DrawDown Strategies

Presented by

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Agenda

1. Bracket Management Overview
2. Tax Efficient Investing Overview
3. DrawDown Strategies
4. Taxation of IRA Distributions
5. Taxation of Social Security

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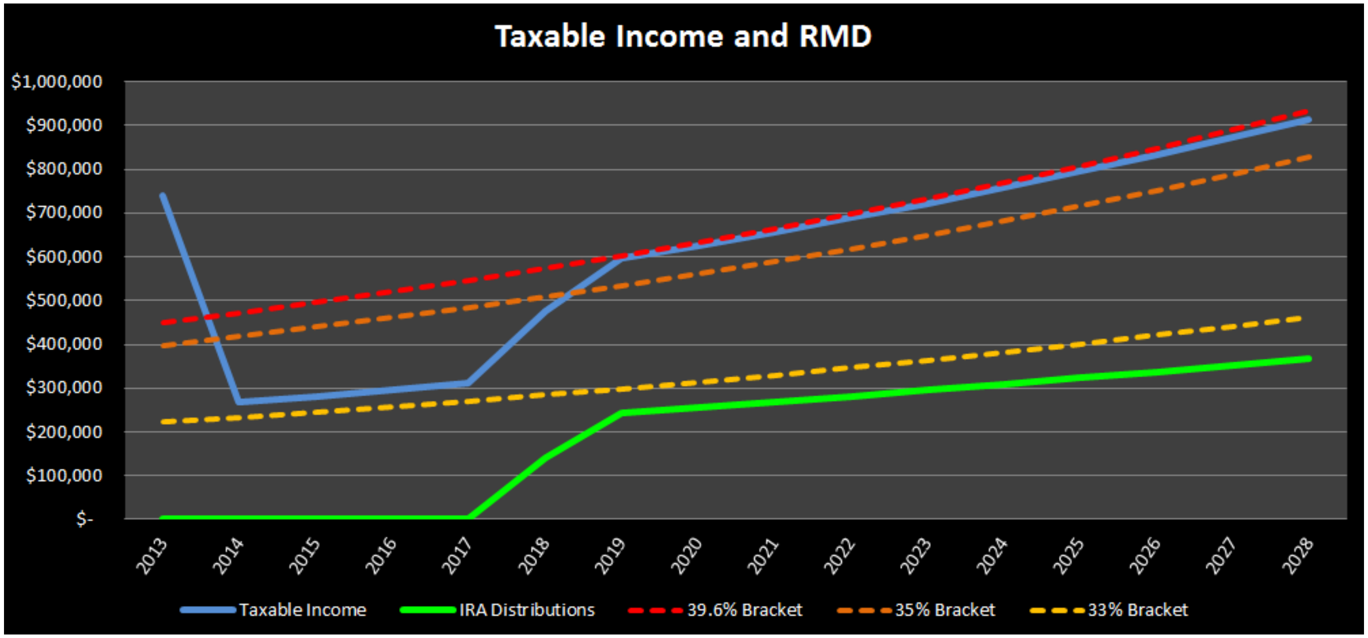
Bracket Management



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Bracket Management

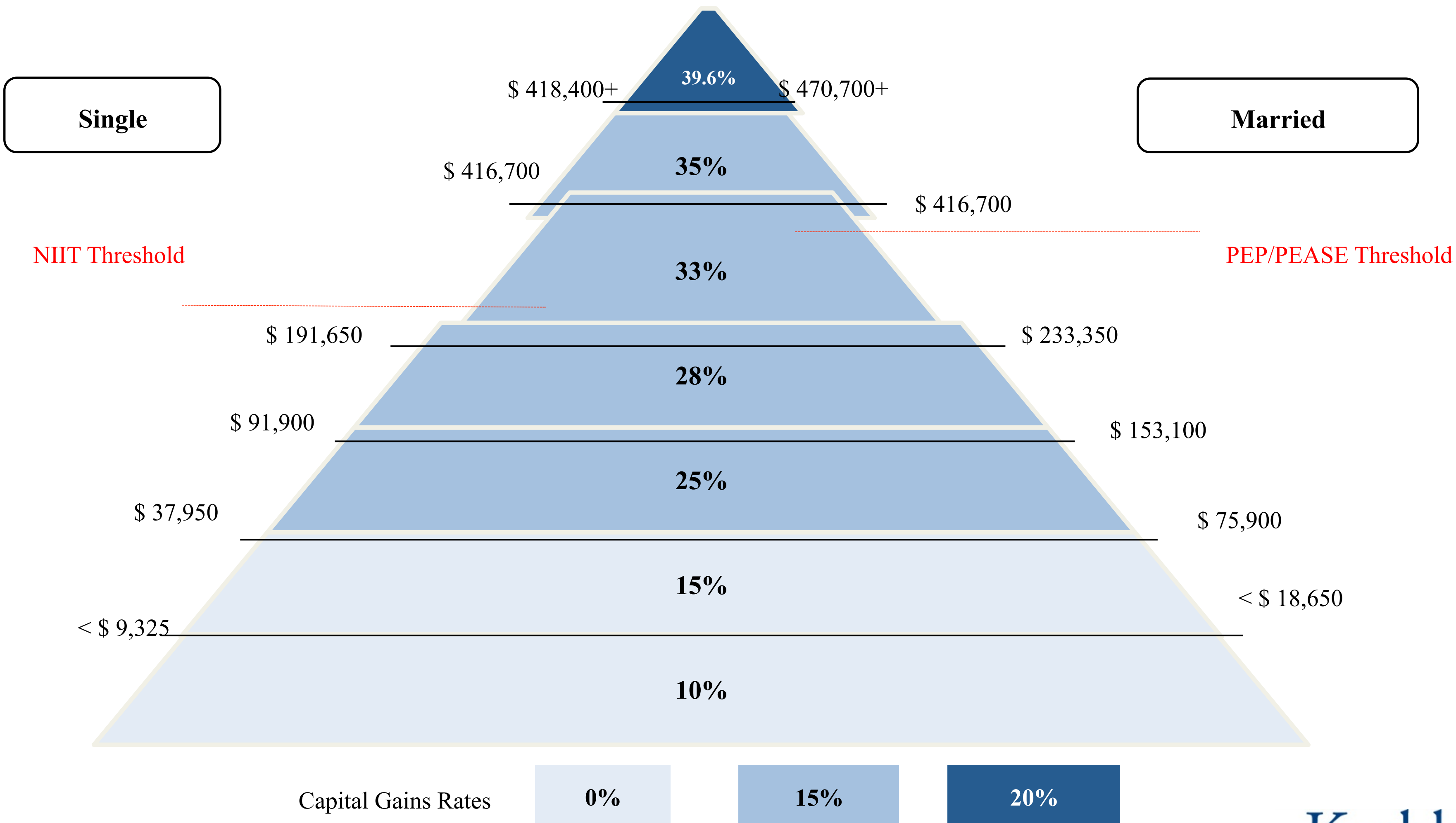
Five Dimensional Tax System

- Ordinary Tax Rates
- Capital Gains Tax Rates
- The AMT
- New "Supertax"
- PEP & Pease Limitations
- New 3.8% Net Investment Income Tax (NIIT)
  - Plus the additional 0.9% Medicare tax on earned income

Bracket Management

2017 Federal Income Tax Rates and Brackets

Rate Based On Taxable Income



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Bracket Management

Phase-Out of Personal Exemptions & Itemized Deductions

Phase-out of personal exemptions (PEP) and limitations on itemized deductions (Pease) as income rises above the following threshold amounts in 2017:

Single taxpayers	$261,500
Head of households	$287,650
Married filing jointly or surviving spouse	$313,800
Married filing separately	$156,900

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Bracket Management

Phase-Out of Itemized Deductions (Pease)

- Pease cuts itemized deductions by 3% of AGI above the threshold amounts up to a maximum of 80%
- Deductions subject to the limitation include:
  - Investment Interest
  - Medical Expenses
  - Casualty, theft and wagering losses

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Bracket Management

3.8% NIIT Overview – Net Investment Income

Includes:

- Interest
- Dividends
- Annuity Distributions
- Rents
- Royalties
- Income derived from passive activity
- Net capital gain derived from the disposition of property

Does NOT Include:

- Salary, wages, or bonuses
- Distributions from IRAs or qualified plans
- Any income taken into account for self-employment tax purposes
- Gain on the sale of an active interest in a partnership or S corporation
- Items which are otherwise excluded or exempt from income under the income tax law

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Bracket Management

Tax Alpha

39.6%

35%

33%

28%

25%

15%

10%

Tax-Free
- Roth IRAs
- Life Insurance
- Tax-Exempt Interest Income

Tax-Deferred
- IRAs, 401(k)s, 403(b)s
- Non-qualified Deferred Annuities

Taxable
- Interest Income
- Capital Gains
- Qualified Dividends

"Fly Below the Radar"

$ 470,700 – 39.6% Bracket

Ouch!

$ 313,800 – PEP / Pease

Okay

$ 250,000 – 3.8% NIIT

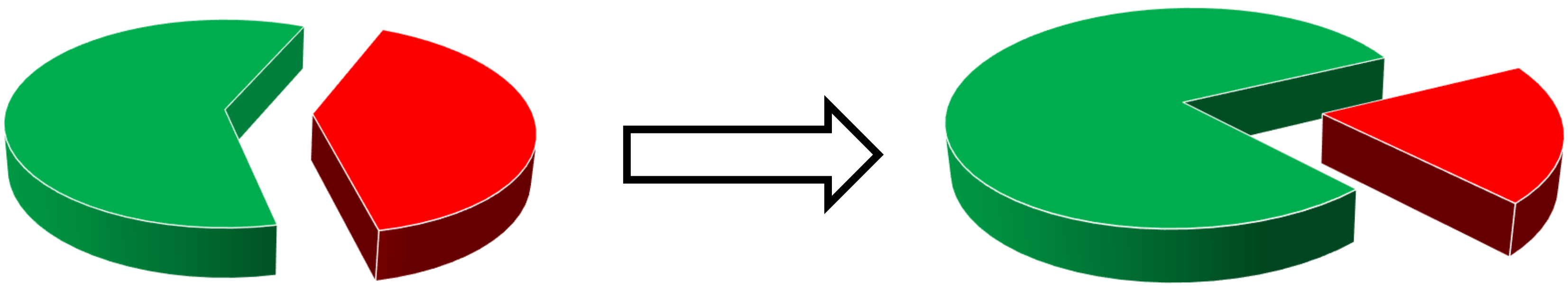
Ideal

Bracket Management

Strategy Summary

- Retirement Plan Contributions
- Roth Conversions
- NUA Opportunities
- Annuities
- Life Insurance
- Estate Planning Techniques (Bypass Trust)
- Gain & Loss Harvesting

Tax Aware Investing



It's not about what you make, but what you keep!

