



Tax Diversification Against Higher Tax Rates

With the recent income tax filing for 2015 behind us, now is a good time to talk about a strategy that may help manage higher tax rates. Nearly all of our clients have an Individual Retirement Account (Traditional IRA), and at some point in our planning meetings, the conversation about a Roth IRA conversion is often discussed. Because future tax rates are unknown, a Roth IRA conversion may offer an opportunity to help manage these potential higher tax rates.

There is the issue of saving taxes by deferring, which we encourage our clients to do, but there are also opportunities to help ensure against future higher taxes. Don't be fooled, because not necessarily all income tax rates will be lower for clients during their retirement years. Client goals are often to retire with their current standard of living, which can mean they do not fall into a lower tax bracket.

Tax risk diversification is important. Diversification in investing means not having all your eggs in one basket, and that same principle can apply to taxes. There are funds that are taxable, tax-free, tax deferred and some that are subject to capital gains rates. Each of these categories has a place in the tax-risk diversification basket. A Roth IRA conversion allows for a client to have a tax-free basket against the hedge of potential higher tax rates in the future.

Another advantage to consider is that a Roth IRA does not have a required minimum distribution (RMD), and will generally be tax-free forever, even to beneficiaries; although Roth IRA beneficiaries are subject to RMD's. Forced RMD's can increase a tax bill each year and could also trigger other taxes, such as those on Social Security benefits. Having at least some assets in a Roth IRA account gives a client better control over their distributions and taxes.

A Roth IRA conversion evaluation should be an ongoing process. Care should be taken in order to minimize the chances that the amount of a conversion pushes a client into the next higher tax bracket. It is important to evaluate the appropriate amount to convert each year to not increase your current tax liability more than you are comfortable with, as the money from the conversion will be taxed as ordinary income. A Roth IRA conversion takes place prior to the end of a calendar year and, consulting with your tax advisor is critical with decisions like these. We suggest having us coordinate with your tax consultant regarding decisions before a conversion is made. To discuss your personal opportunity to save on potential higher taxes through Roth IRA conversions, please contact our office for an appointment.

RFC RESOURCES:

- Social Security – File & Suspend, Suspended:
<http://www.rfcplan.com/resource-center/retirement/file-and-suspend-suspended>
- When Special Care Is Needed: The Special Needs Trust:
<http://www.rfcplan.com/resource-center/estate/when-special-care-is-needed-the-special-needs-trust>

This is for informational purposes only and should not be construed as tax advice. Please consult your tax advisor regarding your personal tax situation.

Roth IRA Conversion Disclosures

-This material is provided for general and educational purposes only and is not intended as tax, legal or investment advice [or for use to avoid penalties that be imposed under U.S Federal laws].Please consult your tax advisor for advice regarding your personal tax situation.

-Conversion from a traditional IRA to a Roth first requires paying taxes on pre-tax contributions, plus any gains. Additionally, the money used to pay these taxes cannot come from your traditional IRA without a 10% penalty, if you are under the age of 59-1/2.

-Converted amounts can be distributed without penalty after five years, beginning January 1 of the year of conversion and ending on December 31 of the fifth year. Each conversion has a separate five-year holding period. If you are under 59-1/2 and take a distribution of converted amounts prior to the five year holding period and attaining age 59-1/2 may be subject to tax and 10 percent penalty.