



SHERPA INSIGHT

Detterbeck Wealth Management, Inc.



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GET REAL - GET A ROTH



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I don't like paying taxes and I'm sure all of you don't either. I've spent virtually all my professional life helping clients minimize or defer taxes. So, what I am about to propose is a little hard for me to say or write. But honestly, when it comes to Roth IRA and Roth 401ks, you really are better off paying a little tax now and reaping huge benefits in the future. You "pay for the seed and the crop will be free".

Many people love to look at their 401k statements and IRA statements and think about all that they have based upon the numbers on the piece of paper. Well, that's an illusion. In most cases, there will be substantial taxes taken out of every distribution. And, it's very likely that income taxes in the future will be at least as much if not higher rates than we have today. So, next time you look at your retirement plan statements discount them by 30 or 40% for the income taxes that will be paid on them. And, remember too that as those accounts continue to grow, the ultimate liability in income taxes grows proportionately.

The solution? "Roth it". It works for all ages.

Here are the advantages of a Roth:

- Tax free withdrawals-regardless of income tax rates
- No required minimum distributions for owners or spouses
- Income tax free legacy to children and grandchildren
- Better trust beneficiary because qualified distributions are tax free (and not subject to taxation at trust level)
- Taxable estate reduces by income tax on amount converted
- Get more net retirement money invested

Generally, the only way you could be better off doing a traditional 401k or IRA rather than a Roth 401k or Roth IRA is if income tax rates in the future are less than they are now. This is unlikely. Current rates are the lowest they have been in 70 years. Let's hope we don't return to the 1940s where marginal rates topped 90% or the 70s when marginal rates were 70%.

Let's look at just four real life examples we've consulted on (names have been changed) which show how Roths work:

("Roth" continued on page 2)

Reaching for the Peak

Want to stretch your retirement plan assets from here to Mt. Everest? If so, have Detterbeck Wealth Management perform our proprietary SHERPA® PEAK RETIREMENT PLANNING. This check-up is designed to evaluate your current status and provide recommendations how you can increase your family legacy by maximizing your retirement plan assets.

Our assessment includes:

- Inventory all assets
- Investigate asset ownership for rollover possibilities
- Review tax returns, beneficiary forms and estate planning documents
- Review opportunities/constraints caused by current custodian.
- Provide a liquidity analysis
- Identify family details and financial vision(s)
- Calculate expected lifetime distributions
- Assess estate and inheritance taxes and family distributions
- Assess income tax issues
- Develop a written plan with specific recommendations to enhance the family legacy and take the Family Retirement Assets to the Peak.

This confidential exam costs \$750 and can be performed in less than two weeks after all the required documents are in hand. Of course, our present DWM clients receive this exam free each year as part of our full SHERPA process.

Please let us know if you are interested in taking your retirement assets to the PEAK.



("Roth" continued from page 1)

1. A 20 yr old college student, Kendrick, with earned income of \$6,000. He can do a \$4,000 Roth or a \$4,000 IRA. The tax savings by doing the IRA will typically be something less than 10%; perhaps 5% or less. In 50 years at 7% appreciation, the \$4,000 contribution will be worth \$117,800, whether traditional IRA or Roth. In a traditional IRA, there will be tax on all distributions and distributions must start at age 70 ½. Tax at 30% for example would be \$35,300. The Roth is fully income tax free, regardless of marginal tax rates 50 years from now. And, the former college student, now 70, may either take distributions or decide to let the funds continue to grow tax free, since they are not subject to minimum required distributions.

2. A 35 yr. old mother of two, Sheila, who works and makes \$40,000 per year. She can either contribute to the company 401k plan or the company Roth 401k plan. Her combined tax rate with her husband is 30%. They can only budget \$10,000 for retirement plans from her pay. She elects the Roth 401k and contributes \$7,000 to the Roth. It will cost her \$3,000 more in taxes in 2007 than if she had done the traditional 401k but now the funds are tax free forever. In 35 years at 7%, she will have \$74,700 in the Roth (either 401k or Roth IRA) versus \$106,700 in the 401k (or IRA) relative to 2007's contribution. Assuming their tax rates 35 years from now are 30%, Sheila will be paying roughly \$32,000 in income taxes on her 2007 401k contribution; a comparable net value of exactly \$74,700. If tax rates are 40% in the future, Sheila's 401k is worth a net value of only \$64,000. And, of course, we are only looking at one year of contributions.

Lastly, if Sheila and her husband could afford to max out their contribution, they get an extra benefit with the Roth 401k. The \$15,500 max contribution would become \$165,500 in 35 years whether as a regular 401k or IRA or Roth 401k or Roth IRA. But again, the Roth amount is tax free forever.

3. Tom a 55 year old, has \$327,000 in his company retirement plan and is about to retire. When he retires, Tom transfers his company retirement plan to a traditional IRA.


Tom's income even in retirement is more than \$100,000 so he cannot convert the IRA to a Roth now. But, in 2010, he can convert regardless of his income. So, in 2010, at age 58, Tom converts the IRA, now worth \$400,000, to a Roth IRA. Tom pays tax on the \$400,000. He can either pay it with IRA assets or other "non-qualified" assets. We recommend other assets be used to pay the tax. Let's say the tax is 35% or \$140,000 and Tom uses other assets to pay the tax in order to maximize the Roth. The \$400,000 grows to \$900,000 in the next 12 years (assuming 7% appreciation). At age 70 ½, Tom can start taking distributions if he wishes (he's not required to for a Roth) or he could grow this asset for the rest of his life. Let's say Tom and his wife both die at age 90 without taking distributions. The Roth IRA is now worth \$3.4MM. Tom leaves 50% (\$1.7MM) to his 60 year old son and 50% (\$1.7MM) to his 10 year old grandson.

Assuming appreciation of 7%, Tom's son takes distributions from the Roth of \$4.3MM, and his grandson takes distributions of \$19.2MM based on their remaining expected years, all income tax free.

Yes, Tom paid \$140,000 tax back in 2011 but his family got \$23.5MM income tax free.

4. Dorothy, age 75, has a \$1MM IRA, which she inherited from her deceased husband, and significant other assets as well. She converts the IRA to a Roth this year and leaves the Roth to her children and grandchildren. She pays \$380,000 in income taxes on the conversion, but this reduces her taxable estate by \$380,000; which could ultimately save her heirs roughly \$190,000 in estate taxes. When Dorothy dies, the children and grandchildren start getting distributions from the Roth IRA. Over the next sixty years, her family would receive \$8.1MM income tax free distributions from the legacy Dorothy and her late husband left for the family.

Roths really work.

There are some tremendous planning opportunities with Roths. We'd be happy to review these with you. Please give us a call. 

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