Personal Finance

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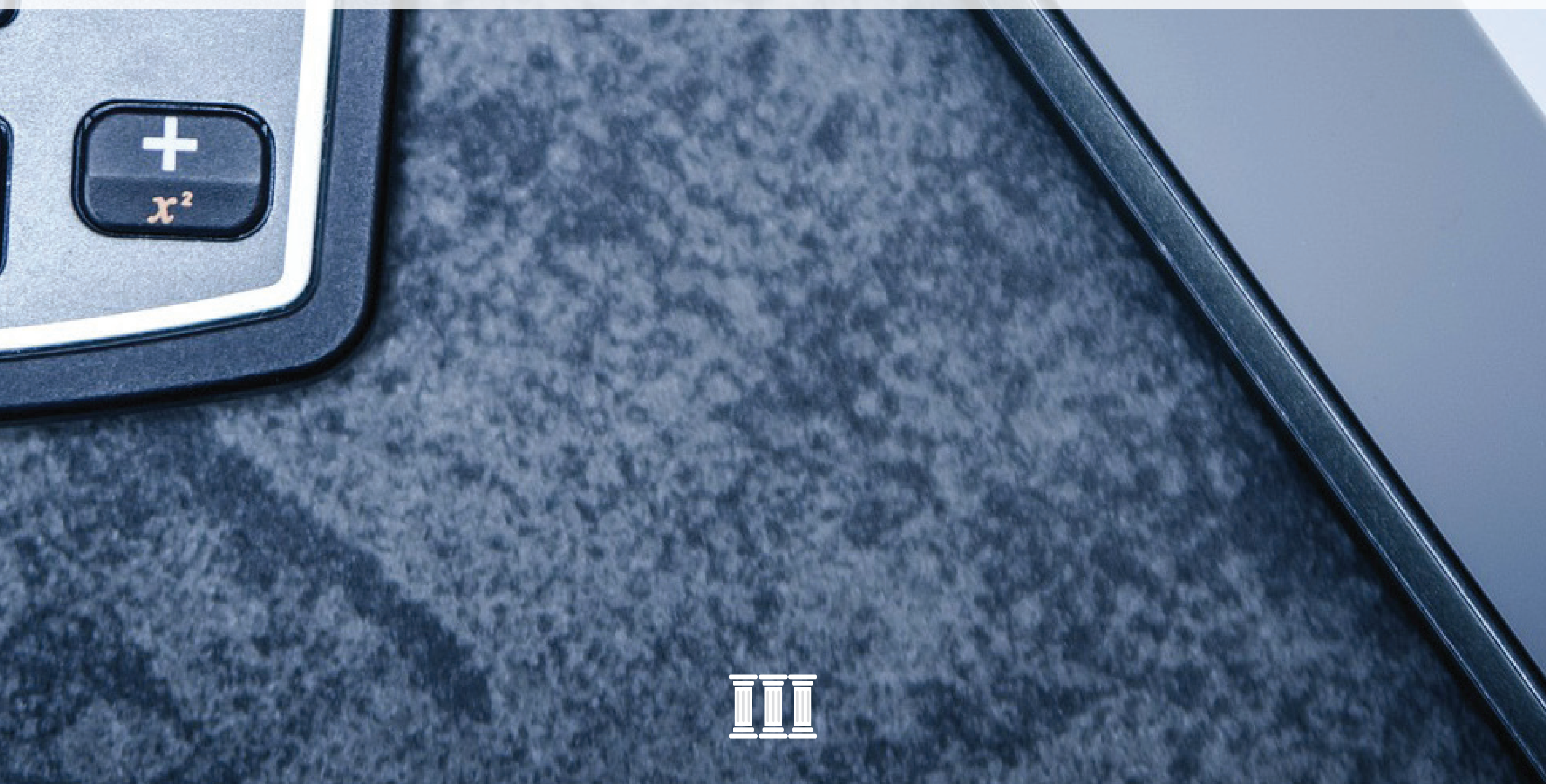

# The Biggest Legal Loophole in the IRS Tax Code!

*By Jim Fink, CFA*

There are very few guarantees in life, but there is one guarantee that I can make to you with 100% conviction: Your taxes will be going up in the future.

There is just no other way around it. Government spending is out of control and the federal budget deficit continues to widen. The entitlements programs are about to put a huge drain on government finances. Our military continues to engage in costly conflicts around the world. And foreign investments in the U.S. are slowly drying up.

The current system is simply not sustainable. In fact, this year alone, the U.S. will spend approximately $27 trillion just to pay the interest on our debt. Unfortunately, there are no easy answers to these dilemmas. And just about any real solution is going to involve tax increases.

Especially if you are in the upper-income brackets or if you have investment accounts, your wealth will almost certainly be targeted. But wouldn't it be nice if you could shelter your investments and your retirement income from taxation?

Well, you can… and I'll show you how in this brief report.

## The Single Best Gift Congress Ever Gave the American Taxpayer

In 1997, Congress passed the Taxpayer Relief Act. Within this act was legislation that created a new type of retirement savings account for Americans. It's called the Roth IRA, and it's named after Senator William Roth of Delaware, who introduced the legislation.

Roth IRAs make the most sense if you expect your tax rate to be higher during retirement than your current rate. They appeal to wealthier taxpayers who want to leave assets to their heirs tax-free. Ed Slott, one of America's leading retirement plan experts, has called the Roth IRA, "the single best gift that Congress ever presented to the American taxpayer."

So why is a Roth IRA so powerful and how is it different than a 401(k) or traditional IRA?

