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Taxes on Sale

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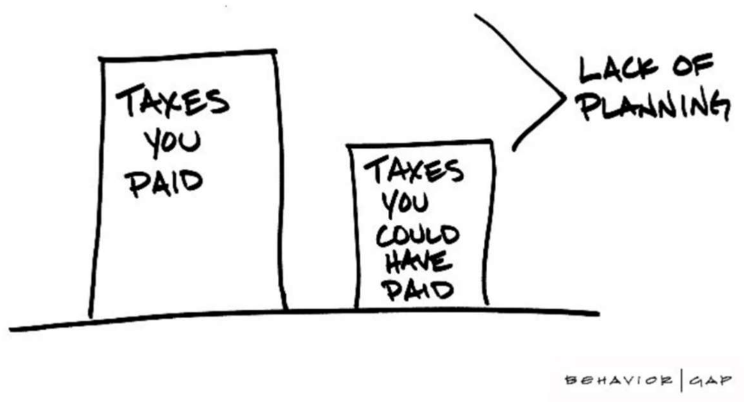
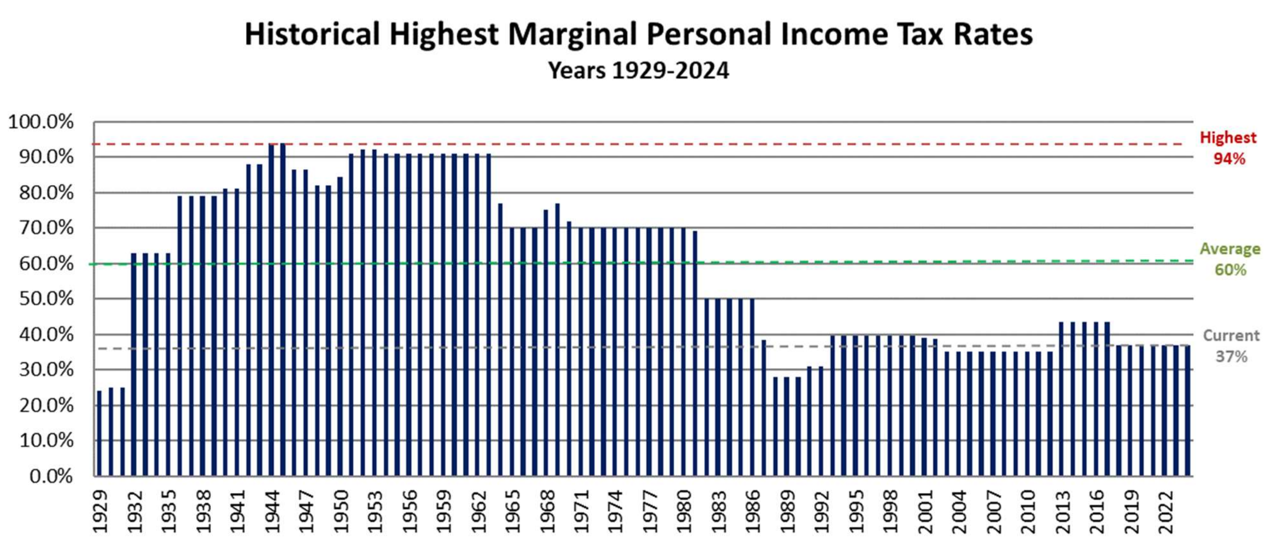
When the price of a quality stock declines, we like the idea of buying more of it while it's effectively "on sale". Simply put, we like getting more for less. The same holds true for financial and tax planning strategies we explore with clients, asking how can you keep more of your hard-earned dollars by paying less to taxes?

If you're a high-income earner, you already know it can be wise to maximize savings in tax-deferred accounts such as an employer's 401(k), which can lower taxable income today. What you may not yet realize, **especially if you are currently in the top tax bracket,** is that there may be tremendous value in paying some tax today to build tax-free savings, which may reduce your taxes in the future.



The Why. Taxes remain the government's main source of revenue and when viewed through the lens of history, a compelling case can be made that U.S. taxpayers face the prospect of higher future tax rates. With the passage of the 2017 Tax Cuts & Jobs Act, taxes are effectively "on sale" until the end of 2025 when this legislation is scheduled to sunset, unless the current administration extends the current policy. Even though it may not feel like it, taxpayers today - including those in the highest bracket - are paying among the lowest Federal tax rates since the Hoover Administration.

