Dynamic Chiropractic

YOUR PRACTICE / BUSINESS

To Roth or Not to Roth

Stanley Greenfield, RHU

There seems to be a lot of confusion and myths concerning IRAs, especially the Roth IRA. Should I stay where I am, or should I switch? Should I continue with the traditional IRA or put all future contributions into the Roth IRA? Is all the hype about the Roth IRA true? Will I live happily ever after? Will all my dreams come true? I will attempt to clear up some of these questions, but the last two are the basis of another article!

An Individual Retirement Account (IRA) allows an individual to put up to $2,000 away per year before taxes. This money can be put into almost any type of investment or account, and the interest earned is tax deferred. After age 59-1/2, you can take the money out and just pay taxes on it as ordinary income. If you take the money out before that, you will pay ordinary income taxes and a 10 percent penalty. (There are times when you can get to this money without the penalty.) You must start taking money out by age 70-1/2 to avoid a tax penalty. There are limitations as to how much of your contribution is deductible, whether you are eligible for another retirement plan, and whether your income exceeds a certain limit.

What is a Roth IRA? A change in the IRA laws in 1998 allowed a person to put away $2,000 per year after taxes, so that you could have a retirement income that was no longer taxable. The only requirement is that the money must be in the fund for at least five years, and you must be older than 59-1/2 to withdraw the money. Unlike a regular IRA, you do not have to take any distributions before age 70-1/2. You can contribute to a Roth IRA even if you are eligible for another retirement plan, and your income is below a certain limit.

In a nutshell you now have the basic definitions of a traditional IRA and the Roth IRA. As with all retirement plans, there are other areas that come into play, but to cover them all would require a book as long as the current one the IRS has on these plans. You can always go to the IRS and ask to read the entire law when you have nothing else to do and there is nothing on television but reruns! Instead, let's look at the effect that these plans have on a retirement income.

Let's assume Bob, a 35 year old, starts at that age to put away $2,000 each year and earns 10 percent on that money each year. With a traditional IRA, at age 65, Bob would have $361,880. Let's assume Bob withdraws $40,000 per year for retirement. He must pay taxes on this amount, and in the 40 percent bracket, his net retirement income is $24,000 per year. Based on those numbers, Bob would receive this amount for 18 years, for a gross amount of $720,000 ($40,000 x 18 = $720,000). Since Bob nets $24,000 per year, his total net is $432,000 ($24,000 x 18 = $432,000).

If Bob had put the money into a Roth IRA, here is what the picture would look like: He would pay the tax on each year's $2,000 contribution. He would be left with a net contribution of $1,200 each year ($2,000 - 40% = $800). His $1,200 per year at 10 percent growth would yield $217,128 by age 65. If Bob took out $24,000 per year, the same as the first example, his money would last for 17 years. The total payout would be $408,000, or $24,000 less than the traditional IRA.

What happens if Bob started with a traditional IRA and then switched to a Roth? Let's assume that Bob contributed to the traditional IRA for 15 years ($69,900). If Bob moves the money to a Roth IRA, he must now pay taxes on the $69,000. At a 40 percent combined tax rate, that leaves a net of $41,940. The $41,940 now goes into the Roth and accumulates tax deferred. Bob contributes $2,000 each year ($1,200 net) until he's 65. At 65, he has $196,296 ($36,924 from the rollover at 10 percent, and $159,372 from the annual contributions at 10 percent). He now starts drawing out $24,000 per year, which will last for 14 years. The total payout is $336,000.

You now have a picture of what a traditional IRA and a Roth IRA will do for you at retirement, and also what will happen to your money if you switch to a Roth IRA. Based on these numbers, you may now feel like the traditional IRA is the best way to go. That may be true if all you need is a retirement income of just $24,000 per year for 18 years. If you need more retirement income and plan on living longer, then an IRA is not the answer for you!

IRAs have some other limitations. Any money in an IRA is subject to estate taxes. Upon your death, the IRS can and will take as much as 55 percent of your IRA, and then take as much as 55 percent of all of your other assets. By the way, this also holds true for all qualified retirement plans.

Money in most qualified retirement plans is sheltered from most law suits. That is not the case with IRAs and SEPs. I have a client who went through a divorce, and his ex-wife got the $75,000 he had in his IRA.

There are alternatives that are available that may be better choices. I would suggest that you look at all of the plans and see which plan(s) work best for you. This is an important matter. To make good decisions and choose wisely, you need to pay close attention and become better educated on retirement plans.

Stanley Greenfield, RHU
1829 Green Heron Court
Jacksonville Beach, FL 32250
Tel: (800) 585-1555
Fax: (904) 247-1266
stan@stanleygreenfield.com

SEPTEMBER 2000