Tax Aware Investing

KEY TOPICS

- Tax Structure – Determining an effective mix of taxable investments, tax-deferred investments and tax-free investments

- Tax-Sensitive Asset Allocation – Understanding the impact that income taxation has on asset allocation and diversification

- Asset Location – Identifying which assets to place in certain investment vehicles

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Tax Aware Investing

Tax Drag Example

Depending on the tax rate, the after-tax growth of a $10,000/year investment earning an 8% pre-tax yield varies dramatically:

Tax Rate	After-Tax Growth Rate*	Final Value
0%	8.0%	$2,590,656
10%	7.2%	$2,102,199
20%	6.4%	$1,712,216
30%	5.6%	$1,400,380
40%	4.8%	$1,150,637
50%	4.0%	$950,255

*After-tax growth rate = 8% x (1-tax rate)

Tax Aware Investing

Three Main Types of Retirement Investment Accounts

- *Taxable investment accounts* – income generated within the account is taxed annually
- *Tax-deferred investment accounts* – income generated within the account is not taxed until distributions are taken
- *Tax-free investment accounts (e.g. Roth IRAs, life insurance)* – income generated within the account is never taxed

Tax Aware Investing

Common Assets in a Client's Portfolio

- IRA Accounts
- Roth IRA Accounts
- ERISA Plans
- Tax-Deferred Annuities
- Life Insurance
- Stocks, Bonds, Warrants, Options
- Employer NSOs and ISOs
- Employer Deferred Compensation
- Real Estate
- Oil & Gas
- U.S. Savings Bonds

Tax Aware Investing

Investment Incentives in the Tax Code

- Qualified dividends
- Long-term capital gains
- IRAs/ 401(k) plans
- Roth IRAs/Roth 401(k) plans
- Real estate depreciation
- Oil & gas
- Life insurance
- Non-qualified annuities
- Master Limited Partnerships (MLPs)
- Index options

Tax Aware Investing

Qualified Dividend Incentives

- Taxation of Interest Income - Ordinary Income
- Taxation of Traditional Dividends- Ordinary Income
- Taxation of "Qualified Dividends" – Capital Gains Rate of 15%

Tax Aware Investing

Capital Gains Incentives

- Gains Deferred until Property is Sold
- Long-term Gains are Taxed at Lower Rates
- Step-up in Basis at Death
- Gifts to Charity or a Charitable Trust that do not Trigger Tax

Tax Aware Investing

Roth IRA and Roth 401(K) Incentives

- Non-deductible contributions
- Tax-free growth
- Non-taxable withdrawals for "qualified distributions"
- Five-year rule & Age 59 ½ Rule

Tax Aware Investing

Real Estate Incentives

- Interest Deductions
- Depreciation Tax Shield
- 1031 Tax-free Exchanges
- Step-up in Basis at Death

Tax Aware Investing

Life Insurance Incentives

- Tax-Deferred Growth
- Tax-Free Death Benefit
- Tax-Free Basis Distributions First
- Tax-Free Loans
- All Contracts are Treated Separately
- Modified Endowment Restrictions

Tax Aware Investing

Nonqualified Annuity Incentives

- Tax-deferred Growth
- Pro-rate Basis Distributions if Annuitized
- All Contracts are Treated Separately

Tax Aware Investing

Retirement Assets – How are distributions taxed?

	Basis	Tax-Free Loans	Earnings
IRA[1]	Pro rata Method	N/A	Pro rata Method
ERISA Plan	Pro rata Method	N/A	Pro rata Method
Roth IRA[2]	Basis First	N/A	Earnings Follow
Non-qualified Annuity	Basis Follows	N/A	Earnings First
Life Insurance[3] Non-Modified Endowment Contract	Basis First	Available	Earnings Follow
Life Insurance[4] Modified Endowment Contract	Earnings First	N/A	Basis Follows

1. All IRAs are combined for the distribution computation
2. All Roth IRAs are combined for the distribution computation
3. Loans available, with interest to the extent of cash surrender
4. Each contract is treated separately for distribution purposes

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Tax Aware Investing

The Benefits of Tax Diversification

Retirement Income of $150,000

Without Tax Diversification	With Tax Diversification
Client accesses $150,000 from her 401(k)	Client accesses $75,000 from her 401(k) and $65,000 from her cash value life insurance policy and/or Roth IRA
The full $150,000 is taxable at an average tax rate of 30% or $45,000	Only the $65,000 from her 401(k) is taxable, and it's taxed at the lower average tax rate of 15% or $11,250
Leaving client $105,000 to spend in retirement	Leaving client $138,750 to spend in retirement

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Tax Aware Investing

Retirement Income of $80,000

100% IRA	A Balanced Strategy	
$80,000	$80,000	
	$40,000	$40,000
401(k) IRAs Approach	IRA	Cash Value Life Insurance/Roth IRA
100% Taxable	100% taxable	Tax Free
$80,000 taxed up to 25%	$40,000 taxed up to 15%	$0,000 taxed at 0%
=$13,319 in Tax	=$4,024 in Tax	=$0 tax
$66,681 to spend after taxes	$75,976 to spend after taxes	

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Tax Aware Investing

Beyond Asset Allocation: Understanding "Asset Location"

- Unlike Asset Allocation, Asset Location is driven by taxation
- Proper investment location reduces taxation

General Rules:

- Fixed income – should be held in Retirement Accounts, Annuities or Life Insurance
- Equities – should be held in taxable accounts

Tax Aware Investing

Ideal Assets for Qualified Plans and IRAs

- Taxable Bonds
- REITS
- High Turnover, Short-Term Gain Strategies
- Nonqualified Dividends
- High yield Stocks
- Option Strategies

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Tax Aware Investing

Ideal Assets for Taxable Accounts

- Low Turn-Over Gain Strategies
- Qualified Dividend
- Long-Term Capital Gain Strategies
- Real estate Investments
- Oil and Gas Investments
- I Bonds
- Tax-Exempt Bonds
- Master Limited Partnership

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Draw Down Strategies

Combing Bracket Management & Tax Aware Investing

Tax-Sensitive Retirement Distribution Planning

Perhaps one of the most important decisions a retiree must make is to determine from which retirement assets to withdraw funds to meet everyday living expenses.

Tax-Sensitive Retirement Distribution Planning

Key Decision Factors

- Size of accounts
- Size of RMDs relative to cashflow requirement
- Investment mix / performance
- Marginal income tax bracket
- Time horizon
- Estate planning goals

Tax-Sensitive Retirement Distribution Planning

<u>Retirement Distribution Example</u>

- Facts
  - IRA owner's age: 62
  - Spouse's age: 62
  - IRA balance: $1,300,000 (100% taxable)
  - Brokerage account balance: $750,000 (cost basis $500,000)
  - Pre-tax rate of return: 6% (2% yield + 4% growth)
  - Itemized deductions: $30,000
  - Social Security benefit in 2014: $30,000 (indexed by $500/year thereafter)
  - Annual after-tax cash flow needs: $144,000 ($12,000/month)
  - State income tax rate: 0%

Tax-Sensitive Retirement Distribution Planning

- OPTION 1 – Withdraw 100% From Traditional IRA First

		2014	2015	2016	2017	2018
Husband's Age		62	63	64	65	66
Wife's Age		62	63	64	65	66
ASSETS		**2014**	**2015**	**2016**	**2017**	**2018**
Traditional IRA						
Beginning Balance		$ 1,300,000	$ 1,252,000	$ 1,201,120	$ 1,147,187	$ 1,090,018
Income	6.00%	78,000	75,120	72,067	68,831	65,401
Distributions		(126,000)	(126,000)	(126,000)	(126,000)	(120,000)
Ending Balance		$ 1,252,000	$ 1,201,120	$ 1,147,187	$ 1,090,018	$ 1,035,420
Brokerage Account						
Beginning Balance		$ 750,000	$ 782,715	$ 815,213	$ 850,097	$ 887,512
Yield (Interest & Dividends)	2.00%	15,000	15,654	16,304	17,002	17,750
Growth	4.00%	30,000	31,309	32,609	34,004	35,500
Subtotal		$ 795,000	$ 829,678	$ 864,125	$ 901,103	$ 940,762
Yield Distributed		(15,000)	(15,654)	(16,304)	(17,002)	(17,750)
Asset Sales		-	-	-	-	-
Net Cash Flow Reinvested		2,715	1,189	2,276	3,410	261
Ending Balance		$ 782,715	$ 815,213	$ 850,097	$ 887,512	$ 923,273
Total Assets		**$ 2,034,715**	**$ 2,016,333**	**$ 1,997,284**	**$ 1,977,530**	**$ 1,958,693**
CASH FLOW		**2014**	**2015**	**2016**	**2017**	**2018**
IRA Distribution		$ 126,000	$ 126,000	$ 126,000	$ 126,000	$ 120,000
Interest & Dividends		15,000	15,654	16,304	17,002	17,750
Social Security (Gross Benefit)		30,000	30,500	31,000	31,500	32,000
Asset Sale Proceeds		-	-	-	-	-
Subtotal		$ 171,000	$ 172,154	$ 173,304	$ 174,502	$ 169,750
Less: Income Tax		(24,285)	(26,965)	(27,028)	(27,092)	(25,489)
Less: Living Expenses		(144,000)	(144,000)	(144,000)	(144,000)	(144,000)
Net Cash Flow		**$ 2,715**	**$ 1,189**	**$ 2,276**	**$ 3,410**	**$ 261**

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Tax-Sensitive Retirement Distribution Planning

- OPTION 2 – Withdraw 100% From Brokerage Account First

Husband's Age		62	63	64	65	66
Wife's Age		62	63	64	65	66
ASSETS		**2014**	**2015**	**2016**	**2017**	**2018**
IRA						
Beginning Balance		$ 1,300,000	$ 1,378,000	$ 1,460,680	$ 1,548,321	$ 1,641,220
Income	6.00%	78,000	82,680	87,641	92,899	98,473
Distributions		-	-	-	-	-
Ending Balance		$ 1,378,000	$ 1,460,680	$ 1,548,321	$ 1,641,220	$ 1,739,693
Brokerage Account						
Beginning Balance		$ 750,000	$ 680,710	$ 603,663	$ 522,459	$ 436,817
Yield (Interest & Dividends)	2.00%	15,000	13,614	12,073	10,449	8,736
Growth	4.00%	30,000	27,228	24,147	20,898	17,473
Subtotal		$ 795,000	$ 721,553	$ 639,883	$ 553,807	$ 463,027
Yield Distributed		(15,000)	(13,614)	(12,073)	(10,449)	(8,736)
Asset Sales		(102,000)	(108,000)	(108,000)	(108,000)	(108,000)
Net Cash Flow Reinvested		2,710	3,725	2,649	1,460	172
Ending Balance		$ 680,710	$ 603,663	$ 522,459	$ 436,817	$ 346,462
Total Assets		**$ 2,058,710**	**$ 2,064,343**	**$ 2,070,780**	**$ 2,078,038**	**$ 2,086,155**

