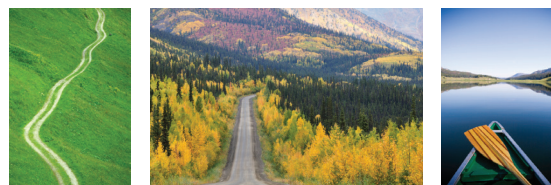


THE NAVIGATOR

A FINANCIAL PLANNING RESOURCE FROM
PEKIN SINGER STRAUSS ASSET MANAGEMENT



We have published this Navigator at this same time each of the past two years in order to highlight the importance of IRAs and to encourage our clients to make their annual IRA contributions prior to the tax filing deadline. Given the vital nature of this topic, we will continue to re-publish this Navigator each year with contribution and deductibility rules updated for the new tax year. We hope that you will find this updated letter to be helpful and informative.

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Individual Retirement Accounts, or IRAs, are one of the most powerful savings and investment tools currently available to investors. An IRA allows assets to grow unencumbered by the drag of taxes, and IRA contributions may be tax-deductible in some cases. This article discusses the key role that an IRA should play in most investors' savings and investing strategies and examines the primary characteristics pertaining to each of the four most common types of IRAs.

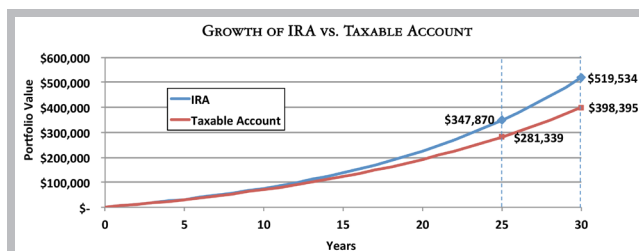
THE VITAL IMPORTANCE OF IRAS

BY MATTHEW BLUME, CFA

Unless you have unusually dutiful and wealthy children who intend to take care of you when you retire, it would be remiss of you not to take advantage of investing in an individual retirement account (IRA), regardless of your income level. By maximizing contributions to an IRA, these accounts help to reduce potential tax liabilities today and allow the assets to grow tax-deferred for many years. Uncle Sam only allows investors to contribute a limited amount to an IRA each year, and there is no "doubling down" the following year if an opportunity to contribute is missed. The tax code allows older savers to make additional "catch-up" contributions, but even this provision only allows for an incremental \$1,000 per year after age 50.

As the maxim goes, "time in the market is more important than timing the market," thanks to the powerful impact of compound returns. To illustrate the power of compounding over time, let us provide an example. An investor contributes the maximum allowed (\$5,500) in an IRA this year; assuming a 7% annual return compounded over 25 years, the original \$5,500 contribution would grow to \$29,850. After 30 years, the original contribution would have grown to \$41,867. The investor would earn an additional \$12,017 (or more than twice the original investment!) just by investing for an incremental five years.

Better yet, assuming the investor were to save \$5,500 in a retirement account every year for the next 25 years, starting this year (and again assuming a 7% annual return), the retirement account would increase to \$347,870 at the end of that period. After 30 years, the retirement account would increase to \$519,534. That represents a nearly 50% difference due entirely to having saved for an additional five years! Furthermore, for an investor in the highest federal income tax bracket and who lives in the state of Illinois, for example (Illinois residents are currently subject to a 4.95% state income tax rate), the value of an IRA after 30 years could be more than 30% greater than a taxable account utilizing the same saving and investing strategy. The chart below provides a graphical representation of how an IRA and a taxable account might grow over time for such an investor, assuming a 7% annual rate of return and annual contributions of \$5,500. For the sake of simplicity, we have not adjusted these numbers for inflation, but they nonetheless provide a clear illustration of the power of "time in the market," as well as the potential benefits of investing in a tax-deferred investment vehicle.



Source: Pekin Singer Strauss | The returns assumed in this illustration are not guaranteed, and each investor's actual experience may be different.



Because investment gains in IRA accounts are tax-deferred or tax-exempt, IRAs can provide investors with the flexibility to change investments whenever necessary without creating a taxable gain. There are four main variants of IRAs that are available to investors, and each type has its advantages and drawbacks, depending on an investor's age, income-tax bracket, distribution needs, etc. The balance of this article will focus on the reasons that a person might utilize one type of IRA over another, as well as the rules and regulations governing each type. Of course, the ultimate decision of which IRA is the appropriate vehicle for you to use should be made in consultation with your portfolio manager.

