ROTH STRATEGIES
TO HEDGE THE RISK OF HIGHER TAXES

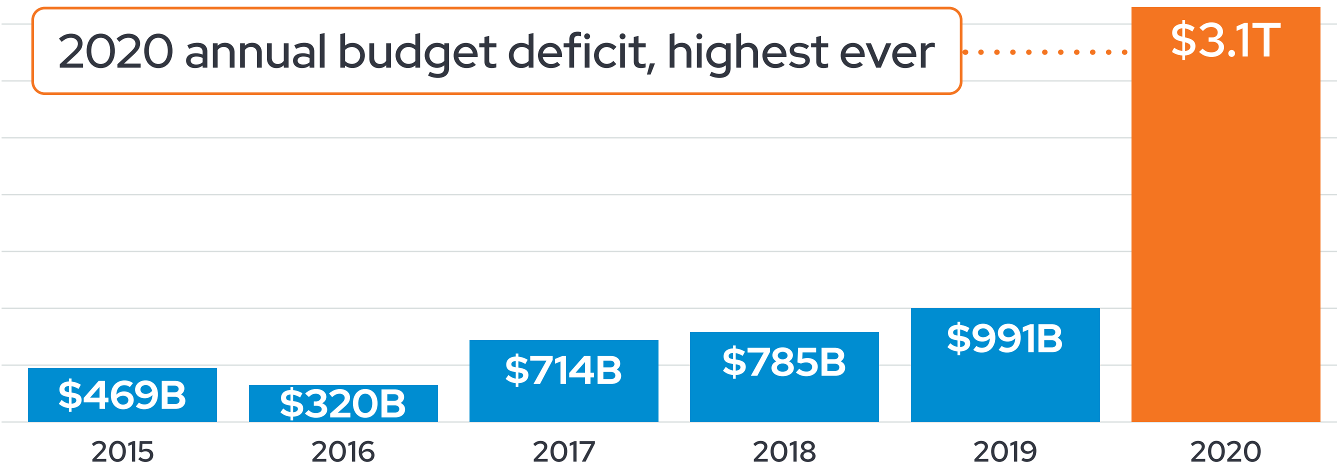
Introduction

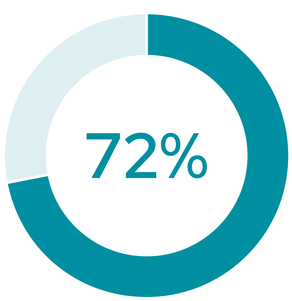
- Explore a range of actionable strategies for clients looking to hedge the risk of potential higher taxes on retirement savings and the application of these strategies in MoneyGuide. Delivered in partnership with Putnam Investments.
- Post- Tax Cuts and Jobs Act (TCJA) taxpayers are experiencing lower marginal tax rates
- However, taxpayers should prepare themselves for the threat of higher taxes, and pursue strategies to hedge that risk whenever possible, and reasonable

Current Tax Environment

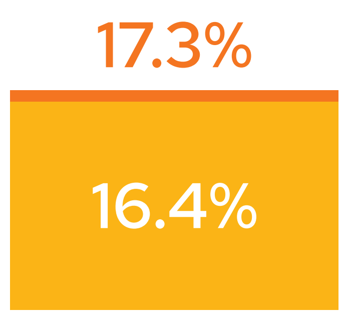
- Lower tax rates from the TCJA
- Doubling of standard deduction and scale-back of popular deductions means the overwhelming majority of taxpayers claim the standard deduction on their tax return
- Alternative minimum tax (AMT) no longer an issue for most taxpayers
- Heirs can still benefit from stepped-up cost basis at death on certain inherited assets
- Uncertainty on tax rates after 2025 when the TCJA expires — or before?

Fiscal Pressures Drives Need for More Revenue





percentage of government spending devoted to mandatory programs + interest



percentage of revenue/ GDP, 50-year average is 17.3%

Social Security trust fund depleted

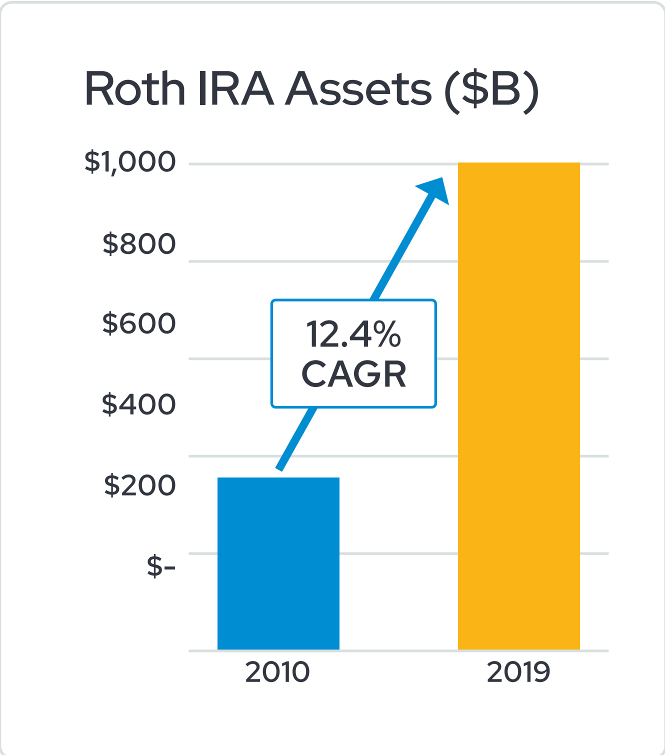
Sources: Congressional Budget Office (CBO), 2020; 2020 Social Security Trustees Report

