

AHWATUKEE FOOTHILLS NEWS

Traditional IRAs Can Be a Tax Time Bomb



February 2, 2022 by Dr. Harold Wong

Americans are not big savers. Prior to the last two Covid years, 7.78% of after-tax disposable income was the average savings rate for the 10-year period from 2010-2019. Source: Statista 2022. People save for many reasons, but a big incentive is the immediate reduction in taxes from contributing to a traditional IRA, 401k, 403b, or 457 retirement plan. To simplify this article, we will call all tax-deferred retirement accounts IRAs.

If you contribute \$6,000 to an IRA and are in the 25% tax bracket, that saves you \$1,500 in federal taxes for that tax year. If you contribute \$19,500 (the maximum 401k contribution limit for 2020 and 2021 for those who are under age 50 and have at least this much of earned income) and you are in the 30% combined federal and state tax bracket, you save \$5,850 of income tax.

At my many live seminars, I meet many who have been good savers and many engineers fall into this category. By the time they are 62, many have saved \$1 million in traditional IRAs, and extra in Non-Qualified money (meaning NOT a traditional tax-qualified retirement plan). Suppose they contributed a total of \$10,000 each year to their retirement plan from age 33 to 62, for a total of 30 years. Total contributions come to \$300,000. If they were in an average 25% tax bracket, they would have saved a total of \$75,000 of income tax. They rode the stock market roller-coaster and now have \$1 million in their IRA. Congratulations!

However, the \$1 million is now a ticking tax time bomb because whenever you pull money out to enjoy in retirement, it's fully taxed as ordinary income because it's really deferred wages. Once you turn age 72, the IRS forces you to start annual Required Minimum Distributions (RMDs), or distributions of part of your IRA. The RMD amount increases each year.

If you have \$1 million in your IRA at age 62, you only need a 7% compound average return for it to become \$2 million at age 72. When you file your tax return for the year, you are shocked to find out that your first RMD is \$72,993 (\$2 million divided by 27.4 year life expectancy). If you always maintain \$2 million, at 82, you have an 18.5 year life expectancy and so your RMD is \$108,108. At 92, your life expectancy is 10.8 years and your RMD is \$185,185.

Suppose you and your wife died in a car crash any time starting at age 72 or older with \$2 million in your IRA and you had 2 kids. If each kid inherits \$1 million, it adds to whatever taxable income they have. Suppose their total tax bracket is 40% and they each owe \$400,000 of income tax on the inherited IRA. You saved \$75,000 of tax by contributing \$300,000 to your 401k; and yet your family pays \$800,000 in total tax. Your family paid 10.67 times the tax that you saved. That's why traditional IRAs are a ticking tax time bomb. The bigger your IRA becomes, the bigger tax burden

occurs! The only solution to this tax problem, or the problem of taxable RMDs, is to do a Roth IRA Conversion. The next article, to be published in March, will cover how to convert your traditional IRA to a Roth IRA, with or without having to pay lots of income tax.

Free Live Seminar and Lunch: Saturday 2/26/2022 at Hyatt Place, 3535 W. Chandler Blvd. Chandler, AZ 85226, with seminar starting at 10 am and Free Lunch at 12:15 pm catered by La Madeleine French Café. Topic is "Advanced IRA Strategies!"

To RSVP for the seminar or schedule a free consultation, please contact Dr. Harold Wong at (480) 706-0177 or harold_wong@hotmail.com. His website is www.drharoldwong.com.

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

To schedule your Free Consultation Contact Dr. Harold Wong at (480) 706-0177 or harold_wong@hotmail.com to RSVP.

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