Challenge Conventional Thinking: Know Why The ROTH IRA Can Be The Most Important Strategic Income Tax Planning Tool During Retirement.

Many experts have concluded that continued tax deferral benefits only one institution – the IRS. Before understanding the planning benefits of the ROTH IRA, every tax payer must know the financial principals that determine whether a ROTH IRA is superior to a traditional IRA.

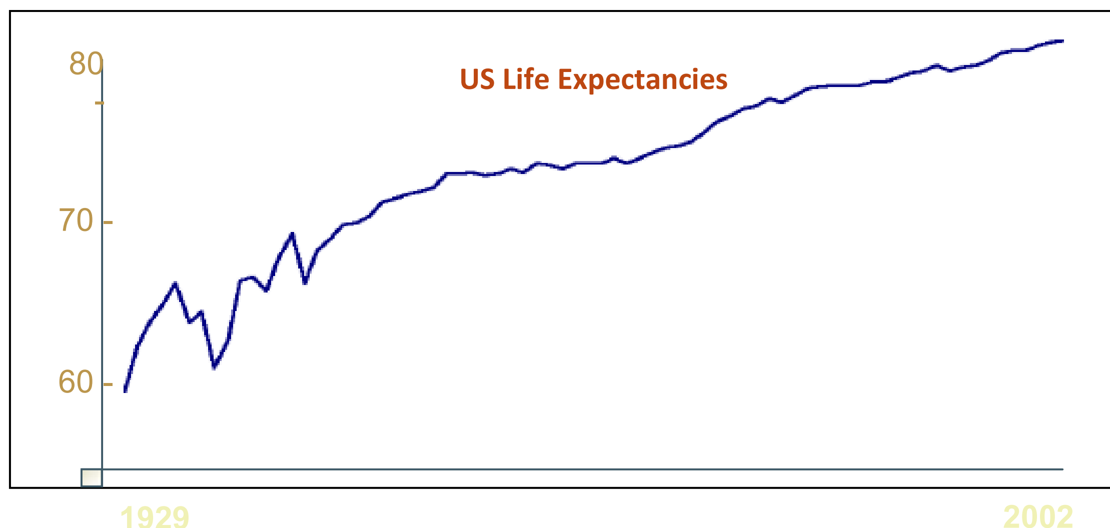
Astute minds ask the question…taxes will be higher or lower in the future?

Regardless of how you answered this question, many credible sources including the Congressional Budget Office, the Social Security Administration (SSA) and other well known government agencies, will continue to have an important impact on the future of every American. Today, at this very moment in time, forces are already in motion that will dramatically change the American way of life and the choices we will all need to make in the future.

Fortunately, with proper planning and knowledge, all our retirements can be significantly improved and positively impact the people and institutions that are important to us.

Many studies have documented America's "Greatest Generation" and their influence in every fabric of American life, including their profound effect in the transfer of wealth. The "Greatest Generation" has left their indelible fingerprint on our global society. What is even more amazing, according to the US Census Bureau, is that the life expectancy of today's 75 year old was only between 63 and 64 years old. This is a common trend with many older demographics in our society. This is incredible! Ponder for a moment; babies are being born today with life expectancies approaching 80 years instead of 64 years (like in 1933. If the trend continues, imagine if all of the babies born today live to be 100 years old instead instead of 80years !

Retirement in America has really changed.



As you can see in this chart, over the last 70 years, Americans have expanded their lifespan by an amazing 33%. This is certainly good news. According to life insurance actuaries, the life expectancy for a citizen of the United States is continuing to expand.