CASH FLOW	**2014**	**2015**	**2016**	**2017**	**2018**
IRA Distribution	$ -	$ -	$ -	$ -	$ -
Interest & Dividends	15,000	13,614	12,073	10,449	8,736
Social Security (Gross Benefit)	30,000	30,500	31,000	31,500	32,000
Asset Sale Proceeds	102,000	108,000	108,000	108,000	108,000
Subtotal	$ 147,000	$ 152,114	$ 151,073	$ 149,949	$ 148,736
Less: Income Tax	(290)	(4,389)	(4,424)	(4,489)	(4,565)
Less: Living Expenses	(144,000)	(144,000)	(144,000)	(144,000)	(144,000)
Net Cash Flow	**$ 2,710**	**$ 3,725**	**$ 2,649**	**$ 1,460**	**$ 172**

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Tax-Sensitive Retirement Distribution Planning

- OPTION 3 – Withdraw From Traditional IRA Up to 10% Tax Bracket

Husband's Age		62	63	64	65	66
Wife's Age		62	63	64	65	66
ASSETS		**2014**	**2015**	**2016**	**2017**	**2018**
IRA						
Beginning Balance		$ 1,300,000	$ 1,363,000	$ 1,428,780	$ 1,497,507	$ 1,569,357
Income	6.00%	78,000	81,780	85,727	89,850	94,161
Distributions		(15,000)	(16,000)	(17,000)	(18,000)	(20,000)
Ending Balance		$ 1,363,000	$ 1,428,780	$ 1,497,507	$ 1,569,357	$ 1,643,519
Brokerage Account						
Beginning Balance		$ 750,000	$ 694,185	$ 632,201	$ 567,787	$ 500,814
Yield (Interest & Dividends)	2.00%	15,000	13,884	12,644	11,356	10,016
Growth	4.00%	30,000	27,767	25,288	22,711	20,033
Subtotal		$ 795,000	$ 735,836	$ 670,133	$ 601,854	$ 530,863
Yield Distributed		(15,000)	(13,884)	(12,644)	(11,356)	(10,016)
Asset Sales		(90,000)	(90,000)	(90,000)	(90,000)	(90,000)
Net Cash Flow Reinvested		4,185	248	298	315	1,147
Ending Balance		$ 694,185	$ 632,201	$ 567,787	$ 500,814	$ 431,994
Total Assets		**$ 2,057,185**	**$ 2,060,981**	**$ 2,065,294**	**$ 2,070,171**	**$ 2,075,512**

CASH FLOW	**2014**	**2015**	**2016**	**2017**	**2018**
IRA Distribution	$ 15,000	$ 16,000	$ 17,000	$ 18,000	$ 20,000
Interest & Dividends	15,000	13,884	12,644	11,356	10,016
Social Security (Gross Benefit)	30,000	30,500	31,000	31,500	32,000
Asset Sale Proceeds	90,000	90,000	90,000	90,000	90,000
Subtotal	$ 150,000	$ 150,384	$ 150,644	$ 150,856	$ 152,016
Less: Income Tax	(1,815)	(6,135)	(6,346)	(6,540)	(6,869)
Less: Living Expenses	(144,000)	(144,000)	(144,000)	(144,000)	(144,000)
Net Cash Flow	**$ 4,185**	**$ 248**	**$ 298**	**$ 315**	**$ 1,147**

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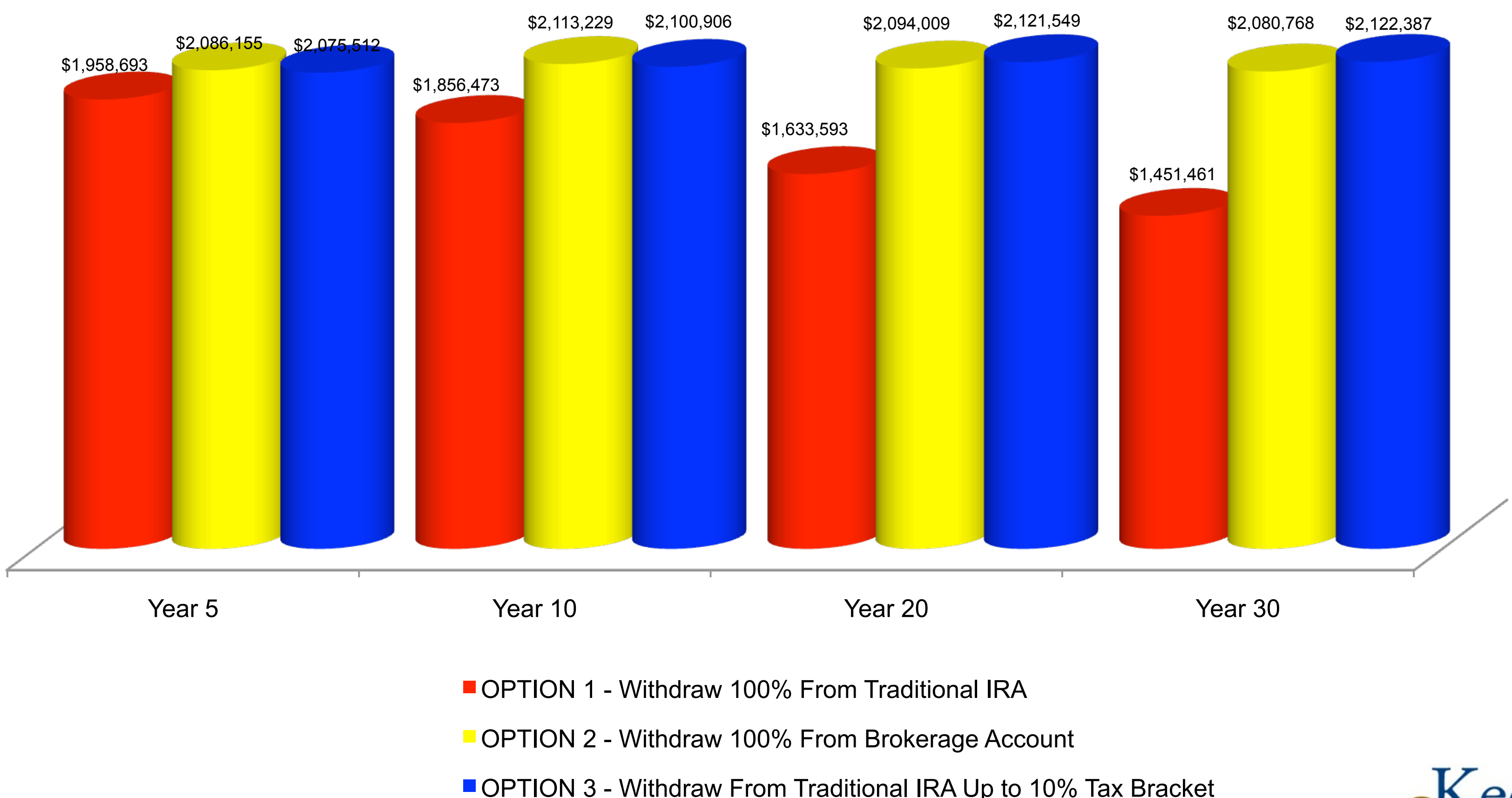
Tax-Sensitive Retirement Distribution Planning

- Summary of Options



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Tax-Sensitive Retirement Distribution Planning

Types of Retired Taxpayers

- *Low income taxpayers* – taxpayers who generally are in the lowest income tax brackets (i.e. 10%, 15%) and are generally eligible for various income tax credits. Further, these taxpayers are usually in situations where their Social Security is not taxed
- *Low/middle income taxpayers* – taxpayers who are generally in the middle income tax brackets (i.e. 15%, 25% 28%) and are generally eligible for certain favorable tax attributes (e.g. 0% tax rate on capital gains/qualified dividends)
- *Middle/high income taxpayers* – taxpayers who are generally in the upper end of the middle income tax brackets (i.e. 28%, 33%) who oftentimes are subject to the Alternative Minimum Tax (AMT), the NIIT and other phase-outs
- *High income taxpayers* – taxpayers who are in the highest marginal income tax bracket (35% and 39.6%) and are subject to several phase-outs and or "surtaxes" (such as AMT & the NIIT)

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Tax-Sensitive Retirement Distribution Planning

Key Questions

- Which assets to spend first?
- When to do Roth conversions?
- What are the advantages and disadvantages of taking stock from a qualified plan?
- When and how to draw non-qualified annuities?
- When and how to draw deferred compensation?
- When and how to draw low basis securities?
- When and how to exercise NSOs and ISOs?

Tax-Sensitive Retirement Distribution Planning

@ Retirement – Top Checklist Items

- Evaluate rollover of pensions and profit sharing plan
- Evaluate asset protection issues
- Manage Net Unrealized Appreciation (NUA) opportunities
- Monitor the 10% IRC §72(t) penalty
- Manage basis in both IRAs and qualified plans

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Tax-Sensitive Retirement Distribution Planning

After-Retirement – Top Annual Checklist Items

- Manage income tax brackets
- Select high-basis securities to sell first
- Manage taxation of Social Security benefits
- Aggressively harvest outside portfolio losses
- Monitor Asset Location
- Tax efficient use of annuities
- Target charitable gifts
- Monitor the 3.8% Medicare "surtax"

Tax-Sensitive Retirement Distribution Planning

Early Retirement Years (to Age 70) – Key Concepts

- Target the 10% and 15% tax brackets
- Try to defer IRA distributions taxed at 25% or greater
- Draw upon "outside" assets and deferred compensation first
- Draw upon traditional IRA assets second
- Draw upon Roth IRA assets last
- Review Roth conversions to manage tax brackets

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Tax-Sensitive Retirement Distribution Planning

Later Retirement Years (Age 70+) – Key Concepts

- Take all Required Minimum Distributions (RMDs)
- If needed for living expenses, draw additional funds from IRA in low income years
- Make Roth Conversions in low income years to reduce future RMDs
- Distribute dividends from taxable account
- Draw down high basis outside assets
- Consider selling capital assets in taxable account first to provide for living expenses in excess of RMDs
- Limit Roth withdrawals to “topping off” annual expense needs
- Update estate planning
- Monitor asset location as asset allocation shifts and accounts are drawn on

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Bracket Management & Distribution Planning

A Solid Distribution Strategy is Key

Four top issues to consider when structuring a distribution portfolio:

1. Which retirement investment vehicles to include in the distribution portfolio
2. The order in which plan assets should be withdrawn
3. Loss harvesting and the specific identification method
4. Tactical income tax planning with defined benefit plans, tax-deferred annuities, Net Unrealized Appreciation, and Roth conversions

Timing is everything

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Bracket Management & Distribution Planning

Determine which tax-favored account to draw from first considering the retirees income tax brackets

Tax-Sensitive Retirement Distribution Planning

Starting points to evaluate proper withdrawal order

Future income at the same or lower tax rate	Future income taxed at higher tax rate
1) Taxable account 2) Tax-deferred account 3) Tax-free account	1) Tax-deferred account 2) Taxable account 3) Tax-free account

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Bracket Management & Distribution Planning

Example

Consider a low/middle income couple who are semi-retired and both age 60. They will earn about $140,000 this year, but they will require an additional $15,000 from their retirement plans to meet living expenses.

