Nexus Notes

October 2016

Friends,

According to Uncle Sam, you can pay him now or pay him later.

To Roth or Not To Roth? This is the question: Whether 'tis nobler in the pocket book to suffer the slings and arrows of outrageous taxes now, or to take arms against a sea of taxes later?

The question for younger folks. As a refresher, one difference between a traditional IRA and a Roth is that contributions to a traditional IRA are deductible from taxable income (assuming you don't make too much income). However, once you begin withdrawing from a traditional IRA sometime after 59 ½, every dollar is taxed at your then marginal income tax rate. You are lowering your tax now for the right to pay more later. Contributions to a Roth IRA are not deductible, however, qualified distributions taken after 59 ½ are not taxable to you. You are paying higher taxes now for the right to pay less later. But are you? If you're just starting out in your career, you're probably in the lowest tax bracket you'll ever be in. Wouldn't it make sense to go ahead and pay taxes at this lowest rate now for the chance to pay less taxes at a higher rate later?

The question for older folks. As people with many more years of earnings and retirement savings under our belts, we are probably looking at sizable 401k and IRA balances. We also have the ability to convert these balances into Roths. However, the same question comes up: To Roth or not to Roth? Converting now during peak earnings years will certainly mean suffering the slings and arrows of even more outrageous taxes at these higher tax rates. But, there are different considerations at this point. Did you know that Roth IRAs are not subject to required minimum distributions (RMDs)? If you don't need the funds for retirement, or only need a little of them to supplement retirement income, you can keep the funds in the Roth thereby allowing them to continue growing tax-free. What about beneficiaries? Should you be one of the unfortunate ones not to make it to your life expectancy (assuming you are single at that time either through divorce or death of a spouse), traditional IRAs and Roth IRAs can be inherited by non-spouse beneficiaries. Assuming an adult child inherits the IRAs, he must pay taxes on withdrawals from a traditional IRA but not from a Roth IRA (assuming the Roth IRA had been established for at least 5 years).

Other planning scenarios involve the taxation of Social Security benefits. Up to 85% of Social Security benefits may be subject to taxation based on the level of income from part time earnings, pensions, and investment income, including withdrawals from Traditional IRAs. However, withdrawals from Roth IRAs do not count as income in the calculation of the taxability of Social Security benefits. To Roth or not to Roth? The answer depends on calculations on your specific financial situation. Don't be like Hamlet's ghost and be doomed for a certain term to walk to the post office and pay too much in taxes. Let's do the calculations and maybe we can make the world your oyster.

P.S. My apologies to The Bard.

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