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Case Study: Minimizing Future Income Taxes with Roth Conversions

Agenda

- Introduction
- Portfolio / Asset / Liabilities Overview
- Future Tax Bracket Forecasts
- Tax Considerations During Roth Conversions
- Summary
- Next Steps
- Discussion / Questions

Introduction

Objective -

- Review proposed investment strategy to minimize income taxes & maximize legacy balance via Roth conversions

Background -

- Retired from XOM Q1 2016 at 57
- Rolled over Pension Lump Sum & 401K to VG Trad IRA Q4 2017
 - Used NUA to roll out low cost basis XOM to ATAX Brokerage Accnt
- Access to Trad IRA without penalty in 2018 (59-1/2)
- Life expectancy per Livingto100.com: 86 me & 106 wife

Portfolio/Assets/Liabilities Overview

VG Retirement Accnts (75%) -

- Trad IRA – 7Twelve portfolio allocation model for VG passive inv's
 - 60% VG MF's
 - 40% Cash (intend to invest 35% in bonds & leave 5% in cash)
 - Use Trad IRA to fund Roth conversions
- Roth IRA's – minimal balances, 5 Yr Rule?

ATAX Accnts (25%) -

- VG Brokerage Accnt* – XOM stock + cash from dividends & recent stock sales
- VG Joint Brokerage Accnt* - 4 stock & bond MF's

Portfolio/Assets/Liabilities Overview, cont.

- Ameriprise Var. Annuity* – 4 stock MF's + 3% fixed acct
- Ameriprise Var. Universal Life Policy* – 4% fixed acct
- VG 529 Plan – Target Fund

*Use these accnts to fund Living Expenses

Assets & Liabilities -

- Spring Branch home built in 2019
 - 30 Yr Fixed Mortgage at 2.5% IR (20% of appraised value). Paying 2 extra payments/yr to minimize total interest paid.
- Heights Townhome built in 2006 & purchased in 2009. Using as rental property since 2016.

Future Tax Brackets Forecast

| Traditional IRA RMD Projections & Associated Federal Income Tax Rate | | | | | | |
|--|------|-------|--------------------|--------------------|--------------------|---|
| Roth Conversions: | | None | \$111K/yr | \$167K/yr | \$222K/yr | |
| Trad IRA Starting Bal, SK: | | X | X-1000 | X-1500 | X-2000 | |
| Age | LEF | LEF | Est Tax Bracket | Est Tax Bracket | Est Tax Bracket | Comments |
| 63 | | | | | | Current age May, 2022 |
| 70 | | | | | | Have 9 yrs for Roth conv prior to RMD's |
| 71 | | | | | | Start RVN SS benefits |
| 72 | 27.4 | 3.6% | 24% | 24% | 24% | Start RMD's |
| 73 | 26.5 | 3.8% | 24% | 24% | 24% | Start WVN SS benefits |
| 74 | 25.5 | 3.9% | 24% | 24% | 24% | |
| 75 | 24.6 | 4.1% | 32% | 24% | 24% | |
| 76 | 23.7 | 4.2% | 32% | 24% | 24% | |
| 77 | 22.9 | 4.4% | 32% | 24% | 24% | |
| 78 | 22.0 | 4.5% | 32% | 24% | 24% | |
| 79 | 21.1 | 4.7% | 32% | 32% | 24% | |
| 80 | 20.2 | 5.0% | 32% | 32% | 24% | |
| 81 | 19.4 | 5.2% | 32% | 32% | 32% | 24% |
| 82 | 18.5 | 5.4% | 24% | 24% | 24% | |
| 83 | 17.7 | 5.6% | 24% | 24% | 24% | |
| 84 | 16.8 | 6.0% | 24% | 24% | 24% | |
| 85 | 16.0 | 6.3% | 24% | 24% | 24% | |
| 86 | 15.2 | 6.6% | 24% | 24% | 24% | |
| 87 | 14.4 | 6.9% | 24% | 24% | 24% | |
| 88 | 13.7 | 7.3% | 24% | 24% | 24% | |
| 89 | 12.9 | 7.8% | 32% | 24% | 24% | |
| 90 | 12.2 | 8.2% | 32% | 24% | 24% | |
| 91 | 11.5 | 8.7% | 32% | 24% | 24% | |
| 92 | 10.8 | 9.3% | 32% | 24% | 24% | |
| 93 | 10.1 | 9.9% | 32% | 24% | 24% | |
| 94 | 9.5 | 10.5% | 32% | 24% | 24% | |
| 95 | 8.9 | 11.2% | 32% | 24% | 24% | Assumes both spouses survive to 95 |

- Consider Roth Conversion Scenarios over a 9 yr period (ages 63 – 71)
- Estimate balance of Trad IRA at age 72
- Spreadsheet calculates RMD's for me & wife (inherited IRA – 10 yrs to liquidate)
- Includes 85% of SS benefits for me & wife
- Assumptions made for IRA ROR's & SS COLA
- Spreadsheet calculates Total Annual Income
- Tax Bracket estimate based on 2022 tax tables. Assumes standard deduction of \$26K.
- Conclusion: Target \$1500K (\$167K/yr) Roth Conversion Scenario

Tax Considerations During Roth Conversions

- Tax Est for \$1500K Roth Conv Scenario
 - MAGI = \$167K Trad IRA W/D (ord inc) + \$18K XOM dividends (cap gain) = \$185K
 - 2022 Tax Table, MFJ: \$83,550 - \$178,150, tax = \$9615 + 22% of amt > \$83,550
 - Standard deduction, MFJ = \$26k.
 - Tax due = \$25K
- Est Annual Living Exp = \$150K
- Required funding from ATAX Accnts* = \$150k exp - \$18K XOM dividends - \$12K VUL distr = \$120K/yr
- Need to sell townhome to help fund 9 yrs of Roth conversions
- Note: To avoid Medicare IRMAA penalty, need MAGI below \$182K
 - 2022 Part B Premium = \$170/mth (\$2,040/yr) for MAGI <= \$182K
 - 2022 Part B Premium = \$238/mth (\$2,856/yr) for MAGI \$182K - \$238K

Summary

- Utilize Roth Conv's to reduce RMD's & future taxes & max legacy
 - Stay within 22%/24% tax brackets before/after RMD's
 - Roth benefits - No RMD's & earnings grow tax free
 - Stay <\$182K MAGI to avoid Medicare IRMAA penalty for Part B Premiums
- Fund living exp's with W/D's from ATAX Accnts* & proceeds from Townhome sale
- Strategy maximizes Townhome value
 - Replaces ordinary income stream (rent) with tax free funds (post sale)
 - Current housing market is hot & interest rates are rising
 - Avoids pending exp's to renovate & replace roof, HVAC, water heaters, etc.
 - Lose some diversity with increased concentration in equities

Summary, cont.

- Strategy delays SS benefits until 70 & max's survivor benefit
 - Longevity in wife's family
 - Inflation protection
- Use low cost basis XOM stock to fund charitable contributions
 - Deduct full market value of stock

Next Steps

- Model scenarios in NewRetirement.com to confirm/quantify results
- Sell Townhome
- Reallocate some ATAX accnts. Continue to diversify from XOM stock.
- Make a plan for Roth IRA allocation
- Allocate cash in Trad IRA to bonds (after Fed is finished raising interest rates?)