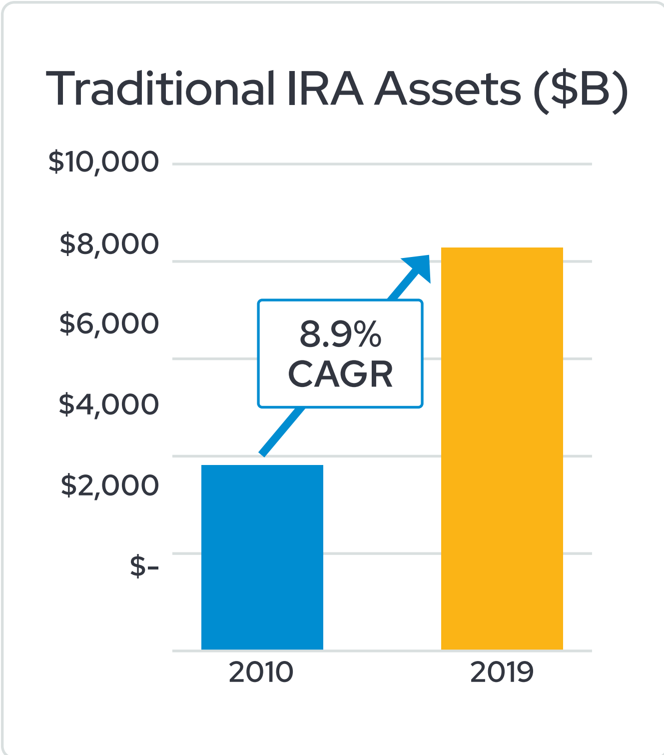
How Roth Accounts Can Hedge Tax Risk

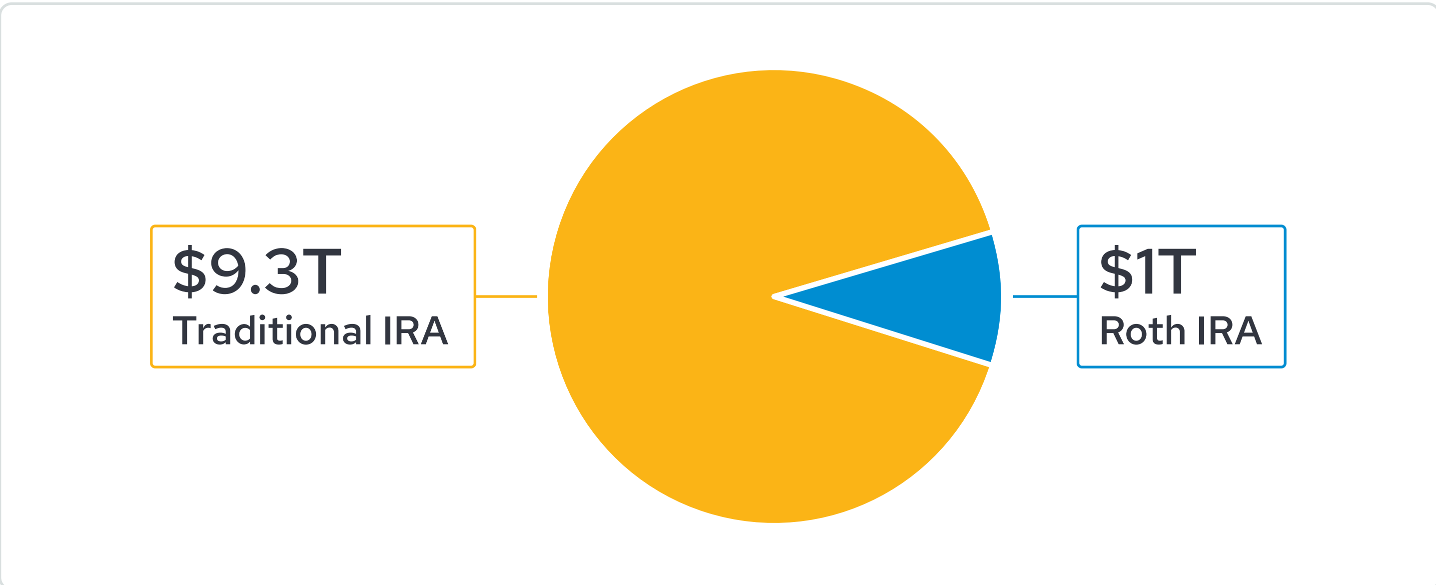
- Tax-free income in retirement
- No RMDs for owner or spousal beneficiary (owner)
- Roth income not considered for taxation of Social Security benefits, Medicare Part B/D premiums, other tax-related phase-outs
- Given the SECURE Act 10-year rule, leaving Roth accounts to heirs may be more tax-efficient

Roth IRA Asset Growth

Roth IRA Asset growth has outpaced traditional IRA assets over the past decade, but only represent roughly 10% of total IRA assets currently.







