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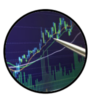
Why The Roth IRA May Be Big Winner In 2016 Presidential Election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With the 2016 presidential election behind us, we can all start thinking about what this country will look like under President Donald Trump. Notwithstanding all the pre-election campaign rhetoric about immigration, foreign policy, etc., one thing we are quite certain about is that President-Elect Trump is serious about reducing personal income and corporate tax rates across the board. Both President-Elect Trump and House Speaker Ryan have put forth proposed tax reform plans and lawmakers will likely consider both plans when coming up with future American tax policy.

personal income tax brackets tax brackets from seven down to three. Under the Trump plan, there would be three income tax rate brackets, 12%, 25%, and a top rate of 33%, which is lower than the current highest income tax rate of 39.6%. Capital gain tax rates will remain much as they are, with a top tax rate of 20% under the Trump plan. However, the biggest change under the Trump tax plan from the current tax system, is that business income of a taxpayer will be taxed at 15%. Whereas, the Trump and Ryan plan would make it difficult for individuals to benefit from specific deductions, as both plans raise the standard deduction limit.

Overall we should expect that a Trump Presidency will usher in lower personal and business taxes for most Americans. So what does that mean for your retirement account contributions? In general, when an individual is deciding to make IRA or pension contributions, such as to an employer 401(k) plan, the biggest question is generally whether contributions should be made in pre-tax or Roth.

A pre-tax IRA or 401(k) plan contribution provides the individual making the contribution with a current income tax deduction for the amount of the contribution, but the retirement account holder would ultimately be liable for income tax on any income taken out of the retirement account, with a 10% early distribution penalty if done prior to the age of 591/2. Whereas, a Roth IRA or Roth 401(k) plan contribution is made with afteris able to keep the Roth account opened at least five years and wait until reaching the age of 591/2, all Roth IRA or 401(k) funds can be taken out tax-free. The Roth IRA does have an income limitation threshold, which is $194,000 for married couples filing jointly, but a backdoor way does exist for those individuals to still make Roth IRA contributions.

When a tax professional helps a client decide between making a pre-tax or Roth IRA or 401(k) plan contribution, one of the primary items the advisor will look at is the financial impact a deduction will have on the taxpayer’s income tax liability. The general thinking goes that if there is less tax to pay then taking a tax deduction would have less of a financial impact than in a higher tax environment, For example, if an individual earns $40,000 in annual income, under the Trump tax plan he or she would be subject to $4800 in taxes, versus a 25% income tax rate in 2016.

Sure, the IRA contribution deduction would be beneficial in reducing any income tax due, but such a deduction would likely have a lower financial impact on the taxpayer than with higher tax rates likely making the Roth contribution a more attractive option for many taxpayers. The Trump victory and a low tax income policy will likely lead more tax advisors to consider and recommend the Roth IRA or Roth 401(k) contribution over a pre-tax retirement contribution. Lower tax rates generally means income tax deductions carry less value. Weighing the financial loss popular choice for more Americans than ever before.

Some people will argue that lower tax rates means that saving money in a tax free retirement account, such as a Roth, will have less value since there would be less tax due on a distribution and the individual would likely be in a lower tax bracket at the retirement age of distribution. This argument ignores the fact that a Trump presidency will likely bring tax rates to historical lows, which for many Americans looking to retire in the next ten or twenty years, will likely mean a future with higher taxes.

It is unclear what type of impact a Trump presidency will have on the country and the entire world, but a Trump tax plan based on lower domestic income tax rates should make Roth contributions the big winner for many U.S. retirement account holders.

Adam Bergman is a tax partner with the IRA Financial Group and founder of the Bergman

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