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TAX-SMART IRA STRATEGIES

5 Tax-Smart IRA Strategies with Big Impact for Your Clients

TAX-SMART IRA STRATEGIES FOR 2022

Each new year brings new experiences and circumstances in the financial world—but one constant, regardless of the date on the calendar, is taxes. Taxes are a critical element of retirement planning, and there are multiple strategies available to mitigate the effect taxes will have on retirement savings accumulations and decreases. It's no secret that IRAs offer several tax-advantages over traditional savings accounts.

For instance, in *Chart A*[1] you can see how, over time, the tax advantages of an IRA can have a dramatic impact on savings. Several assumptions are made for this example including the savers are both contributing the maximum contribution for the IRA and the IRA is recieving a 7% return. For the taxable savings account, we are assuming the retirement saver's effective tax rate is 24% and they are putting the same contribution amount each year ($6000) into their account. Without a tax advantage the contribution would be $4560. With these assumptions and over three decades of savings, the tax-advantaged growth opportunity is clear.

Chart A: Growth of a Traditional IRA vs Taxable Savings Account

In addition to simple savings strategies like incorporating IRAs into their client's future, many financial advisors work with their clients to maximize their tax returns and help individuals gain insight into tax planning and tax preparation. While the list of considerable tax-smart strategies is a vast one, we wanted to focus on a few that fit together with the financial planning work that advisors regularly do with their clients seeking tax-advantaged accounts.

Moreover, we will provide a quick overview of recent legislative changes proposed in the Build Back Better Act and how they may impact IRA savings as time might be running out for individuals looking to maximize a tax-advantaged portfolio.

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[1]Seal, Troy, Estevez, Eric (2021, December 14). This Is How Much You Can Contribute to Your IRA; Retrieved December 22, 2021, from https://www.investopedia.com/articles/personal-finance/092315/how-much-you-can-contribute-your-ira.asp

1. MAX OUT IRA CONTRIBUTIONS

Retirement plan contributions remain a great tax planning and tax reduction vehicle for your clients. However, the IRS places certain restrictions on IRA contributions that are subject to cost-of-living adjustments.

For 2021 and 2022, eligible individuals can contribute up to $6,000, plus a $1,000 catch-up contribution if they turn age 50 or older in the year for which the contribution is made.

Depending upon their income, clients may be able to make a pre-tax contribution to a Traditional IRA, an after-tax contribution, or a contribution to a Roth IRA.

More important than any current-year tax deduction that might be available, the money contributed to an IRA grows tax-deferred (or tax-free in the case of a Roth) until withdrawn in retirement. This helps keep taxable income from interest, dividends, and capital gains out of your client's income, reducing their annual income in the years leading up to retirement.

IRA Contribution Limits

Account Type	2021 Limit	2022 Limit
Traditional IRA	$6,000	$6,000
Roth IRA	$6,000	$6,000
SEP-IRA	$58,000	$61,000
Simple IRA	$13,500	$14,000

Are Your Clients Self-Employed?

For those clients that are self-employed, you might suggest contributing to a SEP-IRA.

- Contribution limits range up to $58,000 for 2021 and $61,000 for 2022, and contributions can be made up until their tax filing date, including extensions, for the calendar year. Also, the account can be opened up until their filing date, including extensions as well.
- Contributions are made by the client's business and serve as a deductible business expense. Earnings grow tax-deferred inside of the account until withdrawn at retirement.
- For clients whose income might cause them to butt up against the limits for the 20% pass-through deduction for their business via the section 199-A rules, this deduction can help these clients stay under those limits in some cases.
- SEP-IRAs can be opened by any type of business entity.
- Business owners can choose to fund their SEP or not each year; funding levels can vary year-to-year as well.
- A SEP-IRA is best for smaller, family-owned businesses or those who are self-employed.

A SIMPLE IRA is a small business retirement plan that is also conducive to the solo self-employed.

