Episode 154 The Financial Advisor’s Guide to Roth Conversions Part 2

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Roth conversions, tax efficiency, tax brackets, taxable accounts, tax deferred, tax exempt, retirement planning, tax projections, hedging strategy, future tax rates, legacy planning, intergenerational tax planning, tax policy, tax flexibility, Roth benefits

SPEAKERS
Briana Corbin, Wade Pfau, Alex Murguia, Bob French, Rob Cordeau

Bob French 00:00
The purpose of retire with style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning.

Briana Corbin 00:41
So we couldn't cover everything about Roth conversions in just one episode. Raise your hand if you're surprised. So here's part two. Alex and Wade are back with Rob Cordeau to keep the conversation going.

Alex Murguia 00:55
Hey everybody, welcome to retire with style. I am Alex Murguia and I'm here with my co host, Wade Pfau, and we have a very special guest, Rob Cordeau, how was that Wade? That was like, that was like, that was to spend. Wasn't it very

Wade Pfau 01:10
monotone that you're the Wade impression to see if I can do it like

Alex Murguia 01:16
Jack par like, hi everybody.

Wade Pfau 01:18
Hey, everyone.

Rob Cordeau 01:19
Like an MC there. Very nice.

Alex Murguia 01:22

Thank you. All right, Rob, take it away. We this is a twofer. Could be a three for but we'll probably keep it to twofer with regards to Roths and this is within our arc on tax efficiency and the like Rob, where did we? Well, Robert Wade, you want to take it from here?

Wade Pfau 01:43
Yeah. I mean, so in the last episode, we started this conversation on Roth conversions. And there's so many topics we haven't touched on yet that we've made it a two parter. But yeah, where do we want to pick up at that point? I think one area that we didn't address yet from the past previous episode was, if you do a Roth conversion, you're going to have to pay taxes. So where do you pay the taxes from? Could you talk about your experiences with that? Rob,

Rob Cordeau 02:11
yeah. I mean, we'll choose whatever seems optimal. You know, if someone has non qualified assets, and it's efficient to do it that way, we'll go that route. You can pay it from the IRA, but it becomes kind of a circular calculation. The more you pull out, the more you have to pay tax on the amount, like an

Alex Murguia 02:33
algorithm for that that like seven.

Rob Cordeau 02:37
And of course, we never want to pay taxes from a Roth account. So that's sort of out of the question. So yeah, it's unique to each client, right? But yeah, it kind of is situation dependent a bit.

Wade Pfau 02:53
Yeah. And actually, with the broader kind of Youtube world, or all the direct to consumer type advice out there, sometimes there's this statement that you should never pay tax from the IRA itself when you're doing a Roth conversion. That's not true. I mean, ideally, you could pay from your taxable brokerage accounts, but if you've already spent them down, there's no problem. Now, if you're under 59 and a half, there could be the penalty, but if you're over 59 and a half, there's no real problem with with paying taxes from the tax deferred account, right?

Rob Cordeau 03:24
Yeah. And if the, if the Delta was large enough between, say, the rate that we're paying, if we're paying at a 10% rate, let's say I might be more inclined to go that route. Typically client, the clients we're working with, have a mix of taxable accounts, tax deferred and tax exempt. So usually there's sufficient funds to pay from a non qualified taxable and

Alex Murguia 03:51
it's funny how it's somewhat of a framing thing, because if you are paying from taxable accounts, if they say no, just pay from taxable not from, well, you've already been taxed on the taxable account, and then you've invested the difference, and then you're going to be taxed again if you're pulling out funds that have capital gains on it. So to some extent, to Wade's point, yeah, Ira should be fine in terms of a candidate.

Wade Pfau 04:16

Yeah, it's generally a little better if you have it to pay from the taxable account, because the general story about tax efficient distributions, you want to spend those taxable assets earlier, relatively speaking, because of their ongoing taxation, unless you're going to leave something as a legacy there and have a clear opportunity, the

Alex Murguia 04:35
conclusion is the same, which is like if it is, if it has to be from The IRA, it's still not kryptonite, it's still not a no go zone,

Wade Pfau 04:45
right? And that's in contrast to some of the advice out there that say, never do a Roth conversion if you have to pay taxes from the IRA. That's simply bad advice. Yeah, of course. But right?

