The Light

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ROTH IRA—A Versatile Investment Tool

By Tim Rowsey, CPA, Investment Advisor Rep.

In 1997 when Congress passed the Tax Reform Act and included the creation of the Roth IRA, they may not have realized what a powerful investment tool they were creating. We see many ways Roths are being used: transferring vast amounts of wealth tax free to another generation, assisting in planning for and paying for college, or simply planning for an individual's own retirement. We are going to focus this quarter on the great potential uses for the Roth IRA. First, it might be helpful to review the basics about a Roth IRA.

One of the most basic elements of the Roth IRA is that contributions into a Roth are made with after-tax dollars. There is no tax deduction for contributing. The huge potential benefit, however, is that all future growth is tax free. In order to be eligible for contributions to a Roth, an individual must have "earned" income. Typically this is in the form of salary or profits from a small business. In addition, married individuals must file a joint return and have income less than $181,000 or there is a phase-out of the amount that can be contributed. If these criteria are met, a contribution may be made of up to $5,500 (if earned income is at least that much), or $6,500 for people age 50 or over.

Another unique feature of Roth IRAs is that there is no required minimum distribution that starts at age 70 ½ as there is for regular IRAs. In addition, if an individual has earned income, he can continue to contribute to a ROTH even after age 70 ½.

Until several years ago there was an income limitation on converting regular IRAs to Roths; however, this has been eliminated. Today anyone can convert an IRA to a Roth as long as they are willing to pay the tax on the conversion. Contributions to a Roth can be made during the year and up until April 15th of the following year for (continued on page 2)

ROTH IRA—A Gift to a Future Generation

By Tim Rowsey, CPA/ Investment Advisor Rep.

The power of the tax free growth of a Roth IRA is compounded even more when there is an extended period of time for the growth to continue. This can happened if a grandparent or parent leaves a Roth IRA to a child or grandchild. If a Roth IRA is inherited by a non-spouse, the person inheriting may place it in an Inherited Roth IRA. They can then access any of the funds tax free, but they are required to take out at least a RMD (Required Minimum Distribution) each year based on their life expectancy. An example may help illustrate the power of time along with tax free growth. For this example we are assuming an 8% growth rate.

Molly Smith is 70 years old and has a Roth IRA with a balance of $100,000. She has a 16 year old granddaughter, Mary, whom she has named beneficiary of her Roth IRA. Molly is not required to take any RMDs from her Roth during her lifetime and just lets the account grow until her death at age 80. Mary inherits the Roth when she is 26. At that time Mary's life expectancy according to the IRS table is 57.2 years. Her first year RMD is $3,774 and it grows each year. If she keeps taking only the RMD, the amounts will be $37,081 at age 55, $55,292 at age 60, and $82,750 at age 65. Over her total lifetime, if she continues to only take the RMD, she will withdraw about $4.4 million dollars all tax free! This is all from the original $100,000 Roth from her grandmother.

In a similar example, Molly Smith at age 70, with the identical Roth IRA, decides to leave her Roth to her son Richard, who is 45. When Molly passes at 80 and Richard is 55 his RMD factor is 29.6. His initial RMD is $7,294, at age 60 is $10,867, and at age 65 is $16,244. Over his lifetime he would withdraw $905,106 tax free.

Each beneficiary has total control of his Roth IRA once it is inherited, and he could immediately (continued on page 2)

Versatile Tool (continued from page 1)

the prior tax year.

Another attribute of the Roth IRA is that the original contribution amounts can be withdrawn tax free at any time. The earnings of the Roth must remain in the account until age 59 ½, and for at least five years before they can be withdrawn tax free. There is also a 10% penalty for withdrawing before age 59 ½. There are, however, a few exceptions to this rule. In addition to the original contribution, earnings up to $10,000 may be withdrawn with no tax or penalty for the purchase of a first time home, and earnings may be withdrawn without the 10% penalty to pay for college.

You may contribute to a Roth even if you participate in your employer's retirement plan. A spouse with no earned income may also contribute to a Roth based on the spouse's earned income.

