# Understanding IRAs and Retirement Plans

## Tax-Saving Strategies

# History of IRAs:

**Employee Retirement Income Security Act of 1974 (ERISA):**

- Federal law establishing standards for private pension plans.
- Did not require employers to have pension plans, but enforces rules for those that do.
- Studebaker went out of business in the late ‘60s and couldn’t pay their employee pensions because they weren’t funded adequately.
- Taxpayers could contribute up to $1,500 per year and reduce taxable income by the amount of the contributions.

**Economic Recovery Tax Act 1981 (ERTA):**

- Under ERISA, IRAs were restricted to those workers who were not already covered by a qualified employment-based retirement plan.
- Under ERTA, all taxpayers who were age 70½ or younger could contribute to an IRA.
- Taxpayers could contribute up to $2,000 to their own IRA and $250 for a nonworking spouse and receive a tax deduction.

# Tax Deferrals for Retirees:

This example uses the assumption that we are putting $2,000 per year in an IRA for 40 years with an assumed 30% tax bracket.

**Example of Tax-Deferred Contribution and Interest/Gains:**

- You put $2,000 per year in an IRA for 40 years at 8% tax deferred.
- After 40 years, you would have $559,562 x .04 (Cash-Flow Rule) = **$22,382**

**Example of Taxable Contributions and 8% Return:**

- You put $2,000 per year (which is $1,400 after taxes) in an IRA for 40 years at 8% taxable return.
- After 40 years, you would have $207,032 x .04 (Cash Flow Rule) = **$8,281**

# Types of IRAs:

**Traditional IRAs:**

- Contributions may be tax deductible.
- Savings grow tax-deferred while inside the account.
- Withdrawals are generally added to your income.
- Withdrawals made prior to 59½ may be subject to an additional 10% early withdrawal penalty.

**Roth IRAs after Tax Contributions:**

- Savings grow tax-deferred while inside the account.
- Contributions may be withdrawn at any time tax-free and penalty-free.
- *Qualified* distributions may include earnings and are also tax-free.

**SEP and Simple IRAs:**

- For businesses and self-employed individuals.

# 2017 IRA Contribution and Income Limits:

- Maximum contribution is $5,500
- If ages 50 or older, contribution is $6,500
- Must have "compensation," such as:
  - Earned income
  - Taxable alimony
- Cannot be 70½ by the end of the year.

# 2017 IRA Deduction Limits, Covered by a Retirement Plan at Work:

| If Your Filing Status Is... | And Your Modified AGI Is... | Then You Can Take... |
|---|---|---|
| **single** or **head of household** | $62,000 or less | a full deduction up to the amount of your contribution limit. |
| | more than $62,000 but less than $72,000 | a partial deduction. |
| | $72,000 or more | no deduction. |
| **married filing jointly** or **qualifying widow(er)** | $99,000 or less | a full deduction up to the amount of your contribution limit. |
| | more than $99,000 but less than $119,000 | a partial deduction. |
| | $119,000 or more | no deduction. |
| **married filing separately** | less than $10,000 | a partial deduction. |
| | $10,000 or more | no deduction. |
| If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status. | | |

Source: https://www.irs.gov/retirement-plans/2017-ira-deduction-limits-effect-of-modified-agi-on-deduction-if-you-are-covered-by-a-retirement-plan-at-work

# 2017 IRA Deduction Limits, Not Covered by a Retirement Plan at Work:

| If Your Filing Status Is... | And Your Modified AGI Is... | Then You Can Take... |
|---|---|---|
| **single**, **head of household**, **or qualifying widow(er)** | any amount | a full deduction up to the amount of your contribution limit. |
| **married filing jointly** or **separately** with a spouse who **is not** covered by a plan at work | any amount | a full deduction up to the amount of your contribution limit. |
| **married filing jointly** with a spouse who **is** covered by a plan at work | $186,000 or less | a full deduction up to the amount of your contribution limit. |
| | more than $186,000 but less than $196,000 | a partial deduction. |
| | $196,000 or more | no deduction. |
| **married filing separately** with a spouse who **is** covered by a plan at work | less than $10,000 | a partial deduction. |
| | $10,000 or more | no deduction. |
| If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status. | | |

Source: https://www.irs.gov/retirement-plans/2017-ira-deduction-limits-effect-of-modified-agi-on-deduction-if-you-are-not-covered-by-a-retirement-plan

# Taxation of Retirement Account Withdrawals (Non-Roth):

- Withdrawals from retirement accounts are generally taxed at ordinary income tax rates.
- Withdrawals are added to your income and taxed at whatever bracket you're in.

