Super IRAs

Earlier this year, Presidential aspirant Mitt Romney revealed, through financial disclosure documents, that he owns an IRA worth between $20.7 million and $101.6 million (the disclosure forms use ranges, not exact figures). Even using the lower figure, $20 million seems rather extraordinary, given that IRA contributions were long limited to $2,000 and only recently have been boosted to $5,000 ($6,000 for those over 50). How did he do it?

It helps if the limits are not quite so low. Bain Capital, which Romney headed, provided its employees with an SEP-IRA, a retirement plan that is somewhat similar to a 401(k) plan. Before 2001, the annual contribution limits to these plans was $30,000.

Much more important is that Bain allowed staffers to invest in its takeover deals. What's more, the staffers could allocate their holdings to taxable accounts or to their IRA, as they wished. Each investor would receive common and preferred shares. The common shares would have the greatest risk and the greatest potential for reward, should a Bain turnaround prove successful. According to an analysis by *The Wall Street Journal*, in one noteworthy deal some Bain employees saw their IRAs balloon 583-fold over just 20 months. Those profits could then be rolled over into the next Bain deal, all compounding occurring tax deferred.

Mr. Romney is not home free with his IRA, because all distributions from it will be taxed as ordinary income. Under current law, that would be a top federal tax rate of 35%.

Super Roths

In contrast, Max Levchin may not be worried about income taxes on his retirement distributions, reports *Forbes* magazine. He's the chairman of Yelp, a social review site. Digging through SEC filings, *Forbes* discovered that Levchin had 7 million shares of Yelp in his Roth IRA. He sold 3.1 million of those shares in 2010, and reinvested the $10.1 million of proceeds tax free. What's more, if Levchin waits until he is 59 ½ to begin drawing down the Roth IRA, he'll never pay income taxes on those outsized gains.

The strategy here, as for the Bain employees, is to place low value securities that have maximum growth potential into the Roth IRA.

Facebook GRATs

Income taxes aren't the only taxes to be concerned about. Poring over the SEC filings, *Forbes* discovered three key officers of Facebook had placed a total of 18.9 million shares into Grantor Retained Annuity Trusts (GRATs) in 2008. How does that work?

An irrevocable trust is created to last for a specific number of years, typically running from 2 years to 15 years. The grantor reserves the right to receive an annuity from the trust for as long as it continues, and beneficiaries will receive the remaining trust assets when the term expires. The funding of the trust is a taxable gift, but the taxable value of that gift will be reduced by the value of the retained interest. In fact, by adjusting the trust terms, the value of the remainder can be brought all the way down to zero, eliminating gift tax liability altogether.

The key is that the IRS tables for making the actuarial determination of value must rely upon hypothetical trust returns, which are very low during periods when interest rates are low. If the assets placed in the GRAT outperform this low bar, all the excess value goes to the family members completely free of tax. The Facebook shares did indeed outperform.

According to the *Forbes* analysis, the three Facebook principals effectively may have made tax-free gifts of roughly $204 million. That's quite a bit better than this year's $5.12 million federal gift tax exemption.

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