These various rules can be combined for some amazing growth and planning opportunities. We will explore these in some of the other articles in this issue. ■

A Gift (continued from page 1)

withdraw the current balance tax free if he chooses. However, by taking only the RMD amount, he allows the funds to continue to grow tax free for an extended period of time and maximize the benefit of the tax free growth.

If an individual does not have a Roth IRA, but has a traditional IRA, that IRA could be converted to a Roth if she is willing to pay tax on the conversion. While there is a tax cost today, a beneficiary could receive considerable future tax free benefits. In addition, conversion of a traditional IRA to a Roth, stops the Required Minimum Distributions that must take place after age 70 ½ in a traditional IRA.

If you are interested in looking at your individual situation and analyzing whether or not a conversion to a Roth might help meet your goals, please give us a call to set up a meeting to discuss your options. ■

ROTH IRA—College Planning

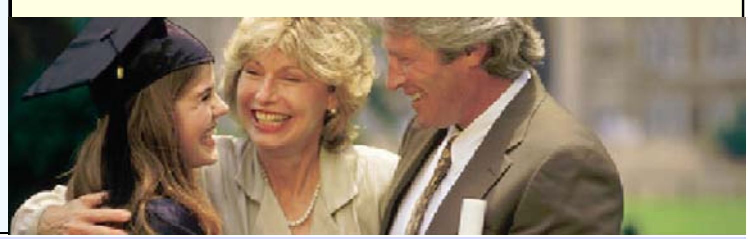
By Tim Rowsey, CPA, Investment Advisor Representative

A Roth IRA may also be used as a vehicle for saving for college. The ability to withdraw the original principal from a Roth, combined with the tax free growth, can make for some interesting planning possibilities. The growth can also be accessed but it would be taxable. The 10% early withdrawal penalty can be avoided if the funds are used for qualified educational expenses. Once again, an example may help illustrate. An 8% growth rate is used in this example.

Glenn and Maggie are a newly married couple who are expecting their first child. They are both 24 years old. They currently both work and are funding the minimum into their company 401(k) plans so that they can get the company match. They would like to begin saving for their new daughter's college expenses, and are also concerned about more funding for their own retirement. They decide to open a Roth IRA and are able to fund $5,500 into it for the first four years. They have a second child, and in the fifth year they are able to increase their Roth funding to $11,000 total, $5,500 in each parent's account. They continue to fund the maximum Roth contribution until the year they turn 42 and their daughter turns 18 and heads off to college. That year they stop funding their Roths.

At this point they have made total contributions into their Roths of $187,000 over 18 years. Their Roths have grown to a combined total of $407,000. For the next six years they withdraw between $30,000 and $32,000 per year to help cover college expenses until they have taken out the entire $187,000 that they originally funded. They then take out $40,000 more for the next two years and avoid penalty since they are using these funds to pay for college as their second child completes his or her degree. If they don't add or withdraw any further funds, their combined Roth values at age 65 will be approximately $1,280,000. If they would go back to adding $11,000 to their Roths each year after their children complete college, and continue to do so until age 65, then their Roth values at age 65 would be approximately $1,600,000.

This strategy of potentially using a Roth for college and/or retirement can be very effective, especially if the parents start early in the process and the growth of investments is good. If you are interested in discussing this strategy further, please give us a call. ■



Market Recap

How the major indices performed in the 1st Quarter 2014

DOW JONES INDUSTRIAL AVERAGE			
1st Quarter return	-0.7%	YTD return	-0.7%
S & P 500 COMPOSITE			
1st Quarter return	1.3%	YTD return	1.3%
RUSSELL 2000			
1st Quarter return	0.8%	YTD return	0.8%
BARCLAYS AGGREGATE BOND			
1st Quarter return	1.8%	YTD return	1.8%

ROTH IRA—Time and Growth

By Tim Rowsey, CPA, Investment Advisor Representative

One of the huge benefits of the Roth IRA is tax free growth. This is most advantageous if there is a long period of time for the growth to take place. For this reason, it is beneficial for an individual to start funding a Roth as early in his or her life as possible. Most young people don't have earned income until they get a part-time job in their teens. At this time the last thing they are probably thinking of is saving for retirement. We have seen examples of a parent or grandparent stepping in to help jump start a Roth. Here is an example. Once again we are using an 8% growth rate.