| | | | |
|---|---|---|---|
| Rate | Single Filers | Married Joint Filers | Head of Household Filers |
| 10% | $0 to $9,325 | $0 to $18,650 | $0 to $13,350 |
| 15% | $9,325 to $37,950 | $18,650 to $75,900 | $13,350 to $50,800 |
| 25% | $37,950 to $91,900 | $75,900 to $153,100 | $50,800 to $131,200 |
| 28% | $91,900 to $191,650 | $153,100 to $233,350 | $131,200 to $212,500 |
| 33% | $191,650 to $416,700 | $233,350 to $416,700 | $212,500 to $416,700 |
| 35% | $$416,700 to $418,400 | $416,700 to $470,700 | $416,700 to $444,500 |
| 39.60% | $418,400+ | $470,700+ | $444,500+ |

Source: http://taxfoundation.org/article/2017-tax-brackets

# Why do Required Minimum Distributions (RMDs) exist?:

- The government *wants* you to save for retirement and gives you incentives to do it (pre-tax contributions and tax-deferred interest growth).
- *But* the IRS still wants its cut after you’ve retired!
- Thus, Required Minimum Distributions – The annual amount that must be withdrawn from a traditional IRA or qualified retirement plan after the account holder reaches a certain age.

# When to take RMDs:

- If older than age 70½…
- Rule: The last date allowed for first withdrawal is April 1st following the year in which the account owner turns 70½.
- Note: Most people take their first RMD within the same year they reach 70½ in order to avoid “double” payment.
- Exception: If you are still working at age 70½ and participating in a retirement plan at a business you do not own, you do not have to take any RMD from that plan until the year you retire. There is no such exception for IRAs.

# How much will your RMDs be?

- Use the formula:
  - Balance of your account on Dec. 31 of the preceding year
    ÷ Your IRS-assumed life expectancy (LE)(Pub 590)
    = Your RMD
- Example: $158,225 IRA ÷ 24.7-year LE (age 73) = $6,406 RMD*

- Uniform Lifetime Table formula decreases by less than 1 year for each year you age. It is recalculated annually in decimals (age-70: LE-27.4, age-71: LE-26.5, age-72: LE-25.6, etc.).

- This formula applies to unmarried IRA owners and owners whose spouses are not more than 10 years younger.

*Source: Investopedia.com

# “Stretch IRAs”

**Pros:**

- Lifelong Income A stretch IRA could potentially provide a lifetime of income to a beneficiary or beneficiaries.
- Minimized Tax Liability: The total tax paid may be lessened due to taking smaller distributions over an extended period of time rather than as a single lump sum.
- Tax-Deferred Growth: Extending the period of time in which distributions are made lengthens the time assets have to grow tax-free and increases the amount beneficiaries receive.

**Cons:**

- Death of Beneficiary: A beneficiary may not live a normal life expectancy.
- Change in Tax Laws: Changes in laws or regulations could have detrimental effects on the owner or beneficiaries.
- Investment Returns: As with any investment, losses or inflation could eat into the value of future distributions.

# 2017 Roth IRA Contribution and Limits:

- Maximum contribution is $5,500
- If ages 50 or older, contribution is $6,500
- Must have “compensation,” such as:
  - Earned income
  - Taxable alimony
- No age limit

# 2017 Roth IRA Contribution Limits:

| If your filing status is... | And your modified AGI is... | Then you can contribute... |
|---|---|---|
| **married filing jointly** or **qualifying widow(er)** | < $186,000 | up to the limit |
| | ≥ $186,000 but < $196,000 | a reduced amount |
| | ≥ $196,000 | zero |
| **married filing separately** and you lived with your spouse at any time during the year | < $10,000 | a reduced amount |
| | ≥ $10,000 | zero |
| **single**, **head of household**, or **married filing separately** and you did not live with your spouse at any time during the year | < $118,000 | up to the limit |
| | ≥ $118,000 but < $133,000 | a reduced amount |
| | ≥ $133,000 | zero |

Source: https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2017

# Employer-Sponsored Retirement Plans:

- If you are still working, check to see what employer-sponsored retirement plans are offered.
- The 2017 salary deferral limit for a 401(k) and similar plans is $18,000 ($24,000 if 50 or older by the end of the year).
- You can contribute money to an employer-sponsored retirement plan and an IRA/Roth IRA.

# Are you earning enough dividends and interest to satisfy your Income/RMDs?

# Stock Market History:


Source: stockcharts.com

# Roth IRA Conversions:

- Special transaction where IRA (or other pre-tax retirement funds) are moved to a Roth IRA.

- Taxable amount converted is added to your income.

- Example: Jill converts $100,000 from her IRA to a Roth IRA:
  - Jill will have to add $100,000 to her income.
  - The conversion income will be taxed at Jill's tax bracket.

- Consult your tax professional.