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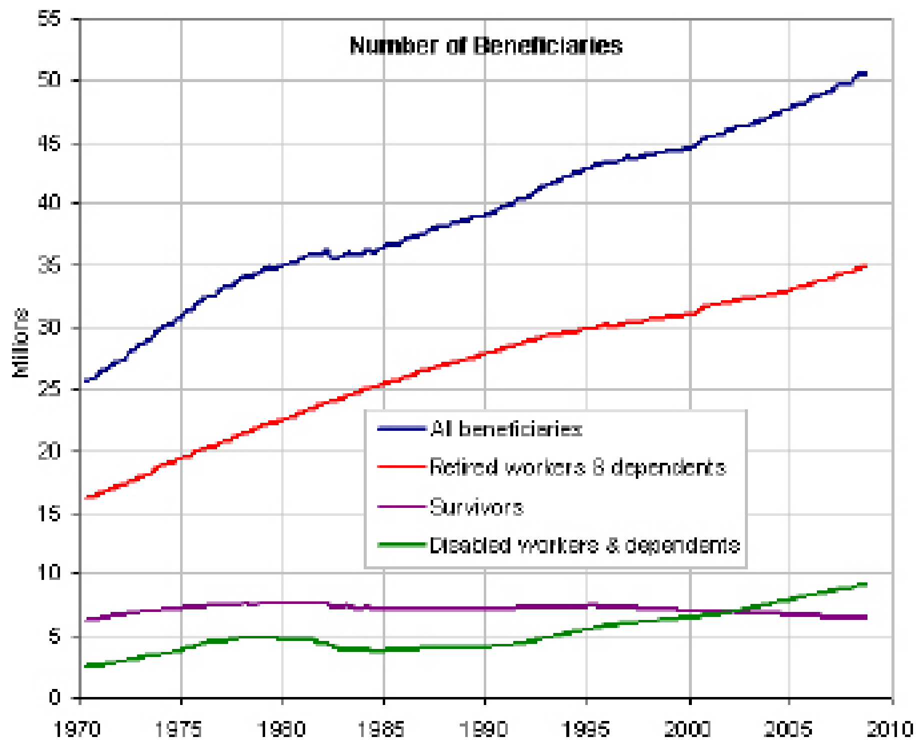
Most of this article is focused on the future. But for a moment, let's examine the past. In 1934 the federal government enacted legislation that created the Social Security System. The US Census Bureau indicates that at the time Social Security was created, the average life expectancy in America was only 63. Now soak that in for a moment. At what age do you begin receiving FULL benefits from Social Security? The correct answer is age 65.

The creators of Social Security envisioned at the time that only those folks who lived beyond normal life expectancy would receive benefits and likely for only a short period of time. Back then, people worked their entire life, retired for a couple of years if they were fortunate, and then passed away. How things have changed!

Today, every American anticipates receiving Social Security benefits. Retirement can easily be ten times longer than it was when Social Security was created. We are not talking about two or three years here. We are talking about two or three decades. As a result, the obligations on the Social Security system are now ten times greater than when the program began.

Longer life expectancy…this single factor, has dramatically impacted the retirement system.

Now, let's briefly examine the number of Social Security recipients over time based on data from the SSA.



People aren't just living longer and therefore receiving more Social Security benefits, there are also more people than ever before as potential beneficiary recipients. This is because of the baby boom generation (1946-1964). There are between 70-77 million people in this group that are eligible for the Social Security benefits. The first boomer began receiving Social Security payments in 2007 so we are really only seeing the tip of the iceberg at the moment.

Here is an overview of how the system works.

As you probably already know, Social Security is a pay as you go system. In other words, when the Social Security Administration receives tax revenue, they don't save up the money for you in a trust account. Rather, the money is passed through directly to beneficiaries receiving payments today.

Social Security, the Baby Boomers and lower birthrates following the baby boom have mixed to formulate an unexpected result from the good intentions of 1934. According to the Congressional Budget Office, something significant happens in 2020: "Thereafter, outlays for benefits are projected to exceed the systems revenues" (U.S. Congressional Budget Office, 2005). This outpacing of revenue gets more significant each year following 2020.

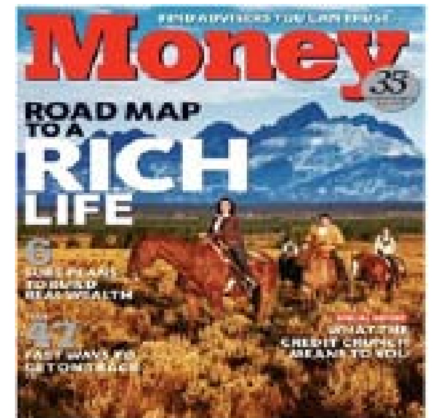
Even if Congress reduces Social Security benefits across the board, the overall cost will still rise simply due to this wave of population heading into retirement. How do you believe the government will fund this single program in the future? Borrow? Cut benefits? Raise taxes? All of the above?