- Contributions can be made up to $13,500 for 2021 and $14,000 for 2022.
- Employers are required to make a 3% matching contribution or a 2% non-elective contribution for all employees, which is a deductible business expense.
- SIMPLE plans are best suited for small businesses with 100 or fewer employees.
- Accounts can only be opened by certain types of business entities.
- Employers are required to match the employees' contributions up to 3%.
- Once the account is funded, it is 100% vested to the employee.

2. BALANCE OUT TAX IMPLICATIONS OF ASSETS

A key consideration for investors is where their investments are held. By this, we mean in what type of account are various types of investments held. For those with taxable accounts as well as tax-deferred retirement accounts (or a tax-free account in the case of a Roth), the location of asset classes among their accounts can have tax implications.

For example, it can make sense to hold equities offering the opportunity for favorable long-term capital gains treatment when sold for a gain in a taxable account. Qualified dividends from these holdings are also eligible for preferential tax treatment.

Conversely, investments that generate interest such as bonds might be better off if held in tax-deferred retirement accounts. This allows the client to defer the taxes on this income until retirement (or avoid it altogether in the case of a Roth account). For clients investing in alternative assets, asset diversification should be a key consideration. Many alternatives have tax implications that can be avoided or mitigated by housing these investments inside of an IRA.

Alternative Assets Can Include Investments In:

- **Real Estate**
- **Private Equity**
- **Private Debt**
- **Crowdfunding**
- **Commodities & Futures**
- **Structured Settlements**

Certainly, investment decisions should not be tax-driven, but when feasible it makes sense to consider the tax implications of asset location.

3. TARGET ROTH CONVERSIONS

Roth conversions are a tax planning tool that stretches beyond the year in which they are completed. Roth IRAs offer your clients tax diversification down the road in retirement as nobody knows what changes in income and/or the future tax laws hold.

Having at least a portion of their retirement assets in an account that won't be taxed can help in planning withdrawal strategies once your clients hit retirement. Your clients can choose to pay tax on some or all of their retirement savings now by converting their IRA or retirement plan savings to a Roth IRA. Although the amount converted must be included in their current-year taxable income (excluding any basis), the converted amount and any investment growth can be withdrawn tax-free in retirement.

Unlike traditional IRAs, there are no RMDs for Roth IRAs during the account owner's lifetime. Some clients prefer to conduct a series of conversions to lower the tax impact each year. You might suggest a Roth conversion for clients whose income is variable or in years where their income or tax bracket is lower than normal.

As mentioned, nobody knows what future tax laws hold. The option to convert may become more limited for certain clients in the near future. The Build Back Better Act introduced legislation proposals in November of 2021 that would eliminate the option to convert after-tax retirement savings to a Roth IRA. Additionally, high earners would be banned from converting pre-tax retirement savings to a Roth IRA beginning in 2032. Although not the first time legislation like this has seen light, the draft summary included a signficant shift in effective dates targeting December 31, 2021. While none of these proposals have made traction as of yet, you may want to discuss the Roth conversion strategy with your clients while conversions are still an option.

PROTECTING INVESTMENT FREEDOM

On September 13th, 2021, the House Ways and Means Committee unveiled a controversial $3.5 trillion government-funding proposal consisting of 881 pages of recommended legislation covering several topics, including retirement plans and Roth conversion limitations as well as IRA investment limitations, titled the Build Back Better Act (BBBA). The proposed legislation package included an urgency on the part of supporting legislators to quickly pass the BBBA without thoroughly vetting the impact of provisions that seemed "slipped-in" regarding investment freedom, IRAs, and small business funding.

While the impact on IRAs might have flown under the radar for many, upon hearing of the legislation proposal financial services organizations started education campaigns to communicate the devastating impact the proposed legislation would have for retirement savers, SDIRA account holders, small business owners, and entrepreneurial startups.