Sources: Congressional Budget Office (CBO), 2020; 2020 Social Security Trustees Report

Changes in Roth Accounts Over the Years

Year	Provision
1997	Roth IRAs established
2006	Roth 401(k) available to plan sponsors
2008	Direct rollovers from qualified retirement plans to a Roth IRA available
2010	Roth IRA conversions available to all taxpayers regardless of income
2010	Roth conversions available within plans
2014	Plan participants able to transfer after-tax plan assets directly to a Roth IRA
2017	Recharacterization option for Roth IRA conversions repealed

Create Tax Diversification and Facilitate Tax-Efficient Withdrawals in Retirement

- Draw income from tax-deferred at lower tax bracket and then shift to other income sources gradually as income increases
- Approach maximizes the use of the lower 10% and 12% tax brackets
- Drawdown of tax-deferred sources can help reduce future RMDs for example

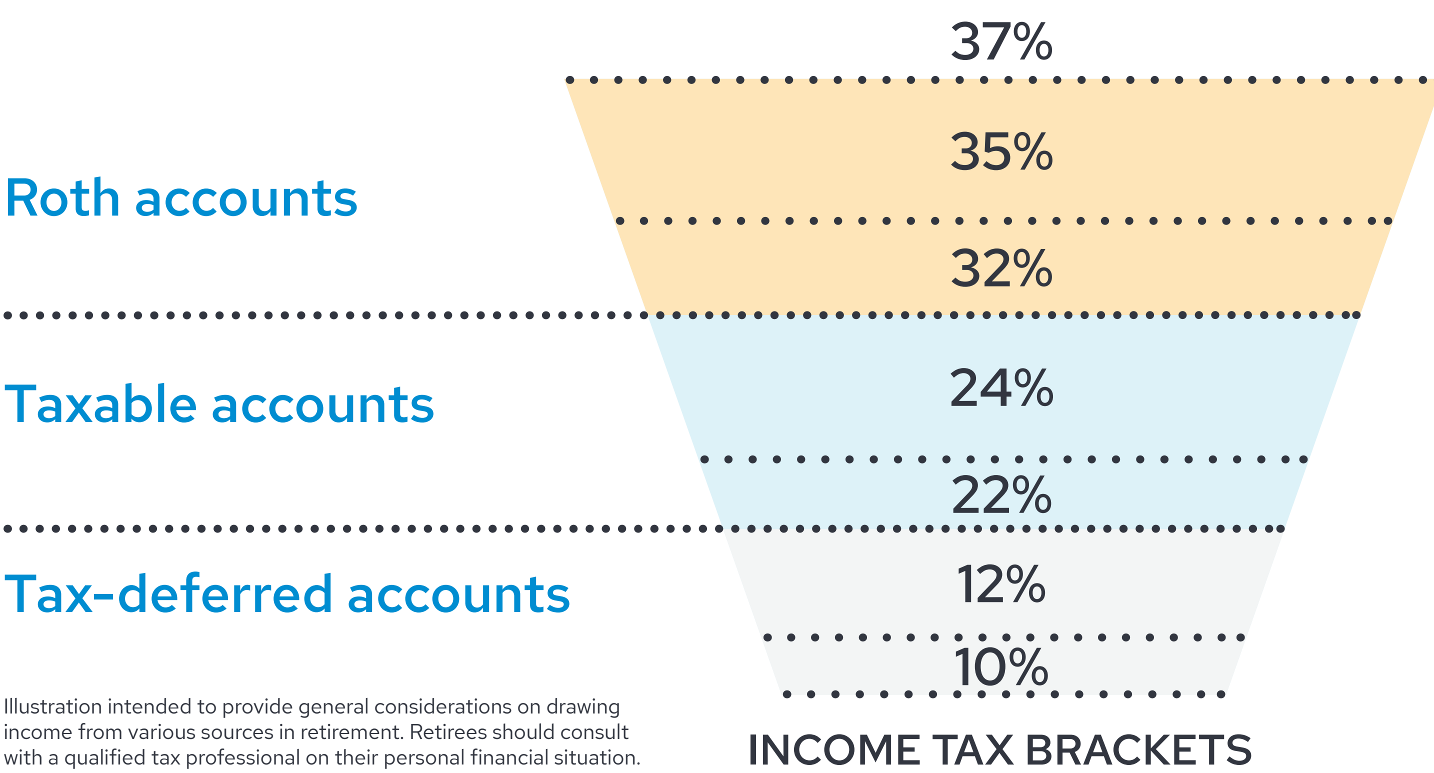
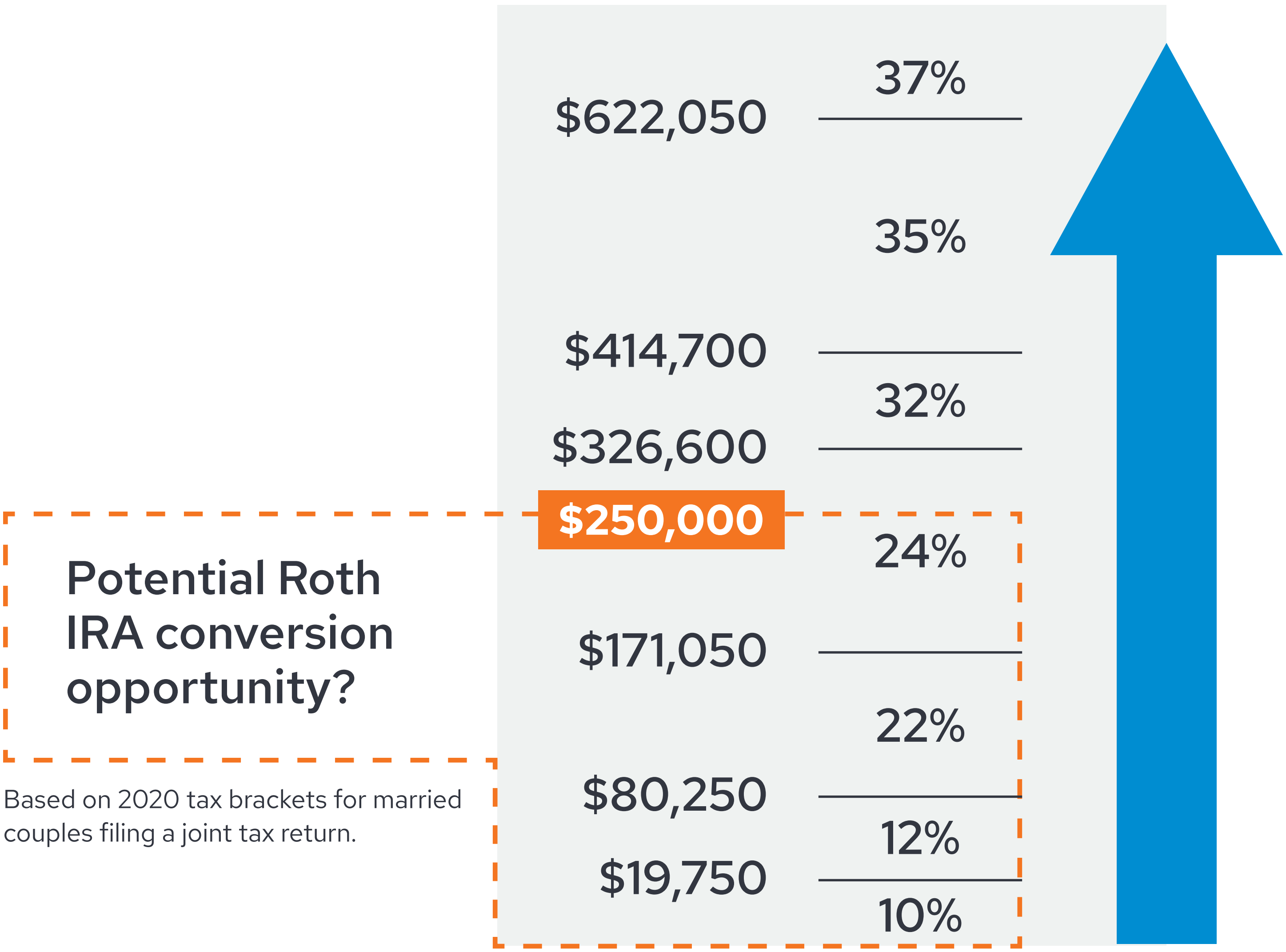