The couple has a number of accounts including an IRA with $100,000 and a Roth IRA with $100,000. These accounts earn a return of about 7%.

Bracket Management & Distribution Planning

Example (cont)

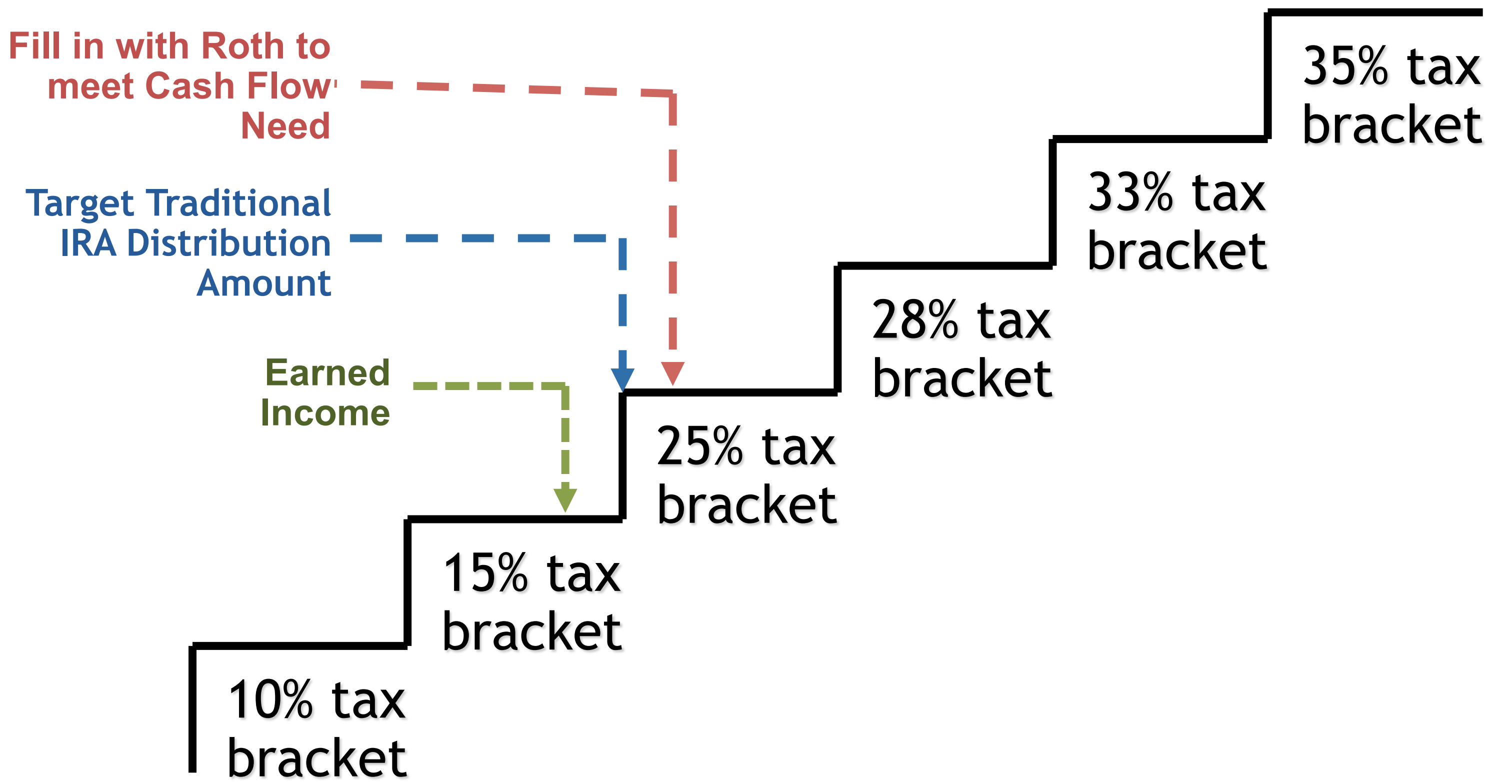
Option 1 – Spend down Roth IRA first

Option 2 – Spend down Traditional IRA first

Option 3 – Mix Distributions

Bracket Management & Distribution Planning

Example(cont) - Option 3 mix



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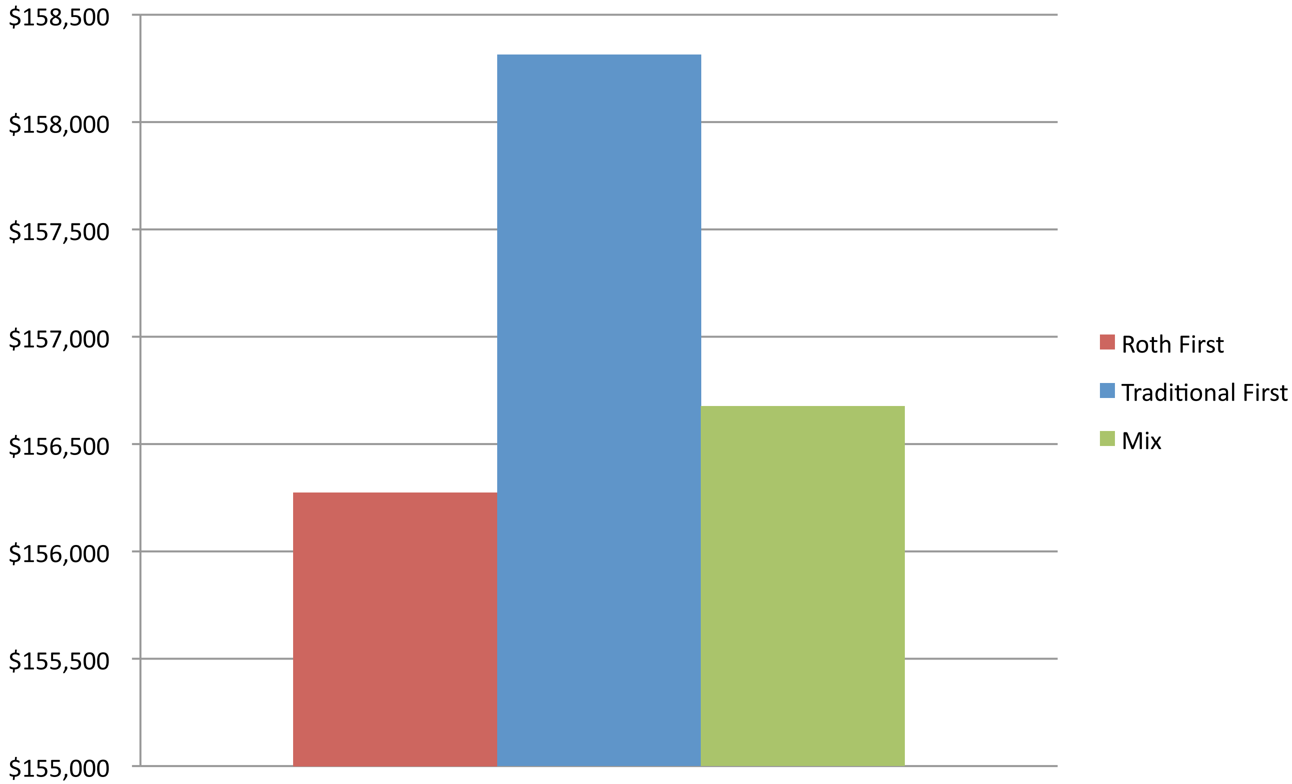
Bracket Management & Distribution Planning

Example (cont) – account values after 10 years if future Traditional IRA distributions are taxed at 15%



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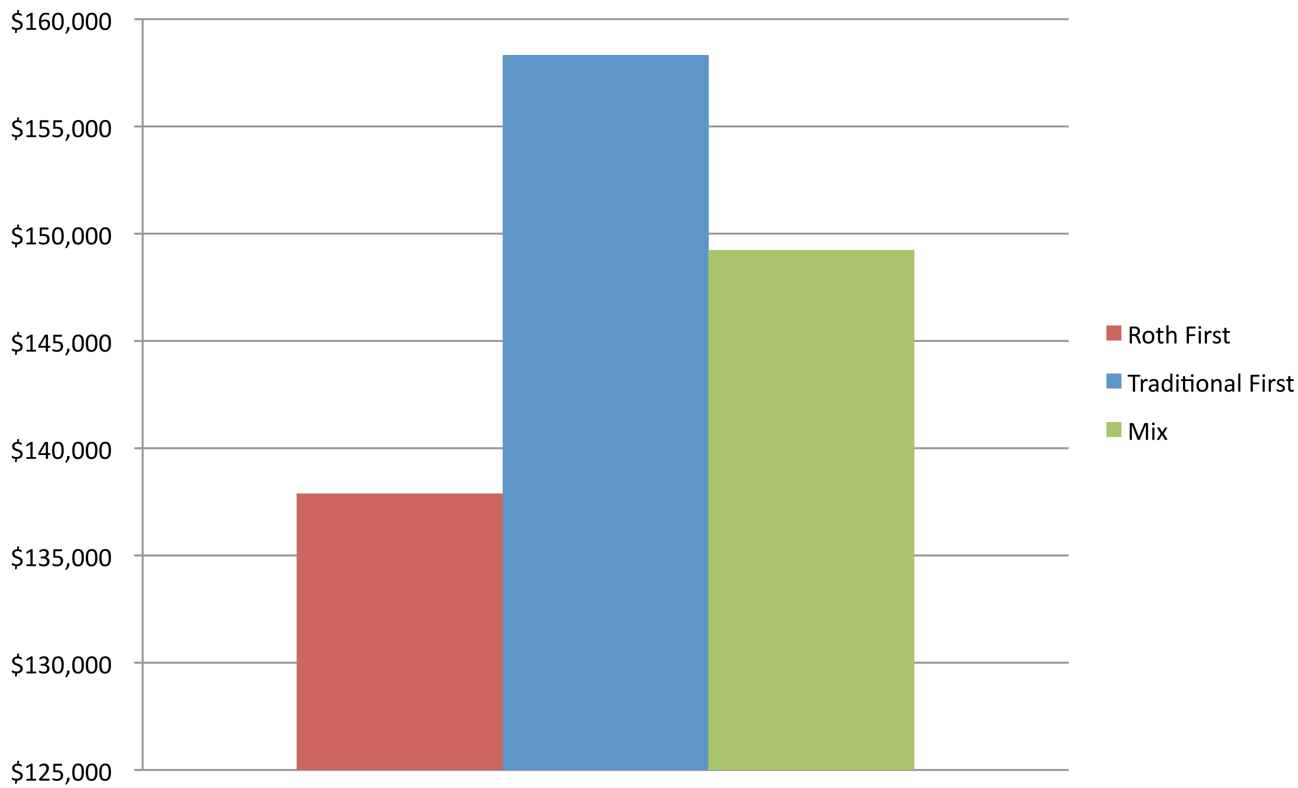
Bracket Management & Distribution Planning

