STARTED A BUSINESS RECENTLY?

THIS STRATEGY COULD SAVE YOU BIG $$$

We started working with a client back in mid-2018, a husband and wife who started a law firm in 2017. Wonderful people I might add! We took them through our process like we do with every new client that we bring on board.

As we started to wrap up our initial planning process and moved into implementation, one of our recommendations was to meet with their CPA for a year-end tax planning session. We do this for ALL our business owner clients because there are SO many strategies/things to consider/tweaks, to help keep more money in your pocket as a business owner.

I had a hunch that a particular strategy would be a huge win for these clients. Before I divulge what this super special, propriety strategy is (totally kidding… every decent wealth manager knows about it), let's walk through why I thought this may make a lot of sense in this case.

When you do comprehensive planning that means you actually get to know every single aspect of a client's life that pertains to their financial wellbeing. And that includes having a deep understanding of their business - is its cash flowing, is it growing or declining, how's the health of the owner, are they ready to get out of their business or are they still building their empire, etc, etc, etc.

Through conversation it was pretty clear that their business was brand new and they'd be claiming a loss in their first full calendar year of business, which in this case was 2018. We knew the loss would be in the ballpark of 60k. So, when we met with their CPA it was confirmed they'd realize an operating loss of approximately what we figured. Here's where it gets exciting!

Knowing that they'd be realizing that loss and that one of them had a Traditional IRA we presented the ROTH IRA Conversion strategy to them and their CPA. It's pretty simple how it works but let me explain for the folks who haven't heard of it.

A ROTH IRA conversion means that you take money from a Traditional IRA and move it to a ROTH IRA. Why the heck would you do that? Well all the money that goes into your Traditional IRA or 401k is tax-deductible. i.e. You make 100k of income in a year and deposit 10k total between your Traditional IRA and 401K you are now taxed on 90k of income not 100k. Make sense? Hopefully.

Then when you "retire" and start taking money out of your Traditional IRA/401k, you pay taxes on your distributions according to the current tax environment at that time. ROTH IRA/401k works like this: Money in = after tax (meaning you don't get to deduct it) and money out = tax free. And yes- all the money you earn in a ROTH IRA over the years is also tax free when you take it out!

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Ok stay with me here. So, let's get back to WHY you would want to do this in a year you're claiming a loss in your business. In this case they were able to take 80k and move it from an account that they'd have to pay taxes on (at a later date) to an account where it'll be tax free! And the bees knees....they paid next to nothing in taxes when they did this!

Typically, when you take money from a Traditional IRA and move it to a ROTH IRA it's a taxable event because you're going from a pre-tax account to a post-tax account. ALWAYS MAKE SURE TO TALK TO YOUR CPA OR TAX PRO PRIOR TO DOING SOMETHING THIS COOL.

Let's quantify this so you can see the real value. I'm going to make some assumptions here, so this example is super easy to follow along with. Let's assume that these clients are both 50 and plan to retire in 15 years and they'll be in the 25% tax bracket when they do. Another assumption is that this 80k would grow to $191k (80k growing at 6% annually for 15 years). If you don't believe me google "compounding interest calculator" and you can check my math.

If they were to take this now $191k out from their Traditional IRA at once (again assuming a 25% tax rate) they'd pay about $47k in taxes. The longer we assume that money stays in the Traditional IRA the more powerful this strategy becomes. Let's say they kept the 80k in the Traditional IRA for 25 years and it grows to 363k. Still assuming the 25% tax bracket (even though it would be much higher based on today's rates) they'd save 90k in taxes! Pretty cool huh?! I'd hope you think saving a boat load in taxes is pretty cool.

Here's a few links to some quality resources if you want to learn more about doing a ROTH conversion and see if it makes sense for you.

- Compounding Interest Calculator
  http://www.moneychimp.com/calculator/compound_interest_calculator.htm
- ROTH IRA Conversion Calculator
  https://www.yourfutureplanning.com/learning_center/calculators/roth_ira_conversion
- ROTH IRA Conversion Rules
  https://www.investopedia.com/roth-ira-conversion-rules-4770480

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