TRADITIONAL IRA

An investor is eligible to invest in a traditional IRA regardless of income level. The primary benefit of a traditional IRA account is that there are no income taxes on investment earnings until withdrawals are made. Investors are allowed to start withdrawing money from a traditional IRA at age 59½ without a penalty, and these withdrawals become mandatory at age 70½. Also, at age 70½, no additional contributions may be made to the account, and a portion of any withdrawals are taxable at ordinary income tax rates. If money is withdrawn prior to age 59½, a 10% Federal penalty tax will be applied to the withdrawal in addition to regular income taxes, which will apply to all earnings and any amounts that were originally contributed on a tax-deductible basis. Mandatory withdrawals, called Required Minimum Distributions, or RMDs, are calculated according to the investor's life expectancy and account size and grow over time as a percentage of the portfolio.

A traditional IRA lets you put away as much as \$5,500 annually, as of tax year 2017, or \$6,500 if you are age 50 or older (these limits will remain unchanged for tax year 2018). The tax deductibility of contributions is dependent on your income and whether or not you have an employer-sponsored retirement plan, such as a 401(k), but anyone who is less than 70½ years old can make a traditional IRA contribution. To deduct a traditional IRA contribution from taxable income, an investor's Modified Adjusted Gross Income, or MAGI, must be less than IRS income limits; these limits are set by the IRS each year and depend upon a taxpayer's filing status. Investors whose incomes exceed these limits may still be eligible for a partial deduction, but these deductions are phased out as income approaches an upper limit set by the IRS. The table below outlines the contribution and deduction limits for traditional IRAs for tax year 2017.

Please note that *even if you do not qualify for a tax deduction*, it may still make sense for you to contribute to an IRA because of the attractive tax shield that an IRA creates for a portion of your investment income.

Traditional IRA Contribution and Deduction Limits			
	Tax Filing Status	Modified Adjusted Gross Income	Allowable Deduction
Filers Covered by Employer-Sponsored Plan	Single or head of household	\$63,000 or less	Full
		More than \$63,000 but less than \$73,000	Partial
		\$73,000 or more	None
	Married filing jointly or qualifying widow(er)	\$101,000 or less	Full
		More than \$101,000 but less than \$121,000	Partial
		\$121,000 or more	None
Married filing separately	Less than \$10,000	Partial	
	\$10,000 or more	None	
Filers Not Covered by Employer-Sponsored Plan	Single, head of household, or married filing jointly and spouse is not covered by employer-sponsored plan	No limit	Full
	Married filing jointly and spouse is covered by employer-sponsored plan	\$189,000 or less	Full
		More than \$189,000 but less than \$199,000	Partial
		\$199,000 or more	None
	Married filing separately and spouse is covered by employer-sponsored plan	Less than \$10,000	Partial
		\$10,000 or more	None

* If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "single" filing status. Source: [IRS](#)



ROTH IRA

While traditional IRA earnings compound on a *tax-deferred* basis, Roth IRA earnings compound on a *tax-exempt* basis. Unlike a traditional IRA, there are no taxes on Roth IRA withdrawals when you withdraw money during retirement. There are also no age limits on eligibility for a Roth IRA, and, unless the laws change, there are no Required Minimum Distributions. However, investors who wish to open and/or contribute to a Roth IRA must meet certain income requirements, which depend on tax filing status. Because of the tax treatment differential, a Roth IRA typically is a better retirement vehicle than a traditional IRA, assuming that an investor meets the requirements to contribute to a Roth IRA.

Contribution limits for Roth IRAs are the same as for traditional IRAs (currently \$5,500 with a \$1,000 incremental catch-up for people older than 50; the same limits will apply for tax year 2018), and investors can contribute the maximum amount to a Roth IRA, regardless of whether or not they participate in employer-sponsored retirement plans. As with a traditional IRA, withdrawals can be made from a Roth IRA without penalty after age 59½, provided that the account has been open for more than five years. Failing to meet these requirements may result in a penalty tax, ordinary income tax, or both being applied to the withdrawal. Tax year 2017 contribution limits for Roth IRAs are shown in the table set forth below.