Surprisingly, the situation with Social Security is not the biggest entitlement challenge facing the federal government. Medicaid and Medicare are both in troubled condition that will become more extreme in the years ahead. This is due to the same demographic issues that we have already explored with regard to Social Security.

Meet Douglas Holtz-Eakin. He is the former director of the Congressional Budget Office. During testimony before Congress, Mr. Holtz-Eakin clearly stated what the challenge is when he and the Congressional Budget Office noted that by 2050, the cost of Medicare and Medicaid programs will expand to an amount, "…which is roughly the current size of the entire federal budget" (U.S. Congressional Budget Office, 2005).

Now earlier we asked a question about how you thought Congress was going to fund Social Security. Borrow? Cut benefits? Raise taxes? All of the above? Here is what the head of the Congressional Budget Office asked members of congress during his testimony. re will the treasury find the money...will they raise taxes?" (U.S. Congressional Budget Office, 2005).

Well, what do you think?



The Troubled Asset Relief Program (TARP)

Since that testimony by Mr. Holtz-Eakin there has been another substantial event that will definitely affect the federal budget.

The October 2008 issue of Money Magazine, in their article "The Price You'll Pay for Social Security and Medicare," refers to the "Bailout."

Does anyone know how big the bailout of 2008 is or will be? $700 Billion? Hardly! That is what Congress initially committed to and the President signed but, as we know, that is not the end of the bailout.

According to Michael Cembalest, Chief Investment Officer of JP Morgan Private Bank, "...the FED (Federal Reserve) now owns or finances $1.7 trillion in private sector assets " ("Eye on the market," 2008 November). Mr. Cembalest continues, "should another few hundred billion be drawn under unlimited swap lines, money market fund guarantees and other existing facilities, the Fed would be the largest private sector bank in the United States."

The Federal Deposit Insurance Corporation (FDIC) has also gotten into the bailout act. The FDIC has, with congressional help, increased the deposit insurance ceiling from $100k to $250k, with a provision that it does not have to be paid for via higher bank insurance premiums ("Eye," 2008 November).

The October 3, 2008 issue of Eye on the Market makes this commentary: "Wow; the FDIC insurance fund is already below its statutory minimum level, the safety net just got increased by 2.5 times, and there's no plan to pay for it. What about Congressmen worried about protecting taxpayers? The cost of future bank failures will be more expensive, and taxpayers will be on the hook for it."

Now, we shouldn't become too concerned about bank failures and pull our short term savings out of banks. What we should consider is who ultimately pays for the FDIC? The FDIC will be able to honor the bank guarantees because Congress can simply toss the tab to the taxpayer. So, we shouldn't be afraid of our banks but should reconsider if taxpayer obligations like this might increase income tax rates in the future. $700 Billion from Congress…$1,700 Billion from the FED…and who knows how many dollars from the FDIC for failed banks.

Who pays this bill? As always, the taxpayer.

Now let's briefly examine another obstacle to a peaceful and enjoyable retirement.

THE STOCK MARKET

For years, market makers have touted the long-term value of investing in shares of publicly traded companies. They have made the case that over long periods of time the market always goes up.

This chart tracks the S&P 500 (excluding dividends) from 1951 to 2008. You can easily see the growth.

Now, this is attractive but we need to fully understand the scale of this chart. It lasts 57 years. Is this how long the typical American invests their money? For most people, after starting their family, paying for things takes a higher priority over saving for retirement.

When do people typically start saving aggressively for their future? When do most people hope to retire? Is it reasonable to state that the average person today only has 15 to 20 years to seriously accumulate for their own retirement?

