Investment Solutions, Inc.

The Long Run Newsletter

Volume 18 Issue 2 | February 2025

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Can I Create a Roth if I'm Over the Income Limit?

Yes, you might be able to create a Roth individual retirement account (IRA) if you're over the income limit. This strategy involves converting a traditional IRA to a Roth IRA.

The idea, often referred to as a "back door Roth conversion," is sometimes used by individuals whose incomes exceed the current limits for direct Roth IRA contributions.

Keep in mind that there are pros and cons associated with a back door Roth conversion, including tax consequences. This article provides a high-level overview that should be used for informational purposes only. Tax, legal, and accounting professionals can provide more detailed insights about the tax implications of this strategy.

Why Consider a Roth IRA?

Think of a Roth IRA as one piece of your retirement income puzzle. When you peek behind the curtain, here are some of the features that some retirement-minded people consider important:

- Unlike their traditional IRA cousins, required minimum distributions do not apply to original owners of Roth IRAs. That can play a role as you create an estate strategy.
- When retirement rolls around. Roth IRAs can add flexibility to your income strategy since you've already paid taxes on that money.
- To qualify for the tax-free and penalty-free withdrawal of earnings. Roth IRA distributions must meet a 5-year holding requirement and occur after age 59½. Tax-free and penalty-free withdrawals can also be made under other circumstances, such as the owner's death. The original Roth IRA owner is not required to make minimum annual withdrawals.

How Does a Back Door Roth Conversion Work?

Let's break down this strategy step by step.

First, you'll need a traditional IRA. For 2025, you can contribute up to $7,000 or $8,000 if you're 50 or older. Your contributions may be tax deductible, depending on your situation, but keep in mind that income limits and other requirements may affect your eligibility.

If you move ahead with a traditional IRA, remember that once you reach the age of 73, you must begin taking the required minimum distributions from a traditional IRA in most circumstances. Withdrawals from traditional IRAs are taxed as ordinary income and, if made before age 59½, may be subject to a 10% federal income tax penalty.

Second, timing matters. One strategy suggests that individuals who convert their traditional IRAs to Roth IRAs sooner rather than later may be more effective in managing their taxes.

Pro tip: The IRS looks at all your traditional IRAs together when calculating taxes on your conversion. This "pro rata rule" means that having existing traditional, SEP-IRAs, or SIMPLE IRAs could affect your tax bill. Your tax, legal, and accounting professionals can provide more detailed insights about how the rule applies in your situation.

SIMPLE IRAs and SEP-IRAs are taxed as ordinary income and follow the same distribution rules and penalties as those of traditional IRAs.

So Much to Consider

Owning a Roth IRA can provide flexibility when creating a retirement strategy and managing an estate. However, similar to any idea, it isn't one-size-fits-all. Many factors should be considered, including your tax situation, existing IRA balances, and long-term objectives.

Citations:

1.IRS.gov, November 12, 2024

Assess Life Insurance Needs

If your family relies on your income, it's critical to consider having enough life insurance to provide for them after you pass away. But too often, life insurance is an overlooked aspect of personal finances.

In fact, according to a 2023 study conducted by Life Happens and LIMRA, which closely follows life insurance trends, nearly 50 percent of Americans say that they have no life insurance coverage at all, even though 39% say they intend to obtain life insurance coverage within the next year.[1]

Role of Life Insurance

Realizing the role life insurance can play in your family's finances is an important first step. A critical second step is determining how much life insurance you may need.

Several factors will affect the cost and availability of life insurance, including age, health, and the type and amount of insurance purchased. Life insurance policies have expenses, including mortality and other charges. If a policy is surrendered prematurely, the policyholder also may pay surrender charges and have income tax implications. You should consider determining whether you are insurable before implementing a strategy involving life insurance. Any guarantees associated with a policy are dependent on the ability of the issuing insurance company to continue making claim payments.

Rule of Thumb

One widely followed rule of thumb for estimating a person's insurance needs is based on income. One broad guide suggests a person may need a life insurance policy valued at five times their annual income. Others recommend up to ten times one's annual income.

If you are looking for a more accurate estimate, consider completing a "DNA test." A DNA test, or Detailed Needs Analysis, takes into account a wide range of financial commitments to help better estimate insurance needs.

The first step is to add up needs and obligations.

Short-term Needs

Which funds will need to be available for final expenses? These may include the costs of a funeral, final medical bills, and any outstanding debts, such as credit cards or personal loans. How much to make available for short-term needs will depend on your individual situation.

Long-term Needs

How much will it cost to maintain your family's standard of living? How much is spent on necessities, like housing, food, and clothing? Also, consider factoring in expenses, such as travel and entertainment. Ask yourself, "what would it cost per year to maintain this current lifestyle?"

New Obligations

What additional expenses may arise in the future? What family considerations will need to be addressed, especially if there are young children? Will aging parents need some kind of support? How about college costs? Factoring in potential new obligations allows for a more accurate picture of ongoing financial needs.

Next, subtract all current assets available.

Liquid Assets

Any assets that can be redeemed quickly and for a predictable price are considered liquid. Generally, houses and cars are not considered liquid assets since time may be required to sell them. Also, remember that selling a home may adjust a family's current standard of living.

Needs and obligations - minus liquid assets - can help you get a better idea of the amount of life insurance coverage you may need. While this exercise is a good start to understanding your insurance needs, a more detailed review may be necessary to better assess your situation.

Citations:

1. LIMRA.com, 2023

For Your Information

- We are open from 9:00 a.m. – 5:00 p.m. Monday through Thursday, and 9:00 a.m. – noon on Fridays.
- We are open during the lunch hour.
- We have a mail drop on the far north door of the building. If you have any information you would like to deliver after normal business hours please drop it off there.
- We are in the process of upgrading our phone system in January. When the upgrade is completed you will be notified of the following new numbers when you call our office:

  Calling Long & Associates, P. C. 405-663-2918 will be upgraded to 405-776-0600
  Calling Investment Solutions, Inc. 405-663-2916 will be upgraded to 405-776-0900
  Fax Number 405-663-2126 will be upgraded to 405-776-0700

Make February your stepping stone to success.

"New month, new intentions, new goals, new love, new light, and new beginnings."
— April Mae Monterrosa

Long & Associates, P.C.
Assisting you with accounting, tax preparation, and tax planning

Investment Solutions, Inc.
Advising you and creating strategies for investment and retirement planning

Benefit Resource Group, Inc.
Handling employee benefits and other business services

Whether you need one of these services, or all three, you'll work with the same professional, knowledgeable staff with our Comprehensive Solutions Program

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