Insights: Volume 5, Issue 2

Join Us in Welcoming Heila Thomas

Heila began her career in the media industry in 2002 at the Orlando Sentinel. Over the years, Heila has worked in Marketing, Communications, Community Relations, Corporate Sponsorships and Partnerships. She grew up in Winter Springs, Florida and now resides in Casselberry with her husband Mike, daughter, Ava Grace, Lily their Pug, and Chloe their Pomeranian. Heila enjoys spending time with family and friends, traveling, going to the beach, and playing tennis. Heila is excited to join our team for a new chapter in her life and looks forward to getting to know each of you!

From the Desk of J.R. Thorsen: Building Your Legacy

One of our team's greatest joys is working with families and helping them build legacies that may extend family values across generations. Families may achieve this by holding family wealth planning meetings, as well as seeking advice from our team about the many year to year steps that may help maximize each generation's contribution to the wealth building process.

One example is the Traditional to Roth Individual Retirement Account (IRA) conversion. We would like you to consult us to see if this simple strategy may make sense for you and your family in helping build future tax-free assets of your family's portfolio.

First, we will outline why some investors have little to no Roth IRA assets. Second, explain the tax bill changes that have occurred that make increasing Roth IRA assets more valuable. Finally, we will conclude by explaining the potential impacts that increasing your Roth IRA assets may have across generations.

To begin, while there are many differences between a Traditional IRA and a Roth IRA one concept remains the same for both, the same type of investments can be held in either type of IRA. Meaning, our team could invest a $500,000 Traditional IRA consisting of all pre-tax contributions in the same way it would a $500,000 Roth IRA consisting of after-tax contributions. The main difference between these two IRAs is how the IRS will tax future growth. Since the owner made pre-tax contributions to the Traditional IRA, all distributions will be subject to income tax. However, since the owner made after-tax contributions to the Roth IRA, all qualified distributions will be tax-free.

If the difference is between taxable and tax-free, one may wonder, why doesn't my family have more Roth assets? History and psychology, we believe, play two key roles.

From history, the Roth IRA and even more so, the Roth 401(k) are two relatively new retirement vehicles. Individuals did not have the opportunity to fund a Roth IRA until it was introduced by Senator William Roth in the Taxpayer Relief Act of 1997. Even then, contributions were limited to $2,000 a year. *(Continued on Page 2)*

Roth 401(k) plans are newer still with updated guidance enabling employers to allow Roth contributions to their 401(k) plans as of January 1, 2006.

From psychology, Roth contributions are an act of delayed gratification. Since Roth contributions use after-tax dollars, they provide no tax break during the year they are made or may even add to tax liability if contributions are converted from a Traditional IRA. Funding a Roth IRA asks you to initially pay more in taxes than you would otherwise pay.

"Life, like lunch, is full of difficult choices."

Thus, many individuals that are enjoying retirement now, may have had little opportunity or immediate incentive to build up their Roth IRA assets during the accumulation stage of retirement planning.

Why have the incentives changed? We contend that two updates in our planning outlook require readdressing these former strategies; potential future income tax policy, and a policy already implemented in the passing of the 2019 SECURE Act.

If your perspective is that income tax rates are most likely not going to decrease for anyone, then perhaps pre-paying your tax liability makes good sense for both you and future generations. In fact, we believe the likelihood is that taxes are more likely to go up than down for some, if not most individuals, given that the tax bracket adjustments made during the Tax Cuts and Jobs Act of 2017 are set to expire on December 31, 2025. This means that unless Congress makes adjustments to keep such cuts permanent, taxes will go back up to pre-2018 levels.

What do these changes mean for my family and me?

First, assuming there are no changes to your distribution needs and Congress simply does not extend the tax cuts enacted by the Tax Cuts and Jobs Act of 2017, distributions from your Traditional IRA will likely be taxed at a higher rate starting in 2025. Two factors may contribute to this result. First, the elimination of the 12%, 22%, 24%, 32%, and 37% income tax brackets, and the reestablishment of the 15%, 25%, 28%, 33%, and 39.6% income tax brackets. Second, the reversion to lower standard deductions which, when enacted, increased the standard deduction for married/joint filing from $12,700 to $24,000, and for single filers from $6,350 to $12,000.

