ANNEX WEALTH MANAGEMENT

Welcome!

July 2024

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Roth Conversion

CASE STUDY

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Why Roth Conversions?

Change:

- Expected future tax rates will be higher than current.
- Current bracket is lower than when you were deferring
- Expected tax code changes or sunsetting tax codes.

Estate Planning:

- Maximizes wealth transfer to heirs.

Efficiency:

- Minimize Required Minimum Distributions (RMDs)
- Tax diversification of retirement assets
- Tax-exempt distributions

Opportunity:

- Tax bracket maximization (includes change of filing status)
- Market decline or market pullback

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Case Study: Fact Set

- **Husband (67) & Wife (61)**
  - Both Retired in 2021
- **Hired Annex in Late 2023**
- **Annual Spending: $150,000**
  - Grows 3% annually
- **Investment Growth Rate: 6%**
- **Life Expectancy:**
  - Husband: 86
  - Wife: 91
- **2023 Taxable income: $0**
  - ACA subsidies for wife and son
  - $14,184 – Amount of Government paid Subsidies and Tax Credits

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Current Asset Breakdown

Asset Breakdown	Husband (67)	Wife (61)	Total	(%)
Cash & Taxable Assets	$841,971	$682,026	$1,523,997	19%
Pre-Tax Retirement Assets	$2,161,535	$2,481,535	$4,643,070	59%
Roth Retirement Assets	**$38,947**	**$40,193**	**$79,140**	**1%**
Total Real Estate Assets	$793,500	$793,500	$1,587,000	20%
Total Personal Assets	$29,000	$29,000	$58,000	1%
Total:	**$3,864,953**	**$4,026,254**	**$7,891,207**	**100%**

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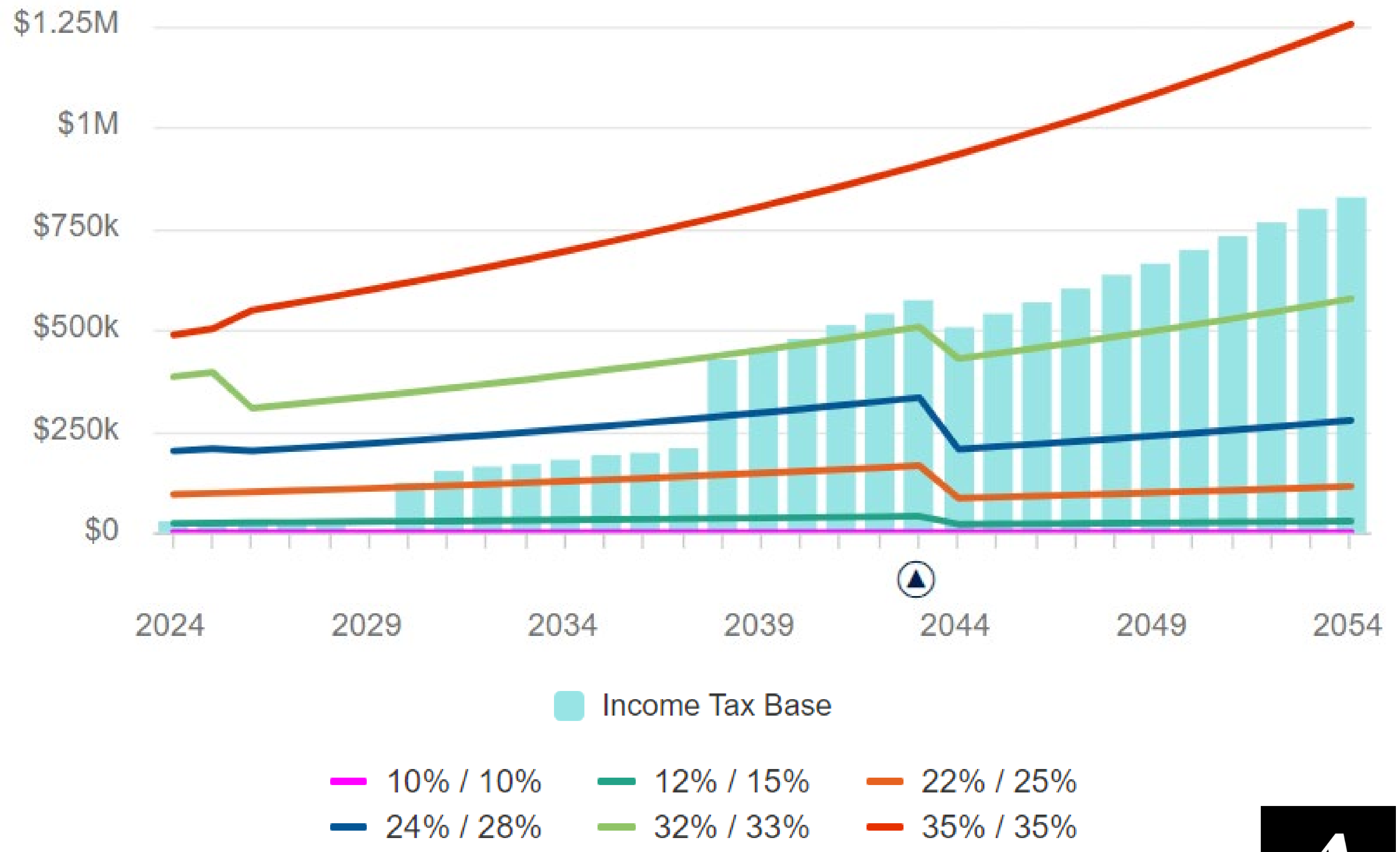
Here is a list of their current assets. As you can see, they have a very strong cash position and over 50% of their net worth is allocated to pre-tax. Only 1% of what they currently have is allocated to Roth.