Rob Cordeau 04:55
And and you're getting some benefit by pulling out an IRA. Way, by nature, has an embedded tax liability in it. So the more I pull out of it, the more I'm reducing a future tax liability. I'm reducing a future RMD. So I agree 100% with your approach. Wade,

Wade Pfau 05:14
yeah, it came up in the last episode. But to emphasize, and we didn't say specifically, but the same that the advice you give like, should I contribute to an IRA or a Roth? And the answer is, well, if you have a lower tax rate today than in the future, put that money in the Roth. Pay the taxes today. If you have a think you're gonna have a higher tax rate today than in the future, so in your peak earnings years, take advantage of the tax deduction today and put in an IRA. That same logic applies to the Roth conversion decision. If I think I can pay taxes at a lower rate today, do the Roth conversion. If I think I'd have to pay taxes at a higher rate today, don't do the Roth conversion. Yeah,

Rob Cordeau 05:52
I agree. And you know that's I'm glad you brought that up, that phrase, that explanation of the timing of sort of a heuristic, a rule of thumb whether or not it makes sense. We've seen that in literature, and everybody, every financial advisor worth his or her salt can spout that off. I, I would submit that it should be a little different than that. Rather than compare your tax rate in a year of conversion, and if it's lower than your tax rate in retirement. Makes sense to convert. I It's a subtle difference, but it's important compare your tax rate in the year of conversion to your tax rate in the year in which you think you will be taking these dollars in retirement. So it's a little more precise. And the reason I look at that is in our experience, clients go through phases in retirement. They go through what we've talked about, the Go Go years, the slow go years, the no go years. So the spending might change for that reason, but the taxation and the tax brackets might change based on, have they started Social Security yet? Has one spouse started RMDs yet? Have both? Have they got to that point where they're really slowing down on spending yet? I mean, we'll have clients go through 456, different phases, and some of those result in different tax brackets. So it's, it's a nice, easy thing to say. Compare your bracket now to retirement, but your retirement bracket isn't just one number for a lot of clients, it's dynamic throughout the whole spectrum of retirement. So I try to help clients to see that they might have some opportunities in the future with lower brackets in retirement that they're just not thinking of presently.

Wade Pfau 07:41
And we did have those a number of episodes on the pitfalls of this, where it's not just those brackets that you're looking at, but the impact on Social Security benefit taxation, the Medicare surcharge, Irma issue, the how your capital gains stack, long term gain stack on top of ordinary income, and that stacking issues. So really looking at that holistically, yep.

Alex Murguia 08:05
So then to wage one into your previous one, then you're not necessarily looking at the average tax bracket in retirement. You're going to try to get as best as you can an estimate of these funds. More or less, you're going to use them in your mid 80s. Again, I'm just making it up. And in your mid 80s, this is most likely your tax bracket in consideration of all the other stuff that's happening. As opposed to just, hey, you're more or less going to be at this bracket on average throughout retirement. That's what you're saying, right? Yeah.

Rob Cordeau 08:36
And if you think about the normal sequence, the conventional wisdom of draw from taxable, first tax deferred, second, tax exempt, last. If we're converting from taxable, I'm sorry, converting from tax deferred over to tax exempt to Roth, I like to view those as the very last dollars that I would have spent in my IRA. Yeah, right. So we have software that will tell us when we're depleting the tax deferred bucket, and it's common for it to be up in the 80s, or actually, it's very common for it to a client never to deplete their tax deferred bucket, and the Roths go to the next generation. So now I'm talking about converting dollars that you would potentially be spending in your 80s or 90s, when spending is lower, when the bracket might be lower, or we spend a lot of time talking about the next generation. What brackets are your kids in? What do they do for work? Well, you know, tell me about their situation. We're trying to assess whether the kids are in the 22 or are they up in the 37% bracket? We're just trying to get a sense for what makes the most sense for do we convert a lot now, some Now, not all.

Alex Murguia 09:51
That's an excellent point. It really is, yeah,

Wade Pfau 09:53
yeah. Then let's talk more about that. Like if, if you're at the point where you think. May be a legacy left to the next generation, then these conversations become intergenerational in nature, and there were some changes with the secure act that impact this, particularly the for like adult child beneficiaries, they're generally going to be subject to. They used to get a lifetime stretch on their inherited IRA. Now it's 10 years where they have to have that account spent down in a 10 year window. And if they're inheriting that in their 50s, they may have to spend that account down when they're in peak earnings years, highest tax rates of their lifetime. And so I think you're kind of getting to that point, but like with this estate planning issue, like, does it? Have you had those conversations about, well, let's we gotta consider taxes on your beneficiaries as well, right?