For 45+ years, investors have been able to leverage their IRA to buy into alternative assets outside of the stock market, which are permitted by the IRS code and acknowledged by the SEC and bank regulators. The original provisions in the BBBA would effectively halt all private placements, private equity, and private debt investments—likely causing great financial losses for hundreds of thousands of taxpayers.

At the same time as the BBBA legislative debate, the SEC released a report detailing the advantages of alternatives for individuals, small businesses, and the economy.[2] The initial proposed legislation within the BBBA bill was a severe overreach and out of touch with the modern investor. The harmful provisions were removed regarding IRAs as the House passed a slimmed down version of the bill in November of 2021.

In late December 2021, Sen. Jo Manchin (D-WV) stated his formal opposition to the BBBA, officially pulling the plug on a chance for passage in 2021.[3] Many speculate a revision of the BBBA might be on the table again for 2022. Although removed in the House, the damaging provisions targeting IRAs and investment freedom could still find their way back into a revised version—or perhaps future legislation.

Along with trade associations such as The Alternative & Direct Investment Securities Association (ADISA), Retirement Industry Trust Association (RITA) and our collegues in the financial services industry, we continue to monitor pending legislation closely and encourage proactive educational, informational, and impact-specific outreach to your local House and Senate representatives.

Make Your Voice Heard

- To find your U.S. Congressional Representative, go to: https://www.house.gov/representatives/find-your-representative
- To find your U.S. Senators, go to: https://www.senate.gov/senators/senators-contact.htm

[2]Subramaniam, R., Jivraj, A., Sirri, E., Savage, J., Bajkowski, J., & Suydam, J. (2021, September 27). Final Report and Recommendations for Private Investments. Asset Management Advisory Committee; U.S. Securities and Exchange Commission .

[3]Lerman, D. (2021, December 19). Manchin Pulls Plug on 'Build Back Better' Bill. Rollcall.com. Retrieved December 22, 2021, from https://www.rollcall.com/2021/12/19/manchin-pulls plug-on-build-back-better-bill/

4. PAY IT FORWARD WITH QCDs

While the SECURE Act raised the age to start RMDs to 72 as of January 1, 2020, the age for taking a qualified charitable deduction (QCD) was left at 70½. For your clients who are at least age 70½ and who have charitable inclinations, using some or all of their required minimum distributions (RMD) to make charitable contributions can help them satisfy their charitable inclinations while helping their tax situation.

RMD Age Requirements:

Birthdate	RMD Starting Age	First RMD Year	2022 RMD Due Date	RMD Calculation Based On
Jan 1 - Jun 30, 1950	70½	2021	December 31, 2022	Your Dec 31, 2021 IRA Balance and Your Age in 2022
Jul 1 - Dec 31, 1950	72	2022	April 1, 2023	Your Dec 31, 2021 IRA Balance and Your Age in 2022

RMD distributions are subject to income taxes at ordinary income tax rates. With the changes in the tax laws beginning in 2017, fewer people can itemize deductions. This may include many of your clients, especially older clients who may not have a mortgage.

While there is no charitable deduction for making a QCD, the amount of your client's RMD that is subject to federal taxes (check the client's state for information on state taxes) is reduced by the amount of the QCD. Besides the tax savings aspect, this can help reduce their income used to calculate their costs for Medicare Part B. Using some or all of their RMD as a qualified charitable distribution can provide your clients with the best of both worlds so to speak.

Qualified Charitable Distributions (QCD) Work as Follows:

- Your client must be at age 70½ at the time of the distribution.
- They can direct up to $100,000 of their RMDs to a qualified charitable organization. The charity must be eligible to receive tax-deductible contributions. This is a total across all accounts.
- QCDs cannot be made to a donor-advised fund, a private foundation, or similar entities. Your client cannot receive a benefit, such as attending a function put on by the charity, from the donation.
- QCDs can be made from Traditional IRA accounts, inherited IRA accounts, SEP-IRAs, and SIMPLE IRA accounts.
- The distribution must be made directly from the client's account in the form of a check made payable to the organization.