As we review each client's situation to identify what tax planning opportunity will have the greatest long-term impact, one of the first areas we look at is how their assets are currently positioned based on how they are treated from a tax standpoint.

For this client, Roth conversions immediately jumped out as a strong opportunity, and we like the fact that they have the cash assets available to cover the taxes on this type of planning. Using cash to pay taxes on conversions vs. withholding from the conversion itself is the most efficient way to cover any tax liability when converting IRA to Roth Assets. This allows us to get more assets into the Roth.

Current Tax Trajectory



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The tools and resources we use at Annex allow us to look ahead and project out what future tax impactions are likely to be. When we looked at this situation, we can clearly see that once RMD's begin, their tax rate and amount of tax they will pay annually is projected to substantially increase.

Across the board, clients are very sensitive and opinionated when it comes to paying taxes. The one thing we know about taxes is that we will never avoid them altogether. We use visuals like these to help clients realize that it may feel good to not pay any taxes right now, but by delaying you may end up paying taxes at a higher rate than what you would if you decided to pay them earlier by incrementally converting IRA assets to Roth.

**Difference between 2043 and 2044 as to why the tax paid is the same but effective rate is higher is attributable the fact that they go from MFJ brackets to Single brackets AND to the 7-year age difference. The age gap results in a significant reduction in RMD compared to when husband was alive.*

Current Tax Trajectory

Year	Age	Gross Income	Total Tax	Effective Tax-Rate	Notable Events
2024	67/61	$97,506	$4,317	4.4%	
2025	68/62	$98,406	$3,971	4.0%	
2026	69/63	$98,494	$3,559	3.6%	
2027	70/64	$98,493	$2,940	3.0%	
2028	71/65	$98,400	$1,482	1.5%	
2029	**72/66**	**$116,820**	**$2,524**	**2.2%**	**RMD Husband: $112,382**
2030	73/67	$243,181	$35,423	14.6%	
2031	74/68	$271,073	$41,216	15.2%	
2032	75/69	$281,943	$43,405	15.4%	
2033	76/70	$292,507	$45,799	15.7%	
2034	77/71	$306,023	$48,865	16.0%	
2035	**78/72**	**$320,836**	**$52,317**	**16.3%**	**RMD H&W: $394,960**
2036	79/73	$336,415	$55,945	16.6%	
2037	80/74	$352,804	$59,769	16.9%	
2038	81/75	$590,671	$141,267	23.9%	
2039	82/76	$625,439	$152,035	24.3%	
2040	83/77	$660,313	$162,715	24.6%	
2041	84/78	$699,599	$175,042	25.0%	
2042	85/79	$740,067	$187,682	25.4%	
2043	86/80	$782,958	$201,157	25.7%	First Life Expectancy
2044	**__/81**	**$678,339**	**$195,123**	**28.8%**	**RMD Wife: $487,088**
2045	__/82	$721,613	$210,116	29.1%	
2046	__/83	$764,304	$224,709	29.4%	