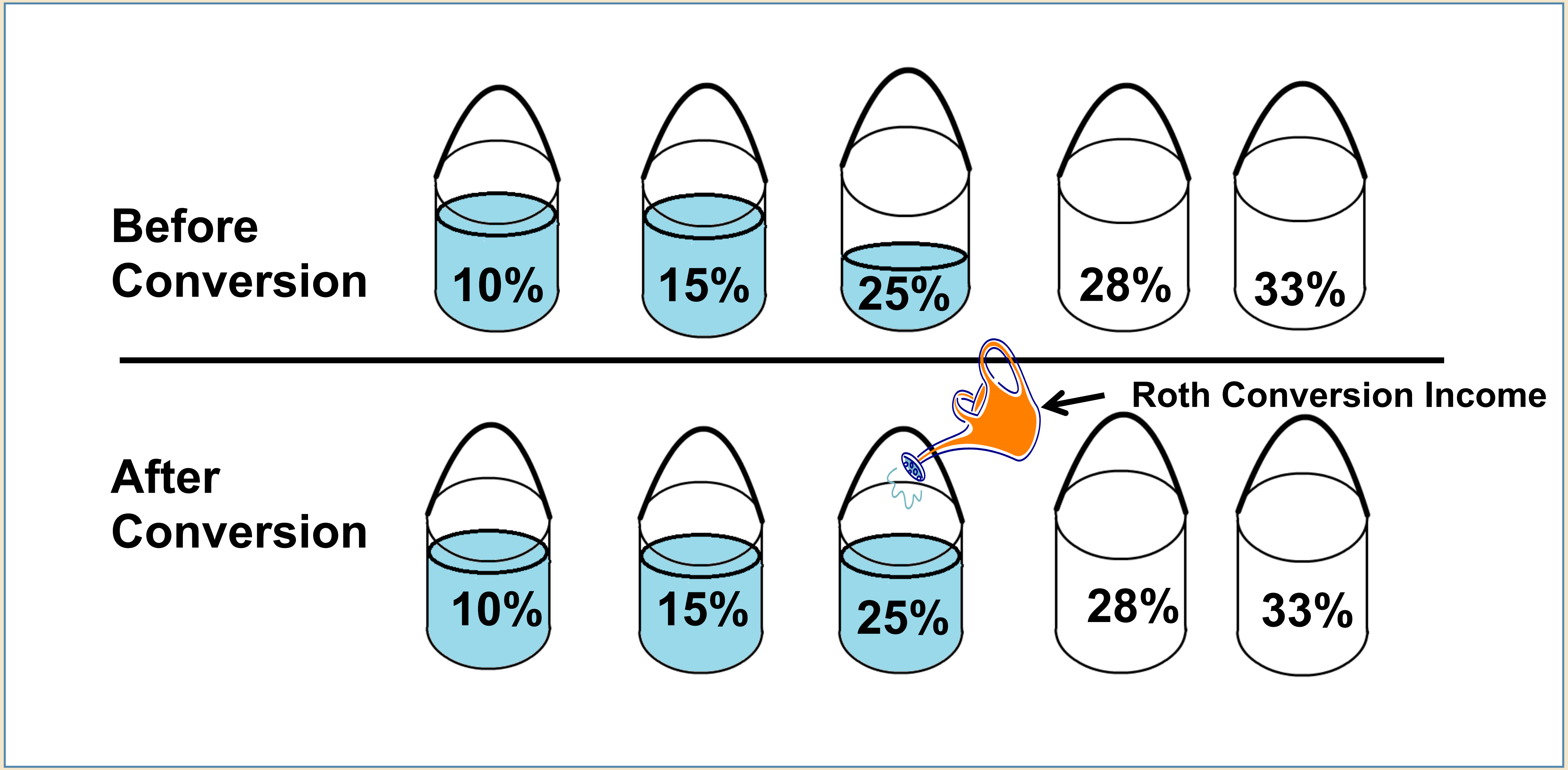
# Who Can Do a Roth IRA Conversion?

- Anyone can convert their IRA (or other eligible retirement account) to a Roth IRA.
- No age limits (high or low).
- No income limits (high or low).
- No requirement to be working.

# Risk of Rising Tax Rates:

- Roth conversions may provide a hedge against an increase in future tax rates.
  - Future tax rates are unknown.
  - Taxes are a major concern for many retirees.
  - Roth conversions allow you to pay taxes at today's tax rates.
  - If you believe your future tax rate will be higher, a Roth conversion may benefit you.
- Can help manage other costs tied to your income:
  - Social Security benefits included in income.
  - Medicare Part B premiums.

# Roth IRA Conversion Strategy:



# Risks of Roth IRA Conversions:

- There is no guarantee that the Roth IRA distribution rules won't be changed in the future.
- A Roth IRA conversion generally can't be recharacterized after October 15 of the year after the conversion.
- A Roth IRA conversion may also trigger other unintended taxes.
- There is no guarantee that investments will appreciate in the Roth account after a conversion.

# Still Have Questions On:

- How can I avoid a 10% penalty for early withdrawals from an IRA?
- Can I make a deductible IRA or Roth IRA contribution?
- How can I avoid a 50% IRS tax penalty?
- How can I reduce the risks of rising tax rates?
- What are the benefits and risks of Roth IRA conversions?

# Thank You!

*Your Disclaimer...*