5. LEVERAGE 401(k) ROLLOVERS

You may have clients who will be leaving their employer for any number of reasons. Managing the disposition of their old 401(k) or another type of employer-sponsored retirement plan is important from both a retirement planning perspective and a tax perspective. This strategy was also targeted in the BBBA. For clients that would benefit from this strategy, the time to have the conversation is soon.

When rolling retirement plan assets over to an IRA account, it's desirable to have your client do a trustee-to-trustee transfer. This eliminates the possibility of them triggering a taxable event, even if unintentionally, by the client withdrawing the funds in cash and then doing a rollover. Taxes at the client's ordinary tax rate are due on withdrawals, and if they are under the age of 59½, a 10% penalty could apply.

Retirement Plan Rollovers to an IRA Offer:

- Continued tax-deferral of the money until withdrawn in retirement (tax-free if in a Roth account).
- The ability to invest these funds in a manner that is consistent with the overall investment and financial planning strategies that you have in place for the client.
- The ability to consolidate the client's retirement savings.
- The ability to diversify retirement assets into areas such as alternative assets if desired.

Rollovers Can Be Made From Employer Plans Including:

- 401(k) Plan
- Profit-sharing Plan
- 403(b) Plans
- Governmental 457(b) Plans

For clients with company stock held in their retirement plan, you might consider a technique called net unrealized appreciation or NUA. Under the NUA rules, the shares of the company stock are distributed to a taxable brokerage account, while the rest of the assets in the retirement plan account would be rolled over to an IRA as normal.

Using NUA will result in your client paying taxes on the value of the shares based on their original cost basis. If the shares are then held for at least a year, any subsequent sale of the shares will be taxed at preferential long-term capital gains rates. For shares that have appreciated greatly since the client acquired them inside of the plan, this can result in substantial tax savings versus rolling the shares over to an IRA and paying taxes on the money at ordinary tax rates when withdrawals are made from the IRA. NUA also offers a form of tax diversification for those with substantial amounts already in tax-deferred retirement accounts.

LOOKING AHEAD

Taxes impact every aspect of our financial lives. For 2021 and 2022, pandemic-related tax topics and pending legislation will be important across the board.

Taking a proactive approach to financial planning with tax-efficient strategies and proposed legislative changes helps clients keep more of the money they earn and is an integral part of helping them reach their retirement and other financial goals.

Tax-smart IRA strategies like being able to max out IRA contributions, offering additional vehicles for asset diversification, leveraging Roth conversions (while you still can), replacing lost itemized deductions, and taking advantage of rollovers are just a few that can make a big impact on portfolios.

As you work with your clients to help get them ready for retirement, keep these and other tax-smart strategies in mind as applicable to your clients.

