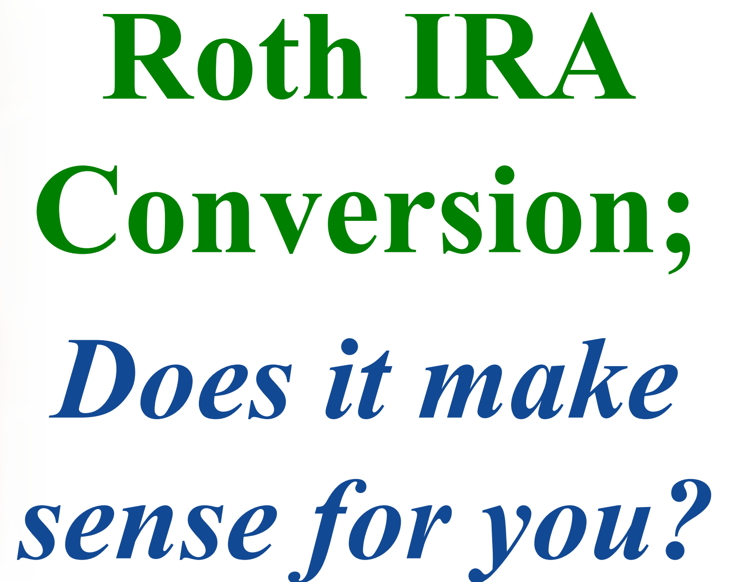

Prepared By

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Atul C. Dubal, CFP is an Investment Advisor Representative offering advisory services through Prudent Prospera Planning, Inc., a California Registered Investment Advisor

Have you accumulated a significant balance in your IRA, 401(k) plan, or other type of retirement savings account? *The taxman is coming for you; you may want to consider converting all or a portion of the account to a Roth IRA.*

Why would you do this? To eliminate the future tax hit that cannot be avoided; tax-deferred retirement accounts are fully taxable, and subject to Required Minimum Distributions beginning at age 72 (under current law).

Understanding the "taxability" of retirement accounts.

Money contributed to a 401(k), IRA, or other type of plan is "pre-tax;" the contributions are not taxed when earned. Growth on the contributions is "tax-deferred;" growth on the contributions is not taxed every year, but when money is withdrawn from the account it is taxed at Ordinary Income tax rates.

Required Minimum Distributions. In the year that you attain age 72, you are required to withdraw at least a minimum amount from the account every year, even if you do not need the money. This is called Required Minimum Distributions, *or "RMD."*

As background, the "theory" behind RMDs is that during your working years Uncle Sam allowed you to save money in your plan "pre-tax" (thus you did not pay income tax on the money you saved in your plan), and Uncle Sam also allowed those savings to grow on a tax-deferred basis (thus you were also not taxed on the earnings on the money that you saved in your plan).

But as you might guess, Uncle Sam eventually wants his taxes, so beginning at age 72 you must begin withdrawing RMD. *The RMD amount is based upon three things:*

- *Your age*
- *Your plan balance as of December 31st of the previous year.*
- *The RMD Divisor that applies to your age.*

Uncle Sam let you save money pre-tax, and let your money grow tax-deferred.

Starting at age 72 he wants to start collecting those taxes.

For smaller accounts, this may not be a problem in retirement, in fact, those with smaller balances in their IRA or 401(k) typically withdraw more than the RMD.

For those with larger account balances, RMD can create a "tax bomb" because it forces them to withdraw much more than they need or want, boosting them into the highest tax brackets.

The Problem with RMD for Large Accounts; An Example.

For those with larger account balances, RMD can create a "tax bomb" because it forces them to withdraw much more than they need or want starting at age 72, boosting them into high tax brackets. Let's look at an example:

For simplicity, let's assume **a married couple, both age 60, have a total of $2.5 Million in retirement accounts** ($1.5 Million for him, $1 Million for her), and they are contributing $20,000 each per year to the accounts through age 66, and they both retire at age 67.

We will further assume that both accounts are growing at 7.45% per year (the Compound Annual Growth Rate (CAGR) of the SS&P 500 TR Index for the past twenty years).

At Retirement (Age 67):

Their home is paid-off and they have other assets for travel and fun**. They need an annual gross income of $200,000** to maintain their lifestyle.

Combined Social Security Benefits	= $ 74,000
IRA Distributions	= $126,000
TOTAL GROSS INCOME	= $200,000

This income puts them in the 22% federal and 13% State (CA) tax brackets after Standard Deductions (16.35% Effective Tax Rate with total tax of $32,708). We see their IRA distributions from age 67 through 71 at the table below.

