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RETIREMENT PARTNERS

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The 3 Big Tax Buckets You'll Want to Know

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Outline

1. What are the 3 Big Tax Buckets?
2. What can we do with all that information?
3. Example of a Roth Conversion

The 3 Big Tax Buckets

All accounts and investments are divided up into 3 different tax categories or in this example tax buckets.

TAX NOW

1st Bucket

TAX LATER

2nd Bucket

TAX FREE

3rd Bucket

You Pay Taxes Annually

TAX NOW

Accounts/ Investments included:

1. Any Bank Accounts- Checking, Savings
2. 1099- DIV or INT- Dividends or Interest
3. Capital Gains - Long term or Short Term

1st Tax Bucket

In Summary:

Within this bucket, we try to reduce the amount of tax paid on a year-to-year basis by choosing the most tax-efficient investments. Use ETFs instead of mutual funds, or hold assets for longer than 1 year. Be aware of how to write off and carry-forward gains and losses.

2nd Tax Bucket

TAX LATER

You pay taxes when you withdraw money from these accounts.

Types of Accounts:

1. 401(k)
2. IRA
3. 457/ Thrift Savings Plan
4. Simple IRA
5. SEP IRA

3rd Tax Bucket

These types of Accounts include:

1. Roth IRA
2. Roth 401(k)
3. Cash Value Life Insurance
4. Municipal Bonds

Note: Anything designated Roth means it's post tax

Other Accounts:

Annuities:

Are considered a combination of the tax now and tax later. If you put in non-qualified or tax now money into an annuity, the amount you put in will never be taxed again. However, gains in this account are taxed at your ordinary income rates. Annuities within IRAs would always be taxed at your ordinary-income rate.

HSAs Accounts:

Are a combination of tax now and tax free, and potentially tax later. It's an account for future health expenses. If you do use this money for health insurance payments you'll receive triple-tax benefits.

- Contributions are pre-tax
- It's not taxed when money is taken out if used for medical expenses
- It's not taxed on an ongoing basis

However, if you use the HSA account for anything other than what it's intended for you will likely pay tax and fees.

What can we do with all this information?

TAX NOW

20% of retirement accounts

TAX LATER

70% of retirement accounts

TAX FREE

10% of retirement accounts

Listed above is generally speaking how most individuals have their retirement portfolios set up. Moving forward let's assume that taxes will increase in the next upcoming years. With that being said we'll want to move our money into the "Tax Free Bucket" but how do we do that?

How Do I Move Money from Tax Now to Tax Later?

ANSWER:

You can deposit money directly into tax-deferred accounts such as IRA, 401(k), 403(b)s, TSP, etc.

How Do I Move Money from Tax Now to Tax Free?

ANSWER:

You can make deposits into a Roth IRA, CV Life Insurance, Roth 401(k), or Municipal Bonds.

How Do I Move Money from Tax Later to Tax Free?

ANSWER:

To move money from a Tax Later to Tax Free bucket, use a Roth Conversion strategy. There is no limit to the number of conversions you can do, but you will pay tax each time you do a conversion.

- Please consult your CPA when you are considering a Roth Conversion. Your financial advisor and CPA should work together to create a Roth Conversion strategy.
- Note once you do a Roth Conversin you CANNOT reverse it or undo it.

EXAMPLE OF ROTH CONVERSION:

1. Determine your Real Tax Rate (RTR)
RTR = Federal Tax Paid ÷ Adjusted Gross Income= Federal Tax % + State Tax = Total RTR (Federal + State)

2. If you want to convert $10,000 from your IRA to a Roth IRA. You will pay tax.
For example, Assume your RTR is 15%.

3. $10,000 - 15% (1,500) = $8,500
Or
If you pay the 1,500 upfront with other cash, The full $10,000 will be deposited into your Roth IRA

This example is for illustrative purposes only and dose not take into account your particular investment objectives, financial situation or needs and may not be suitable for all investors. It is not intended to project the performance of any specific investment and is not a solicitation or recommendation of investment strategy.

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