Illustration intended to provide general considerations on drawing income from various sources in retirement. Retirees should consult with a qualified tax professional on their personal financial situation.

10 Actionable Roth Strategies

1. Determine your projected income before year-end as a basis for a partial Roth IRA conversion



Based on 2020 tax brackets for married couples filing a joint tax return.

2. Wait until year-end approaches to do a Roth IRA conversion

- TCJA repealed recharacterization option – analysis of conversion more critical since the conversion cannot be reversed
- Better idea of projected income and overall tax situation closer to year-end
- Be aware of "downstream" implication of a conversion – impact on Medicare Part B/D premiums, exposing investment income to 3.8% surtax, §199A QBI deduction for business owners, etc.

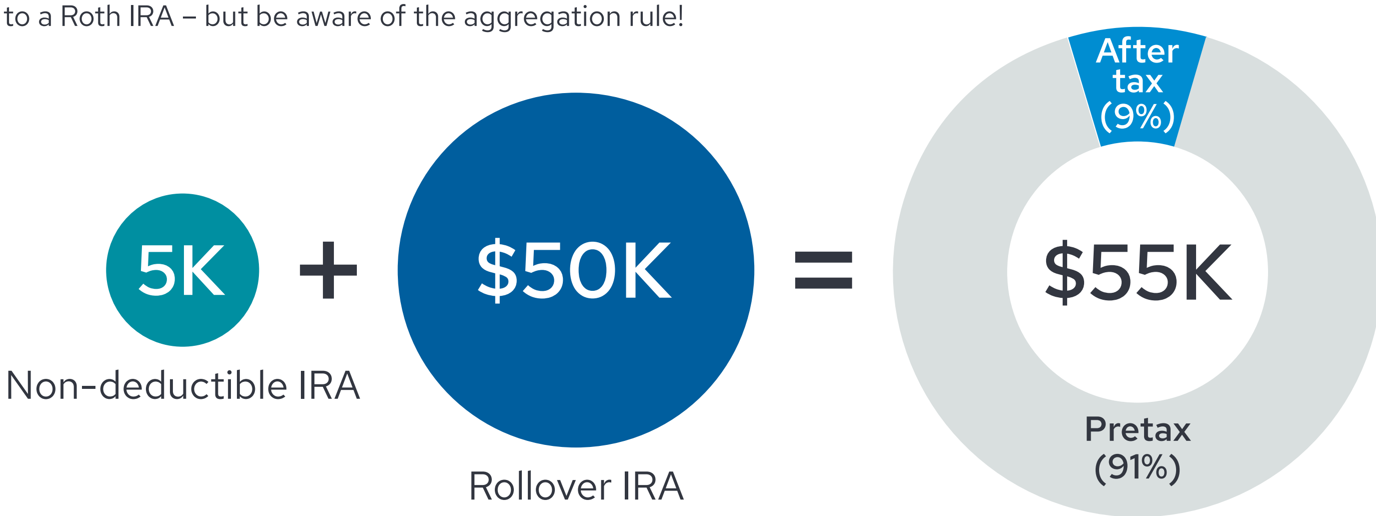
3. Contribute to a non-deductible IRA and then subsequently convert to a Roth

2020 income phase-outs for Roth contribution:

Single = $124,000

MFJ = $196,000

Contribute to a non-deductible IRA then subsequently convert to a Roth IRA – but be aware of the aggregation rule!



If taxpayer converts $5,000 to a Roth IRA, for tax purposes he/she would report $4,550 (91%) as taxable income

4. Business owners with net operating losses (NOLs) might consider a Roth conversion

- CARES makes temporary changes to net operating losses (NOLs)
  - Five-year maximum carryback
  - Temporary suspension of NOL deduction limit against taxable income (80% typically; 100% under CARES)
- For business owners not carrying back NOLs to prior tax returns, using an NOL to offset income from a Roth IRA conversion may make sense
- Assumes business structured as a flow-through or pass-through entity for tax purposes.

5. Leverage after-tax retirement plan contributions to create a sizeable Roth position

- Some qualified retirement plans allow voluntary, after-tax contributions into the plan above and beyond normal salary deferrals under the 402(g) limit ($19,500 + $6,500 catch-up contribution for those age 50+)
- For 2020, the limit for overall contributions into a defined contribution plan (i.e. the 415 limit) is $57,000 (not including catch-up contributions)
- In 2014, the Treasury Dept issued guidance (IRS Notice 2014-54), clarifying that after-tax assets held within a qualified retirement plan can be directly transferred to a Roth IRA once a triggering event applies
- May allow for de facto, large Roth IRA contributions for those already maxing out their retirement contributions

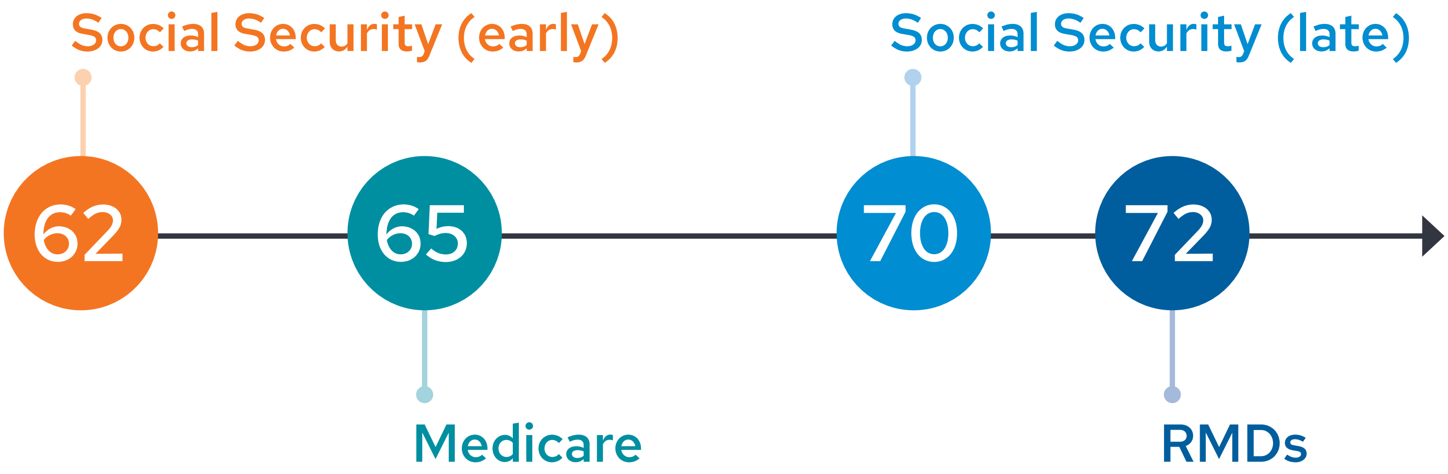
6. Match tax deductions with a Roth IRA conversion