IRA DISTRIBUTIONS PRIOR TO AGE 72

				His IRA			Her IRA			TOTAL IRA
				Assumed CAGR 7.45%			*Assumed CAGR 7.45%*			
His Age		Her Age		Begin Balance	Distribution	End Balance	Begin Balance	Distribution	End Balance	Distributions
60	61	60	61	$1,500,000	$0	$1,633,240	$1,000,000	$0	$1,095,990	**$0**
61	62	61	62	$1,633,240	$0	$1,776,406	$1,095,990	$0	$1,199,131	**$0**
62	63	62	63	$1,776,406	$0	$1,930,239	$1,199,131	$0	$1,309,957	**$0**
63	64	63	64	$1,930,239	$0	$2,095,531	$1,309,957	$0	$1,429,038	**$0**
64	65	64	65	$2,095,531	$0	$2,273,139	$1,429,038	$0	$1,556,992	**$0**
65	66	65	66	$2,273,139	$0	$2,463,977	$1,556,992	$0	$1,694,478	**$0**
66	67	66	67	$2,463,977	**$63,000**	$2,601,340	$1,694,478	**$63,000**	$1,774,513	**$126,000**
67	68	67	68	$2,601,340	**$63,000**	$2,748,937	$1,774,513	**$63,000**	$1,860,510	**$126,000**
68	69	68	69	$2,748,937	**$63,000**	$2,907,529	$1,860,510	**$63,000**	$1,952,915	**$126,000**
69	70	69	70	$2,907,529	**$63,000**	$3,077,936	$1,952,915	**$63,000**	$2,052,203	**$126,000**
70	71	70	71	$3,077,936	**$63,000**	$3,261,039	$2,052,203	**$63,000**	$2,158,889	**$126,000**

Distributing only what they need from the IRAs.

The Problem with RMD for Large Accounts; An Example *(continued)*

Now let's fast forward to the year in which they both attain age 72, when they must begin taking Required Minimum Distributions (RMD) from their IRAs.

As we see at the table below, in the first year of RMDs, **their RMD they are forced to withdraw nearly DOUBLE what they need** ($211,716 total RMD versus $126,000 need).

This additional income puts them in the 24% federal and 16% State (CA) tax brackets after Standard Deductions (21.4% Effective Tax Rate with total tax of $61,073). We see their IRA distributions at age 72 at the table below.

IRA DISTRIBUTIONS AT AGE 72

His Age		Her Age		His IRA (Assumed CAGR 7.45%)			Her IRA (Assumed CAGR 7.45%)			TOTAL IRA
				Begin Balance	Distribution	End Balance	Begin Balance	Distribution	End Balance	Distributions
70	71	70	71	$3,077,936	**$63,000**	$3,261,039	$2,052,203	**$63,000**	$2,158,889	**$126,000**
71	72	71	72	$3,261,039	**$127,384**	**$3,367,112**	$2,158,889	**$84,332**	$2,229,112	**$211,716**

Forced to distribute a lot more than they need from the IRAs.
AND THIS IS ONLY THE BEGINNING!

His Age		Her Age		TOTAL IRA Distributions
75	76	75	76	**$277,402**
80	81	80	81	**$379,187**
85	86	85	86	**$501,811**

As they age, the RMD factor increases each year. Assuming the same 7.45% annual rate of account growth, their tax liability continues to increase:

Federal Marginal Bracket	State (CA) Marginal Bracket	Effective Tax Rate
24%	18%	23.6%
32%	20%	26.6%
35%	23%	30.3%

Even after taking the RMD income that far exceeds what they need, there will still be a sizable amount left at their death. ***What does the taxman do then?***

Taxation of Inherited Retirement Accounts

When the owner of a tax-deferred retirement account passes away, the rules on how and when those who inherit the account can be a bit complex – it depends upon the relationship of the beneficiary to the deceased account owner and if the death occurs before or after January 1st, 2020. **The information below applies to the death of an IRA account owner after January 1st, 2020.** *In all cases the account is going to be taxed.*

Beneficiary is a Spouse.

A spousal beneficiary essentially just assumes the inherited IRA. They may do so by renaming the account in their name or by transferring the balance into an IRA they already own in their own name. **Spousal beneficiaries must withdraw RMDs based upon their own age, which are subject to tax as Ordinary Income when distributed.**

Beneficiary is a Non-Spouse.

