

July 1, 2015

Hello Friends:

I have many ideas and thoughts swirling around in my mind that I could write about for this 3rd quarter newsletter so I decided to discuss taxes and IRAs. I find that nearly all of my conversations with clients usually has some discussion about tax implications from investments. This one topic seems to be first and foremost on the minds of investors. So today I wanted to discuss the tax implications of a Traditional IRA.

We all want to avoid a sharp decline in our investment accounts and we carefully evaluate risk in attempt to protect the valuation from a sharp decline. If our account lost 25%, or 33% or even 50% of its valuation that would probably be a painful experience that we would want to avoid.

Yet this is exactly the kind of decline that our IRA accounts will likely suffer once the IRS and the Franchise Tax Board (for California residents) have their way and siphon off a large piece of our funds to support whatever government does with our money. Once a taxpayer turns age 70 ½, the tax authorities require that individuals begin a withdrawal program with a formula that will require larger and larger withdrawals each and every year.

For most retirees, the source of income is from social security, rentals, pension, and dividends and interest from investment accounts. Plug in the forced extra income from the IRA and it could have large adverse tax implications. For some high income earners, the extra IRA income could also be subject to an additional 3.8% Medicare tax that was added in 2013. So the next time that you look at the total value of your IRA (or 401k) account, just ballpark 2/3 for you and 1/3 for them.

If your investment account dropped by 1/3 because of market volatility, that would be quite painful. Yet the potential decline for an IRA because of the implication of taxes is just as severe and will be just as painful. And the tax implications against retirement plans is under attack.

Presidential hopeful Hillary Clinton recently stated that she believes that "the deck is stacked in favor of the wealthy and my job is to reshuffle the cards". She has borrowed a page from the Obama play book and if she is elected, in my opinion, reshuffling of the deck really means higher tax rates and an attempt to redistribute the wealth.

I believe that the solution to reduce tax implications of an IRA are to convert those funds to a Roth IRA. Once the investments have landed in a Roth IRA, there are no required minimum distributions and no age 70 ½ distribution rules. Funds can stay in a Roth for as long as you want and none of the appreciation, dividends or interest are subject to any taxes, not even the extra 3.8% Medicare tax. If you want to take the money out, you can, and no tax. For a young taxpayer in their 30's, I believe that the decision is a no brainer. For someone older, say in their 60's or 70's, the decision isn't as clear cut, but I believe that it still warrants careful consideration.

The money that is transferred from a Traditional IRA to a Roth IRA becomes taxable at the time of conversion. So the bottom line consideration is, would you prefer to pay taxes now on a lesser amount or taxes in the future on a greater amount. Under the old rules, only a taxpayer with Adjusted Gross Income under \$100,000 could make a conversion, but the Bush tax cuts opened up this conversion opportunity for everyone. If you would like to have a conversation about IRAs, just call or send an email and I will evaluate your situation. And as always, any IRA conversion to a Roth should only be done after consulting with your tax advisor.

Sincerely,  
  
Jim Aljian

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