Rob Cordeau 10:55
Exactly, yeah, especially as the IRAs get larger and larger, and if the number of siblings children is smaller. You know, if we have one child receiving a seven figure IRA as an inheritance, that that's going to be seven figures dropped on their 1040 as taxable income, that's going to push

them through all the brackets, up to the top bracket, right? So there is some planning there, like when we have clients who have an inherent IRA, we we have a spreadsheet we build that looks at the next 10 years, we estimate their bracket in the next 10 years, and we actually come up with a mini distribution plan for that inherited IRA over the 10 year period to try to optimize where We think their brackets will be. What's going to happen on the tax cuts and Jobs Act sunsets? If it does, you know, all that sort of calculations are going into that. So we try to do as much as we can on that. It's tougher with our clients, because their children may not be clients of ours. So we're going kind of hearsay from the parents, what do their children do for work, getting a sense for what we think they might make and what bracket they might be in. So it's, again, there's a lot of broad assumptions being made to try to figure out,

Alex Murguia 12:15
because you've done these for a while now, I don't think you're ever going to be precisely correct, I don't, but I don't think that's the goal either. I think you just want to be directionally correct. Uh, looking back at, you know, you've done this for years and years now, so looking back at, hmm, I nailed this, or I was off on this. What's, what's your, what's your, like, anecdotal sense, yeah. And Rob is one of the most humble folks I know. So he's not gonna embellish his record here. I'm just more curious. I don't expect anyone to hit this, but you know, what do you think? No, I

Rob Cordeau 12:51
mean, I think we talked about some of the home runs in the last episode, right, where you really nail it when it comes to converting and serial conversions and filling up brackets and but I can't even say if my records been correct, because I have to fast forward another 20 or 30 years to go through.

Alex Murguia 13:08
And you look at these and you course correct all the time. So it's not like it's written in stone, either. But I was just, you know, someone tells me this, oh, this will happen 20 years. You always view it with that. Okay, we'll see. But,

Rob Cordeau 13:22
you know, this gets back to a comment I made in the last episode about how Roth conversions are like hedging, right? We are trying to hedge against future tax bracket increases, right, or or future increases to our own personal bracket. And this, this led me to a thought experiment that I want to perform on the two of you, because I am interested in hearing what you have to say. So hear me out. It's going to take a couple minutes, but it and it is related to the Roth conversion discussion. So I want you to imagine that I'm going to give you each a million dollars, and you have to use that in wagering on the outcome of the World Series. Okay, now the World Series for, for anyone listening to this, we are in the middle of the World Series right now, recording this October. The Dodgers are playing the Yankees. The Dodgers are up three games to 07, game series. So you can wager your million. You can bet for for one team or any combination you can you can split it up between the two teams, and there's no like point spreads or anything. This is very basic. If you're it's binary. If your team wins, you double your money. If your team loses, you lose 100% of your money. There's probably a name for that. I don't gamble, so I don't know what it's called, but so that's the kind of basis for this discussion. One other thing to make it interesting that it's this isn't play money. Imagine we've just had yesterday a cataclysmic market event. You've lost all your retirement money. So this million

dollars actually really means something to you. All you have is Social Security and whatever you walk away with from this game. And one other caveat. If, if you're a Red Sox fan, what happens in Vegas stays in Vegas. So your red sox friends will never find out that you, that you put some money with the Yankees. So Wade, you're a numbers guy. Oh, and I'll give you one other factoid in the history of the World Series, more than 100 years no team has ever come back from a three game deficit to win a seven game series more than 100 years so Wade, you're a numbers guy. You're going all in with the Dodgers. Are you splitting it? What are you doing?

Wade Pfau 15:33
And you do have to allocate all of the money too.

Rob Cordeau 15:38
You can't pull it. You got to bet all million and the point that the Dodger, any percentage you want, three games

Wade Pfau 15:45
to zero. So yeah, I mean, the odds are really at this point, statistically speaking, the Dodgers would win, although you may want to hedge your bet somewhat by not going all in with the Dodgers. I'd probably be thinking like maybe 80% of it would go with the Dodgers, the other 20% with the Yankees as a way to hedge the risk on that. Okay,

Rob Cordeau 16:10
all right, I'll get back to that in a minute. So Alex, what are your thoughts? How are you betting?