All beneficiaries of an IRA who are not the spouse of the deceased account owner are treated as non-spousal beneficiaries; there is no special treatment or exception for children unless they are minors. **Non-spouse IRA beneficiaries must withdraw all Inherited IRA assets or 401(k) plan by December 31st of the 10th year following the IRA owners' death; this is called the "10-Year Rule."**

Here's the point: Unlike assets held in accounts that are not IRAs or other retirement accounts, there is no "stepped-up basis" to beneficiaries for assets held in IRAs or retirement accounts. The beneficiaries must withdraw all of the Inherited IRA money within 10 years and pay Ordinary Income taxes on the withdrawals. *Let's look at a simple example:*

The daughter of the deceased IRA owner and her spouse together **earn $350,000 per year**. After 401(k) contributions and standard deductions, they are in the 24% Federal and 16% State marginal tax brackets and pay **total tax of $93,534; they keep $216,465 of the $350,000 gross income.**

She inherits her mothers $2 Million dollar IRA, and to comply with the 10-Year rule decides to take a level withdrawal of $200,000 per year.

The $200,000 IRA withdrawal is treated as income, pushing gross income to $550,000. After 401(k) contributions and standard deductions, they are now in the 35% Federal and 21% state marginal tax brackets and **pay total tax of $182,119; they keep $327,880 of the $550,000 gross income**. ***They paid $88,585 in taxes on the $200,000 inherited IRA withdrawal – 44%!***

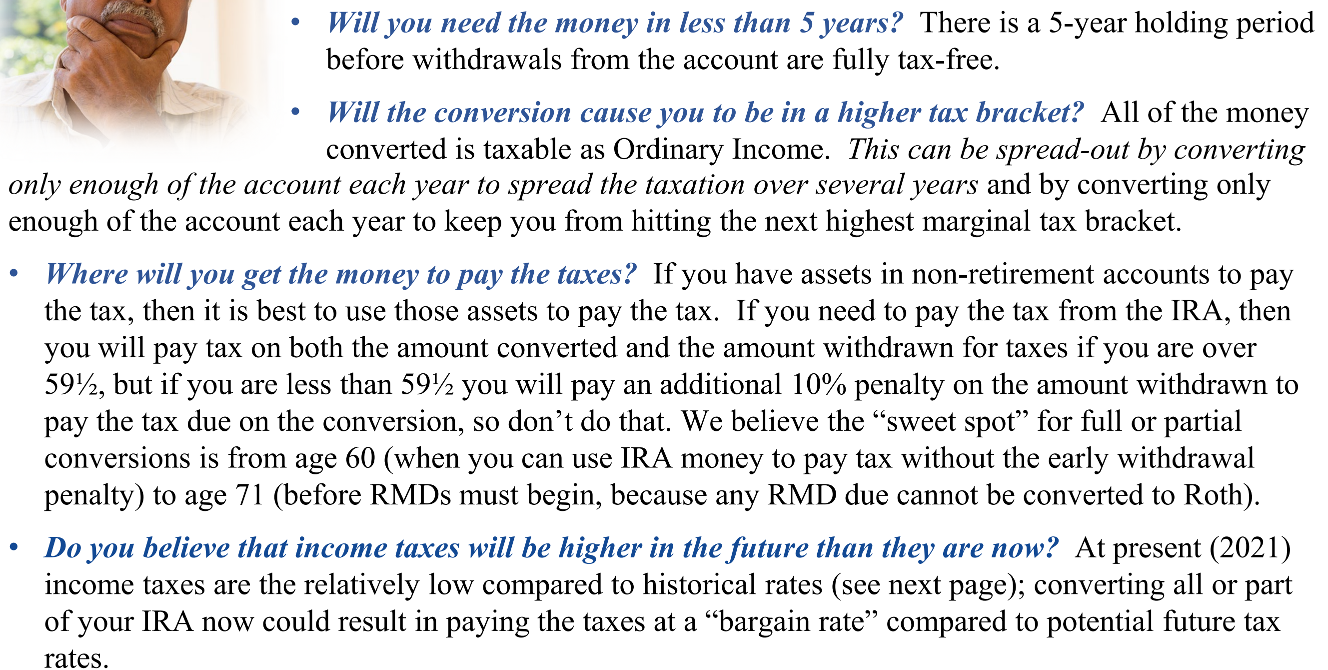
Roth IRA Conversion

ANYONE CAN CONVERT A TRADITIONAL IRA OR 401(K) PLAN TO A ROTH IRA;
there is no income limit on who can convert to a Roth IRA.