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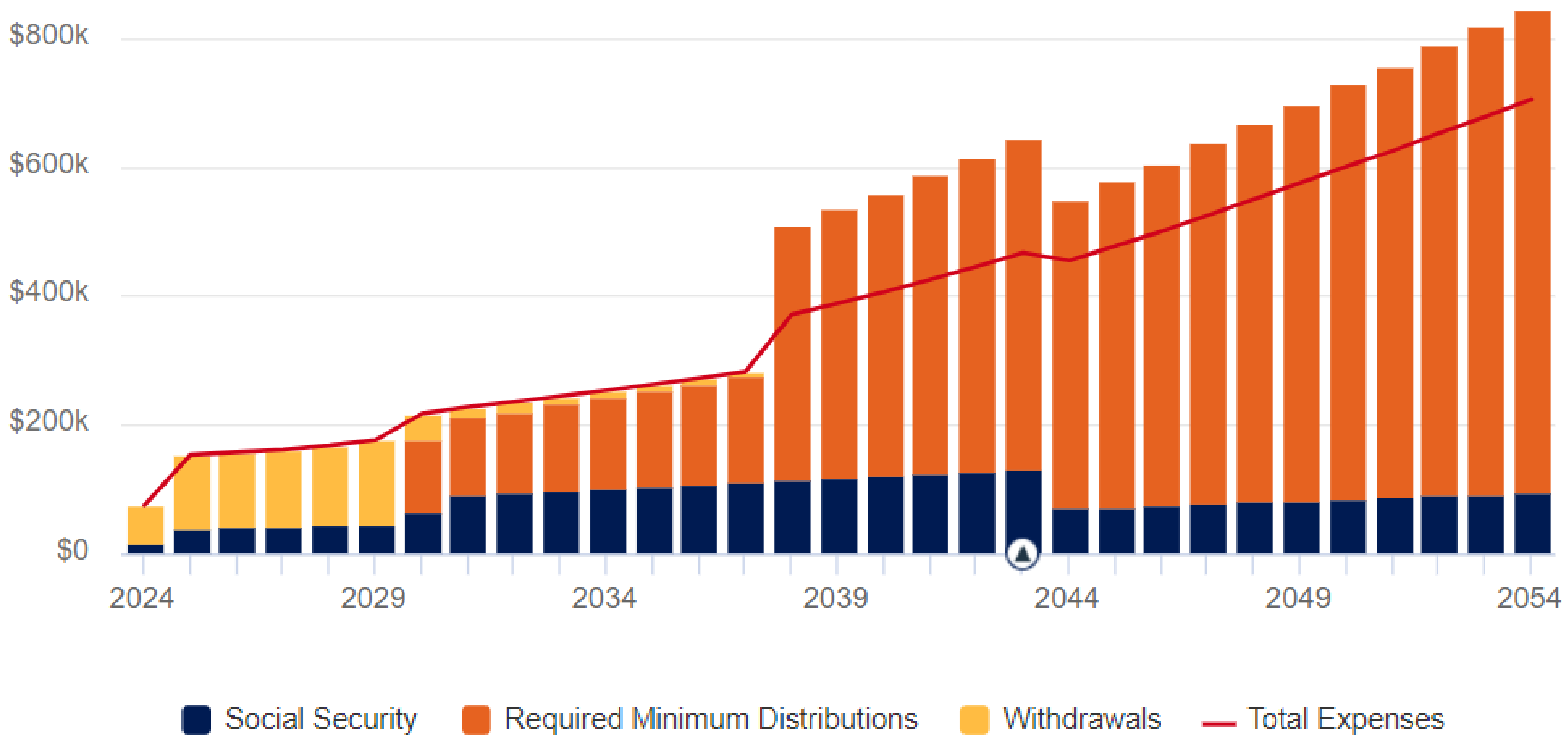
Future Cashflow Trajectory