- Lump deductions into a tax year when converting traditional IRA assets to a Roth
- For example, if making annual charitable gifts, consider a donor-advised fund to lump charitable contributions in a single tax year
- Also may consider a Roth IRA conversion in a tax year when overall income is lower than usual

7. Use first-to-die life insurance to fund a Roth Conversion for surviving spouse

- Liquidity provided by life insurance proceeds can help surviving spouse cover the tax cost of a Roth IRA conversion
- Can provide a tax-free source of income to surviving spouse or an eventual tax-free bequest to heirs
  - SECURE Act new 10-year rule may make Roth IRAs a more tax-efficient asset to leave to the next generation

8. Consider Roth Conversions before reaching certain milestones



9. Capitalize on market downturns as an opportunity for a conversion

- Sharp market downturns may provide a temporary opportunity to convert to a Roth – the lower the value, the lower the tax cost of the conversion
- If/when that position recovers, subsequent appreciation from conversion date is tax-free (assuming Roth requirements are met)
- Consider a taxpayer who converted during the market downturn associated with the COVID pandemic
  - Through mid-November, the S&P has recovered over 60% from the low in March 2020

10. For 2020, consider converting the amount of the suspended RMD

- CARES Act suspend RMDs temporarily for 2020
- Consider a Roth conversion in the amount of the (suspended) RMD to create a source of tax-free income in retirement in case it's needed

Roth Strategies **in MoneyGuide**

2020 Marginal Federal Tax Rate Schedules

Single	Married Filing Jointly	Head of Household	Bracket
Up to 9,875	Up to 19,750	Up to 14,100	10%
9,875 to 40,125	19,750 to 80,250	14,100 to 53,700	12%
40,125 to 85,525	80,250 to 171,050	53,700 to 85,500	22%
85,525 to 163,300	171,050 to 326,600	85,500 to 163,300	24%
163,300 to 207,350	326,600 to 414,700	163,300 to 207,350	32%
207,350 to 518,400	414,700 to 622,050	207,350 to 518,400	35%
Over 518,400	Over 622,050	Over 518,400	37%

Tax Planning in MoneyGuide

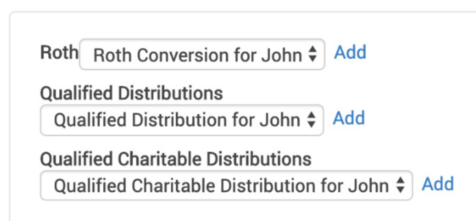
MoneyGuide's Tax Planning feature is designed to analyze how various tax-efficient strategies such as Roth conversions impact a client's probability of success as well as total lifetime tax liability. users.

Using the Tax Planning Features

The strategies discussed within this guide are accessed and implemented in separate locations depending on the user's license type:

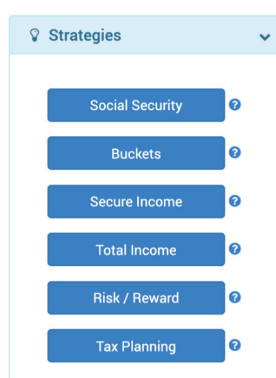
MoneyGuidePro

Users can access the Qualified Charitable Distribution (QCD), Qualified Distribution and Roth Conversion goal strategies within the What If Worksheet by navigating to the Goal Strategies section as shown:



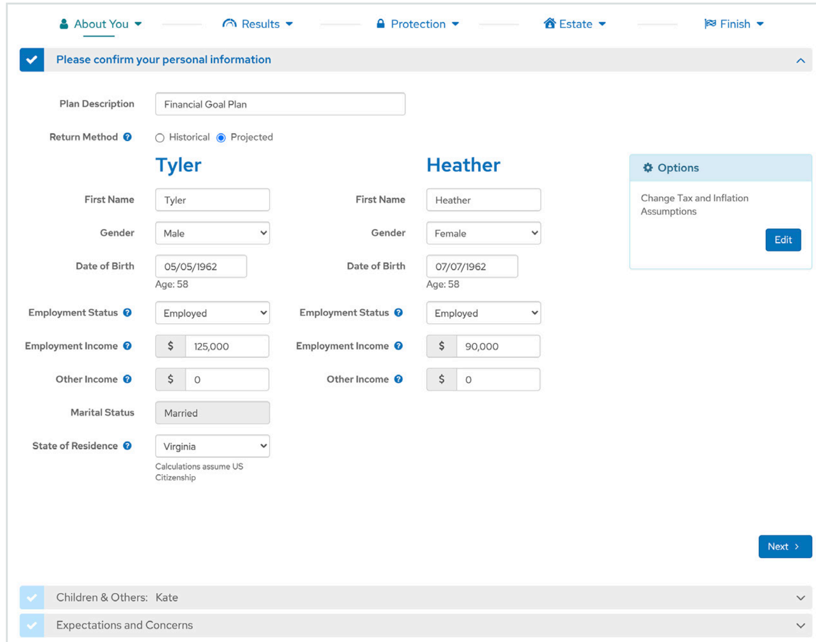
MoneyGuideElite

Users have access to the full suite of Tax Planning tools including Qualified Charitable Distributions (QCDs), Qualified Distributions and Roth Conversions within both the Goal Strategies section located within the What If Worksheet in addition to the Strategies section located on the Recommended Scenario page by selecting the Tax Planning button.