Example (cont) – account values after 10 years if future Traditional IRA distributions are taxed at 25%



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Bracket Management & Distribution Planning

Consider the order of withdrawal to account for the tax consequences to the retiree's heirs:

Bracket Management & Distribution Planning

Tax consequences to the retiree's heirs:

- Estimate whether the retiree will be able to leave retirement accounts to their heirs
- Evaluate drawing down taxable investment assets first followed by retirement accounts & other tax benefited assets.
  - Consider the possibility of a large step-up in basis potential for elderly clients
  - Consider the deferral value of a Spousal Rollover & Inherited IRA
- If client expects to be in the same or lower tax bracket than beneficiaries, consider accelerated taxation and shifting assets to tax-free vehicles

Bracket Management & Distribution Planning

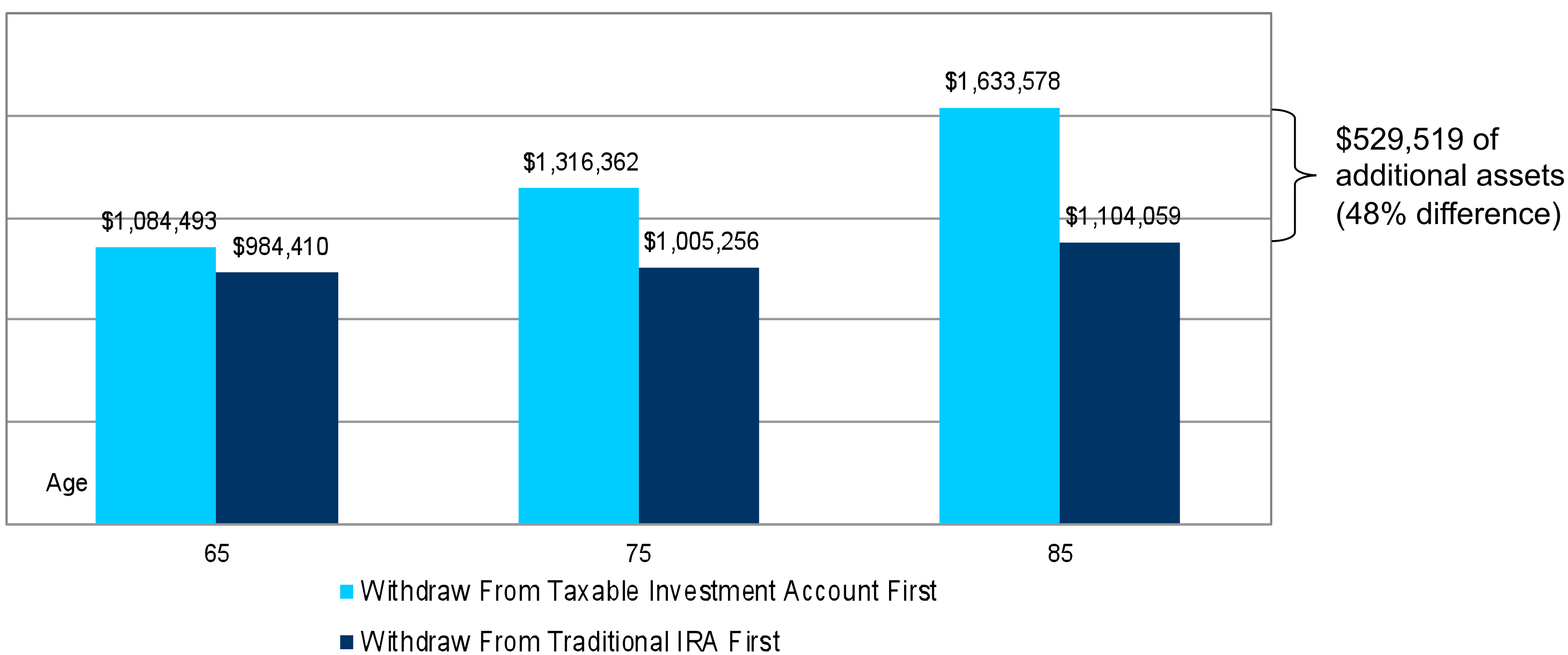
Example

- Client, age 60 and single, has a $500,000 taxable account and a $500,000 Traditional IRA
- Client needs $60,000 annually for living expenses
- Client receives $12,000 of Social Security beginning at age 62
- Annual return consists of 3% ordinary income (i.e. interest income) and 4% growth on the value in each account
- The stock earnings are tax deferred until the time of sale, then taxed as long-term capital gains
- 25% ordinary income tax rate
- 15% capital gains tax rate
- 85% of Social Security benefits are subject to income tax

Bracket Management & Distribution Planning

- Principle #2 – Example (cont.)

Benefit of Withdrawing Funds from a Taxable Account First
Balance at a Particular Year



***Note**: the retiree will be able to leave a large tax benefited account to heirs*

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Bracket Management & Distribution Planning

Why Try to Preserve IRAs for heirs?

1. Income tax deferral

2. Income tax free growth

An inherited IRA will always be more valuable to an heir than a taxable account due to the tax benefits.

Stretch Out IRAs

"Inherited" IRA - Case Study

6 Scenarios

- Immediate distribution
- IRA payable to non-qualified beneficiary (five-year rule)
- IRA payable to surviving spouse (no spousal rollover)
- IRA payable to surviving spouse (spousal rollover)
- IRA payable to child
- IRA payable to grandchild

Assumptions

- IRA owner's age - 65
- Spouse's age – 60
- Child's age – 35
- Grandchild's age - 10

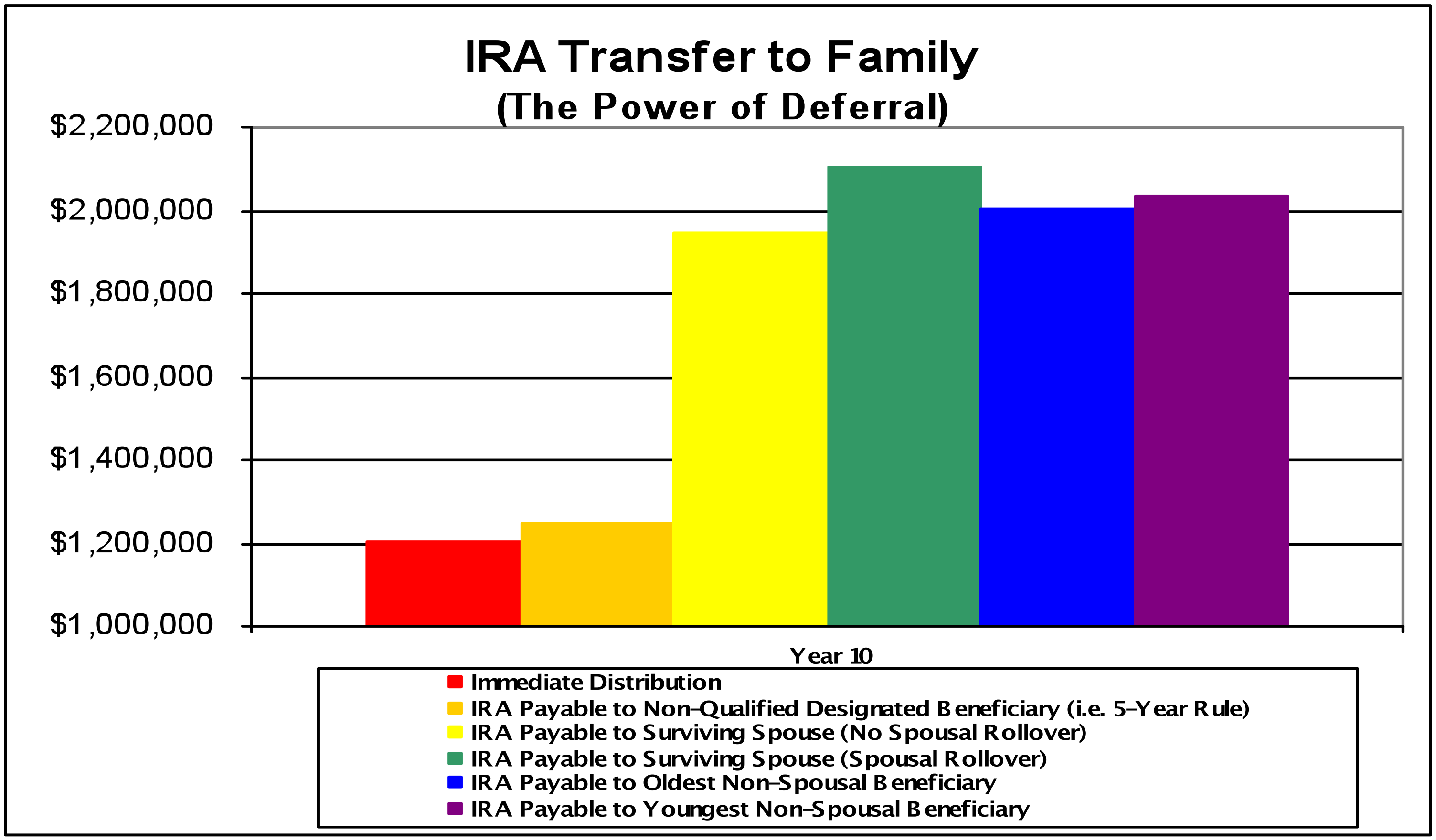
- IRA balance - $1,000,000
- Brokerage account balance - $0

- Pre-tax growth rate – 8%
- Ordinary income tax rate – 40%
- Capital gains tax rate – 20%