Bob French 16:17
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Alex Murguia 16:45
Well, I think out of the 40 instances in which a major league team has led three zero I just read up on this, only one has come back

Rob Cordeau 16:57
red. Sox, yeah, that's right. And

Alex Murguia 17:03
let me see here, extremely low odds, the probability I'm trying to read my chat. GPT answer in the slowest way,

Rob Cordeau 17:17
fat. GBT said between a two and a 3% chance come back. So 97 to 98

Alex Murguia 17:24
I must have hit stop before it was it was reading it, but I was, that's exactly why you were saying it. I was typing it. I even put the microphone on mute so you wouldn't hear the typing. So what is

the chance? It's a low problem? Are you going to come is the answer. This is the probability of a Roth conversion tax increase or something.

Rob Cordeau 17:44
It's, it's that, well, you didn't tell me what you're gonna bet. How much? How much would I bet? Yeah, I was trying to cheat that I lost track.

Wade Pfau 17:56
Point 8% Yeah. I

Alex Murguia 17:58
mean, look, if you wanted me to bet a million bucks at the Yankees 4% I this is me without even thinking, if I'm doing this right, I mean, I would put 909 196,000 on the Yankees and 4000 on the Dodgers. I don't know some

Wade Pfau 18:18
whatever Did you mean to do the other teams? Yeah,

Alex Murguia 18:20
the other way around. The other way around,

Rob Cordeau 18:21
yeah, yeah, that's up 996,000 so if the Yankees pull it off, it's not impossible. The Yankees pull it off. You and your wife just have Social Security income scraping by on it. I won

Alex Murguia 18:36
$4,000 as well.

Rob Cordeau 18:38
Yeah, yeah, exactly. So I've got 8000 now, you each engaged in some hedging. So

Alex Murguia 18:45
we're talking about the magnitude of loss is huge for me here, if

Rob Cordeau 18:49
that rare event happened. But I want to change it up just a little to illustrate something. Now, let's bet on the World Series in the year 2044, 20 years in the future. We don't even know the players, the teams. You just have to bet American League versus National League, okay, same rules, million dollars. What's your split going to be? And as a factoid, American League has won 57% of the World Series. National League has won 43

Alex Murguia 19:19
are we playing with the DH. Are we playing with the DH?

Rob Cordeau 19:23
For your purposes? Yes. Wade, go ahead. What's

Wade Pfau 19:28

your 50? You don't lose anything. You'll end up always just you'll

Rob Cordeau 19:31
end up with a million, right? You lost 500,000 on one side, but you doubled your 500 so you walk away with a million, right? So you split down the middle. How about you? Alex, I'm going for

Alex Murguia 19:41
the American League.

Rob Cordeau 19:42
Let's go for the American League. 57% right? See, and the idea is, we all hedge, right? Because why do we hedge? We hedge because we're uncertain of the future. If you had a crystal ball and you could see. Was going to win with 100% certainty. You'd put a million on the Dodgers or the Yankees or whoever, right? But as we as things get more uncertain, we hedge even more, right? We go out 20 years on this. We don't even have a data point. We don't even have a single player look at so we say, All right, I'm going to split it down the middle, right, because I just don't know, and this is where I go with Roth conversions, that I just don't know with certainty whether tax legislation is going to change and the bracket for this client that I'm working for is going to be higher in the future or lower. I don't know if one of the spouses is going to pass away and they're going to be a widow or widower and a higher bracket or a lower one. So since I don't know those things, it's beneficial to be humble and to say, since I can't predict the future, let's just not go crazy. Let's not let's not remove the thought of Roth conversions. They are powerful and a great tool, so let's engage in them. But let's also not take the approach of, let's convert our entire, you know, pre tax IRA, and go crazy with this thing, right? You know? So we're hedging in both directions because we simply don't know what the tax regime is going to look like 20 or 30 years in the future.