Chart 1.1

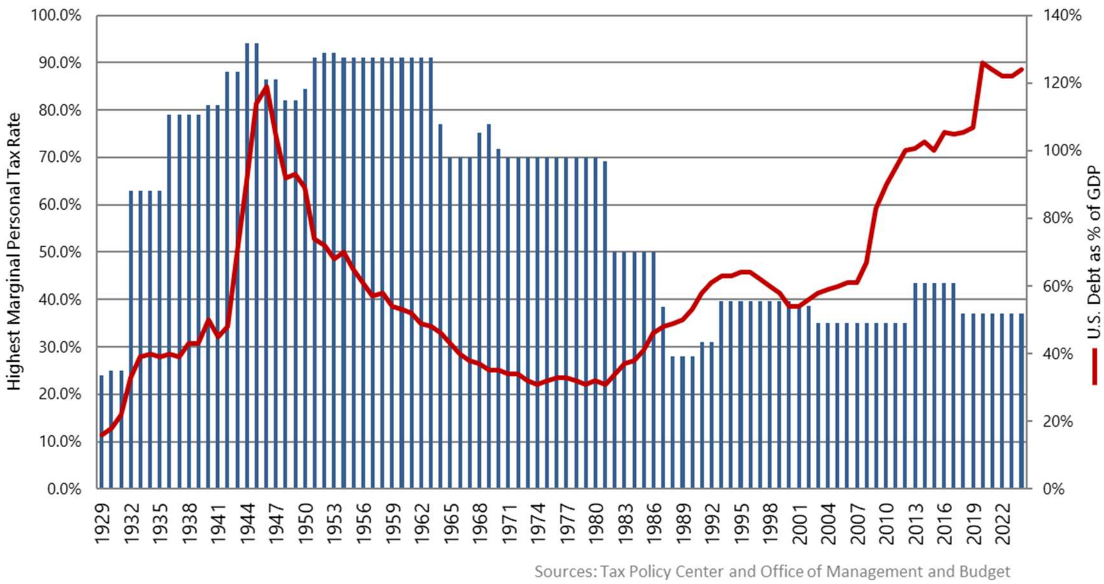


A Revenue Reckoning. Consulting history once more, when our national debt has exceeded the annual productivity of the entire U.S. economy (i.e. debt greater than 100% of GDP), the government has remedied this imbalance by collecting more revenue - a.k.a. higher taxes - in the ensuing years. Chart 2.1 illustrates that it has been decades since our lawmakers effectively addressed the ballooning national debt relative to tax revenues collected. Further, the painful reality depicted in Chart 2.1 makes a strong case for a period of revenue reckoning - higher rates across all tax brackets - in order to reduce the national debt and improve the country's financial strength once again.

Chart 2.1

Federal Income Tax Rates / U.S. Debt as % of GDP

Years 1929-2024



Small actions taken consistently over time. While no one knows what tax rates will be in the future, there can be real advantages to building tax diversification among your assets today. ***If your current annual income exceeds $165,000 (single filer) or $246,000 (joint) and you are precluded from directly funding a Roth IRA, a multi-year or "back door" conversion strategy may be a valuable*** way to create and build a Roth IRA that will enjoy both tax-free compound growth and withdrawals. Further, such conversions can reduce the size of "required minimum distributions" (RMDs) that the IRS will ultimately mandate you withdraw from tax-deferred Traditional IRA and 401(k) accounts. These annual distributions must be taken whether or not you need to realize that much income and/or it pushes you into a higher tax bracket, which can result in higher Social Security taxes and/or higher Medicare surcharges. By contrast, the IRS does not mandate withdrawals from tax-free accounts such as Roth IRAs, thereby affording you flexibility to help mitigate your future tax liabilities. From a legacy planning perspective, Roth accounts can also be an excellent way to leave money tax free to your heirs.

Time Sensitive. One final note on tax-free accounts such as Roth IRAs and/or Roth 401(k) accounts is the uncertainty regarding how long this potentially tax-efficient strategy will exist. The Roth provision is a highly debated item when Congress is negotiating tax law. Lawmakers may be realizing the folly in allowing taxpayers to pay tax on Roth contributions today, in lieu of taxing far larger balances in these accounts tomorrow. Since Roth accounts may not be available forever, there's no time like the present to start planning for the future.

TL:DR Call us to explore how you may be able to build a tax-free investment portfolio via a Roth IRA, especially if you are a high income earner.

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401(k) plans are long-term retirement savings vehicles. Withdrawal of pre-tax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Roth 401(k) plans are long-term retirement savings vehicles. Contributions to a Roth 401(k) are never tax deductible, but if certain conditions are met, distributions will be completely income tax free. Unlike Roth IRAs, Roth 401(k) participants are subject to required minimum distributions at age 70.5. RMD's are generally subject to federal income tax and may be subject to state taxes. Feel free to consult your tax advisor to assess your situation. Unless certain criteria are met, Roth IRA owners must be 59½ or older and have held the IRA for five years before tax-free withdrawals are permitted. Additionally, each converted amount may be subject to its own five-year holding period. Converting a traditional IRA into a Roth IRA has tax implications.

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