate
- Oil & gas



Passive Activity Losses & Real Estate

- **Losses from real estate rental activity are passive by default. IRC § 469(c)(2).**
- Passive losses cannot offset income from non-passive activities, such as income from a Roth Conversion.

PALs

Oil & Gas Investments

- **Consider investments in oil and gas partnerships for sophisticated high-income clients.**
 - Investors can deduct 100% of their share of the intangible drilling costs (IDCs) in the year they are incurred
 - IDCs are typically 65% to 85% of the total investment
 - Percentage depletion deductions are allowed after the well is producing
 - NOTE: AMT add back if deduction exceeds 40% of AMTI

Oil & Gas Investments

Caveat:

Oil and gas investments can be risky. Tax savings should not be the only consideration.



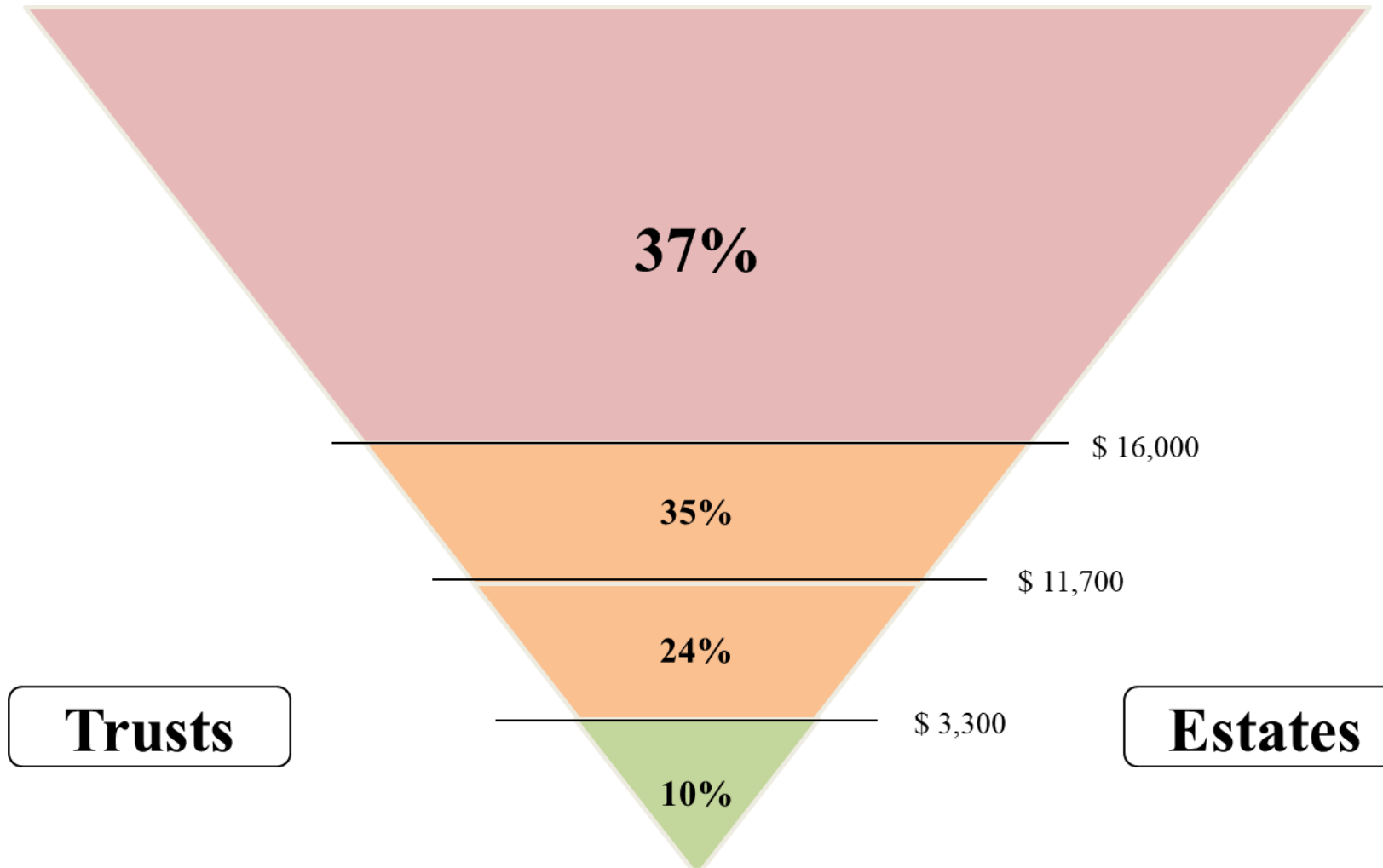
Income Taxation of IRA Trusts

Income Taxation of IRA Trusts

- Income taxed to either the trust or the beneficiaries
 - If income is accumulated, then the income is taxed to the trust/estate (37% Rate)
 - If income is distributed, then the trust/estate gets an income tax deduction and beneficiaries report taxable income
 - Roth and Traditional
 - IRA income distributed on a pro rata basis

Foundational Concepts

2026 Ordinary Income Tax Rates for Estates & Trusts



Trusts

Estates

Disability Trusts

- Special Lifetime “EDB” Rules
- Roth Conversion Strategies
- CRT Strategies
- Two Trust Strategy

Foundational Concepts

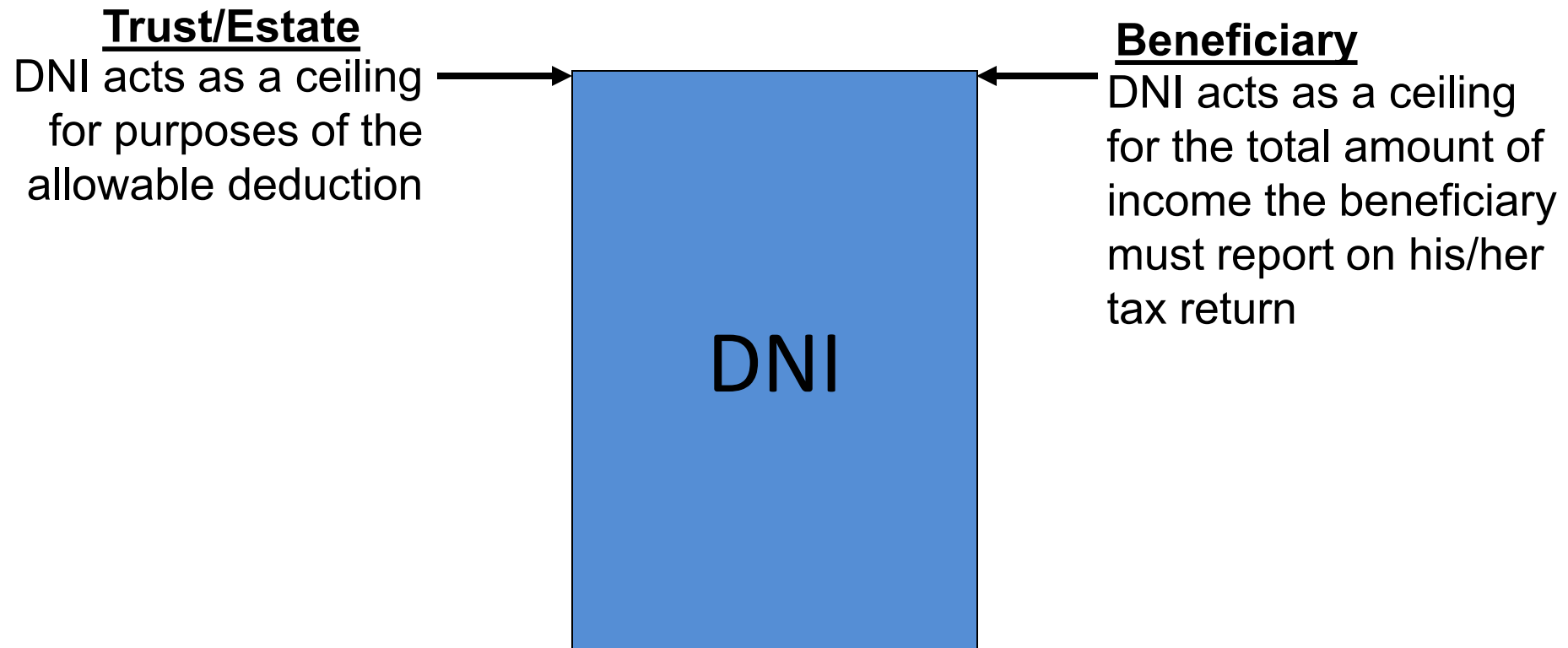
Distributable Net Income (DNI)