The biggest difference between these accounts is when you pay taxes on your money. With a traditional IRA or 401(k) plan, you contribute pre-tax dollars. That means you don't pay any taxes on the money you contribute. This deduction helps lower your current tax burden.

Your principal then grows tax-free. However, the withdrawals you make at retirement (you are eligible to withdraw funds after age 59½) are subject to income tax. If your investments grow to a substantial size (as you hope they will), you may have substantial tax implications when you finally go to withdraw those funds!

Contributions to a Roth IRA, on the other hand, are paid with after-tax dollars. So, your Roth contributions will not reduce your current taxes. But after that, you're done! That means, your principal grows tax-free and you pay no taxes upon withdrawal (as long as you are 59½ and the account has been open at least five years). No matter how large your account has grown or how much annual income you may derive from it—you pay no taxes at all in retirement!

This can be a very powerful advantage, especially if you expect your retirement account to accumulate significant gains over the years. Whether your account is worth $2,000 or $2,000,000, the gains and future income are tax-free for life!

But that's not the only important difference between these types of accounts…

With a traditional IRA or 401(k), if you were to withdraw funds from your account before you are eligible, you would be required to pay taxes and penalties on the amount withdrawn. You don't want to access these funds until retirement anyway, but if there was an emergency and you needed to get your money, this can be a drawback.

With a Roth IRA, on the other hand, you have already paid taxes on your original contribution. Therefore you can access these funds at any time and for any reason, with no taxes or penalty due. Keep in mind, this does not apply to your earnings. You are not eligible to access those funds (without paying tax and penalty) until age 59½ and the account has been open for five years.

So, let's say you contributed $25,000 to your Roth IRA and the account has appreciated to $40,000. You can withdraw up to $25,000 from that account with no implications. Anything above that amount would be subject to tax and penalties.

This is another powerful advantage of a Roth IRA. In a pinch, you can access the funds you contributed, without incurring a liability!

And there is one other major difference you may be interested in. With a traditional IRA or 401(k) plan the government requires you to begin taking withdrawals from your account by age 70½. It doesn't matter whether you need the money or not.

However, with a Roth IRA, you never have to touch that money if you don't want to. That means if you want to let it continue compounding and then pass those funds to your beneficiaries, they could inherit the account 100% tax-free!

The Roth IRA is one of the simplest and most effective tax shelters available for individuals. In fact, some experts have called it the biggest tax loophole in the entire Internal Revenue Code. Nearly everyone qualifies to open a Roth IRA, and if you have not already, I suggest you do.

There are two ways to go about it. It's very easy to set up a new account with any broker or you could convert an existing 401(k) or IRA plan. Keep in mind that you are not required to convert the entire amount. You can convert any amount you wish.

However, please note that there could be significant tax consequences to converting an existing retirement account to Roth status. Therefore, you may wish to consult your financial advisor or accountant before making that decision.

The benefit of tax-free gains and tax-free income for life can be huge. In most cases, it's well worth the up-front cost to convert. And you may especially wish to consider this if your existing retirement account has experienced losses. This could reduce or possibly even eliminate the tax consequences of converting.

I strongly recommend that you operate any actively managed account (one where you are frequently opening and closing trades) in a tax-advantaged status. That way the tax implications of trading are eliminated and you also won't be tempted to make investment decisions based on tax consequences.

Setting up a new Roth IRA is quick and simple. All you need to do is contact your preferred broker, fill out the form, and fund your account. If you are converting an existing retirement account, it will take longer. So you may wish to set up a new account first, and then roll the funds into that account later.

The second thing you'll want to do is make sure that your Roth IRA account is approved for trading options. Again, this requires a very simple form which can be filled out in just a few minutes.

Be sure to include "income" as part of your investment objectives. And at the very least, you could seek approval to write covered calls. This strategy is very safe (safer than buying a stock outright, in fact) and you should receive approval right away.

If possible, I also suggest you get approval to sell puts in this account. When practiced properly, this is also a very safe strategy, but it generally requires a higher level of authorization.

You will not be able to trade on margin in a retirement account—federal regulations prohibit it. But regulations do not prohibit you from selling "cash-secured" puts in a retirement account. However, some brokerages still do not allow it. So you might have to check with a few different brokers. I have been told that www.interactivebrokers.com allows cash-secured puts in a retirement account (and they also have very low commission rates).

If you are not able to sell puts in your Roth account, don't worry about it. You can accomplish most of the same objectives with covered calls, and you should have no trouble getting clearance for those trades.

In my opinion, everyone who qualifies for a Roth IRA should set one up. Contribute the maximum possible amount. And use the recommendations and options strategies I will provide to you in Personal Finance to generate substantial gains and income for life!

In closing, let me reiterate that I am not a tax expert. My field is investing. There could be significant tax consequences to the decisions you make regarding your retirement accounts. As always, you should consult a qualified tax professional before making any changes to your current retirement account. You can also find more information on Roth IRAs at this IRS website.

To Your Success,

Jim Fink

Jim Fink

IMPORTANT NOTES:

Guidance concerning the stocks highlighted in this report is believed to be accurate and represent our best advice at the time of writing. However, market conditions change constantly and guidance at the time of this writing may not reflect our latest advice. For our current take on any stock in this report, it is vitally important that you check the Portfolio tables on the website and confirm that the stock still earns a buy rating. Furthermore, confirm that the stock trades below our current buy limit. Do not buy any stocks above our recommended buy limits. If a stock's price exceeds our buy limit, wait for a pullback or invest in another Portfolio holding that trades below our buy limit. Any advice in the Portfolio tables, a recent issue of the publication, or our email alerts always trumps older advice in this special report. We reserve the right to substitute special reports as market trends dictate.

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