

THE ARIZONA REPUBLIC

Roth IRA: Tax-Free Income for Life!

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To CPA's and financial advisors, the history of tax planning has been: "Never pay a tax today if you can defer it till later." However, this assumption may not be true, particularly for Seniors and Baby Boomers. For the last 30 years, Baby Boomers and their parents have contributed to traditional IRA and 401(k) accounts. The advantage is that contributions are tax-deductible, but future withdrawals are taxable. In essence, one is deferring wages from one's job or profits from one's business.

In the Taxpayer Relief Act of 1997, the Roth IRA concept was created and named after Senator William Roth. This concept is the opposite of the traditional IRA: contributions are NOT DEDUCTIBLE, but withdrawals are TAX-FREE. The key technical requirements are that one does not withdraw money until one is at least age 59.5, and the Roth IRA be established for at least 5 years.

Contribution limits are the same as for traditional IRA's. For the 2008 tax year, the limit is \$5,000 (and an extra \$1,000 to \$6,000 total, if one is 50 years old or over). There are annual income limits to be able to contribute to a Roth IRA: For the 2008 tax year, it's \$101,000 for a single taxpayer and \$159,000 for married filing joint return. There is no contribution to a Roth IRA if you are married filing separate returns.

Example: A 45-year old contributes \$5,000/year for 25 years to either a Roth IRA or a traditional IRA. If there's a constant 5.00% rate of return, there will be \$251,000 by age 70. If there's a 30% tax rate when he retires,

his net after-tax income will be \$8,785/year. In contrast, his Roth IRA retirement income will be \$251,000 times 5% rate of return = \$12,500/year, or 43% more.

To be fair, we have not assumed that the traditional IRA investor actually takes his annual tax savings and invests it, each and every year for 25 years. In the 30 years since I passed the CPA exam, I rarely see this discipline. Americans look forward to using their tax refund to buy something. If they were in a 25% tax bracket, the tax savings on a \$5,000 annual traditional IRA contribution is only \$1,250, which barely covers one's Starbucks habit.

There is a specific advantage for those who want to accumulate funds for their spouse or leave a legacy to their kids and grandkids:

- Unlike a traditional IRA, the Roth IRA does not force required minimum distributions after age 70.5. The IRS has an actuarial table that forces minimum distributions from traditional IRA's, which increase as the taxpayer grows older and are taxable each year.

Case study: Let's look at an investor age 70, who has \$224,972, earns 5.00%, and is in a 25% tax bracket. In a traditional IRA, by age 81, he would have \$180,622 because of required minimum distributions. In contrast, he would have \$296,988 left in a Roth IRA. This is 64% more. By age 91, he would have \$483,762 in his Roth IRA and the traditional IRA would have shrunk drastically.



Dr. Harold Wong, Ph.D
DrHaroldWong.com

- With proper planning, the income from the Roth IRA funds can be tax-free for the life of the investor, his spouse, and potentially even the kids. The net income enjoyed by the family can multiply by 2-12 times.

- If one believes that tax rates will go up in the future, the Roth IRA advantage is even bigger. When the current President says that we will have \$1 trillion+ budget deficits for the foreseeable future, and we have multi-trillion dollar bailouts for 2008-2010, 99% of the people attending my seminars feel that tax increases are a certainty.

Winter Education Campaign: Please attend one of the 10 seminars that are scheduled for March, 2009. The details will be listed on my AZ Republic blog site.

Author: Dr. Harold Wong earned his Ph.D. in Economics from UC Berkeley and passed the CPA exam in 1979. Through his seminars, publications, and consultations, he helps Seniors and Baby Boomers maximize retirement income and reduce taxes. Contact him at: (480) 706-0177 or haroldwong1@yahoo.com, or read his previous articles on his AZ Republic blog at: www.DrHaroldWong.com.