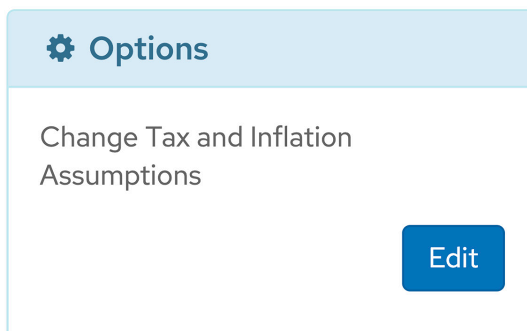


Sunsetting the TCJA and waiving 2020 RMDs in MoneyGuide

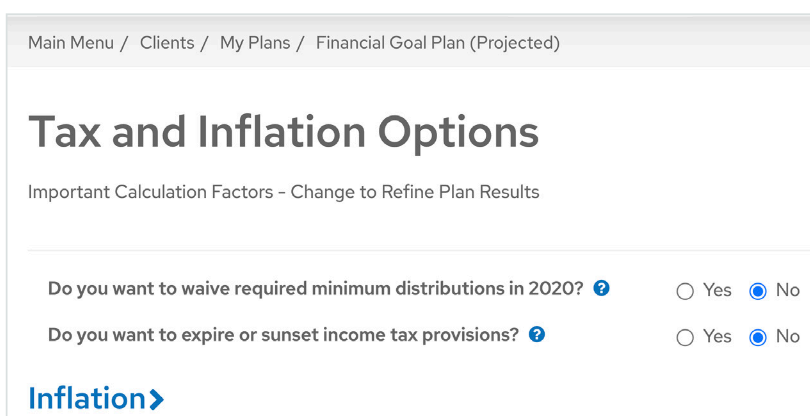
1. Go to the Personal Information page of the client's financial goal plan.



2. On the right-hand side of the page, you will find the **Options** tool: **Change Tax Inflation and Assumptions**. This is available to most users. If you do not see this option, your Firm has customized these setting and you should contact your back office for additional information.



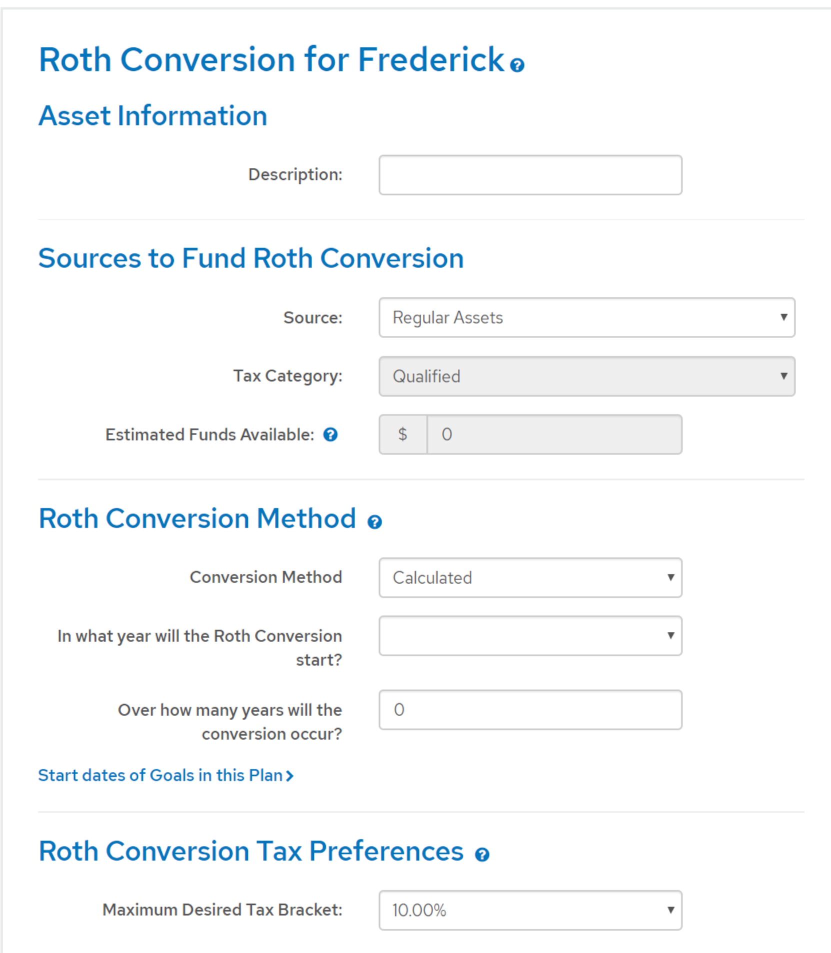
3. Press **Edit** and this will bring you to the **Tax and Inflations Options** page. The option to waive RMDs for 2020 and the ability to sunset income tax provisions (TCJA) is available. Note, the changes you make here are for this client's plan alone and will not impact the plans of other clients; this is not a global change.