Roth IRA Contribution Limits		
	Modified Adjusted Gross Income	Allowable Contribution
Married filing jointly of qualifying widow(er)	<\$189,000	\$5,500 (\$6,500 if 50 or older)
	>\$189,000 but <\$199,000	Partial amount
	>\$199,000	None
Married filing separately and lived with spouse at some point during the year	< \$10,000	Partial amount
	> \$10,000	None
Single, head of household, or married filing separately and did not live with spouse at any time during the year	< \$120,000	\$5,500 (\$6,500 if 50 or older)
	> \$120,000 but < \$135,000	Partial amount
	> \$135,000	None

Source: [IRS](#)

While the Roth IRA contribution limits listed above prevent high income earners from making direct contributions to a Roth IRA account, anyone can convert a traditional IRA into a Roth IRA, regardless of income level. Some higher income investors rely on this conversion option every year, by making an annual contribution to their traditional IRA and then converting those traditional IRA assets to Roth IRA assets. It should be noted that some Roth IRA conversions may be taxable events if the assets being converted have not yet been taxed as ordinary income.

SEP IRA

A Simplified Employee Pension (SEP IRA) may be the best retirement account option for sole proprietors and small businesses with up to 100 employees. Employers can contribute as much as 20% of self-employment income each year, and this limit rises to 25% if the company is incorporated. Contributions are capped at \$54,000 for tax year 2017 and will increase to \$55,000 in 2018 (assuming this falls below the 20% and 25% limits). As with most other non-Roth retirement accounts, investment returns grow tax-deferred until money is withdrawn.

Contributions to SEP IRA accounts can be made by both the employer and by the employee. Contributions made by the employer on an employee's behalf must be the same percentage for each employee annually. These contributions are tax-deductible as a business expense and are not mandatory every year. However, employers must decide each year whether or not to fund their accounts, and if they make contributions for themselves, they must also make contributions for all eligible employees.

In general, any employee who has worked for the same employer in at least three of the past five years should be allowed to participate in a SEP IRA, provided that he or she is at least 21 years of age and earns at least \$550 annually. SEP IRAs carry the same rules as traditional IRAs when it comes to employee contributions. Employees can contribute up to \$5,500 or \$6,500 if they are age 50 or older for tax year 2017 (this same limit will apply in tax year 2018). Sole proprietors are subject to the (higher) employer limits rather than the employee limits.

Any withdrawals that are made from a SEP IRA prior to age 59½ are subject to ordinary income tax, as well as a 10% penalty. Withdrawals become mandatory after age 70½, at which point all withdrawals are taxed at ordinary income tax rates.



SIMPLE IRA

A Savings Incentive Match Plan for Employees (SIMPLE IRA) is an alternative to 401(k) plans for businesses with 100 or fewer employees. These plans are a win-win for employers and employees. Employers can either match employee contributions or simply contribute 2% of employee salaries up to the statutory contribution limits. Employers who match employee contributions may match up to the lesser of 3% of each employee's salary or \$12,500 for tax year 2017 (\$15,500 if the employee is 50 years old or more). These limits will remain unchanged for tax year 2018. The employer receives a tax deduction on the contributions while employees receive extra compensation via contributions to their retirement accounts. Like other IRA plans, SIMPLE IRAs grow tax-deferred until withdrawals are made.

There are no age limits on participation in a SIMPLE IRA plan. However, withdrawals made before age 59½ may incur a steep 25% penalty if the withdrawal is made within the first two years of joining the plan, and there may still be a 10% penalty for withdrawals taken after the first two years. Money in SIMPLE IRAs is locked into the accounts, so an employee who moves to another employer within two years of joining a plan must wait until the two years have passed before moving the money to another plan in order to avoid the penalty.

CLOSING THOUGHTS

As noted above, IRAs are powerful savings tools that should generally be maximized each year. Given the real possibility of increasing tax rates in the future, investors would be wise to consider every tax-sheltering opportunity afforded to them. IRAs provide one important such opportunity. We would urge anyone who is eligible (and able) to consider making the maximum contribution to his or her IRA each and every year. If you are already contributing the maximum amount to a 401(k) plan, then you have taken an important step in preparing for retirement. However, although contributions to an IRA may not be tax-deductible for you, we would still encourage you to consider making IRA contributions in addition to your 401(k) contributions in order to take full advantage of all of the tax-sheltering options that have been made available to you.

If you do not yet have an IRA, do not delay talking to your portfolio manager to discuss whether opening and contributing

to one makes sense for you. For those who already have an IRA, we encourage you to make contributing to your account every year a high priority. As the examples we discussed showed, even one year of delay can make a major difference over time, due to the power of compounding. And, as always, we are more than happy to help you to understand how best to take advantage of IRAs.

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