21:26
I think, I

Alex Murguia 21:27
think you're right. I think people, I love the way you posed it, which to me, if I'm interpreting it, is people, you know, it builds on this recency thing, where you take what's happening now and you just extrapolate it, right? And so by asking, by pointing out the current Dodgers, Yankees, you're thinking about the who's pitching, and all this kind of stuff. Right at the end of the day, it's just a guess, but you give yourself the sense that you know what's going to happen, but then the Roth conversion is really the 40 years later. Now make that same bet, but what happens is, when you pose it like that, we naturally think, well, I don't even know who owns the teams, much less you know who's the starting pitcher or anything like that, right? But what you're getting at, I think, is that you're making the Roth conversion decision. Don't make the Roth conversion decision with your view on what's happening right now, and the taxes, things are gonna go up, things are gonna go down or whatever. Because really, you're making this decision for what's going to happen in 30 years, let's just say, and if that's the case, you really have no idea, regardless of who's in, who's we have an election coming up, regardless of who's going to win in this upcoming election, that's really what happens. But people make that decision 30 years in the future with the information they think is happening right now that will never change. Hence you're saying, let's not be silly about this. Let's just hedge and that's it. And I think that's the key

takeaway that I'm taking away from the very beginning, which is, it's just a hedge strategy for your taxes. It's no free lunch.

Rob Cordeau 23:02
Yeah, I think that sums it up perfectly. It's and it's just that humility that we don't know we there are black swan events that happen. We talked about, could a could we see a flat tax environment? Could, you know, these things could throw a massive monkey wrench, and all the work we did in trying to get ahead of the curve, and, you know, convert it 22 or 24% there could be a massive change that we weren't expecting. And again, without a crystal ball, I can't go crazy and just convert everything I have and push myself into higher brackets to do so when I don't really know future tax rates, or I'll give you another black swan event. What if there is a cataclysmic, cataclysmic market event and your portfolio loses 50 or 60% of its value, and then then you went to a great deal of trouble to convert a bunch of stuff to Roth, when you could have spent a lot of years in a lower bracket because you simply have less money to work with in retirement. I mean, there's a lot of the whole idea of a black swan event is you can't predict it. It's not easy to predict. So I think hedging when it comes to Roth conversions, again, as much as I love Roth conversions, and we do a lot of them every year, it's being measured in our approach for how much we choose to do.

Wade Pfau 24:25
Yeah, yeah, that's fair. And that's kind of the idea of directionally doing some Roth conversions. Maybe a good idea, if it's and right, if you knew exactly how long you're going to live, exactly how much you need to spend each year, and whether that's health expenses that are deductible, if you knew exactly what market returns you'd get every year, if you knew exactly what the tax policy would be each year, then you could solve this. And so here's how much I should Roth convert every year over my lifetime and have the exact, precise answer. Now, as soon as you recognize you don't know any of those variables as. It no longer becomes possible to be so precise, so hedging, but moving direction.

Alex Murguia 25:06
So I think we've got a good overview of, okay, the conceptual underpinning of a Roth and things. Why? Why doing it? What are the considerations, the tax play, the hedging, this or that. Where do you see on the on the flip side, where do you see things go sideways? Yeah. Besides, okay, you ended up being in a higher tax bracket in retirement, not lower that we've discussed.

Rob Cordeau 25:32
I think it's just failures, failure to notice a low income year and take advantage of it, right? So occasionally we come across clients. So usually prospects have come to us and we see that they've, they've had opportunities for the past few years, but they haven't been taking advantage of it, so not recognizing they're in a low bracket, and should have been converting. We already talked about the this could

Alex Murguia 25:58
be someone. They may not even know it, but they're, they have a career change in their early 50s, and they're going to start up a business or something, and they've got two years where I'm putting in the work to build up the business. Well, those two years, even though this isn't an

issue that you're not going to really look into until your 60s, you those are two years that are quote, unquote freebies, if you will. That's

Rob Cordeau 26:19
right, yeah, okay. So, so missing those opportunities, that's probably the biggest mistake I see, over confidence about your understanding of where tax rates are going to be in the future. I see over we've talked about hedging over converting right, which usually is corollary of overconfidence about future tax rates. So those are probably the biggest areas of mistakes that I see. And then, just to your point, Alex, it is, and yours Wait, it's, it's more directional. It's, it's making sure that we are engaging in it. To some extent, our goal isn't to convert 100% of the pre tax, if it's a large account, it's to just position us better in the future, to give us more tax flexibility. That's something we didn't talk about. Just it really does open up some doors if, especially if you don't have any Roth so to be able to convert if you've got taxable tax deferred, and now you're creating a third bucket by performing those conversions, it just creates a bucket for you in the future that if tax rates go up, or if there's a situation where you do need to manage your AGI, manager Your taxable income in some way, having that tax free bucket to pull from can be really neat for flexibility purposes. If, you know, if Congress does spike up income, you know, change the rates in a particular year, whatever it is, it's just nice to have that flexibility.

