

# 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.

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