What then, is a reasonable time line to use when considering Stock Market performance? Consider these time lines:

Between 1951 and 1972 the S&P 500 (excluding dividends) grew by an average of 8.12%.
Between 1972 and 1997, the S&P 500 grew by an average of 8.99%.
Between 1997 and October 2008, the S&P 500 grew by an average of 2.02%.

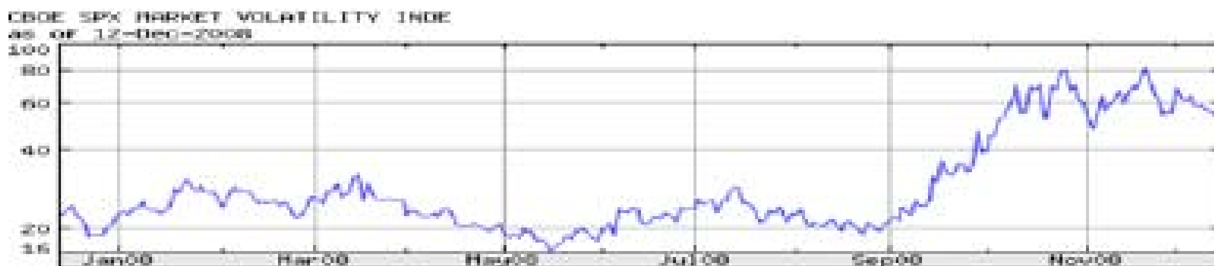
Thesse dramatic differences can be attributed to one important event. In 1972, the modern 401(k) was created. In a 401(k), an employer deducts an amount you choose from each paycheck you receive an in some cases "matches" those funds up to a certain limit. The funds are sent to a money manager that offers primarily, if not exclusively mutual funds.

For this reason, the US Census Bureau reports that 80% of this money is tied directly to stock market performance (Holden, et al, 2005 p.16).

The infusion of money has led a run up of money pouring into the stock market for years. If you think about it, the 401(k) contributions have been driven by baby boomers reaching their highest earning years and directing their focus to accumulating for retirement. The market has received a steady diet of new dollars continuously since this time.

What happens to any market when new participants enter with their money and begin bidding for a particular asset like a share of stock for example? Prices tend to go up. With so many investors could this market become more volatile?

Have we witnessed that?



An interesting thing happened in 2007. The first baby boomer began receiving Social Security benefits. That means over the next 18 years, over 70 million people will be contemplating retirement. When these folks retire, will their 401(k) accounts continue to receive contributions?

No Paycheck = No Contribution.

What happens to any market when existing participants leave or simply stop bidding with their new money? Prices will tend to go down.

The following chart tracks the S&P 500 from the creation of the 401(k) until December, 2008. This market has received record capital over this time with investment dollars from the largest group of high income earners in world history, the baby boomers.

Look at the trading volume. In 1972, the market traded 130 million shares. In recent times that figure has reached six billion shares. There certainly has been an increase in those participating in bidding for stocks.

As boomers head to retirement, is it conceivable that money could flow out of this market or at least level off? If that happened, could this market potentially lose value? If boomers stop creating new income and investing that income, could the market experience slower growth than in the past? Is the stock market saturated at this point? Does the price of stock shares actually exceed their intrinsic value?

TAXES and MARKET RISK

If taxes go up and the market goes down, your retirement may be different than you envisioned unless you avail yourself to proper planning opportunities.

What if you could eliminate your future tax burden on your retirement account?
What if you could insure that you never lose a penny from stock market losses?

Enter the ROTH IRA. The fact is that you may be able to convert your IRA or other retirement account into a federal income tax-free status. Here are the FAQs:

What is the barrier to conversion?

When you convert your traditional retirement account, you will owe taxes on the entire amount converted.

Retirement Account Optimization (RAO) Strategy

We have just completed an exhaustive study that allows tax payers to accomplish the following goals.

Recover a portion of the tax cost from conversion on a tax-free basis
Imagine converting your taxable account; paying the tax bite and receiving a significant portion of that money back on a FEDERAL INCOME TAX-FREE bases!

Evaluate optimal conversion method
By executing our RAO Strategy, you can optimize a retirement account to maximize benefits from day one!