The catch? **You have to pay the taxes due on the amount of the IRA that is converted** *(but you don't have to convert the whole account at once, you can do it in pieces over time).*

ROTH IRA ADVANTAGES

- **Contributions are after-tax.**
- **Account growth and withdrawals are are tax-free if the account has been established for at least 5 years before withdrawals of any earnings** (withdrawals of earnings prior to five years can be taxable, but you can withdraw already-taxed contributions before 5 years) **and you are at least age 59½** when the withdrawal is made.
- **There are no Required Minimum Distributions for a Roth IRA.**
- **There is no taxation of the Roth IRA to beneficiaries after the**
- **5-year holding period.**



Is a Roth Conversion Right for You?

There are a number of factors that must be considered, including:

- ***Will you need the money in less than 5 years?*** There is a 5-year holding period before withdrawals from the account are fully tax-free.
- ***Will the conversion cause you to be in a higher tax bracket?*** All of the money converted is taxable as Ordinary Income. *This can be spread-out by converting only enough of the account each year to spread the taxation over several years* and by converting only enough of the account each year to keep you from hitting the next highest marginal tax bracket.
- ***Where will you get the money to pay the taxes?*** If you have assets in non-retirement accounts to pay the tax, then it is best to use those assets to pay the tax. If you need to pay the tax from the IRA, then you will pay tax on both the amount converted and the amount withdrawn for taxes if you are over 59½, but if you are less than 59½ you will pay an additional 10% penalty on the amount withdrawn to pay the tax due on the conversion, so don't do that. We believe the "sweet spot" for full or partial conversions is from age 60 (when you can use IRA money to pay tax without the early withdrawal penalty) to age 71 (before RMDs must begin, because any RMD due cannot be converted to Roth).
- ***Do you believe that income taxes will be higher in the future than they are now?*** At present (2021) income taxes are the relatively low compared to historical rates (see next page); converting all or part of your IRA now could result in paying the taxes at a "bargain rate" compared to potential future tax rates.

Roth IRA Conversion;

Does it make sense for you?

Many believe that significantly higher taxes are inevitable.

As you can see from the tax history chart here, past top rates have been as high as 70% to 92%, and as high as 50% in 1980. Top rates have decreased significantly since then, but government spending has continued to increase.

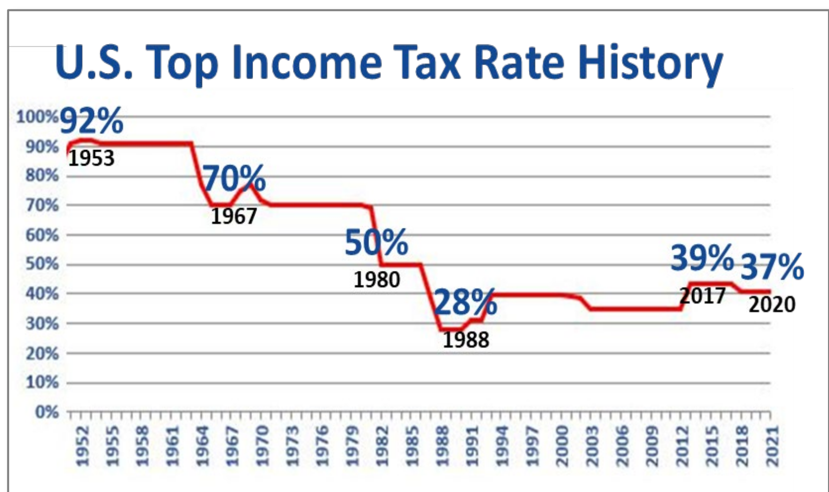
The Federal debt is now more than $28 Trillion dollars and growing.

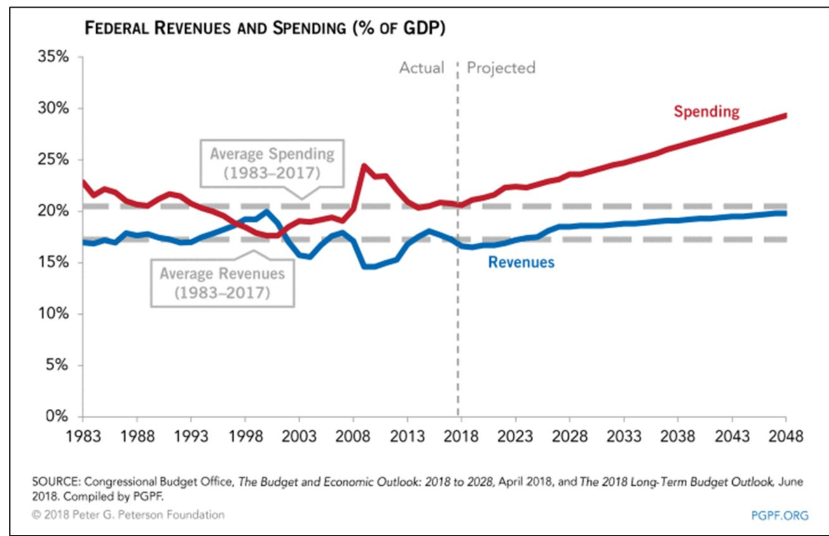
Projected government spending has consistently outpaced revenues as you can see at the chart at the lower right**.**