Stretch Out IRAs

"Inherited" IRA - Case Study

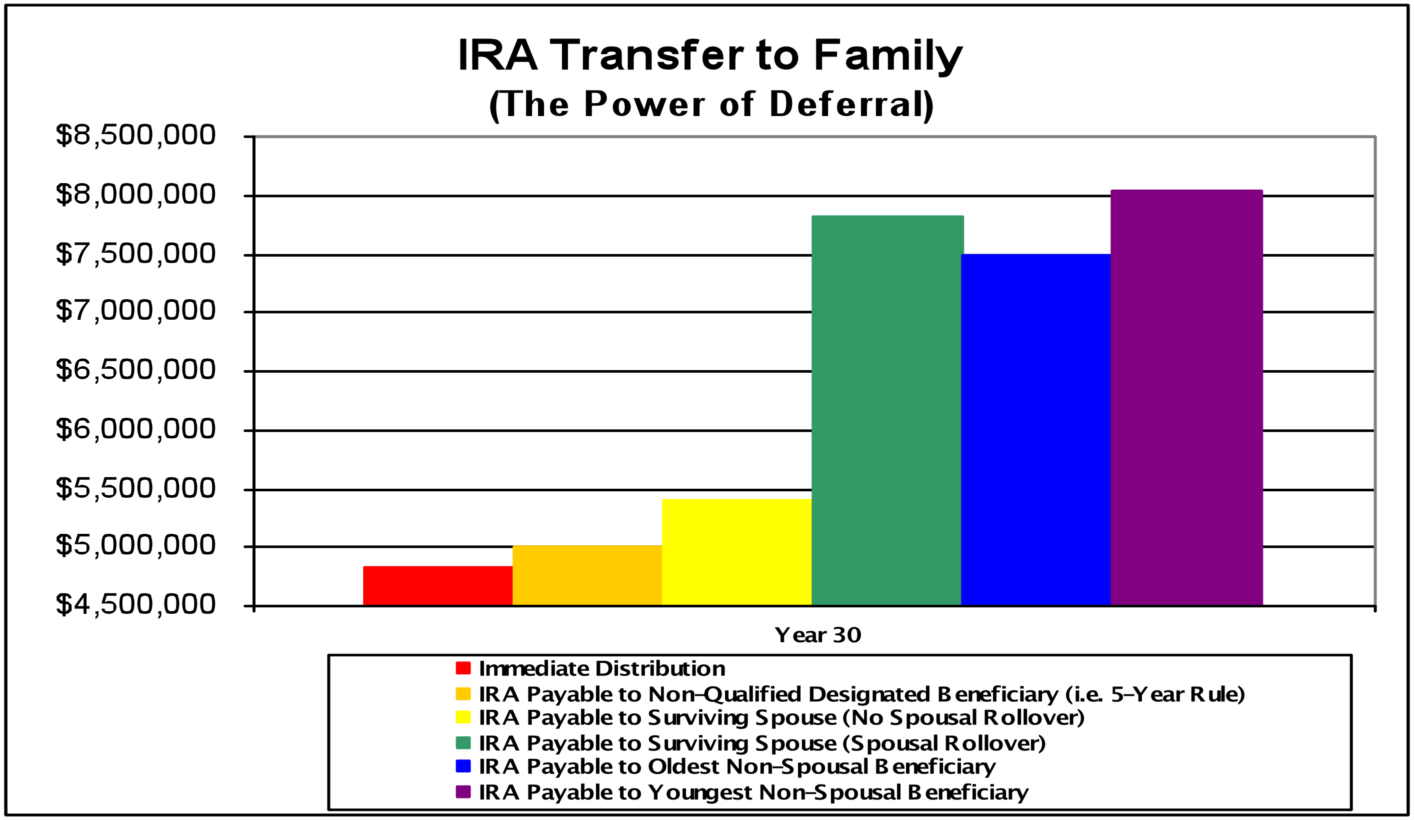
Summary – Year 10



Stretch Out IRAs

"Inherited" IRA - Case Study

Summary – Year 30



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Tax-Efficient Investing & Distribution Planning

Monitor & Adjust Asset Location

- Income producing assets = Traditional IRA
- Capital gains assets (modest growth) = Taxable investment account
- Capital gains assets (rapid growth) = Roth IRA

	Bonds	Stock
IRAs	$250,000	$250,000
Taxable Accounts	$250,000	$250,000

	Bonds	Stock
IRAs	$500,000	$0
Taxable Accounts	$0	$500,000

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Tax-Efficient Investing & Distribution Planning

Asset Location Example

- Bonds and stocks both generate a 7% pre-tax rate of return
- The capital gains on stock are deferred until the time of sale, then taxed as long-term capital gains
- The amount of any tax savings from a deductible IRA contribution is invested in a taxable investment account earning the same yield as the IRA
- The values shown for the IRA include the value of the taxable investment account
- The client is in the 25% ordinary income tax bracket (15%* for capital gains purposes)

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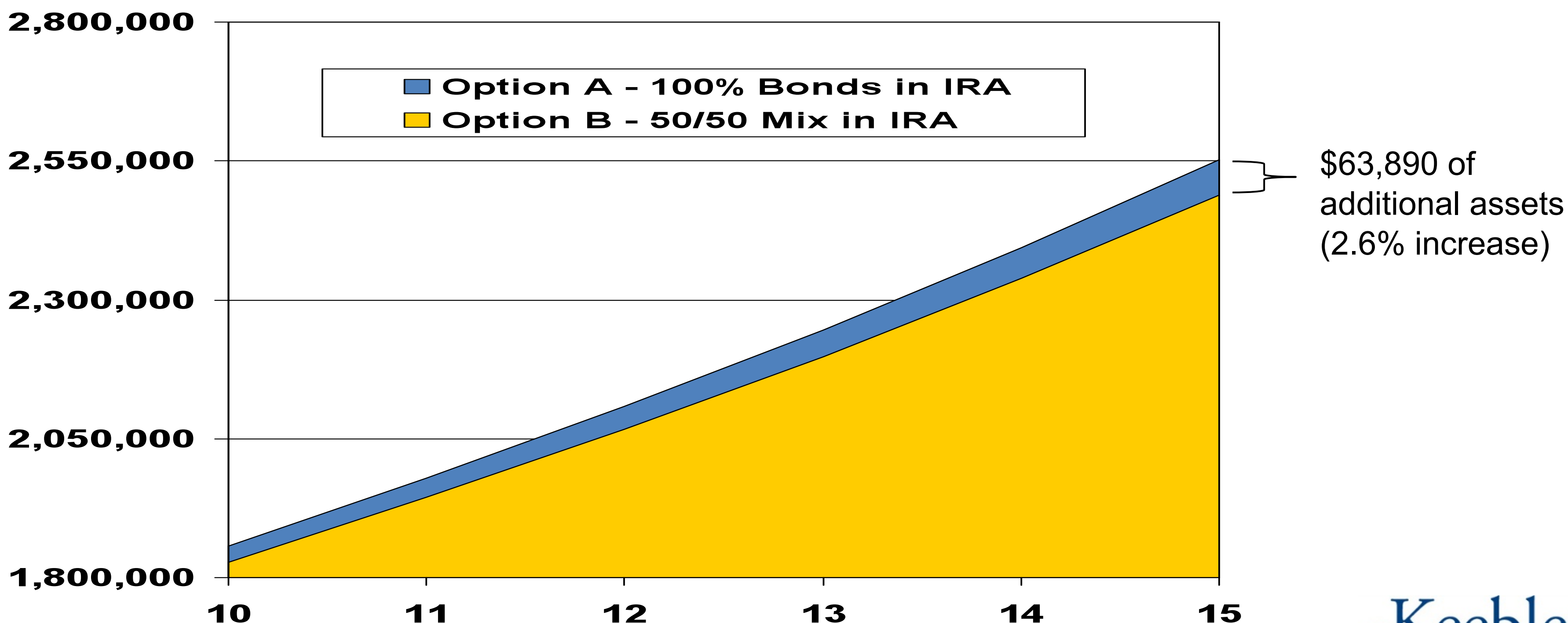
Tax-Sensitive Retirement Distribution Planning

Asset Location Example (cont.)

- Orange = 50% stock / 50% bond investment mix
- Blue = additional $63,890 of after tax growth over 15 years if proper asset location exercised & bonds are 100% in IRA



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Tax-Efficient Investing & Distribution Planning

Spend-down strategy should be structured in a way so as to maximize current & future after-tax funds.

Factors to consider

- Investment returns within each account tax structure
- Current and projected future income tax rates
- Taxability of Social Security
- Required Minimum Distributions
- Long-term strategic goals

Taxation of IRA Distributions

Foundation Concepts

- When an IRA has non-deductible contributions, a portion of each IRA distribution will be a return of non-taxable "basis" to the IRA owner
- In determining the non-taxable portion of an IRA distribution, all IRAs and IRA distributions during the year (including outstanding rollovers) must be combined for apportioning "basis"
  - See IRS Form 8606

Taxation of IRA Distributions

Foundation Concepts

"Basis" Apportionment Formula (IRS Form 8606)

(1) Current year non-deductible IRA contributions*
(2) Prior year non-deductible IRA contributions
(3) Total non-deductible IRA contributions (1 + 2)
(4) FMV of all IRAs (as of 12/31)
(5) Outstanding rollovers
(6) Distributions
(7) Roth IRA Conversions
(8) Total value of IRAs, distributions and Roth IRA conversions (4 + 5 + 6 + 7)
(9) "Basis" apportionment formula (3 / 8)

*** NOTE: This is only applies for non-deductible contributions made during the current tax year (i.e. 1/1 – 12/31)**

Taxation of IRA Distributions

Foundation Concepts

"Basis" Apportionment Formula - Example

Current year non-deductible IRA contributions	$	1,000
Prior year non-deductible IRA contributions		6,000
Total non-deductible IRA contributions	$	7,000
FMV of all IRAs	$	350,000
Outstanding rollovers		20,000
Distributions		10,000
Roth IRA conversions		-
Total value of IRAs, distributions and Roth IRA conversions	$	380,000
"Basis" apportionment formula		**0.0184**
Gross IRA distribution	$	10,000
Non-taxable portion		(184)
Taxable IRA distribution	$	9,816