While the reestablishment of the personal and dependent exemptions may help for some individuals, we feel the likelihood is for most of our retirees the net result of these reversions will result in a larger tax liability. Required Minimum Distributions (RMDs) increase as a percentage of the IRA assets with age, which means even if the IRA account balance remains flat, an individual could have a larger tax liability each year.

Finally, the 2019 SECURE Act changed how Designated Beneficiaries can take distributions from inherited IRAs received from an owner who passed away in 2020 or later. A Designated Beneficiary is someone who is a non-spouse more than ten years younger than the IRA owner, a minor that is not the child of the IRA owner, a child of the IRA owner who has exceeded the age of majority, or qualified trusts. That means for many of the non-spouse beneficiaries (in most circumstances, adult children of the last surviving spouse) the rules have changed! *(Continued on Page 3)*

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The 2019 SECURE Act eliminated the ability for those beneficiaries to “stretch” their inherited Traditional IRA distributions in the form of Required Minimum Distributions during their lifetime. Instead, now all IRAs inherited by Designated Beneficiaries must be emptied by the end of the tenth year following the year of the IRA owner’s death. However, no distributions are required before the tenth year.

To illustrate, let us assume two difference scenarios. Beneficiary T and Beneficiary R. Both are 55, still working, married, have taxable incomes of $125,000, are not going to retire in the next ten years due to uncertainty of healthcare costs, do not need additional income, and recently inherited $500,000 from a parent. However, Beneficiary T received a $500,000 Traditional IRA and Beneficiary R received a $500,000 Roth IRA in 2021.

Beneficiary R has an easy possible strategy to pursue. She can simply leave the money untouched in her Beneficiary Roth IRA for ten years and, assuming an eight percent rate of return, her $500,000 Roth IRA will have grown to $1,079,462.50. She can distribute this money in the tenth year and add it to her taxable investment account.

Beneficiary T has a much more complicated balancing act to consider. Let us say he can achieve the same eight percent return in his Beneficiary Traditional IRA, but must settle for a lower after-tax return on his taxable investments of 6.4% that creates a twenty percent tax drag. Not wanting the lower after-tax return, he could also let his Beneficiary Traditional IRA grow to $1,079,462.50 in which case, assuming the current tax rules, his net after-tax addition would be $716,287 due to a $363,177 tax liability. This assumes the favorable tax climate continues into 2030 by Congress extending the existing rules past 2025.

Even if Beneficiary T has access to professional advice, structures his distributions to take out funds in growing fractional amounts over ten years (one tenth in year 1, one ninth in year 2, etc., culminating with the balance distributed in year ten), Beneficiary T would end up with a $780,631.04 after-tax addition to his investment account. The end result is a ten-year cumulative tax liability of $298,831.46. (Please see chart below.)