5 Tax-Smart IRA Strategies with Big Impact For Your Clients

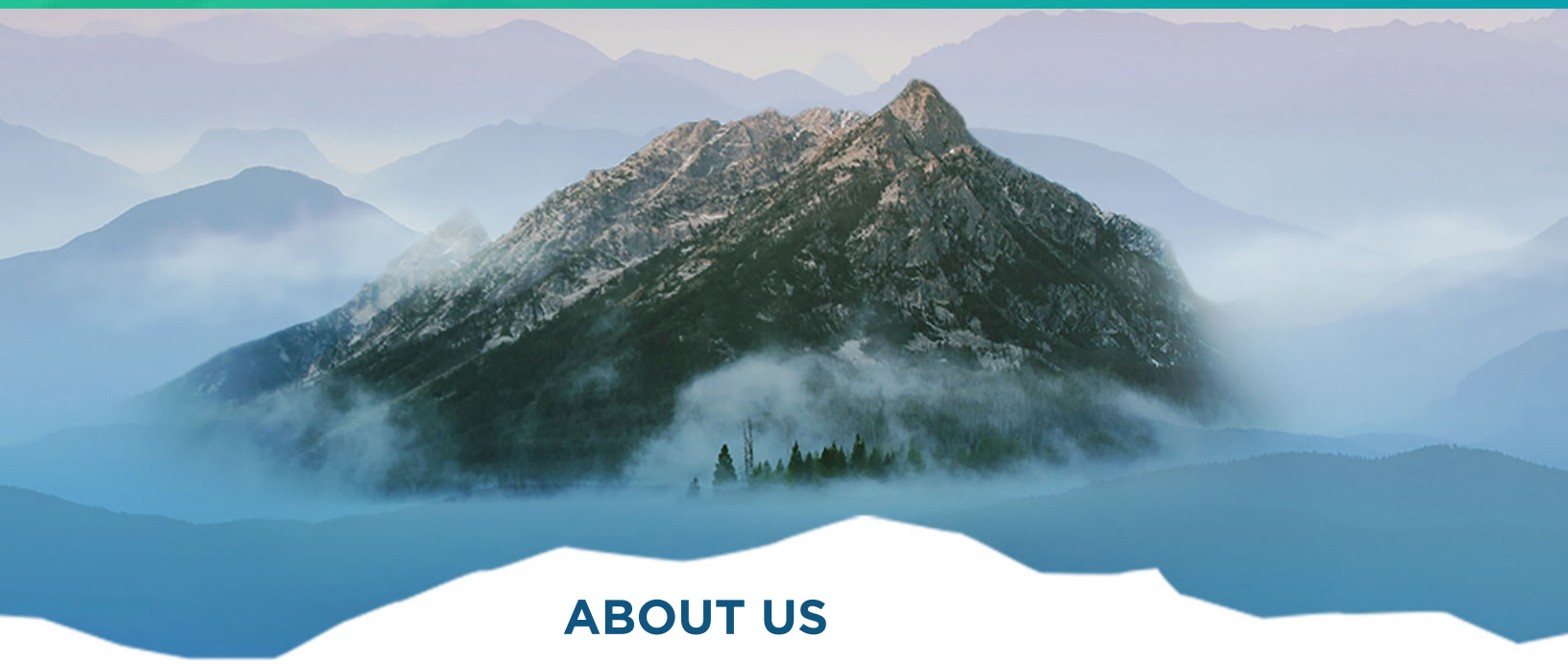
1. **Max Out IRA Contributions**
2. **Balance Out Tax Implications of Assets**
3. **Target Roth Conversions**
4. **Pay It Forward with QCDs**
5. **Leverage 401(k) Rollovers**

Grow Your Self-Directed IRA Knowledge

Find more great content at the STRATA Insights Blog:

- Traditional or Roth self-directed IRAs
- Strategies for leveraging IRAs with alternative assets
- IRA prohibited transactions
- IRA allowable investment vehicles
- Legislation updates related to alternative investments and IRAs
- The benefits of tax-advantaged investing
- Timely topics around RMD, FMV, UBTI/UDFI and more for tax-advantaged retirement accounts
- And much more

www.StrataInsights.com/insights



ABOUT US

STRATA Trust Company is a premier national custodian for alternative assets and non-exchange traded investments in self-directed IRAs. STRATA has been helping investors use their retirement account funds to invest since 2008.

With offices in Waco and Austin, Texas, our team's vast experience in handling the details and complexities that alternative investment transactions require is unrivaled. Our seasoned team's experience in the custody of alternative assets spans over 350 years. With a well-established reputation for honesty and integrity, STRATA is committed to delivering responsive, flexible and innovative solutions.

At STRATA, we work to ensure that the highest standards for safety and soundness are met. As a subsidiary of Horizon Bank, SSB, STRATA is a Texas-chartered trust company regulated by the Texas Department of Banking, which has long set the benchmark among state banking regulators. Strict controls are in place to ensure the safety of uninvested cash, and independent auditors are retained to conduct regular audits of our operations.

STRATA TRUST COMPANY

Carve your own path to retirement.

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