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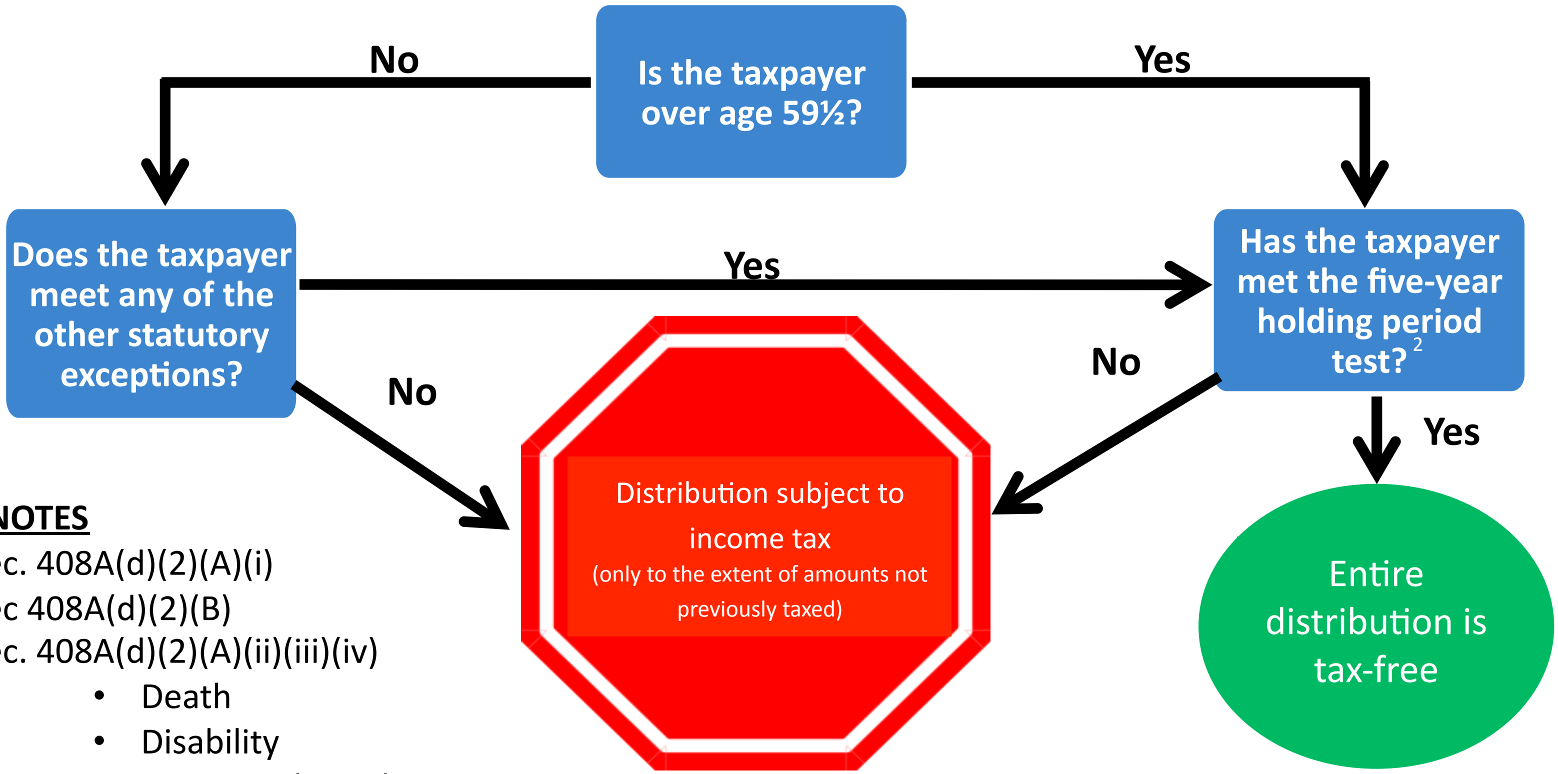
Roth IRA - Taxability of Distributions

("Seasoning Rule")



FOOTNOTES

IRC Sec. 408A(d)(2)(A)(i)

IRC Sec 408A(d)(2)(B)

IRC Sec. 408A(d)(2)(A)(ii)(iii)(iv)

- Death
- Disability
- First-time homebuyer expenses (up to $10,000)

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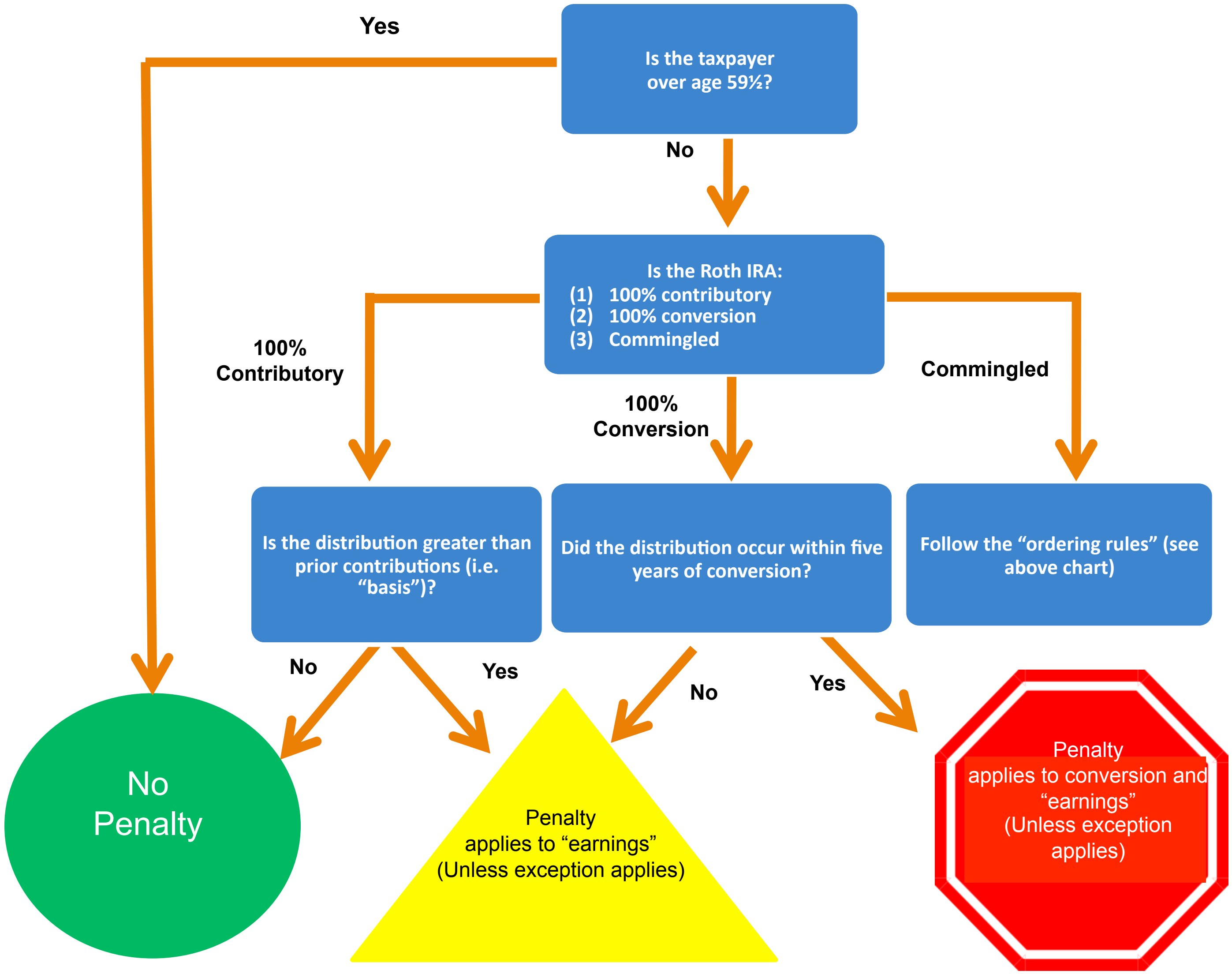
Roth IRA - Application of 10% Early Withdrawal Penalty ("Penalty Box Rule")



Exceptions to 10% early withdrawal penalty :

1. Death
2. Disability
3. Series of substantially equal periodic payments
4. Medical expenses greater than 7.5% AGI
5. Health insurance premiums for unemployed individuals
6. Higher education expenses
7. First-time homebuyer expenses (up to $10K)

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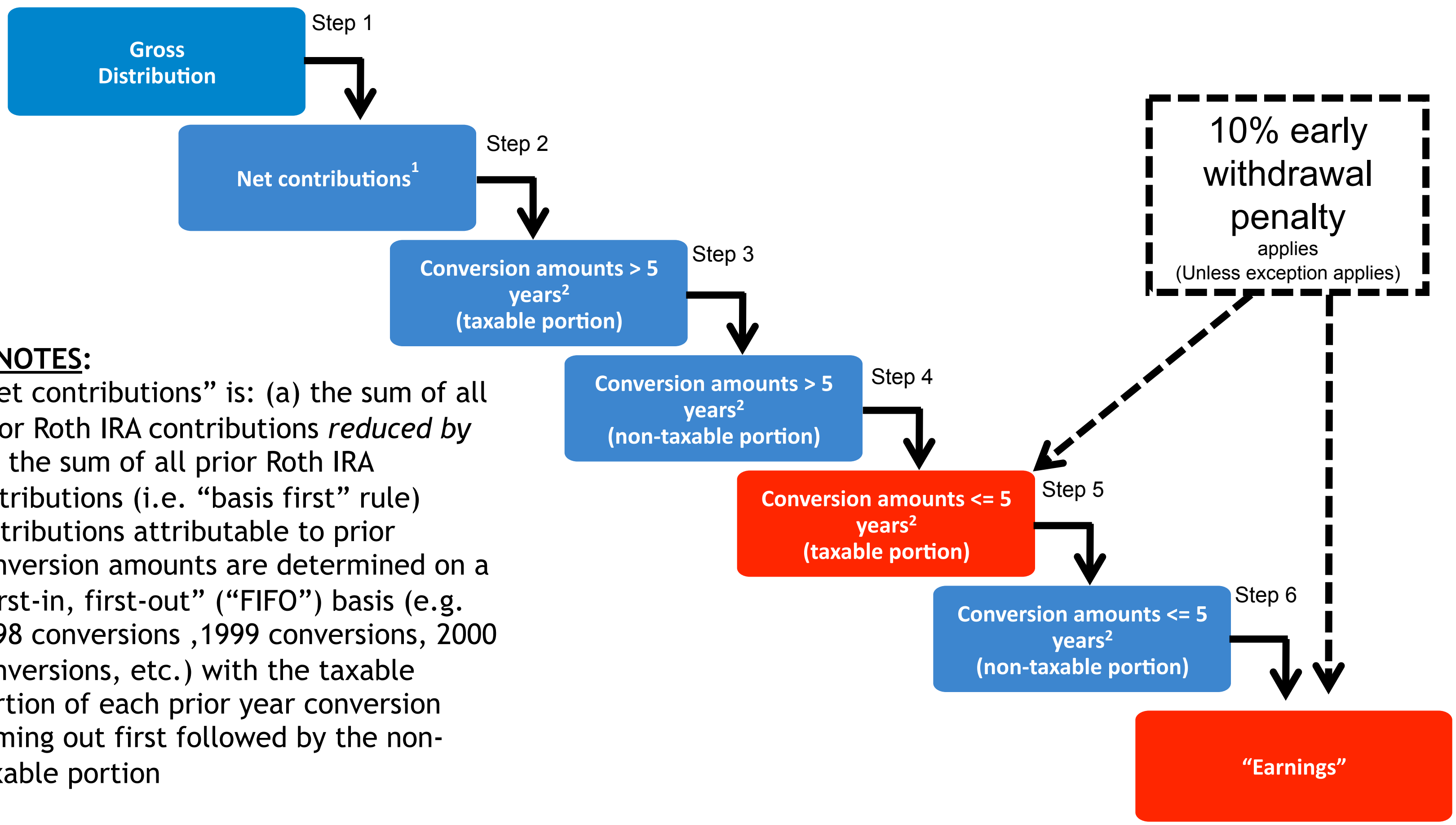
Roth IRA - Application of 10% Early Withdrawal Penalty **("Ordering Rules")**