Wade Pfau 27:58
Yeah, we never clearly said this episode, but right the value of the Roth is when you have to meet expenses in retirement, it's a resource that does not go into your adjusted gross income. So it's

Alex Murguia 28:10
helpful. You may want to see with a little more vigor way, because I think that's quite important. It's coming across like, Hey, by the way, asterik, I think this needs to, like, hit your head. So why don't you

Wade Pfau 28:25
a distribution from your Roth does not enter your adjusted gross income, therefore it's not part of your taxable income, and it helps you avoid problems related to social security, benefit taxation, Medicare premium surcharges, preferential income stacking Affordable Care Act, subsidy losses, anything along those lines that can be potential issues in retirement. Yeah,

Rob Cordeau 28:48
and you know, for us as planners, when I've got a client that has all three of those buckets, it just opens up so many.

Alex Murguia 28:56
Just to be clear, for consumers listening, conceptualize taxable

Wade Pfau 29:01
the taxable.

Rob Cordeau 29:02
So like joint trust accounts, the tax deferred. So IRAs, Roths, 403, B's, tsp and the tax exempt bucket, the Roth type accounts. When I have all three of those, we can do a tax projection for a

67 year old and and take a look at where they're at and say, Well, yeah, you know, maybe we'll, we'll pull a little bit from Roth to to just keep your income below that break point for Irma or for whatever else it happens to be, so we can more closely dial in exactly what We want for an AGI, and that can be really powerful for wave to your point prior episodes you've talked about, kind of some of those non linearities that kick in, things like the Irma break point, that one extra dollar spikes your your costs significantly, things like that, you know. And that's another point that's interesting. In years past, we used to be able to convert, and the old rules were you could do a re characterization of a Roth conversion, so we could go back after the fact. And we used to do this, we'd go back in the early part of the next year, figure out what the what AGI we wanted, and we would re characterize just enough to push us back down under. We'd do two projections, one before the year ended and one after. The IRS caught on to our little scheme, and they did away with that

Alex Murguia 30:35
by cut on you don't mean us at McLean in general. I row tomorrow,

Rob Cordeau 30:47
that that probably wasn't the best approach, and they changed the legislation. So now re characterize or off conversion. Once you pick your number, you're kind of stuck with so

Wade Pfau 31:03
because the other trick, you could convert a bunch of different assets, and then the ones that subsequently gained in value, you keep the conversion the ones that lost in value, you characterize back and try again next year. But yeah, I think we've covered quite a bit

Alex Murguia 31:23
Thursday. Go on,

Wade Pfau 31:25
yeah, are you getting to the back door Roth? And just yeah,

Alex Murguia 31:28
why don't you just to make sure? Because it's some people, sometimes when you just say Roth in their heads, they have back door in parentheses. And you may not be you know, that's not what you were talking about. But go on. One is pre retirement, once, post, etc. Wait, yeah,

Wade Pfau 31:44
there's a pro rata rule that if you have non deductible contributions in your IRA, whenever you do a Roth conversion, you have to do the proportion. You can't decide, I only want to move non deductible contributions. I want you have to do pro rated based on what percentage of the overall accounts across all your IRAs are deductible and growth versus non deductible? That's not a problem for the Roth conversions we've been talking about in these episodes. But if you're simply doing a backdoor Roth conversion, where you're you're still working your income exceeds the thresholds allowed for a direct Roth contribution. You contribute non deductible funds into your IRA, and then a week later, convert to convert those funds to the Roth IRA, the pro rata rule could get you. And so that's where discussions of the pro rata rule become relevant. But what we're talking about, the pro radical idea, is just actually, for a Roth

conversion, you're not going to pay taxes on 100% of the conversion. That's kind of a nice feature.

Rob Cordeau 32:50
Yeah, no, that's true. And and a couple of other points we we chatted about, but we haven't talked about it yet in the episode, is some other considerations, like what state you're going to reside in in retirement. So we're in, if you're in a high tax, income tax state in the year of conversion, but you know, hey, we're going to, we're going to retire down to Florida, where there's no income tax. That's another factor in the calculation that there might be a few percentage points there that you're paying more to convert that you won't pay when you're pulling from a pre tax IRA. So another just a consideration to make sure that you plug in when you're when you're doing all the math for this.