Convert from a Traditional to a Roth IRA
You will be able to clearly analyze the costs and execute the process of a properly performed ROTH CONVERSION while avoiding penalties!

Protect assets from Market Volatility
Understand how market volatility can consume a retirement account during distribution. Avoid this risk forever while receiving competitive interest growth!

Accessing the ROTH Conversion Marketplace…

NEW Workshop! Our new 136 slide Retirement Account Optimization Strategy consumer workshop contains the most compelling information in the industry regarding taxes, Government spending and how retirement accounts will be affected. This program opens eyes and books a substantial percentage of appointments.

NEW Illustration System!

Our new Roth Conversion Illustration system gives you the ability to clearly demonstrate not only how a conversion works, you can also show a head to head comparison so tax payers can evaluate if conversion is right for them.

You will also be able to build an Optimization Strategy customized for the client with the product you are utilizing.

Product Search Engine!

This amazing tool is loaded with hundreds of annuity products. Now you can effortlessly find the product solution for your specific client's needs! Everything you need to know on the product is displayed on one page. Each product is displayed in the same format so you can easily compare one to another.

Blow Away Stretch IRAs!

We'll even reveal how our Roth Conversion approach can beat Stretch IRAs by as much as 300%.

Access these tools, resources and our masterful support team that can help you lock down giant cases and further your practice at…

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Now, keep reading! There's more Roth IRA Planning Gold on the following pages.

Conversion Evaluation

Option One: $100,000 IRA

$25,000 Owed to IRS*

$75,000 IRA After Taxes

$25,000 Tax To Convert

$82,500 Starting Value

Roth IRA $75,000 Income Tax Free**

Roth IRA Conversion

Roth IRA Advantage

AMERICAN INVESTORS
Life Insurance Company
Income Select Bonus (High Band $75k+)

Traditional Stretch IRA

Using a traditional IRA and the same assumptions

$843,495 ROTH Federal Income Tax-Free!

$100,000

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ROTH FAQs

If my spouse inherits the Roth IRA from me, do they need to begin taking required distributions?
NO! A spouse is not required to take any withdrawals at all.

Your Roth IRA may allow you to keep more of your Social Security benefits?
Currently, as much as 85% of Social Security benefits become taxable if your income exceeds certain thresholds. In determining those levels, the IRS includes half your Social Security benefit, any income from a retirement job, pension payments, investment earnings, interest earned on Municipal Bonds and withdrawals from regular 401(k)s and IRAs.

Withdrawals from Roth IRAs are excluded from this calculation!
By converting to a Roth IRA and pulling money from it, you may be able to protect some or all of your Social Security check from the IRS!

A Roth IRA can be a powerful tool to leave more money to your children or grandchildren.

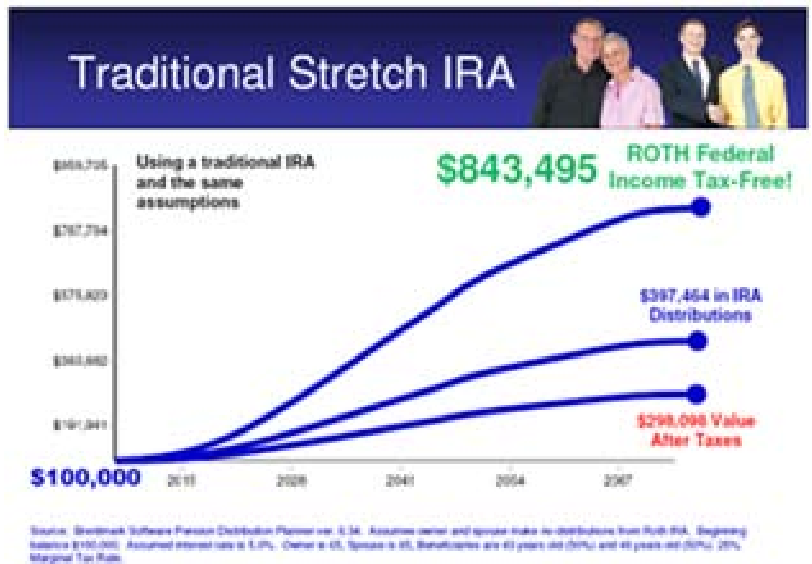
If it turns out you don't have to touch your Roth IRA, you can pass it along to your children, who can take the money right away.