Another tell-tale sign that conversions may be a good fit can be seen when looking at their future cashflow projections. What we see here is that when the second spouse begins taking RMDs, they are required to distribute more assets from their accounts than what they need for annual spending. These distributions will generally be fully taxed. As a result, taking more distributions from your accounts than what you need is very inefficient from a tax standpoint.

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Proposed Strategy

Annual Conversion Strategy					
Year	Husband IRA	Wife IRA	Cumulative Total	Marginal Rate	Effective Rate
2024	$364,950		$364,950	24%	17.9%
2025	$380,570		$745,520	24%	17.9%
2026	$201,250		$946,770	25%	14.8%
2027	$213,500		$1,160,270	25%	14.8%
2028	$219,900		$1,380,170	25%	14.9%
2029	$219,900		$1,600,070	25%	15.3%
2030		$169,520	$1,769,590	25%	15.0%
2031		$162,340	$1,931,930	25%	15.4%
2032		$167,325	$2,099,255	25%	15.4%
2033		$172,700	$2,271,955	25%	15.4%
2034		$178,381	$2,450,336	25%	15.4%
2035		$183,960	$2,634,296	25%	15.4%
2036		$189,656	$2,823,952	25%	15.4%
2037		$165,000	$2,988,952	25%	16.8%
Total	**$1,600,070**	**$850,266**	**$2,450,336**		

What you see here is the directional strategy we created and shared for the clients. As you can see, we proposed converting assets incrementally over time to maximize current tax brackets and reduce the overall tax they will pay over the course of their retirement.

With any form of tax planning, there are always pros and cons to consider. It is important to identify and communicate these to the clients and allow them to understand the benefits and potential tradeoffs.

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Total	**$1,600,070**	**$850,266**	**$2,450,336**		

Strategy Notes:

- **Pros:**
  - Reduces future Medicare Part B surcharges
  - Accelerates IRA distributions in lower tax brackets
  - Hedges against untimely passing of a spouse
  - Creates a more efficient transfer of wealth to heirs
- **Cons:**
  - Forfeit ACA Subsidies and adds an extra $14,000/yr. expense for the wife's health insurance to age 65.
  - Reduces taxable/cash assets due to higher tax bills

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2024 Tax Projection – Conversion Strategy

Marginal Tax Bracket Information

The marginal tax rate for your ordinary income is as follows:

Marginal Rate	Ordinary Income Threshold	
10.0%	$0 to $23,200	
12.0%	$23,201 to $94,300	
22.0%	$94,301 to $201,050	
24.0%	**$201,051 to $383,900**	**You: $378,543**
32.0%	$383,901 to $487,450	
35.0%	$487,451 to $731,200	
37.0%	Over $731,200	

Medicare Part B/D Premiums For 2026

Medicare Parts B and D premiums can be impacted by Modified Adjusted Gross Income* (MAGI). Amounts to the right are in addition to the base premiums. Amounts are monthly per person.

**MAGI = AGI + Tax-Exempt Interest*

MAGI Threshold	Part B Premium Adjustment	Part D Premium Adjustment	
$0 to $206,000	$0	$0	
$206,001 to $258,000	$70	$13	
$258,001 to $322,000	$175	$33	
$322,001 to $386,000	$280	$54	
$386,001 to $750,000	**$384**	**$74**	**You: $419,108**
Greater than $750K	$419	$81	

Our ability to incorporate proactive tax planning allows us to land on a more precise number for the amount to convert each year. For these clients, we settled on $365,000 for two reasons.