Year	Inherited Account Balance	Tax Defferred Rate of Return	Year End Amount in Tax Derrerred Assets	Year End Distribution	New Taxable Income	Net After Distribution Taxed at 22%	Net After Distribution Taxed at 24%	After Tax Return	Beginning Year After Tax Assets	End of Year After Tax Assets
2021	$ 500,000.00	1.08	$ 540,000.00	$ 54,000.00	$ 179,000.00	$ 37,245.00	$ 4,750.00	$ 1.064	$ -	$ 41,995.00
2022	$ 486,000.00	1.08	$ 524,880.00	$ 58,320.00	$ 183,320.00	$ 37,245.00	$ 8,033.20	$ 1.064	$ 41,995.00	$ 89,960.88
2023	$ 466,560.00	1.08	$ 503,884.80	$ 62,985.60	$ 187,985.60	$ 37,245.00	$ 11,579.06	$ 1.064	$ 89,960.88	$ 144,542.43
2024	$ 440,899.20	1.08	$ 476,171.14	$ 68,024.45	$ 193,024.45	$ 37,245.00	$ 15,408.58	$ 1.064	$ 144,542.43	$ 206,446.73
2025	$ 408,146.69	1.08	$ 440,798.42	$ 73,466.40	$ 198,466.40	$ 37,245.00	$ 19,544.47	$ 1.064	$ 206,446.73	$ 276,448.79
2026	$ 367,332.02	1.08	$ 396,718.58	$ 79,343.72	$ 204,343.72	$ 37,245.00	$ 24,011.22	$ 1.064	$ 276,448.79	$ 355,397.73
2027	$ 317,374.86	1.08	$ 342,764.85	$ 85,691.21	$ 210,691.21	$ 37,245.00	$ 28,835.32	$ 1.064	$ 355,397.73	$ 444,223.51
2028	$ 257,073.64	1.08	$ 277,639.53	$ 92,546.51	$ 217,546.51	$ 37,245.00	$ 34,045.35	$ 1.064	$ 444,223.51	$ 543,944.16
2029	$ 185,093.02	1.08	$ 199,900.46	$ 99,950.23	$ 224,950.23	$ 37,245.00	$ 39,672.18	$ 1.064	$ 543,944.16	$ 655,673.76
2030	$ 99,950.23	1.08	$ 107,946.25	$ 107,946.25	$ 232,946.25	$ 37,245.00	$ 45,749.15	$ 1.064	$ 655,673.76	$ 780,631.04

So what are the key take away for Retirement Savers in 2021?

~Consider beginning your after-tax contributions to your company Roth 401(k) and Roth IRAs if you are still working.

~Consider converting portions of your existing Traditional IRA assets to Roth IRA assets to either pre-pay the tax liability for yourself during your retirement or help your beneficiaries during this favorable tax environment. *(Continued on Page 4)*

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Please investigate all options for handling inheritance of retirement assets with your tax and legal advisors before enacting a strategy. We, at Thorsen~Hixenbaugh~Kovaleski Wealth Advisors, understand your desire to maximize the benefits you can receive from your IRA. These strategies may be complicated so we are happy to discuss them with you! Our team looks forward to assisting you and your family with your financial goals and objectives for generations to come.

Wells Fargo Advisors Financial Network is not a legal or tax advisor.

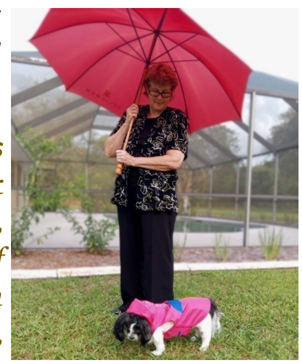
Team Updates

We appreciate all that you share with us about your family, goals, and life changes. We would like to take this opportunity to give you a little update about our lives outside the office.

"We are very proud to announce the graduation of our youngest daughter, Mary Grace, from Bishop Moore Catholic High School. She is continuing her education at the University of Central Florida with an intended degree in Aerospace Engineering. I am also very proud that that she chose my alma mater! Go Knights!" ~Sarah

"Living in Orlando is great because of all the fun activities in our backyard. I was fortunate enough to do a stay-cation at Walt Disney World resorts where I was finally able to experience the new Rise of the Resistance Star Wars themed ride. One day, Kent stopped by and we shared an Epcot Day with Jessie. She snapped this picture of us walking from the resort area into the back entrance of Epcot." ~J.R.

Molly, Mia and Leo, the Holley family's furry members were all decked out for Mary Grace's graduation celebration! ~Sarah



Is Snicker Doodle spoiled with her own raincoat...noooo! We are prepared the Florida summer storms! ~Donna

Our family works together, but also likes playing together! We enjoyed a lovely week in Satellite Beach! Jack, Monica, and Jan, John's mom, joined us at the beginning of the week where we enjoyed dining outside in the gorgeous weather with delicious food, and spent time sharing 'do you remember stories.' Kent, Jessie, and Linda, Jessie's mom, joined us in the middle of the week for some relaxation on the beach. During our adventure on the Banana River we saw manatees, dolphins, string rays, and a variety of birds. Also, we caught a glimpse of a rocket launch, marveled at the supermoon, discovered more fabulous restaurants and evenings were spent with board game competition! ~Karen

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