<u>FOOTNOTES</u>:

1. "Net contributions" is: (a) the sum of all prior Roth IRA contributions *reduced by* (b) the sum of all prior Roth IRA distributions (i.e. "basis first" rule)
2. Distributions attributable to prior conversion amounts are determined on a "first-in, first-out" ("FIFO") basis (e.g. 1998 conversions ,1999 conversions, 2000 conversions, etc.) with the taxable portion of each prior year conversion coming out first followed by the non-taxable portion

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Taxation of Social Security Benefits

<u>Taxation of Social Security Benefits</u>

Adjusted Gross Income (AGI) (IRS Form 1040, Line 37)

Plus:

½ gross Social Security benefits received

Tax-exempt interest on Series EE U.S. Savings Bonds

Adoption assistance payments

Foreign earned income

Income from U.S. possessions

Income from Puerto Rico

Student loan interest deduction (IRS Form 1040, Line 33)

<u>Tuition and fees deduction (IRS Form 1040, Line 34)</u>

<u>Modified Adjusted Gross Income (MAGI)</u>

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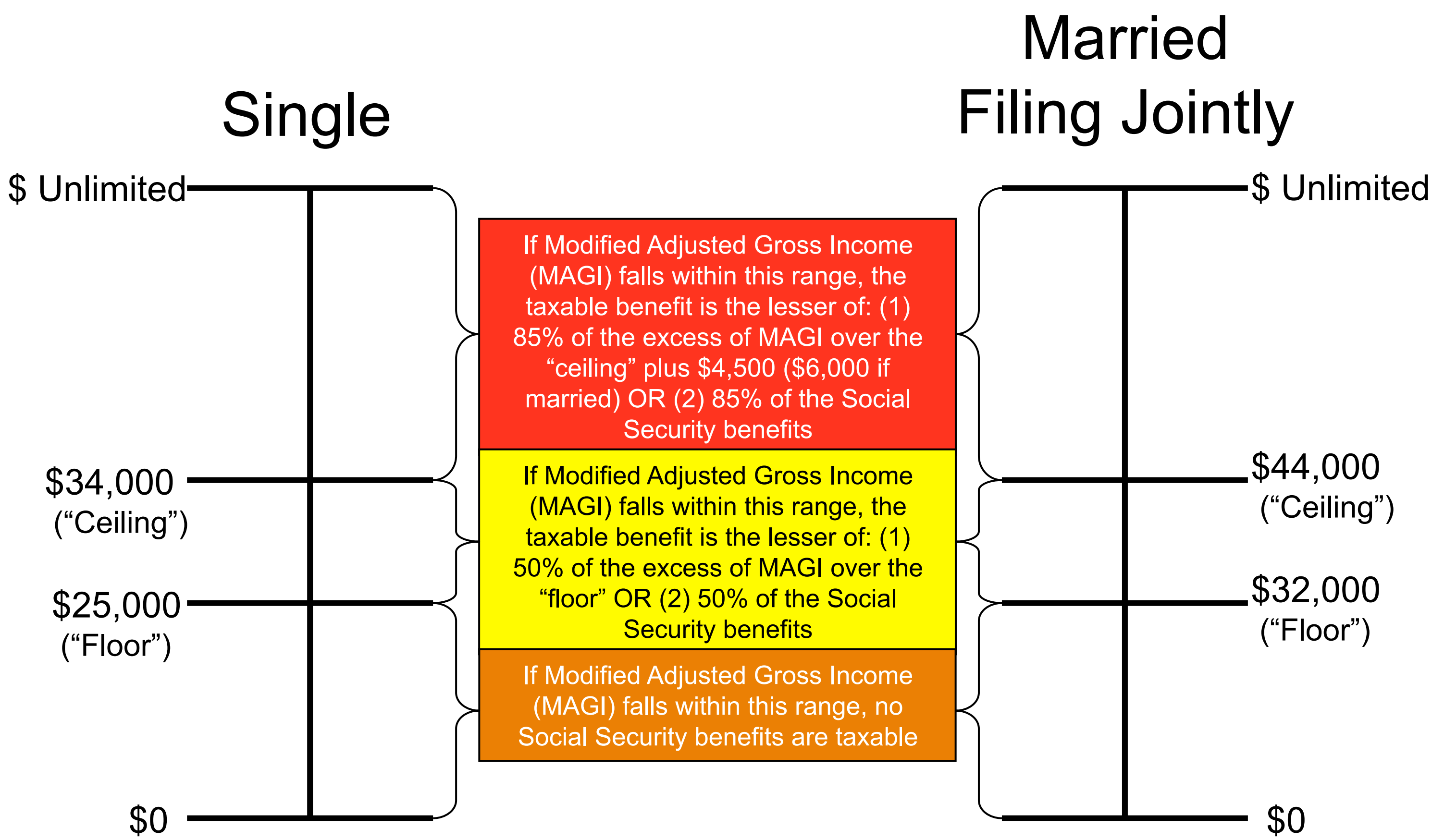
Taxation of Social Security Benefits



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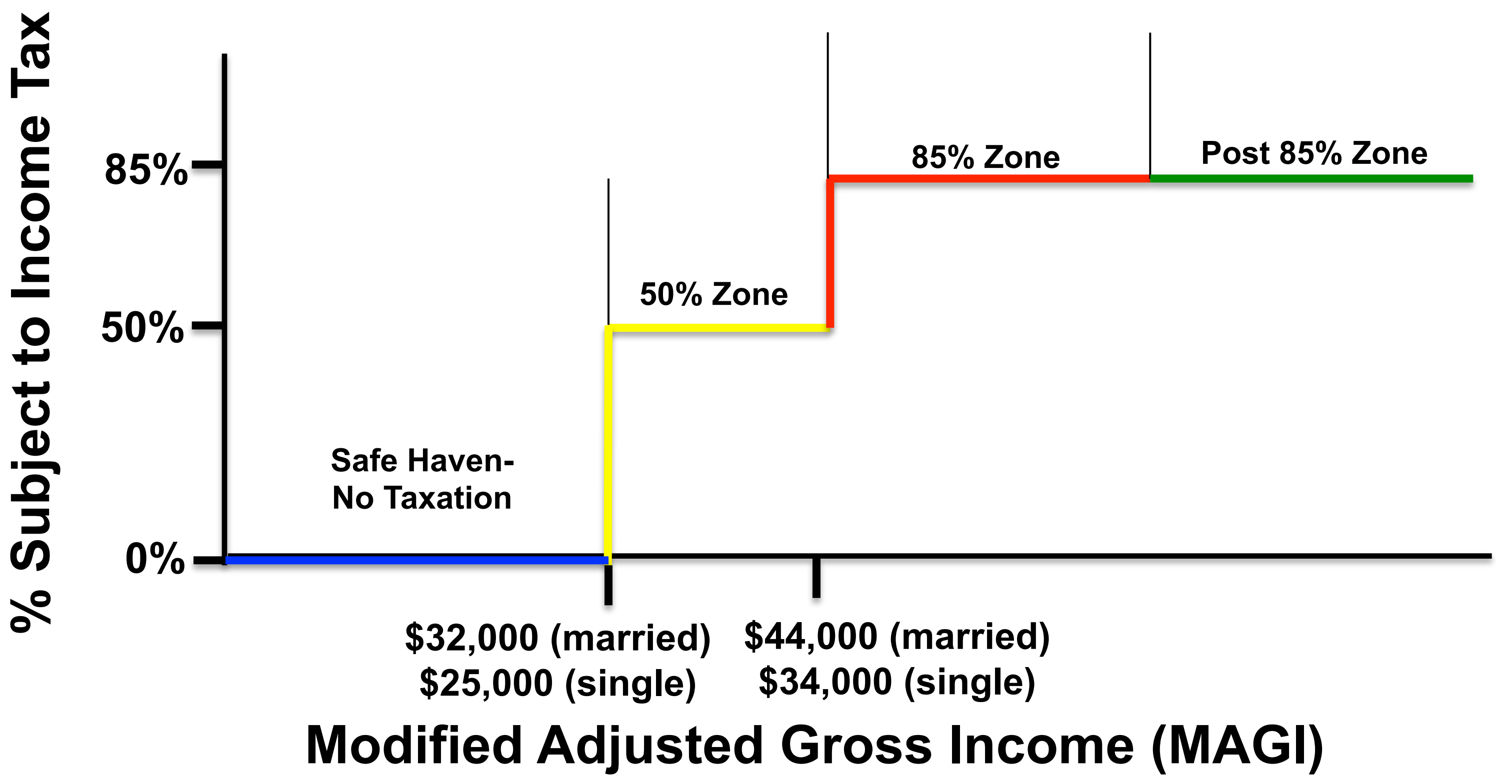
Taxation of Social Security Benefits



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Social Security Benefits

- Start with amount from Form SSA-1099
- Part of this amount may be subject to tax
- Taxable portion depends on amount of "provisional income"
- Provisional income = Modified Adjusted Gross Income (MAGI) + ½ of SS benefit
- MAGI = Adjusted Gross Income (AGI) before SS is included plus:
  - Tax-exempt interest on Series EE U.S. Savings Bonds used to pay tuition
  - Adoption assistance payments
  - Foreign earned income
  - Income from U.S. possessions
  - Income from Puerto Rico
  - Deductions claimed for student loan interest and qualified tuition

Example

- Facts
  - John, a single taxpayer, has regular income of $25,000 and tax-exempt income of $5,000
  - He receives social security of $20,000
  - His provisional income is $25,000 + $5,000 + $10,000 (1/2 of SS) = $40,000
  - Because this exceeds his base amount of $25,000, a portion of the social security will be subject to tax

Calculation of Amount Subject to Social Security

- Provisional Income = $40,000
- Tier I income
  - ($34,000 - $25,000) x .5 = $4,500
- Tier II income
  - ($40,000 - $34,000) x .85 = $5,100
- Total amount subject to tax
  - Lesser of $9,600 ($4,500 + $5,100), or
  - $17,000 (.85 x $20,000 of social security benefits)
  - $9,600 is subject to tax

Tax Planning to Reduce the Taxation of Social Security Benefits

- Convert IRA Income to Roth Income
- Utilize Annuities to Defer Income
- Utilize Insurance to Turn Taxable Income Into Tax-Free Income
- IRA Contributions if Wages Exist

Questions?

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