

Roth Time Now

How to beat the taxman in planning for a good Income at retirement?

By Shane Dez as to be printed in September 2005 issue of California Brokers magazine

Is there any wonder why some clients are so confused about which type of qualified retirement account to choose? Studies show that people don't save for retirement because they're confounded by all types of accounts. There's the retirement plan at work, annuities, traditional individual retirement arrangements (IRAs), Roth IRAs, and plain old savings and brokerage accounts.

Here's the quick and easy (and probably smartest) saving strategy you can help any of your qualified clients to choose: Have them Contribute to a Roth IRA. The Tax-Free growth, Tax Free Income and withdrawal flexibility you cannot beat. Compared with an employer-sponsored retirement account - - such as a 401(k) or 403(b) -- or a traditional IRA, the Roth is by far more flexible and likely will lead to more money in retirement.

Let's take a closer look:

Getting your hands on the money

Besides fostering tax-free growth, the ROTH IRA has flexible withdrawal rules. Contributions to a ROTH -- that is, the money you save into the account -- can be withdrawn at any time, penalty- and tax-free. For example, let's say you have contributed \$20,000 to a Roth, and it grew to \$25,000. You can withdraw your twenty-grand contribution at any time,

no questions asked. However, if you try to take out that \$5,000 gains before you're 59 1/2 and the account has not been set up for five years, then you may be subject to penalties (Except in special cases).

So, ROTH is a great place for your money because you can start withdrawing the principle if you should need it before age 59 1/2 without any hassle. ROTH IRA is also a good account for college savings, emergency savings, and other goals your clients may have.

ROTH Basics

The maximum that can be deposited in a Roth in 2005 is \$4,000 (\$4,500 for age 50 or older). Unfortunately, not everyone is eligible. Once your adjusted gross income reaches \$100,000 if you're single or \$150,000 if you're married, the amount you can contribute to a Roth begins to decrease, reaching zero for those with an AGI of \$110,000 (singles) or \$160,000 (married). So, if your clients are not eligible for a ROTH, let them stick with their other type of qualified plans.

If you open a traditional IRA account in a year, you can no longer fully contribute to Roth in that same year, but you can split between the two for the same contribution year.

The Biggest Bullet Point;

You can have a Roth IRA with full contribution AND as many as any other types of tax qualified plans, such as a 401K, SEP, Defined benefit & Contribution plans, and so on....

With a ROTH, contributions do not reduce taxable income, so there's no deduction. However, the ROTH is a tax-free account; no taxes are paid on the interest, dividends, or gains – ever

Should you pay taxes now or later?

Simply ask yourself these questions:
Should you pay taxes now when your account is small, or never pay taxes no matter how big it grows? Should you prefer to pay taxes now, while you're still earning income and can easier afford to cover the tax liability, or when you've stopped working, every penny counts and can hardly afford to make up for anything Uncle Sam takes away from you? The answers are easy. Yet so often overlooked or totally ignored.

Additionally, the more taxable income you receive in retirement, the more likely your Social Security benefits will also be taxed. Income from a Roth IRA, however, does not affect the calculation of whether you'll pay taxes on a portion of your retirement benefits. And, with ROTH IRA, there is

No required distributions, either,

Since, employer-sponsored retirement accounts, traditional IRAs and all other tax qualified plans are tax-deferred -- you'll have to pay taxes on

the money at some point. And Uncle Sam doesn't want to wait forever, so he came up with something called minimum required distributions (MRDs). According to the rules, you must begin taking money out of any of your, so called, tax qualified IRA funds by April 1st of the year following the year in which you reach age 70 1/2 -- whether you need the money or not. (Unless you're still working. In which case, you can delay MRDs until after you retire.)

However, since IRS doesn't have a vested interest in the tax-free money in ROTH IRAs, they aren't subject to MRD rules. So, if you can live on your Social Security, pension, other savings, and perhaps part-time work, then the money in your ROTH can keep growing tax-free, creating a bigger bundle for when you do need it.

No Income tax to your heirs

A ROTH IRA is also good for the beneficiaries of your estate. Just as you would receive the proceeds of a ROTH tax-free, so would your heirs. On the contrary, beneficiaries have to pay income taxes on the money inherited from 401(k) s, SEP, traditional IRAs and all other qualified plans. (Both forms are still subject to estate taxes, if applicable.)

In spite of all these advantages, there are all kinds of calculators that theoretically indicate which account will provide more for us in retirement. The conventional wisdom is that, if your tax bracket now is higher than your bracket will be in retirement, a deductible account might be the better bet.

However, the problem with calculators and similar analyses of the ROTH vs. traditional IRA dilemma is, they all assume that any tax savings realized from contributing to a deductible account is invested elsewhere. Therefore, creating more money in retirement. However, this just isn't a realistic assumption. People don't say to themselves, "Well, my tax bill is \$800 less because I contributed to my 401(k), so I'll buy 32 shares of Microsoft and not touch it until I'm fully retired"

No, that tax savings usually goes somewhere else -- and usually not to any type of savings account. Have you ever invested your tax savings? Neither have your clients. Boiled down to the essentials, you're contributing to a retirement plan to make your golden years more affordable, not to necessarily give yourself a tax break today (as great as that can be).

The Bottom Line

So, if you're indecisive which way to go with an affordable saving plan, ROTH IRA could be the way to go. Simply stated, The ROTH individual retirement account is the hottest saving plan ever.

You open the account with after tax money, but from then on everything is Tax Free, even when you withdraw the money, plus no minimum required distribution. It is all yours. No taxes to you as long as you live. No income taxes to your heirs. No government intervention. It is just that simple. With no string attached.

Again, here are the key attractions:

- Unlike all other IRA's, you pay no taxes when you withdraw. That means Tax-Free Income AND Tax-Free growth.
- Unlike all other IRA's you don't have to start taking money out or stop putting money in at 70 ½.
- Unlike all other IRA's, contributions to a Roth -- that is, the money you save into the account --NOT the gain-- can be withdrawn at any time, even before 59 and ½, with NO penalties and NO taxes.
- Unlike all other IRA's, after 5 years or 59 ½, whichever is later, any withdrawals including all gains are Tax-FREE.
- Unlike all other IRA's, everything is income tax free to your heirs.

Do we have enough reasons to help our clients Plan for a Tax-Free Income at retirement. You bet, we do.