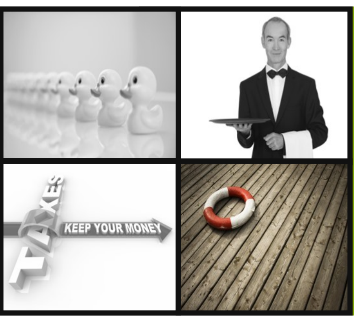

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Money Matters: To Roth or Not to Roth?

BRASS RING wealth management

As a retirement planning specialist I have met thousands of people over the years and held countless conversations regarding investments, retirement, and everything in between.

Those conversations have illustrated the harsh reality that most individuals are not addressing how taxes can ruin their retirement.

A significant factor with regards to your retirement longevity is having accounted for and deciding on how to pay your tax bill.

No one likes paying taxes. By itself, not liking taxes isn't uncommon. What is, is the lack of action taken to reduce them.

When was the last time you gave proper consideration or even a second thought about taking real action to eliminate some or all of them from their retirement plans?

If you want to reduce or eliminate most income taxes in retirement you should be making time to look at Roth IRA's and Roth IRA conversions.

A Roth IRA is the closest thing to a silver bullet in its application to eliminate some or all of your tax burden.

What's a Roth?

Roth's are individually established and controlled retirement accounts. You have to have an existing IRA or and earned income to get one. You can invest in virtually anything inside of the account so long as you meet the investment requirements and suitability.

Unlike its cousin the traditional IRA, deposits to a Roth are money funded after tax.
Roth IRA distributions or withdrawals are state and federally tax-free.

This occurs because any contribution into a Roth IRA is always returned to you without being taxed a second time. Similar to Traditional IRA's, a 10% IRS tax penalty and taxation on interest earned would apply if you take money out of the Roth prior to reaching age 59 1/2. Another penalty applies if your over age 59 1/2 but have not had the Roth IRA open for more than five years.

Since your contributions have already been taxed they are always returned to you without interference.

Other Benefits

Some other outstanding features of Roth IRA's are that they are not subject to required minimum distributions or RMD's.

Traditional IRAs, 401(k) plans, 403B plans, and other tax deductible and tax-deferred accounts all have a mandated distribution commencement date. They must begin at age 72. RMD's are required regardless of health, need, or financial situation.

Even if you are fortunate enough to not need the monies, they still have to come out. Once they are out, there is no way of getting them back into another IRA or similar plan.

"There are only two things certain in life... Death and Taxes"

~Benjamin Franklin

The federal government is serious about it too. If these RMD distributions do not take place, the IRS will apply a 50% tax penalty on what should've been withdrawn, in addition

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to the taxes that are owed. Conversely you *never* have to take a distribution from a Roth at any age.

Taxed: Now, Later, or Never?

Traditional IRAs, 401(k)s, and 403b plans, are typically funded with tax deductible contributions. All of them grow tax-deferred, i.e. taxes are not due on any growth or interest earned while the money stays in the plan.

The flip side is ***that all of the money that you contribute into those plans, plus any interest or growth you earn is subject to taxes whenever money is taken out.***
Additionally, when distributions do occur, you pay taxes on them at your ordinary income tax rate.
What we accept is that ***you will never avoid paying taxes on a Traditional IRA*** or similar plan. If you do not spend all the funds in your accounts through RMD's or withdrawals during your lifetime and your spouse inherits your account, your spouse continues to pay the taxes. If they still have a balance at their death, your beneficiaries will. All withdrawals are included and taxed as ordinary income!
Keep in mind that if all of your retirement funds are invested in the same tax deferred accounts, if ever there was a change to the tax code or rates ***ALL*** of your accounts are effected. Because all of your taxable funds eggs are in the same basket. You have no alternative source for income or tax management. Remember, Roth distributions are tax free.

How do I get one?

Roth IRA's can only be funded through after-tax deposits and taxed Traditional IRA to Roth IRA conversions.

Contributions
Anyone with an earned income is able to able to contribute up to $6,000 whichever is less. If you're over the age 50 you can contribute up to $7,000. Spouses can open accounts as well even if they are not working. Married couples making $14,000 a year could contribute $12,000 or $14,000 to their Roth IRA's depending on their age.