For example, growing 20 years at 5%, a $100,000 Roth IRA could leave your children with $265,329 in federal income tax free cash.

Before deciding to convert to a Roth, you should carefully consider where and how you will hold these converted assets. Do you anticipate using some or all of your retirement account in the future? There are several income planning strategies that will accomplish this goal.

Wealth transfer is another strategy. Your heirs can benefit even more if they choose to Stretch their inherited Roth IRA. Here is an example of a typical family.

How is a Roth different?



Think of a Roth as the mirror image of a regular IRA or 401(k): Instead of collecting a tax benefit up front, you get your break at the back end. When you fund a traditional IRA, you can take an immediate tax deduction on your contributions, but you then pay income taxes when you pull your money out. When you open a Roth IRA you're not entitled to a deduction, but you can withdraw all your money, including earnings, tax-free. The Roth 401(k) works the same way.

IMPORTANT:
Mathematically, there's no difference between getting a tax break at the beginning or end. All else being equal, you end up in the same place whether you pay taxes at the outset or in retirement. This is true unless taxes are higher in the future. For example, let's say you contribute a dollar to a Roth IRA and a dollar to a Traditional IRA. We'll grow each account at 5% and assume a constant tax rate of 25%.

The Roth IRA dollar must first be taxed so the account begins with $0.75 while the Traditional IRA will begin with the full $1.00. Over the next ten years, the Roth will grow to $1.22 while the IRA will be worth $1.62. The IRA has a tax obligation of 25%. Subtracting taxes brings the after tax value of the traditional IRA down to equal that of the ROTH account.

So Why would I pick a Roth IRA?

Because in the real world, not everything is going to be equal. Two things can give a Roth the edge. First, the contribution limits are the same for Roth IRAs as for regular 401(k)'s and IRAs, and that fine distinction means you can shelter a larger sum from taxes in a Roth. As an example, contributing $15,500 in after-tax dollars to a Roth is the equivalent of putting away $21,528 (at a 28% tax bracket) in pre-tax dollars in a regular 401(k) or Traditional IRA. Keep in mind that if you begin contributing to a Roth IRA or Roth 401(k) instead of a Traditional IRA or 401(k), you will be increasing your current income taxes.

The second item is changing tax rates. If your income tax rate is higher in the future, a Roth IRA becomes an even better program because you paid taxes at a relatively lower rate. Going back to our example, if 10 years from now, taxes are 30%, the Traditional IRA would only be worth $1.13 after taxes falling short of the Roth IRA value. So, if you believe taxes will be higher in the future, you may want to consider a conversion from your current retirement account to a Roth IRA.

Is it possible to know my future tax bracket?

That is a challenge because it will be related directly to your income and what Congress does to tax rates. Our earlier examination of government spending pressure does make the case for higher taxes in the future. Social Security...Medicare...Medicaid...The Bailout...this uncertainty provides yet another reason to put at least some money in a Roth. It makes sense to eliminate your tax exposure if you can afford the tax cost of conversion.

If you do not convert and Congress raises tax rates, your spendable income from your retirement account will shrink even more.

Will Congress take away the tax benefits?

Even a Roth can't immunize you from every conceivable tax hit. It's possible that a future Congress could change the rules by, say, taxing consumption instead of income, which could make Roth withdrawals taxable. But outright reneging on the promise of tax-free Roth withdrawals seems unlikely, at least without some transition or grandfathering rules. What's more likely is that Congress will simply raise income tax rates, putting the burden on wage earners and retirees pulling money from regular IRAs and 401(k)s.

How Does One Move Their Old IRA Into a Roth?

By simply transferring your Traditional IRA into a Roth IRA. This year, you'll have to meet income-eligibility rules - your modified adjusted gross income (whether you're single or married) can't exceed $100,000 the year you convert.

