STAFFORD WELLS

personal wealth management newsletter

January 7, 2013

Dear Clients & Friends,

Tax time is right around the corner. There is still time to save for retirement and save on taxes ....

It's called a backdoor Roth. And it's for you if your income is too high.

Many investors want to save money in a Roth IRA or a traditional IRA but cannot because their incomes exceed the amounts the federal government sets as qualification limits ($125,000 for individuals and $183,000 for couples).

However, you can easily get around this hurdle through a backdoor option. First, open up a nondeductible IRA and fund it with up to $5,000 ($6,000 if you are age 50 or older) for an individual and $10,000 (or $12,000) a year for a married couple. Then, immediately convert the nondeductible IRA to a Roth IRA.

This may sound like a lot of work for tax savings on a few thousand dollars, but when you factor in the benefits of tax deferred growth, the value is there. Consider a husband and wife who put away the maximum a year ($12,000) for 10 years. Assume a conservative 7 percent growth rate and no taxes on the gains or income. After 10 years, the portfolio's value is $165,797.

As an investment advisor, I like these IRAs especially for clients who do not have much in tax-deferred funds as they are part of a tax diversification strategy. In addition, it is difficult to manage a client's portfolio if it contains only taxable funds, as there are many good investments that are best placed in a tax deferred account because they either generate too much short term gains or interest income which is taxable at ones full tax rate.
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Why do you want to convert your nondeductible IRA to a Roth IRA? Because you are not required to withdraw funds upon retirement age unlike a regular IRA. Second, unlike a regular IRA, withdrawals on all the assets in a Roth are tax exempt. Finally, when a Roth IRA is part of your estate, the federal government does not require beneficiaries to start taking distributions, which are taxed at the beneficiary's tax rate upon your death. Instead, beneficiaries can wait until they actually need the funds and withdraw them tax free.

There is one caveat to note: If you have other IRAs including rollover IRA's, you have to take into account those assets along with your $5,000 nondeductible contribution to determine taxes on the conversion. In this case, this strategy can become expensive and may very well not be worth executing. However, you can and still should consider opening and funding the nondeductable portion

of your IRA.

If you plan on opening a nondeductable IRA, it is always best to confirm with your accountant or advisor. And in order to get the benefit for 2012, you will need to do this before April 15th.

Please let us know if we may be of help or advise you on tax-deferral strategies.

My best,

Susan
Susan J. Templeton

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