These contributions are excluded from any other types of contributions with retirement plans. So even if you are contributing to your employers 401(k) plan or a 403b plan you are still eligible to contribute to a Roth at these levels

If your income is from dividends and interest from savings or investments, Social Security, or pensions you are not able to contribute. You have to be working and earning in order to contribute, 1099 or W2 wages only. For example, if you earned $3,000 this year you would only be able to contribute $3,000 to your Roth.

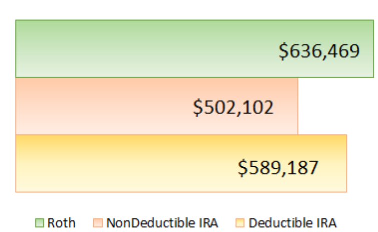
Another great feature about contributions is that you have until April's tax filing deadline of the current year to contribute to a Traditional or Roth IRA for the prior year. You can make a full contribution in April of 2022 for a 2021 Roth.

Roth's are such a good deal that not everyone is able to get one. If you're lucky enough to earn more than $144,000 a year as a single individual you are not eligible to contribute to a Roth IRA at all. The IRS begins to phase out your ability to make contributions to a Roth starting at $129,000 a year. If you are married and earn more than $244,000 in the current year *neither* of you are eligible to contribute to Roth's. The contribution phase-out for married individuals starts at $204,000 a year.
Even though the IRS restricts who can contribute based upon how much you make and how you earned it the do not close the door completely.

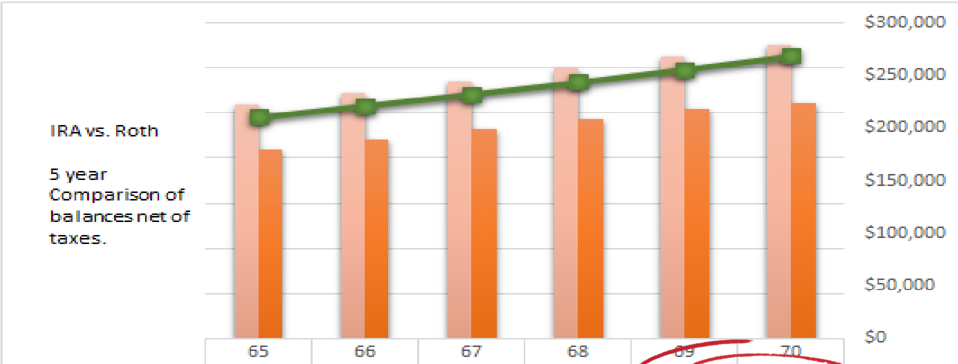
"I love the Roth IRA. Tax-free income in retirement is a truly great deal."

~Suze Orman

A couple both age 32 save $3,000 a year. One into a Roth one into a traditional IRA.



*30 years of withdrawals starting at 65, a consistent 25% tax bracket, and 6% growth. This is a hypothetical illustration and does not represent an actual investment. There is no guarantee similar results can be achieved. If fees had been reflected, the return would have been less.



	65	66	67	68	69	70
Pre Tax IRA	$260,000	$272,375	$285,345	$298,939	$313,188	$325,795
Net IRA	$210,000	$220,500	$231,525	$243,101	$255,256	$261,119
Roth	$210,000	$220,500	$231,525	$243,101	$255,256	$268,019

Assumes:
Full Conversion of IRA, 5% Growth Rate, 25% Tax rate . Includes additional taxable funds to compensate for the money that was not lost to taxes under the No Conversion scenario. If over age 70 1/2, the side fund assumes deposits of the remainder of any required minimum distributions after taxes have been paid. The growth on this account is taxed each year. In year 5 a $9,316 RMD is required and taken from balances. This is a hypothetical illustration and does not represent an actual investment. There is no

There is another way to get your hands on some tax-free money.

Roth Conversions

Roth conversions have been around since 1998. A Roth IRA conversion is the act of turning a Traditional IRA into a Roth IRA by paying the taxes on the amount of the IRA that you're turning into a Roth. Any traditional IRA owner and in some cases beneficiaries, are allowed to convert all or a portion of the Traditional IRA into a Roth IRA regardless of size, income, or age.

It does not matter if you are 90, making $400,000 a year and want to convert your $10 million dollar account. Conversions can be partial or full, and can be done all at once or over several years.