Something big happens in 2010.
In 2006, Congress eliminated the income test effective in 2010. At that point, you'll be able to convert regardless of how much you earn.

NOTE: This legislation only applies to CONVERSION to a Roth IRA. It doesn't change the income-eligibility rules for making annual contributions to a Roth. When you convert, income tax is owed on the amount being converted.

How can one convert their 401(k) to a Roth IRA?

Until you change jobs or retire, you typically can't roll your 401(k) into a Roth IRA. Between jobs or at retirement (at 55 or older), you're free to switch your 401(k) to a Roth IRA as long as your income allows it ($100,000 or less until 2010).

How do taxes work with Roth conversions?

You may encounter a few tax challenges when you convert. The first is how you'll pay the tax bill.

You could use some of the IRA or 401(k) balance, but a conversion is more likely to pay off if you foot the bill with outside funds. If you're under $59^{1/2}$ years old, you'll pay a 10% early-withdrawal penalty on the qualified funds you tap to pay the taxes, eroding the benefits of making the swap. This is just another reason to use non-qualified funds to pay the tax

What if I convert and the total conversion plus my ordinary income exceeds $100,000?

Many people hearing about this for the first time become concerned that the act of conversion would make them ineligible to do it in the first place. The good news is that the amount you convert doesn't affect your eligibility. For example: if your Adjusted Gross Income is $97,000 and you convert a $20,000 IRA, that doesn't push you over the $100,000 cap. Keep in mind that a large 401(k) or IRA could nudge you into a higher bracket.

What if I have non-deductible IRA or 401(k) money? Can I just roll over the non-deductible dollars to the Roth IRA?

No. When you move just a piece of your IRA money into a Roth, for tax purposes the amount you convert is considered to have the same blend of pretax and after-tax dollars as all of your non-Roth IRAs. That could leave you with a complicated tax bill if you are converting just a portion of your IRA funds.

When is the best time to convert?

Speaking strictly of the tax impact, if your retirement money is in the stock market, you should convert after the market has tumbled a bit. A lower account value equals a lower tax bite for conversion. For example, Americans watched the stock market tank in 2008 by approximately 40%. By converting after the market losses, an IRA owner would pay 40% less in taxes to convert to their new Roth IRA.

What if I have my money in the market and it falls after I convert?

You actually get a "do-over." This is called a "recharacterization." Essentially, you can undo the conversion and return your money (plus earnings, if any) to a traditional IRA, then reconvert later based on the lower value. This would reduce the tax at time of conversion.

For example, you convert a $100,000 IRA to a Roth and shortly afterward the value drops to $80,000. Even though your Roth is worth 20% less, you'll still owe taxes based on its value on the conversion date, or $28,000 assuming you are in the 28% bracket. By "recharacterizing," however, you can move the $80,000 back into a regular IRA and reconvert later. Assuming your IRA is still worth $80,000, your next conversion will cost you $22,400, leaving you with the same amount in the Roth but saving you $5,600 in taxes.

You can undo a conversion anytime up to the filing deadline, including extensions. So if you converted in the 2008 tax year, you can switch back as late as Oct. 15, 2009. If you want to switch into a Roth again, you must wait until the year after your original conversion (2009 in this example), and you must wait 31 days after you did the "recharacterization."

Can my children "Stretch" a Roth IRA?

Yes! As an alternative to taking a lump sum, your non-spouse beneficiaries may stretch withdrawals (and tax-free growth) over the rest of their lives. This can turn the $100,000 Roth IRA into millions in tax free income in the future.

How easy is it to get money out of a Roth?

You can withdraw your Roth earnings without taxes or penalty as long as you are 59 1/2 years old or older and you've had a Roth IRA for at least five years. The rules for a Roth 401(k) are similar, but as a practical matter you can't touch your money until you leave your job.

What if you need the cash sooner?

Once you've had a Roth IRA for five years, you can withdraw your earnings without paying taxes or a penalty if you become disabled or are buying your first home ($10,000 max); you can also take out money penalty-free for certain education costs, though you will owe taxes on your gains. A Roth 401(k) allows for tax and penalty-free withdrawals for disability only.

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