First, ~$365k places these clients toward the upper end of the 24% tax bracket. When we look over the long-term, this is a very favorable bracket for them.

However, we are faced with a decision and that is to max out the 24% or dial back on the conversion amount to get under the Medicare, or IRMAA Thresholds. The decision for this year is to emphasize the 24% bracket since the future increase will only impact the husband in 2026 as the wife will not be Medicare eligible.

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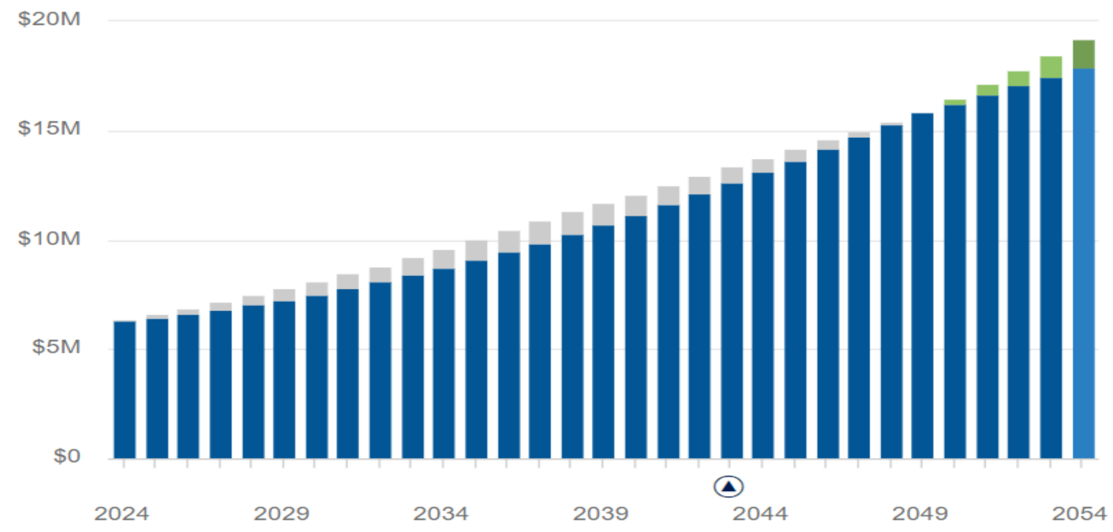
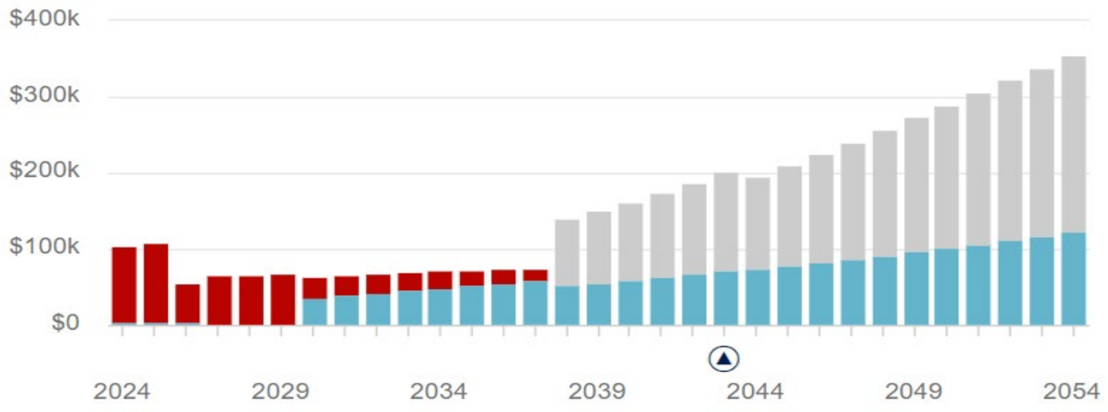
Strategy Impact