Another great feature is that conversions do not count towards your ability to contribute to a Roth. You could convert a $100,000 IRA and still be able to contribute The full $7,000 (assuming your 50) because each is classified separately. Converting a Traditional IRA essentially makes the IRA tax-free, effectively resulting in making a contribution.

Let's suppose you have a $10,000 Traditional IRA, but you've decided you want a Roth instead. You don't have any additional funds to make contributions but you typically get a $2,000 tax refund. Instead of spending the refund, you could use those funds to pay the taxes on the converted IRA. Assuming you stayed in the same tax bracket the refund would allow you to have an additional $10,000 in a Roth. Walla! You have a new Roth without having to come up with money from the same or another account.

It is generally preferable that funds are available to pay the taxes due upon conversion from funds outside of their IRA. If you elect to take a distribution from your IRA to pay the conversion taxes, please keep in mind the potential consequences, such as an assessment of product surrender charges or additional Internal Revenue Service penalties for premature distributions.

Food for Thought

Rarely do we consider our long term future, so here are a few questions to get started.

1. Over your life, how much do you think you have paid to the IRS?
2. Can you ever remember a year in which you paid less in taxes than the year before?
3. Is the value of your IRA(s) the lowest you ever want it to be?
4. Are your beneficiaries likely to close your account all at once or over time?
5. What happened to your tax filing status when one of you passes away?

Example:

Assume a constant 25% income tax bracket. An IRA owner has a $100 traditional IRA and $25 in a taxable account.

If he converts, he has a $100 Roth IRA. Over some period of time, it grows to $200, all of which is tax-free.

Over the same period of time, if the IRA owner doesn't convert, his traditional IRA will grow to $200, or $150 after income tax.

His $25 taxable account will grow to less than $50, since the income and gains on the taxable account will be taxable each year.

Because the $200 Roth IRA is tax-free, it's more valuable than the after-tax value attained without the Roth IRA conversion.

Roth Recap

- ✓ Tax Free Distributions
- ✓ Tax Deferred Growth
- ✓ Spousal Continuation of tax free distributions
- ✓ No RMD's
- ✓ Tax Free inheritance for Beneficiaries
- ✓ Distributions are not counted towards income
- ✓ Creates a complimentary tax strategy
- ✓ Wide range of investment flexibility
- ✓ Often protected from Bankruptcy
- ✓ $12,000 to $14,000 may be contributed each year

Retirement Income Considerations

It has been my experience over the last 20+ years that when people retire they don't do it because they want to spend less or restrict their lifestyle, at least for the first decade or so.

Most want to maintain their standard of living. Sure, your commute is less, and you save money on lunches, but in reality you have more free time to take vacations, spoil the grandkids, or take up old hobbies, and that all takes money. The amount spent doesn't typically change but where it comes and goes does. Because many retirees maintain their standard of living they also maintain the same tax bracket they were in while they were working.

The MFJ tax filing status qualifies you for the lowest tax brackets and rates that the government allows. These tax brackets are designed to capture as many people as possible. A married couple filing jointly earning $172,750 a year and then retiring and making $81,051 a year stays in the same tax bracket 22%

"The Roth IRA is a very important tool in virtually anyone's Total Money Makeover."

Dave Ramsey

A married filing jointly couple would have to earn less than $81,051 in 2022 in order to drop into the 12% range.

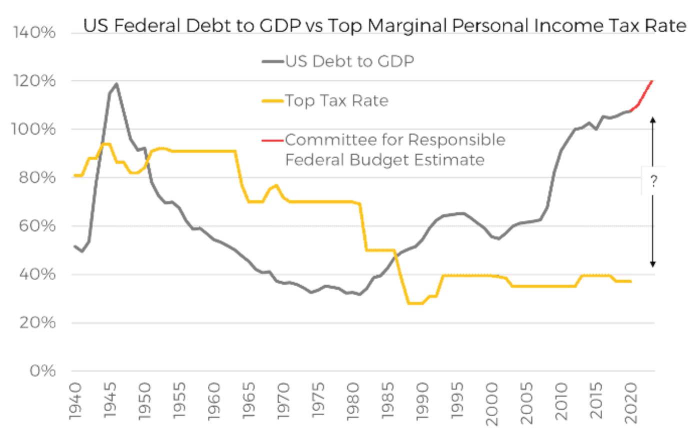
It's worse for single filers. A single filer reaches a 22% tax bracket at $40,256 and 24% at $86,376.

