

AHWATUKEE FOOTHILLS NEWS

Roth IRA Makes a Big Difference in Retirement



November 4, 2020 by Dr. Harold Wong

In previous articles, I've listed the main benefit of a Roth IRA Conversion. You will have no tax on unlimited earnings for your and spouse's life; and for the first 10 years that your heirs inherit your Roth IRA.

If Biden wins the election, his Tax Plan outlines a number of changes that will greatly increase the benefit of doing a Roth IRA conversion now.

Example #1: You and your spouse are age 60 with \$122,050 of federal taxable income and your federal tax would be \$18,431.

You have \$500,000 in a traditional 401k and decide to convert \$500,000 to a Roth. Your taxable income would be \$622,050 and the tax would be \$167,307.50. So, the marginal federal tax cost of doing a \$500,000 Roth IRA Conversion would be $\$167,307.50 - \$18,431 = \$148,876.50$. Of course, if one combined the 26% solar tax credit with Section 179 from leasing solar business equipment, one could owe \$0 federal tax on the \$500,000 Roth IRA Conversion.

Assume that you do not need most of this money when retired due to high social security and perhaps a pension. Assume that by the time both of you die; it will have grown to \$4 million. Now your only child who is single inherits it and in 10 years it has grown to \$6 million, when it must all be distrib-

uted. Assume that your child has other taxable income and is still working a good job. Now his tax on the \$6 million times a 39.6% rate = \$2,376,000.

Under the Biden Tax Plan, the maximum federal rate increases from 37% to 39.6%. In contrast, had you done a Roth IRA Conversion, there would be NO federal income tax.

Example #2: You and your spouse are both age 50 and do not plan to retire until age 70. You have saved \$500,000 in your traditional IRA. You are lucky enough to be able to retire on two Social Security (SS) checks, which are \$84,000 because both waited until age 70 to take SS and you has a \$26,000 pension. Assume that your IRA will be worth \$4 million upon your death at age 90.

You also own 3 rental houses worth \$1,000,000. You only have 1 child. Because you are both engineers, you like to make detailed plans for the future. If you held the 3 rental houses until death in 30 years, assume they would be worth \$2 million. Under current tax law, with the step-up in basis, your child could sell them for \$2 million upon your death, and would owe \$0 federal income tax.

Under the Biden Tax Law, there is NO step-up in basis or capital gains treatment and the full \$2 million sale of the

rental houses will be taxed at 39.6%, resulting in \$792,000 federal tax (assuming that taxable income is at least \$1 million). This is because your child decided to cash in your \$4 million traditional IRA that he inherited upon the death of Dad and Mom. He pays 39.6% of \$4 million = \$1,584,000, or a total of \$2,376,000 on what he inherited.

Action Planning Step: You decide to sell your 3 rental houses immediately while the market is hot. You will use the \$1 million to contribute to your Roth IRA and 401k accounts over the next 20 years. You will also convert your current \$500,000 to a Roth IRA. Now, your son will owe \$0 federal income tax on the millions he will inherit. Few advisors plan for the next generation.

Free Information on Income Tax Savings, Retirement Planning, and Solar Business Investments can be found at www.drharoldwong.com or www.solarbusinessinvestments.com

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Dr. Harold Wong earned his Ph.D. in Economics at the University of California/Berkeley and has appeared on over 400 TV/Radio programs.