

## IRA Vs Roth

Okay, what earns more, a Roth IRA or a regular IRA? That's a good question. It's important if you're putting money into IRAs and you're deciding which one to put it in. It's even more important if you're thinking about taking a regular IRA and converting it to a Roth. What makes sense? How do I determine? Well, in the next eight minutes, I'm going to show you some key concepts that you need to understand when thinking about converting from one to another and, and some concepts that may help you reduce your taxes in the future. In fact, I'm pretty sure for many of you, there's going to be a surprise in here, so let's go, let's have some fun with it.

In this example, we have two people. We have Bonnie and we have Clyde. Both of them have \$100,000 in an IRA and they're going to let it grow and their intent is to let it grow for years and years and later on in retirement to take it out and spend it.

Now, Bonnie decides that she wants to convert it to a Roth now. So she wants to pay the tax, get it out of the way and make it a Roth where forevermore, it will be free of income tax. And just to keep matters simple, I'm going to assume that the tax on everything is 25%. Everybody gets taxed at 25%. Now, what Bonnie's going to do is she's going to take of this \$100,000 IRA she's going to send \$25,000 to the tax man and that's going to leave her with \$75,000 that she can put in her Roth and have it grow tax free forevermore.

In the meantime, we have Clyde and Clyde has this \$100,000 and he says, "Wait a minute. It doesn't make sense to me to take that money out now and give it to the government. If I leave it there, I'll have more money in my IRA to grow. And thus, when I retire, I'll have more money that I can spend. It just seems to make sense, to keep the money there now and have more. It seems obvious." So, he leaves it there.

Now both of them, let's say they invest in exactly the same way, and over years and years and years, both of them double in value. Okay? Well, if Bonnie started with \$75,000 in her Roth and it doubled in value over the years, that would grow 2 X 75 or \$150,000. She now will have the \$150,000 taxes all paid up in her Roth. Clyde's \$100,000 would double in value and it would become \$200,000.

Okay. Now, at this point it seems like boy, Clyde was smarter. He's got \$200,000 in his IRA. Bonnie only has \$150,000 but wait a minute. Clyde has not yet paid tax on that money. To take and enjoy that money, he's going to be taxed on 25%. 25% of \$200,000 is \$50,000. He is going to have to pay \$50,000 in tax on that money. Well, if I take \$50,000 from \$200,000, I'm left with \$150,000 that he has to spend.

Well, Bonnie has \$150,000 and Clyde has \$150,000. The fact that he put all that extra money in and let it grow there for years, doesn't bring him any further ahead. This is one of the things that people get confused. I think because there's more money there I'll have more money in the end. What Clyde was doing, he was growing the tax man's

money, the IRS's money for them, and he wasn't growing his money for him, so he really didn't come out of it.

Now here's the key point. Here's the thing you really need to understand: what happens in all these years that the IRAs were growing? Taxes went up, let's say they went from 25 to 35%. Well, now, when he goes to spend his IRA money, he's going to have to pay more in tax. And instead of having \$150,000, he'd have about \$130,000 that he could spend. Bonnie having locked in this 25% taxes way earlier and having paid it then, still keeps her \$150,000 because it's now tax-free.

So, if over the years taxes go up, a Roth IRA retains its value while a regular IRA begins to drop in value. Now to do a Roth conversion, there's some logistics, some calculations, some strategies you want to do. How much should I convert every year? Is it the right thing to do? And, and there's ways to calculate that, but to understand these principles is important.

Now, I want to mention some reasons why taxes may go up in the future. One is the law says they will. In 2018, we did the Tax Cuts and Jobs Act that reduce taxes for most taxpayers, lowered the tax brackets for most everybody. But, you know, we cut taxes, but we didn't cut federal spending to meet that, so the law has to sunset, or end, and the taxes go back in a few years, so we know by law taxes are due to go back up in a few years.

A second reason, is, as I record this, we're in the midst of a pandemic and the government is basically borrowing or printing money like mad to try to help the country. We're going to have to pay those loans back at some point and it's likely that in order to pay them back, we'll have to raise taxes.

A third reason why taxes may go up for some of you is that some of you, like me, may be married. If you're married, you're probably filing jointly, married filing jointly. And if you're married, it's probable that one of you will die first, usually us guys crap out and the ladies may go on for many years. In fact, 80% of men die married and 80% of women die single, but whoever dies first, the surviving spouse will then be filing as a single taxpayer and taxes on a single tax payer are higher than they are for a married taxpayer. So getting the money into a Roth away from taxes while you both get a bigger tax break, so to speak, can be a wise thing to do too.

I hope this was useful in helping you understand some of these concepts. Pass it on to friends and neighbors who may need to know this. I have three quick things before we end, three important things you need to know.

One is this is sort of a general description and we've done some simplifications. It's not meant to be specific tax advice. Don't try this at home. Talk to a licensed tax or financial professional before you do this.

Two, you may want a copy of this whiteboard to look at. If you'd like to get a copy of this whiteboard, along with a whole report on tax strategies for retirements that that could be useful. If you'd like to get copies of these, you can click on an email link and email us your email address. If you'd like to actually get paper copies, so you don't have to squint at a little screen, you can give us your mailing address and we'll send a real paper copy to you delivered by a uniformed employee of the US government.

And third, this is a little snippet from some workshops I've taught the last 10 years at UNC and Brunswick Community College in tax planning and retirement planning. You know, right now we can't get a group of people in a room for a workshop, but people still need to know this. This is important information. When I do workshops, people can always ask questions. They can raise their hand or come up later at the end and ask questions. If you've got a question about this and how it might apply to you, down below there's another link you can click and you'll go to an online calendar and you could book a 15 minute phone call with me to get your questions answered if you like.

So, I hope this was useful, again share it with friends and we'll talk to you later.

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