Tax Tango

You are your spouse are retired, things are good, and you find yourself not taking as much from your IRA's as you thought you would, so they continue to grow. As you approach age 70 this happens…

The average male life expectancy is currently 76.1 years, females is 81.1. If this was you, you would be taking RMD's for 5 years under favorable tax rates. In the 6th year lets assume the husband dies. What just happened? The next year the surviving widows filing status changes from MFJ to Single. ***The same income is now taxed 40% percent more.*** These required distributions come out of plans whether you need them or not.

You are going to pay the taxes, you can choose to do it over time or all at once.



Source: Internal Revenue Service; Office of Management and Budget; Cresset Capital.
Chart #1052

Ever Increasing

Assuming your IRA is invested for the long term, most want it to grow. What also grows with it? If you guessed your tax bill you are right.

The larger your tax deferred account value becomes, the larger your potential tax bill becomes. The larger your account becomes the larger your RMD's become, which in turn forces more taxes to be paid each year. RMD's are ordinary income and are used to calculate how much tax you pay on all your income. The better we do with our investments, the larger the tax bill grows.

“the thing I like about Roth’s: There are no lifetime required minimum distributions. So, even at 72, if you don't need the money, it still grows. And it grows in the best account you could have: a tax-free account, never eroded by taxes. So, it's pure growth for the rest of your life.—

~Ed Slott
Morningstar Conference
March 2015

Do you remember my question from earlier? Whatever the value of your IRA’s are today, you want them to be worth more in the future, correct? If you do a good job of investing in your IRA it should grow. Many of us don’t think about how doing well with our investments translates into more taxes.

If the value of your IRA’s today is the smallest amount it will ever be, it also begs to question that you will also pay the least income tax on it if it were closed out. Every day that it grows you end up paying more taxes on the balance.

One more thought. All things being equal, which account will grow faster? One where you have to take ever increasing annual distributions, or one that you never have to take any distributions from, ever?

Pensions for Your Kids

Not that you haven’t helped your kids enough already, but consider this. Both Traditional and Roth IRA’s have a special distribution option. This option is to choose to not close out an account altogether in one year or over 5 years which are common, but to spread out the distributions over 10 years.

The option is commonly called a “Stretch IRA”

Stretching the IRA allows the account to remain open and growing continually tax deferred, and minimizing the taxes to the heirs who in many cases are in a higher tax bracket than the owner.

How about this. If you were a beneficiary would you rather receive taxed distributions for 10 years or a tax free distributions? Ones that you could use to, fund your own Roth, help with monthly bills, or use as a tax free pension?

Is a Roth Conversion right for you?

Now that we know the nuts and bolts lets get to the real question.

Taxes rule the roost in retirement. Once you fully realize that any money that you have in a traditional IRA or similarly taxed plan is going to be taxed as ordinary income and potentially at the highest marginal rate possible you are half way to choosing whether or not you will pay more than you need to, and no mistaking it, it is a choice.

You can choose to take money out of those IRA’s over time using an RMD schedule, chipping away at the balance until you and your spouse pass away and the kids close the account, possibly all at once, adding the IRA

Use someone else’s money to pay for Roth conversions!

Individuals with life insurance policies might think twice about canceling them, others should look into getting more.

For cents per dollar, life insurance creates instant monies above investment returns, and is tax-free to the beneficiaries receiving funds.

What about using these cheap tax free dollars to pay the taxes on converting traditional IRA’s into Roth’s as an estate planning option?

*All guarantees subject to the claims paying ability of the issuing insurance company.

balance to their incomes and paying and even higher rate on the IRA and their other income. Or, look to convert your balances to a Roth. Knowing for certain the amount of taxes you will pay and that it will be the lowest possible rate.

Other Considerations

Q. What if I change my mind

A. If you have converted an account and then changed your mind you can recharacterize the Roth back into a Traditional IRA. You have to file an amended return and complete the transaction by October 15 of the following year .

The highest tax rate that can be applied to an IRA is not 37% it is 77% !!!

