INVESTMENT UPDATE
NEWSLETTER

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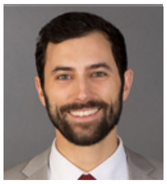

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Tax Specialist

IRA Tax Planning – RMDs, Donations, and Roth Conversions

New Tax Law brings annual considerations for those taking Required Minimum Distributions (RMDs) now or soon. Plan ahead to make your assets go further!

Distribute your RMD directly to charity

The Tax Cuts and Jobs Act has increased the standard deduction from $6,350 in 2017 to $12,000 in 2018 ($12,700 to $24,000 for married couples filing jointly). With the deduction for state and local taxes limited to $10,000 per year, and other deductions eliminated, most taxpayers without large mortgages or high medical costs will be using the new standard deduction.

The Joint Committee on Taxation estimates that only 6% of taxpayers will itemize their deductions in 2018, down from roughly 30% in 2017. You may be included in the 24% of taxpayers who are losing the tax benefit from reporting charitable contributions on Schedule A. However, taxpayers over age 70 ½ may still exclude from taxable income up to $100,000 in IRA distributions by distributing the funds directly to a qualifying charitable organization. This allows a “deduction” even for those who take the standard deduction.

Backdoor Roth conversions

Taxpayers planning to leave large IRAs to their beneficiaries may consider converting traditional IRA funds to a Roth IRA. The conversion is taxable now, but the Roth IRA funds can grow and be withdrawn tax free by the beneficiary. The new tax law’s increased standard deduction and lower tax rates will reduce the tax liability caused by these conversions for many taxpayers, especially those at lower income levels. Because these tax breaks will sunset in 2025 if not extended by Congress, now is a good time to take advantage. Keep in mind that RMDs must be met before converting any traditional IRA funds to a Roth.

The new tax law brings another key change: Roth re-characterizations are now disallowed. Previously, taxpayers had until October 15 of the following year to re-characterize Roth conversions back to a traditional IRA if they found they did not benefit from the conversion. Once they are made, Roth conversions can no longer be reversed, consequently, planning is essential. Conversions should be made toward the end of the tax year once the taxpayer can estimate their income and the tax implications.

Example:

Ron and Mary are married, both aged 75 with a $10,000 budget for charity, a $15,000 RMD and other income that puts them in the 22% marginal tax bracket. Their house is paid off and their medical expenses are relatively low so they do not itemize and therefore do not benefit from a Schedule A deduction for charity. They have the following options:

Option 1

Distributions
- Distribute $10,000 to charity
- Distribute $5,000 to self

Tax Rate
- Taxable IRA distribution of $5,000
- Marginal tax rate = 22%

Tax on IRA Distribution
- Total Tax on Distribution = **$1,100**

Option 2

Distributions
- Distribute $15,000 to self and then
- Donate $10,000 to charity

Tax Rate
- Taxable IRA distribution of $15,000
- Marginal tax rate = 22%

Tax on IRA Distribution
- Total Tax on Distribution = **$3,300**

Distributing the $10,000 directly to charity means they only pay tax on $5,000 of the RMD. ***Planning ahead saves Ron and Mary $2,200.***

Ron and Mary want to eventually leave the IRA funds to their daughter, Joan, who earns a high wage. They expect that Joan will remain in a high tax bracket, so she will benefit from the tax-free growth and withdrawals of a Roth IRA. They have already met their RMD; therefore, Ron and Mary decide to convert $10,000 of their IRA funds to a Roth before the end of year. They will allocate the $2,200 they previously saved to pay the tax on the Roth conversion. RMDs and Roth conversions affect everyone differently.

If you have questions on how these options may benefit you, or other consequences of the new tax law, please give us a call. Our new Tax Specialist, Stephen Paul, CPA is here to help you plan ahead.