## The OBBBA's Impact on Retirement Savings

Take-Away: The OBBBA make saving for retirement easier with more after-tax income available for those savings, thanks to new income tax deductions. However, converting a traditional IRA to a Roth IRA might be more challenging decision to make when the phase-out rules for these new deductions are considered.

Background: As was previously reported in a couple of missives, the One Big Beautiful Bill Act (OBBBA) does not contain any new provisions that directly deal with retirement savings contributions or distributions- there is no SECURE 3.0 Act buried in the OBBBA. However, there are several new tax provisions, either in the form of more tax deductions, or phase-out ranges that limit those new income tax deductions that *indirectly* can *impact* retirement savings decisions.

Lower Income Tax Rates and Broader Tax Brackets: The low(er) federal income tax rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37% are now *permanent,* at least until another Congress shows up and finally decides to take seriously the growing federal deficit and Social Security's looming insolvency. Moreover, the broad(er) federal income tax brackets are also made *permanent,* which should encourage more traditional IRA owners to convert part of their traditional IRA to a Roth IRA, in effect 'filling up' their lower income tax bracket with that conversion income to an aggregate amount that yet still avoids the next higher income tax bracket.

More Tax Deductions: Individuals may feel more comfortable contributing more of their earnings to traditional IRAs and 401(k) accounts if they are eligible to claim some of the new federal income tax deductions that should improve their cash-flow, claiming either the *senior deduction, the tip deduction, the overtime pay deduction, the broadened qualified business income (QBI) deduction, or the enhanced SALT deduction that was increased from $10,000 to $40,000.* The availability of these tax deductions should enable more individuals to contribute funds for their future retirement (presuming that inflation does not consume these anticipated income tax savings.) However, with relatively low modified adjusted gross income (MAGI) limits, Roth IRA conversions could push reported income over the high end of the phase-out range, causing some of these new tax deductions to be lost.

Why More Roth Conversions? Most advisors are quick to point out, as I did above, that nothing is really *permanent* though when it comes to Congress, maybe finally confronts in the next decade an escalating federal deficit and the looming insolvency of Social Security, which suggests the likelihood of higher income tax rates or narrower income tax brackets would not be all that surprising. That 'worst-case-scenario' might make Roth conversions in the near future much more expensive than today, which might lead to more traditional IRA owners to consider a Roth conversion, i.e., they choose to pay the income tax now on the conversion amount, while at a marginally lower federal income tax rate.

'Filling the Bracket:' Roth conversions are an effective way to reduce deferred income taxes when future tax rates might be higher. A Roth conversion would be to convert enough of a traditional IRA to a Roth IRA while keeping the taxable income that results from that conversion in a lower marginal federal income tax bracket, e.g., the 24% tax bracket.

Example: A married couple chooses to engage in a Roth conversion in 2025. The couple can have up to $394,600 in taxable income in 2025 and owe no more than 24 cents on each of those 'conversion' dollars. In short, a retirement savings plan that annually uses Roth conversions within the low(er) marginal income tax brackets could eventually reduce or possibly eliminate future required minimum distributions (RMDs.)

The challenge, then, is how to determine how much of a traditional IRA to a Roth IRA to convert by shifting those dollars, subject to the currently low(er) income tax rates, to a Roth IRA. This decision is affected by whether the traditional IRA owner is eligible for some of the 'new' income tax deductions, or the 'enhanced' SALT deduction. More taxpayers may itemize their tax deductions going forward, which, practically speaking, delays identifying the individual's ultimate income tax rate into the next calendar year when their income tax return is prepared, while the Roth conversion has to take place in the current calendar year. While a reduction in the anticipated tax due this year might generate an increase in the amount converted to a Roth IRA by year's end, it could also be a costly move. Some guesswork and estimates will be required if a decision is made to convert part of a traditional IRA to a Roth IRA, as indicated by the following example.

Example: Starting this year, the SALT deduction is a maximum $40,000, either for a single individual or a married couple. Julie converts $100,000 of her traditional IRA to a Roth IRA in

2025. But that Roth conversion increases Julie's modified adjusted gross income (MAGI) from $500,000 to $600,000. By increasing Julie's income to $600,000 with the Roth conversion, she can only claim a SALT deduction of $10,000. Had Julie not done a Roth conversion of $100,000 she would have been eligible to claim the full $40,000 SALT deduction;  with Julie's Roth conversion of $100,000, she lost $30,000 in SALT deductions for 2025. Julie's 35% federal income tax bracket (that is where her MAGI place her) results in total effective income tax cost to Julie is 45.5% due to the loss of $30,000 in SALT deduction caused by her Roth conversion. Would Julie be better off making a tax-deductible contribution to her IRA (or 401(k) account) rather than make a Roth conversion, to bring down or keep her AGI at the $500,000 level in 2025 in order to obtain the full $40,000 SALT deduction? This will require some calculations.

Qualified Business Income Deduction: In 2025 the qualified business deduction (QBI) is 20% for individuals with taxable income of $197,300 for single individuals and $394,600 for a married couple who file jointly. For the next $50.000 (for a single person) and $100,000 ( for married couples filing jointly) this QBI deduction starts to shrink until it disappears at $247,300 (single) and $494,600 (married.) (However, with higher taxable income, there is no QBI deduction available for specified personal service businesses, e.g., physicians and lawyers.) Under the OBBBA, in 2026 the ranges for reducing the QBI deduction increase from $50,000 to $75,000 (single) and from $100,000 to $150,000 (married, filing jointly) while the taxable income thresholds will be adjusted for inflation. Accordingly, the 20% QBI tax deduction can be appealing, but its availability can make a Roth conversion decision difficult. A Roth conversion will increase taxable income and additionally increase the QBI tax deduction. However, if the Roth conversion puts the individual's taxable income over the larger MAGI amount, the QBI deduction might be lost altogether. The actual taxable income amount for 2025 will not be known until a tax return is filed in 2026.

Planning Observations: Tax planning for a potential Roth conversion might become complex for high earners. Focusing solely on the SALT deduction, with AGI at $500,000 or below, a Roth conversion seems like a safe bet as long as the $500,000 AGI ceiling is not breached. If the individual's MAGI is over $600,000 the SALT deduction is limited to $10,000 and locked-in, and planning for Roth conversions will be just like it was after 2017 and before the OBBBA. If an individual's MAGI falls into the phase-out range ($500,000 to $600,000), a Roth conversion might create tax problems because it pushes the individual into higher marginal income tax brackets. For some of the other 'new' tax deductions that also have phase-out ranges, a Roth conversion could jeopardize claiming the new deduction, depending on the individual's income.

Conclusion: Roth conversions can provide long-term, tax-free benefits, but they can also result in the short-term loss of MAGI-based income tax deductions. Any Roth conversion with these new tax deductions and their phase-out rules will not be done in a vacuum and will require some careful financial analysis and planning.

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