Q. What funds should I use to pay the taxes?

A. There's no doubt you're better off by using cash to pay the income taxes. With current interest rates, taxes and inflation produce a negative return on current savings accounts.

B. The next best place to use is taxable investments. Whenever you liquidate an investment you must report a capital gain or loss, and taxes are either paid or reduced. "Tax harvesting," as it's called is a way to strategically sell certain securities within your portfolio to minimize the tax effects. By using a tax harvesting strategy you might be able take money out of your taxable accounts to pay a conversion tax bill with little or no additional taxes owed.

C. A third option is to use the IRA itself. This can be the most expensive option and has the greatest negative affect on the balance. If you pay the tax from your IRA, you lose the potential benefit of tax-free growth on that amount, defeating the purpose. If you're under $59^{1/2}$ the IRS will apply an additional 10% penalty on to the monies that you used from the IRA...Yikes!

Q. Do Conversions affect my entitlements?

A. Social Security

Maybe, unless you are 62 or older and collecting Social Security payments, there is no real affect. If you are collecting social security keep in mind your normal retirement date as it could cause a reduction in benefits.

Remember that conversions are included as income. A large enough conversion could cause a reduction in your annual benefit as well as taxation of your Social Security payments.

B. Medicare.

Maybe, your annual income is used to determine your Part B Medicare insurance premiums. If you are age 65 or older a conversion is included in your income. If your income goes up dramatically fro the year before your part B premiums will go up the following year.

Complex Estate Considerations

Credit Shelter Trusts

A Roth IRA is a more valuable asset to fund a credit shelter or generation-skipping transfer (GST) tax-exempt disposition. An IRA is valued for estate and GST tax purposes without regard to income taxes payable.

Leaving an IRA to a credit shelter trust limits the stretch-out to the spouse's life expectancy but there is no restriction to leaving an IRA to a grandchild, or a GST tax-exempt trust.

Reasons to Convert

1) You do not need the funds to maintain your current standard of living
2) You expect to be in a higher tax bracket in the future
3) Your heirs are in a higher tax bracket than you
4) You have a long life expectancy
5) You have outside funds to pay the conversion taxes

Decoupled Estates

A Roth IRA avoids double taxation in a decoupled state. Double taxations can occur on Traditional IRA's: income and estate taxes. An income tax deduction is allowed to the recipients for the federal estate tax payable with respect to income in respect of a decedent, such as IRA benefits. By converting to a Roth IRA, the income tax is removed from the estate.

Trusts as Beneficiaries

The income tax cost of leaving assets in trust has increased as a result of the recent Tax Payer Relief Act. ATRA increased the top income tax rate to 39.6%, from 35%, for trusts, with income over $11,950. The acts also made the 2001 and 2003 tax rate reductions permanent for individual taxpayers with taxable income up to

Use guarantees to pay conversion taxes

Certain specialized annuities will pay the beneficiaries of contract values more than what was deposited and earned at the contact owners death.

Some companies will pay as much as 30% more than what the contract is worth at annuitants death. Beneficiaries receive a premium over and above the growth inside of the policy.

Converting an IRA to a Roth reduces ones estate value. This is a way to earn back monies lost due to conversions when the account is allowed to be invested can grow over time.

*All guarantees subject to the claims paying ability of the issuing insurance company.

$400,000 (single) or $450,000 (joint). In addition, the 37 percent these reductions allow many IRA owners to convert IRA at tax rates below 37 percent. By converting to a Roth, IRA owners can leave their IRA benefits to their children and grandchildren in trust, rather than outright, without subjecting the IRA benefits to tax at 39.6% or giving up the estate tax and asset protection benefits of the trust.

It's not what you earn, but what you keep that matters.

As you can see it is all about taxes. Roth conversions are not appropriate for everyone. Generally speaking the higher the tax bracket and the longer the time frame the better it is to convert. To answer any questions or to schedule a time to create your custom illustrations on how a Roth contribution or conversion can benefit you, call, email or stop by to set up a time to learn more.

7300 Dixie Hwy Ste. 800
Clarkston, MI 48346
855-BRASSRW
Mobile 248-330-8707
Business Text: 248-206-3445
info@brassringwealth.com | www.brassringwealth.com