- Determines the amount of the trust's or estate's income distribution deduction.
- Determines how much the beneficiaries must report as income on their tax returns.
- Determines the character (e.g. interest, dividends, IRAs etc.) of the taxable income in beneficiaries' hands.



Foundational Concepts

Distributable Net Income (DNI)



Estate Tax Considerations

Estate Tax Considerations

- The same amount GST exemption must be allocated for a Traditional IRA or a Roth IRA – the Roth is much more efficient

		Traditional IRA	Roth IRA
Value of Assets		\$ 1,000,000	\$ 1,000,000
Less: Income Tax	37%	(370,000)	-
Net to Trust		\$ 630,000	\$ 1,000,000
GST Exemption Allocated		\$ 1,000,000	\$ 1,000,000

Estate Tax Considerations

- “Missing” IRC § 691(c) deduction
 - To prevent double-taxation, a beneficiary can claim an income tax deduction for estate taxes paid on IRD
 - However, the deduction is equal to the amount of federal estate tax paid
 - The deduction state estate tax paid is “missing”

Estate Tax Considerations

“Missing” IRC § 691(c) deduction example

	Traditional IRA	Roth IRA
IRA balance	\$ 1,000,000	\$ 1,000,000
Less: Federal and state income taxes on Roth IRA conversion (40%)	-	(400,000)
Taxable Estate	\$ 1,000,000	\$ 600,000
Federal estate tax (40%)	\$ 400,000	\$ 240,000
State death tax (10%)	100,000	60,000
Total estate taxes	<u>\$ 500,000</u>	<u>\$ 300,000</u>
Post-death traditional IRA balance	\$ 1,000,000	
Less: IRC §691(c) deduction	(400,000)	
Post-death traditional IRA balance subject to income tax	<u>\$ 600,000</u>	
Federal and state income taxes on IRA distributions (40%)	\$ 240,000	\$ -
Net IRA balance to beneficiaries	<u>\$ 260,000</u>	<u>\$ 300,000</u>

Reconciliation: \$100,000 state death tax x 40% post-death income tax rate = \$40,000 (double-tax component) *OR*
 \$400,000 income tax on conversion x 10% state death tax rate = \$40,000 (estate tax savings)

Estate Tax Considerations

- “Fading” IRC § 691(c) deduction
 - The deduction is calculated on the date of death value
 - Post-death appreciation of pre-tax assets is not offset
 - This results in the relative amount of the deduction “fading” over time

Frozen-in-Time

Estate Tax Considerations

- “Fading” IRC § 691(c) deduction example

	No Planning	Roth IRA Conversion at Death
Traditional IRA balance at death	\$ 1,000,000	\$ 1,000,000
Less: IRC §691(c) deduction	-	(450,000)
Taxable portion of Roth IRA conversion	\$ 1,000,000	\$ 550,000
Federal and state income taxes on Roth IRA conversion (40%)	\$ -	\$ 220,000
IRA balance available for future distributions	<u>\$ 1,000,000</u>	<u>\$ 780,000</u>
Total future IRA distributions	\$ 2,000,000	\$ 1,560,000
Less: IRC §691(c) deduction	(450,000)	-
Less: Amounts not subject to income tax	-	(1,560,000)
Taxable portion of future IRA distributions	<u>\$ 1,550,000</u>	<u>\$ -</u>
Federal and state income taxes on future IRA distributions (40%)	\$ 620,000	\$ -
After-tax total future IRA distributions	<u>\$ 1,380,000</u>	<u>\$ 1,560,000</u>

Reconciliation: \$1,560,000 - \$1,380,000 = \$180,000 *OR* \$620,000 future income tax liability - \$440,000 future value of income tax liability on Roth IRA conversion (i.e. \$220,000 x 2).

CONCLUSION

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