VALUE GAINED
$1,302,725

Total Taxes



CUMULATIVE TAXES
$2,474,789
($1,962,737)
VS BASE FACTS

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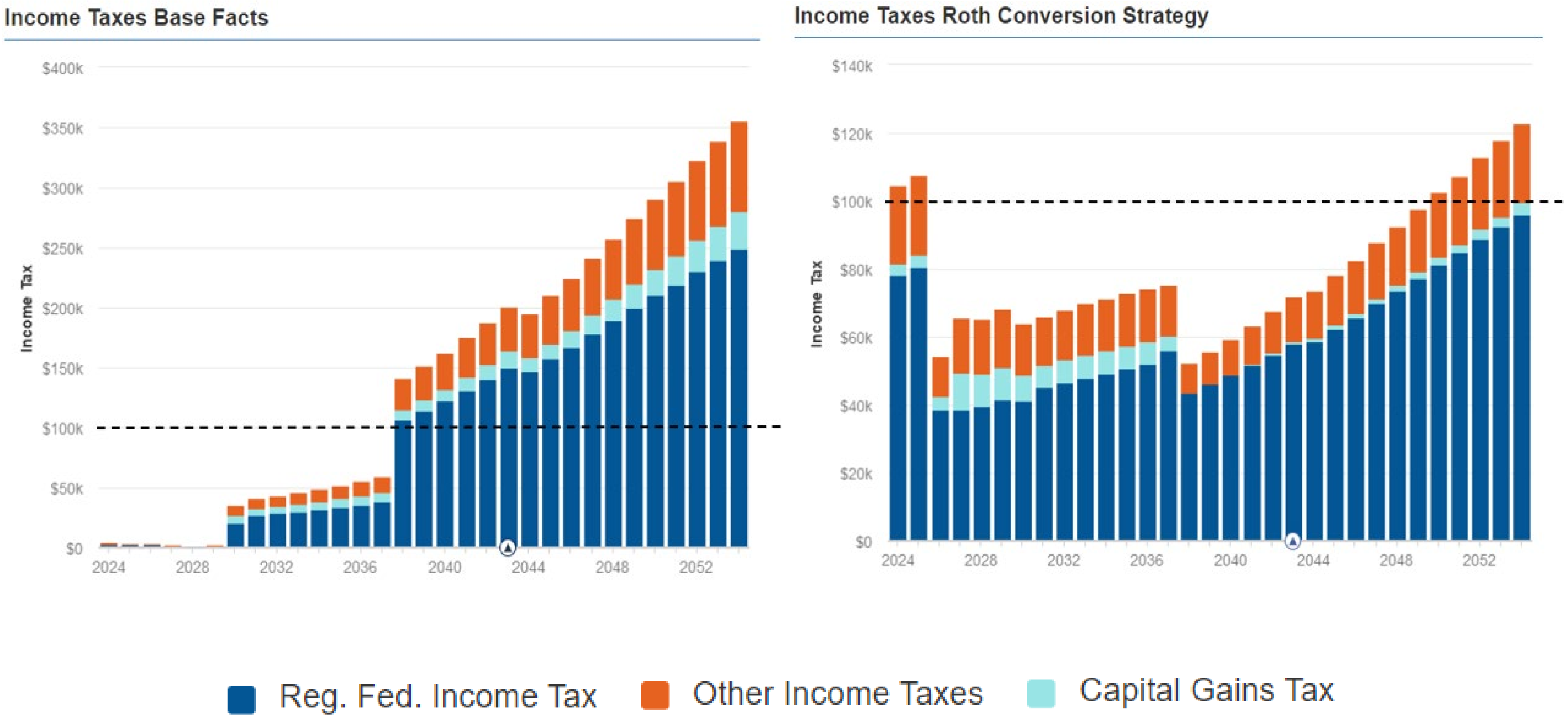
Any time we look at proactive planning, we must understand if the strategy we are considering will add value.

What you see here is that this strategy may have a significant impact to their long-term plan in a positive way.

Much of the value gains comes primarily from two sources:

1. **Tax savings - by accelerating income into lower brackets.**
2. **Significantly reducing the amount of RMDs and distributions above and beyond what they need to spend.**

Income Tax Impact



Looking at the impact on their future income taxes, pay attention to the Scales used on the vertical axis for each plan.

