TRI-STAR TRUST BANK

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TIPS FROM YOUR

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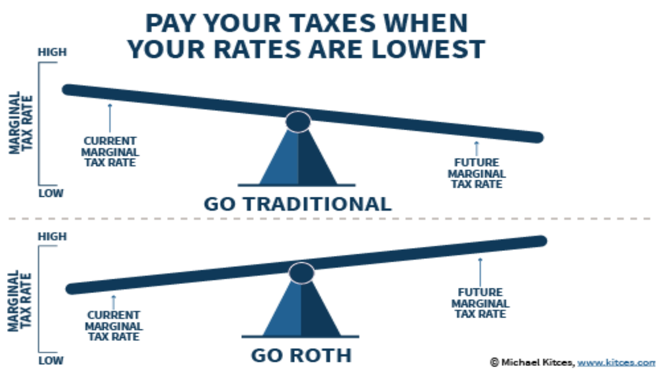
The Roth IRA

The Roth IRA was sponsored by and named after Senator William Roth of Delaware, and was established through the Taxpayer Relief Act of 1997. The Roth IRA has afforded many workers, and subsequently retirees, an additional savings source with unique tax advantages.

By having a diversified mix of account types, such as a bank account, a personal investment account, a 401(k), an IRA, and a Roth IRA, you will have the ability to strategically withdraw funds during retirement with the goal of managing and minimizing taxes. A Roth IRA presents tax benefits to owners and beneficiaries that are not available in other account types.



There are instances when saving into a Roth IRA makes sense, and also instances when it does not. Fundamentally, Roth IRAs are most appropriate when you expect that your tax rate now will be lower than your tax rate after you retire and begin needing withdrawals from your investments to supplement your other income sources.

Roth IRA Rules:

There are various rules associated with eligibility, contributions and distributions for Roth IRAs.

1) You must have earned income (wages) to contribute into a Roth IRA.
2) Contributions are limited to $5,500 per year of wages.
3) You may also make an additional catch-up contribution of $1,000 after age 50.
4) To fully contribute, your modified adjusted gross income must not exceed $118,000 if you file Single or Head of Household or $186,000 if you are a Married Filing Jointly taxpayer.
5) Roth IRA contributions receive no up-front tax deduction.
6) Investments within the account grow tax-free.
7) Contributions (or basis) may be withdrawn at any time and for any reason tax-free and penalty-free.
8) Earnings that you withdraw before age 59 ½ or before you've held the account for 5 years are taxable as ordinary income and also will incur a 10% penalty.
9) Early withdrawal penalties on earnings may be avoided if the funds are used to pay for a first-time home purchase, qualified education expenses, or medical expenses.
10) Penalties may also be waived in the event of disability or death, or if the distribution is made in substantially equal periodic payments (SEPP).
11) Contributions can be made after age 70 ½ and Required Minimum Distributions, which begin for Traditional IRAs at age 70 ½, are not imposed on Roth IRA accounts.
12) The deadline to contribute to a Roth IRA is April 15th of the following tax year. For example, the deadline to make 2018 Roth IRA contributions is April 15, 2019.

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Other Roth IRA Considerations:

5 Year Rule:

- The 5 Year Rule stipulates that you must hold the Roth IRA at least 5 years from the year of the first contribution to avoid taxes and penalties on distributed earnings.
- Distributions of earnings after age 59 ½ but before the 5 Year clock expires are subject to income taxes and a 10% penalty unless one of the exceptions applies.

Roth 401(k) Funds:

- Many employer retirement plans now offer participation into a Roth 401(k).
- Maximum contribution amounts are $18,500, and $24,500 after age 50.
- Be aware that the 5 Year clock does not begin with your first Roth 401(k) contribution; it only begins with your first Roth IRA contribution.
- Therefore, it is important to have a Roth IRA open to receive a future Roth 401(k) rollover at least 5 years before you expect to begin taking withdrawals from this account.

Roth Conversions:

- A Roth IRA conversion is one method of accumulating funds within a Roth IRA for those who are phased out of contributing based on high income.
- The IRA account holder chooses an amount to convert from an existing IRA into a Roth IRA.
- Taxes will be due in the year of the conversion on the amount of pre-tax dollars converted.
- Ideally, conversions are initiated in low tax years.
- In the past, you were able to re-characterize or undo a Roth conversion by October of the year following the conversion. The tax reform bill that passed in December 2017 has eliminated the ability to re-characterize.

Should you convert to
a Roth IRA?

It depends on several factors:

- **Is retirement near?**
- **Will you be in a lower tax bracket?**
- **Do you lack money to pay the taxes upfront?**

If you answer yes to these questions, it may not be a good idea to convert.

Backdoor Roth IRA:

- Anyone with wages, regardless of income level or participation in an employer plan, is able to make non-deductible contributions into a Traditional IRA.
- These non-deductible contributions can then be immediately converted into a Roth IRA through a tax loophole known as the Backdoor Roth IRA.

Pro Rata Rule:

- When you hold both pre-tax (deductible) and after-tax (non-deductible) funds within your combined IRAs and you convert these funds into a Roth IRA, you will pay taxes on the percentage of the converted amount attributable to the pre-tax portion.
- For example, if you have $7,000 of pre-tax funds and $3,000 of after-tax funds in combined IRAs and you convert $4,000 into a Roth IRA, 70% of the $4,000 (or $2,800) will be taxable.
- The IRS does not allow you to cherry-pick and convert non-deductible money first to avoid taxes.

Does a Roth IRA make sense for you?

Roth IRAs are a retirement saver's dream! Contributions can be withdrawn at any time with no tax consequences, investments grow tax-free, there are no mandatory distributions, and no taxes are due when qualified withdrawals are taken. However, they are not without a few drawbacks and a complex set of rules to follow.

Please reach out to your Tri-Star financial advisor, if you would like to discuss whether a Roth IRA would be beneficial to you.