Roth Conversion

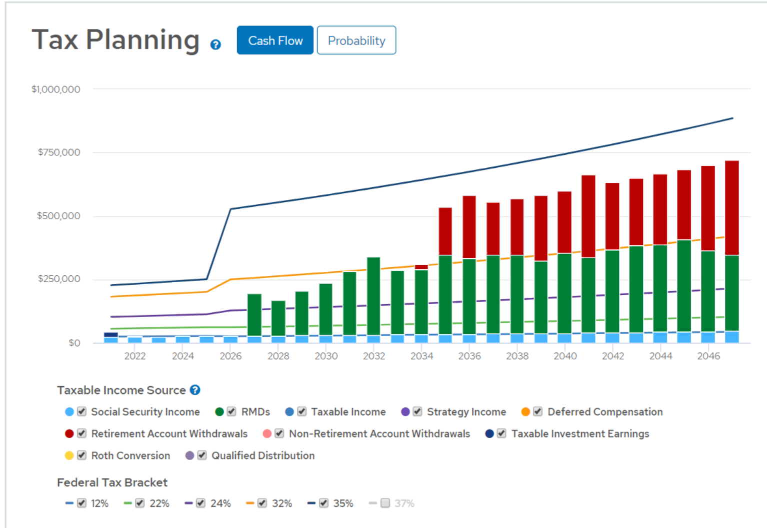
A Roth Conversion strategy allows for modeling the conversion of qualified assets into a Roth IRA. Use this strategy to not only view Roth assets passing to heirs, but also illustrate how converting qualified assets (Traditional IRAs and Employer Retirement Plans) into Roth assets impacts the tax burden and Probability of Success.

- Personalize the strategy by inputting a client specific title.
- Select either Regular or Locked assets as the source of funding the conversion.
- The Estimated Funds Available value will equal the amount of qualified funds available from the specified source in the year the Roth Conversion starts.
- The Conversion Method can be either system Calculated or Manually Entered. See below for more detail.
- Select a life event such as Retirement or a specified year to perform the Roth conversion.
- The entered value will equal the duration in number of years to convert Roth assets.
- The Roth Conversion Tax Preferences vary by the conversion method selected. The Maximum Desired Bracket method is designed to fill the specified bracket with qualified distributions equal to the last dollar of the bracket minus all other taxable income, less deductions. See below for detail.

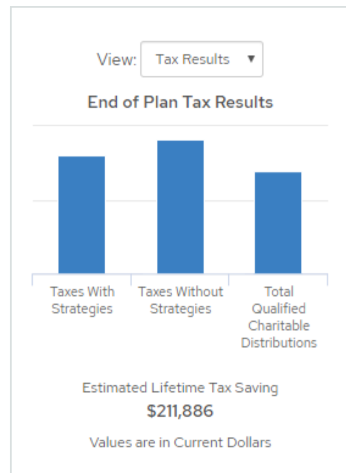


MoneyGuideElite – Tax Planning Graph

The Tax Planning graph is designed to help the advisor tell a story to his or her client. It will help answer questions like: How would this strategy impact the plan, and when might be the best time to implement the selected strategies? By now, one might be asking, “How do I use this page to answer those questions?”.



For instance, one might identify that the RMD bar (i.e green bar in the image above) causes the total taxable income to exceed a tax bracket in a majority of the displayed trials, but the RMD amount in addition to all other inflows may be more than the client needs to cover their expenses. By implementing the QCD strategy, one may be able to show a client how the strategy ultimately reduces their tax liability. The same line of reasoning and context clues can be applied to the other qualified distribution and Roth Conversion strategies. The benefit of implementing these strategies is shown not only on the graph, but also on the End of Plan Tax Results comparison graph, as shown on the right:



By changing the view from Tax Results to Asset Values, one can also provide a comparison of the End of Plan value for each tax category With and Without Strategies, as shown on the right.

	With Strategies	Without Strategies
Taxable	$34,992,144	$39,329,802
Qualified	$129,387	$1,327,235
Roth	$8,455,796	$0
Tax-Free	$668,558	$668,558
Total:	$44,245,886	$41,325,595

If at any point one wants to remove a Roth Conversion strategy uncheck the “Include” box as shown in the image below. This may be for situations where multiple instances of the same strategy have been built for different time periods, or different alternative strategies, and a quick comparison of the impact those separate strategies have on the plan would be beneficial.

Note: Remember, any box left checked will be added to the Recommended Scenario.

Roth Conversions

Include	Owner	Description	Conversion Amount	Max Bracket	Start Year	End Year	Edit	Delete
☑	Tyler	QCD Strategy	Calculated	22%	2027	2030		

Call us at: 1-800-841-5312

Receive a one-on-one demo
and/or a 14-day Free Trial

For more financial planning ideas
and content from Putnam visit:
Putnamwealthmanagement.com