If they take no action, they reach $100k of annual income taxes in 2035, roughly 3 years after both RMD's begin.

By taking action, they wouldn't reach $100k of annual income taxes until 2042.

When looking at the final year of the financial plan, we can see that income taxes exceed $200,000 in the scenario where no action is taken. In the scenario where we accelerate income in earlier years using Roth conversions, the income taxes are approximately $150,000 in the last year.

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Annual RMD Impact

Notable Events	Year	RMD: No Planning	RMD: Roth Conversion Plan	Impact of Conversions
Husband First RMD	2030	$112,382	$39,462	-$72,920
Both Spouses RMD	2038	$394,960	$209,029	-$185,931
Year After First Death	2044	$478,088	$265,468	-$212,620
Year of Second Death	2054	$749,282	$416,053	-$333,229

The strategy also has a significant impact on reducing the Annual RMD amount. Lower RMDs typically result in lower taxes

This is especially important in years following a spouse's death. The surviving spouse must continue to take RMDs all pre-tax assets, but the taxes due spike as this spouse now must file as single on their tax return.

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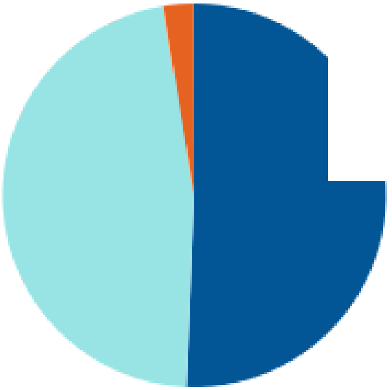
Assets at Last Death

Tax Type Breakdown - Last Year (2054) Base Facts

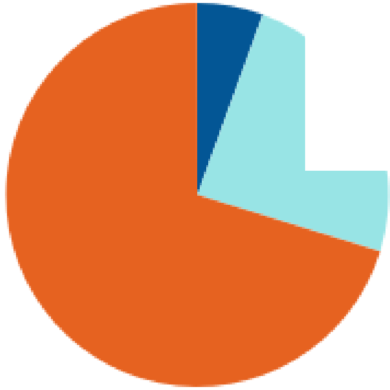


■	Taxable Assets	50.67%
■	Tax-Deferred Assets	46.72%
■	Tax-Free Assets	2.62%

Details - 2054

Account	$ Value	% Value
Taxable Assets	$9,066,572	50.67%
Tax-Deferred Assets	$8,360,333	46.72%
Tax-Free Assets	$467,978	2.62%
Total Portfolio Assets	**$17,894,883**	**100.00%**

Tax Type Breakdown - Last Year (2054) Roth Conversion Strategy



■	Taxable Assets	5.57%
■	Tax-Deferred Assets	24.18%
■	Tax-Free Assets	70.25%

Details - 2054

Account	$ Value	% Value
Taxable Assets	$1,069,576	5.57%
Tax-Deferred Assets	$4,642,238	24.18%
Tax-Free Assets	$13,485,794	70.25%
Total Portfolio Assets	**$19,197,608**	**100.00%**

For many clients, paying taxes during their retirement so their kids can have a greater tax-free inheritance is usually a primary driver for why we do Roth conversions. What we find is that maximizing tax brackets and lower their taxes during retirement often leads to more assets and a bi-product is that assets pass to the next generation more efficiently. We refer to this concept as the ability to maximize "family wealth" and often highlight this benefit with a number of our clients.

With the passing of the Secure Act in December of 2019, Non-spouse beneficiaries can no longer stretch Inherited IRA RMDs over their lifetime. Rather, they have 10 years to liquidate the account and can distribute whatever amount they want at their discretion. As a result, heirs that receive assets can enjoy 10 years of additional tax-free growth within the inherited Roth IRA, making it more efficient than having to spread out Traditional Inherited IRA distributions over that 10-year period in order to balance the tax impacts overtime.

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Thank You!

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