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A Registered Investment Advisory Firm

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What's Next for Your IRAs?

Your Traditional and Roth IRAs probably do not get the attention they deserve. You know your contributions are safe and growth is slow and steady, and you are aware you will have to make decisions and take action around age 70. But during this time, your IRAs have been growing income tax deferred. Or, you have rolled over other retirement plan money into IRAs. If you have large IRAs, you have large opportunities to prepare for and large obstacles to avoid now.

Let us review IRA basic differences quickly.

Both Traditional and Roth IRAs can provide generous tax breaks but differ by the timing of when you get to claim them. Traditional IRA contributions can be tax deductible on both state and federal tax returns for the year you make the contribution, while withdrawals in retirement are taxed at ordinary income tax rates. Roth IRAs provide no tax break for contributions, but earnings and withdrawals are generally tax-free. So with traditional IRAs, you avoid taxes when you put the money in. With Roth IRAs, you avoid taxes when you take the money out in retirement.

The next distinction is that Traditional IRAs require you to start taking required minimum distributions (RMDs) at age 70 1/2. Roth IRAs, on the other hand, do not mandate withdrawals during the lifetime of the owner. So, if you don not need the money, Roth IRAs can continue to grow tax-free throughout your lifetime, making them effective wealth transfer vehicles. While estate taxes can still apply, beneficiaries of Roth IRAs do not owe income tax on withdrawals and can stretch out distributions over many years.

Unfortunately you may not be able to depend on these fundamentals for long.

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Why? 2016 represents the last budget year of the Obama presidency. The proposals announced a few months ago include changes to Traditional and Roth IRAs. Budget proposals tend to be wish lists of ideas that might be put on the table during negotiations. Therefore, it is impossible to predict whether or which of the proposed changes might be in play. Here are some proposals that could significantly affect your IRAs.

- For aggregate tax-favored retirement accounts (Traditional IRA, 401k, etc.) below $100,000, Required Minimum Distributions would be eliminated.
- Roth IRAs, like Traditional IRAs, would be subject to Required Minimum Distributions at age 70 1/2.
- Another proposal would eliminate the so called backdoor Roth IRA in which people whose income prevents contributions to Roth IRAs, so they instead contribute after-tax dollars to a Traditional IRA and then rollover that amount to a Roth IRA.
- For non-spousal inherited IRAs, distribution would be required over five years, with exclusions for disabled or minor heirs.
- For those with very large IRAs, a cap would prevent them from making any further contributions to any kind of retirement plan. If enacted today, the cap calculates at $3.4 million.

Even though these proposals are uncertain, you would be prudent to prepare for any potential impact on your IRA plan. With that uncertainty, the question most IRA owners will first think to ask themselves is…

Should I convert my Traditional IRA to a Roth IRA?

Typically conversion is driven by tax arbitrage opportunities. However, when the IRA is a significant component of your estate, that is not enough. The decision to convert must be integrated with your broader financial and wealth transfer goals in the context of your current financial situation. For larger IRAs, the analysis also has to take into account state income tax rates and estate tax law choices. We need to separate the question of conversion into four categories. You should talk to us about your choices in each of these four:

- **Strategic Conversions** can create advantages for your multigenerational wealth transfer goals.
- **Tactical Conversions** take advantage of short term income tax saving opportunities specific to your personal financial objectives and short term tax attributes.
- **Opportunistic Conversions** arise in particular situations in the investment landscape.
- **Hedging Conversions** make sense when looking at projected future events with high probabilities of occurring.

One extremely beneficial aspect of conversion from Traditional to Roth IRAs is that for a period after the conversion, you have the option to “recharacterize” the conversion—in effect erasing the conversion as though it does not appear to be the best decision. Once that period is over, however, if you access the funds in the Roth IRA during the first five years, you will incur income tax liabilities and/or penalties de-

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pending on your age.

IRA Decisions are not limited to just the two kinds of IRAs.

IRAs share some elements with permanent life insurance policies, particularly that the value of your IRAs and life insurance policies grows income tax deferred. However, while you are required to begin withdrawing from your Traditional IRA at age 70 ½, in your life insurance policies, that growth continues until the policy matures, as indicated in the life insurance contract. Also, income tax deferral and possibly estate tax avoidance can happen by removing the IRA from your estate using a life insurance trust. In addition, the death benefit of a life insurance policy can pay the estate tax liability so your heirs do not have to invade the inherited IRAs. Of course health becomes a factor in any analysis of life insurance suitability.

Traditional IRAs also allow you to preserve income tax deferral across generations. These stretch IRA arrangements can have a significant effect on multigenerational wealth transfer but only with very careful planning, decisions, and documentation. Similarly, your IRAs can be used in a Charitable Remainder Trust to provide income for surviving spouses and children and eventually fund your charitable goals.

You can see why you should be asking questions about your IRAs now. Please let us know if we could provide you with further insight on this topic, as we would be happy to do so.

Best Regards,

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Source: "Planning for very large IRAs", Robert Keebler, CPA/PFS, MST, LLP, Keebler & Associates.

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