Alex Murguia 33:37
Okay, are any other tips and tricks rob from the from the front lines, different, but that are more nuanced, similar to how you pointed out that it's when you're going to spend it, not so much your average tax rate at retirement, that can add color to the decision making. Like, what wisdom would folks have other than just, you know, hey, this is the this is the decision tree. But there's always more than that in life. Yeah,

Rob Cordeau 34:09
I you know, if you're not inclined to go down that path of all the subtle nuances that we've talked about right of, where do we think? You know tax policy is going to go years in the future, you could take a very simplistic approach and just try to get a sense for your future tax rate when it will come out, and then try not to exceed that. That would be like a really, really basic so, you know, let's say you're in the 22% bracket, and you might want to fill up that bracket with Roth conversions serially over a period of years, while you have that opportunity to do so, so that you know so it's that's often where we're going. And when we perform a tax projection, we're looking at all those issues, right? Tax brackets, we're looking at the Irma break points. We're looking at Capital Gains effect. Tax if those are still in place. So we're kind of trying to keep track of everything that's going on, because this is really, this is a dial that's completely discretionary. A lot of things on our tax return are not discretionary, right? Whether it's w2 pay that's coming in, or RMDs or social security, but the dollar amount we decide to generate as income in terms of our Roth conversion, we're in absolute control that. So it's great to incorporate a tax projection with that right, because we can dial that in exactly where we want it. We can place the AGI just under a break point that makes sense for the client.

Alex Murguia 35:46
That's amazing. And I'm just struck by, yeah, a lot of work goes on in in these kind of decisions that are, you know, quite nuanced and interesting. How do you balance? And we can end with that. And I think we did it with directionally. But I want to leave the listeners with something along the lines of, if I wanted to do this, what would be the first step that I would take to begin to even analyze this? Yeah, and, you know,

Rob Cordeau 36:15
can leave it because, yeah, great question. I think, because it is such a tax driven decision, it has to start with taxes. So you know, you have to have a sense of what is your bracket now. So if you don't know that, or don't know how to calculate it, then connect with an advisor, or connect

with your accountant, if you're sharp enough to plug it all into turbo tax or whatever software you use, you know, plug it into last year's, try to get a sense for it. As advisors, we have pretty advanced tools that help us perform a really accurate tax projection year to year, but that's the first step, right? You got to figure out the tax piece, and then it's, as we mentioned, fairly complicated assumptions to figure out what we're comparing to and and then come up with a plan like, like you said, Alex, it doesn't it's not chiseled in stone. You don't have to execute the same dollar amount of Roth conversions every year. You can change it over time as situations change. But again, getting back to that hedging thing, getting it started, we're at least converting some we're creating a larger tax exempt bucket. We're opening up more flexibility in retirement. And if we do it right, we're paying a smaller amount in taxes now than than we would later on. So it's a great strategy. It, I guess my biggest caution is making sure that it's measured and disciplined and then we're not just all excited about it. Going to go all in that we that we do an appropriate amount each year.

Wade Pfau 37:56
Great, excellent. If anyone listening wants to follow up with you, Rob and maybe even discuss whether their own situation might be something that you could provide some value to to improving their financial situation. What's the best way for them to learn more about you and reach out to you?

Rob Cordeau 38:15
Yeah, they can. I know on our McLean website, McLean asset management, the there's a section about the team. So there's a bio for the advisors. There's a way to reach out to contact one of us. They are McLean. Am calm. So happy to connect with anybody who needs it.

Wade Pfau 38:33
Great, great. And to spell that for the audience, yeah, let's

Alex Murguia 38:39
see how you do it. Do the URL? How do you spell the spell out the URL,

Wade Pfau 38:45
m, c, L, E, A, N, A, M, for Asset management.com,

Alex Murguia 38:52
all right, and the last one I'll say is in the show notes, where Wade and I are setting up for a Q A session. So we will have a link where, if you have questions, hit, hit us up on the show notes, and write that, you know, type them in. And like I said, we're doing our best to do our talk radio version retire with side where we hit up questions, but we want to answer questions that are, you know, that you folks are having. So set them up, and we're going to try to do a big push to for a lot of Q and A sessions towards the end of the year. Alrighty, thank you everyone for listening in, and I will catch you next week on retire with style. Thanks, Rob,

Rob Cordeau 39:34
thank you.

Bob French 39:35

Wade and Alex are both principals in McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only, and are not intended to provide specific advice or recommendations for any individual or on any specific securities To determine which investment. May be appropriate for you consult your financial advisor. All investing comes with a risk, including Risk of Loss past performance does not guarantee future results.