Retirement **plan assets in the U.S. are well over $30 Trillion.** These plans are a huge source of potential revenue for the U.S. government, so it seems logical that taxation on retirement plans is not likely to decrease in the coming years.

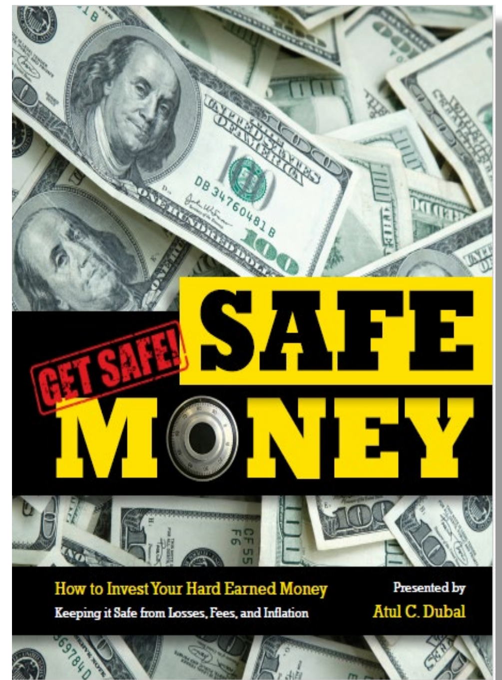
What do you think? Will taxes be higher or lower in the coming years?

Does it make sense to consider converting to a Roth IRA now while rates are still relatively low?





Yes! *Please send me your free books.*



I am most interested in:

- ☐ Comprehensive Financial Planning
- ☐ Investment Portfolio Management
- ☐ Retirement Income Planning
- ☐ Annuity & Life Insurance Solutions
- ☐ Social Security Benefit Analysis
- ☐ Tax Planning & Management
- ☐ Charitable Giving & Tax Deduction
- ☐ 401(k), IRA, and Roth IRA Plans
- ☐ Restricted Stock Option Plans
- ☐ College Funding

Name ________________________________ Age ______

Spouse ________________________________ Age ______

Address: ________________________________

City ____________________ State ______ Zip __________

Mobile Tel: ________________ Email ____________________

Comments ________________________________

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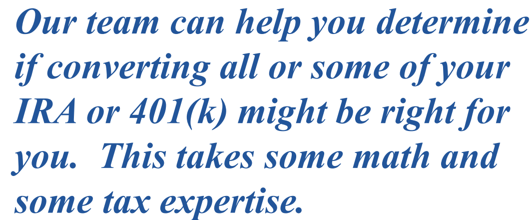
Roth IRA Conversion;
Does it make sense for you?



ATUL C. DUBAL, *CFP®*

I am a fully independent, fee-based investment advisor and licensed insurance professional. This means that I am bound by the "fiduciary standard," meaning that I am bound – both legally and ethically – to work only in your best interest, not in the interest of any bank, brokerage, or insurance company.

I am a Certified Financial Planner® (CFP®). This means that I have passed the highest level of competency certification available for personal and small business financial planning.

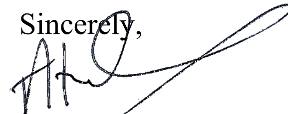
I offer over 30 years of experience and expertise in helping my clients achieve their financial goals. My team and I bring a rich and diverse base of experience related to tax-aware planning, retirement income planning, investment management, estate conservation, insurance, and college funding planning.

I serve clients from a variety of backgrounds throughout the United States, with a specialty focus upon the sometime unique needs and situations of my Indian community living and working in the U.S .

I reside in Pleasanton, California with Maya, my dear wife of over 30 years. We are blessed with a son and a daughter, now grown adults.

My team and I look forward to working with you.

Sincerely,



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