Chad just turned 16 and got a part-time job. His grandparents have told him that for every dollar of earned income he has, they will put that amount into a Roth IRA for him. Over the next few years he makes between $800 and $3,600 per year at part-time jobs and then heads to college. His grandparents match his earned income in Roth contributions for him. During his college years he works a summer job and makes more than the $5,500 Roth contribution limit, so his grandparents max out the funding of his Roth. When he graduates and begins a full-time job, his grandparents also fund the $5,500 limit into his Roth for his first four years of full-time employment and then they stop all funding.

Over this ten year time period a total of $45,300 has been put into Chad's Roth IRA. Chad never adds any more money into his Roth, but also never withdraws any funds. When he turns 65 he will have approximately $1.4 million in his Roth. This can be withdrawn tax-free any time after Chad turns 59 ½, and can provide a wonderful tax-free income stream for his lifetime.

If Chad had withdrawn $15,000 for a down payment for a house at age 30, and also an additional $30,300 at age 44 to help pay for his own child's college, he would have just been pulling some of the original contribution back out of the Roth. These withdrawals would all be tax and penalty-free even though he would not yet be 59 ½. Even with these withdrawals, Chad's Roth IRA value at age 65 would still be over $1 million.

The gift of his grandparents to fund his Roth is compounded greatly by the growth of the investments and the element of time. If you would like to discuss how a Roth IRA might work to help you build value, call for a consultation. ■

Market Update

By Tim Rowsey, CPA
Investment Advisor Rep.

The first quarter of 2014 got off to a rocky start for equities.
After a strong 2013, the Dow Jones Industrial average dropped almost 7% by February 3rd. It slowly recovered most of that decline through the rest of the quarter and ended the quarter with a loss of 0.8%. The unusually cold winter weather was even a contributor to the decline. The broader market as represented by the S & P 500 faired a little better ending the quarter with a gain of 1.3%. The transition to Janet Yellen as the new Federal Reserve chief seemed to go smoothly. The Fed continued their taper plan and bonds have settled. Smaller cap stocks as represented by the Russell 2000 also showed a small gain for the quarter with an increase of 0.8%.

Bonds had a strong quarter.
The Barclays aggregate Bond index increased by 1.8% for the quarter. PIMCO's flagship Total Return bond fund also showed a gain for the quarter with a 1.3% gain.

Market conditions look positive as we head into spring.
While the first quarter was choppy with many significant ups and downs, the overall economic climate appears to be good. There are positive signs in strong corporate earnings, continued low interest rates and overall growth in the economy. These factors could continue to drive growth in the markets. As always, we believe that a balanced exposure to bonds and equities is a prudent choice for most investors. ■

SPRING is finally here!

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Subscriptions are free. Paperless delivery is available upon request. Call Cheri Smeltzer at 419-496-0016 or email her at csmeltzer@lightwealth.com to be added to our list or to change your subscription.

At Lighthouse Wealth Management, we want to help our clients reach their financial goals and have plenty of peace of mind along the way. We offer a holistic, full service approach. We start by getting to know and understand our clients' wants, needs, and dreams. We partner with them to help them navigate all the financial challenges of life. We can help answer financial questions, help with tax planning and preparation, and guide our clients with their investments to help them reach their ultimate financial goals.

Just as a Lighthouse provides guidance to passing ships, Lighthouse Wealth Management provides our clients with solid, trusted, conscientious guidance to help them navigate risks and lead them to their financial goals.

Lighthouse Wealth Management believes in giving back. We give 10% of our profits to charities, including CURE, International. **www.cure.org**

Our Services

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Helping individuals navigate their financial lives.